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ARTICLE: The Dichotomy Between Investment Advice and Investment Education: Is No Advice Really the Best Advice?

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SUMMARY: ... A DC plan is made up of individualized plan accounts established on behalf of each participating employee, who is also the plan investor. ... Thus, the plan investor bears the investment risk. ... " And, in 2001, the American Economics Association awarded the prestigious John Bates Clark Award to Matthew Rabin, a behavioral economist at the University of California, Berkeley. ... This alone calls into question the nature of plan investor decision making. ... Assume, however, that an investment adviser breaches its fiduciary duty to the plan investor by providing incompetent advice, and the plan investor suffers investment losses as a result. ... Awards now may flow either to plan accounts or directly to the harmed plan investor. ... Once the SEC finally resolves the content and form of investment adviser reporting outside of the benefit plan context, it seems inefficient for Congress to write, and the DOL to interpret and enforce, separate standards for disclosure when advice is provided regarding benefit plan assets. ... It is difficult to see why a plan investor should receive different types of disclosures for investments made through a benefit plan than the same investor would receive for investment advice on non-plan investments. ... That relief should not be contingent upon the continuing existence of a benefit plan, the status of a former plan investor's plan account, or any other artificial limitations. ...

TEXT: [*2]

I. Introduction

Imagine a nation where the structure of securities law discourages individuals who are responsible for investing more than $1 trillion from obtaining necessary investment advice. That legal regime would cause investors to earn lower investment returns than they could if they had access to needed investment advice. The systemic ramifications, however, would be even more troubling. Economists would abhor the implications for the efficient allocation of capital. Market experts would be concerned about the long-term stability of markets where investors engage in irrational decision making.

As incredible as it may seem, that is exactly the nature of the legal regime that governs the investment of more than $1 trillion of retirement plan assets in the United States. <=2> n1 One reason often proffered to explain why [*3] the domestic system of retirement support relies so heavily on employer-sponsored plans is that specialization enhances investment returns. <=3> n2 As repeat and sophisticated players, employers have the ability and the economies of scale to obtain appropriate investment expertise. <=4> n3 However, for most people now, this old model of investing retirement assets is no longer reality. Over the past twenty-five years, employers have increasingly transferred the responsibility for investment decision making to employees. <=5> n4 This change has been praised for giving employees flexibility and control over the ways in which their retirement assets are invested. <=6> n5 With flexibility and control, though, comes individualized risk.

As a matter of positive law, in this Article I show that federal law operates to discourage employers from providing individual employees who make investment decisions for their retirement accounts with investment advice. Most narrowly, this is the result of an affirmative decision by the Department of Labor ("DOL") to differentiate investment education from investment advice. <=7> n6 More broadly, it is a reflection of inconsistent positions within various layers of DOL regulation on the extent to which individuals can be expected to make reasonable investment decisions on their own behalf. Moreover, because of the division of regulatory authority between the DOL and the Securities and Exchange Commission ("SEC"), the specific legal standards evidence very different views of the appropriate provision of investment advice depending on whether the very same individual investor is investing assets held in a pension plan or in a non-pension investment account. Counterintuitively, the legal regime imposes stronger disincentives for the provision of advice regarding the investment of the pension plan assets, which typically should be invested for the long-term, than it does for the investment of non-pension assets.

Part I provides some explanatory background on trends in benefit plan [*4] sponsorship in general, and 401(k) plans <=8> n7 specifically. <=9> n8 It also discusses the reasons underlying the increasing popularity of 401(k) plans and the delegation of plan investment choices to individual participants. Part II considers research by behavioral economists, which indicates that participants' actual investment decision making departs from theoretical economic models of efficient utility-maximizing behavior. It then evaluates empirical data on the ways in which participants currently invest their plan assets. Part III analyzes the ways in which the current regulatory regime discourages the provision of investment advice to plan participants. It shows that the negative incentives affect all three classes of parties involved in the provision of investment advice: the employers who sponsor the plans, the advisers who provide the advice, and the participants who need the advice. In order to focus the discussion and emphasize the investment responsibilities borne by plan participants, I refer to them in this Article as "plan investors" when discussing them in that role.

Having established the background and the nature of the problem, I then discuss resolution of the problem. Part IV evaluates a variety of proposals that have been offered to address the need for investment advice, including one current legislative initiative, and concludes that none of the proposals offers an optimal solution for the provision of investment advice. Part V provides a proposal for the regulation of investment advice that would appropriately balance the competing interests of employers, investment advisers, and plan investors.

II. The Shift of Responsibility to Employees

A. Retirement Plan Typology

In many discussions of employer-sponsored retirement plans, the most basic distinction is between a defined benefit and a defined contribution plan. <=10> n9 One primary difference between defined benefit and defined contribution plans is who bears the investment risk. The traditional employer-sponsored retirement plan in the United States is known as a defined benefit (DB) plan. <=11> n10 DB plans promise benefits based upon a [*5] formula, components of which often are years of service and employee salary. <=12> n11 For example, a DB plan might provide for benefits of 1.5% per year of service multiplied by the employee's salary averaged over the final five years of employment, payable beginning at age 65. At retirement, an employee with thirty years of service and a final average salary of $50,000 per year would be entitled to an age sixty-five pension benefit of $22,500 per year. <=13> n12 Most DB plans pay benefits in the form of an annuity; thus, the retiree receives monthly benefits for her lifetime. <=14> n13 Many DB plans also provide early retirement incentives once employees reach an age and service threshold, such as age fifty-five and thirty years of service. <=15> n14 The employer bears the first tier of risk in a DB plan because, regardless of the performance of the plan's investments, the employer must sufficiently fund the plan to provide the promised benefits. <=16> n15 The Pension Benefit Guarantee Corporation (PBGC), which is funded with premiums paid by DB plan sponsors, bears the second tier of risk because it guarantees payment of certain plan benefits in case the employer defaults.

A second type of plan is known as a defined contribution (DC) plan. A DC plan is made up of individualized plan accounts established on behalf of each participating employee, who is also the plan investor. <=17> n16 Employers can avoid liability for investment decisions by delegating investment choices to the individual account holders. <=18> n17 The plan investor's ultimate benefit is the value of that plan investor's account - the sum of all contributions and investment gains and losses. <=19> n18 Thus, the plan investor bears the investment risk. Because of the way benefits are calculated, the plan's assets always equal the plan's liabilities. Therefore, DC plans are not insured by the PBGC. <=20> n19 DC plans typically provide for payment of benefits in the form of a lump sum. <=21> n20 In DB plans, the sponsoring employer must contribute to the plan whatever funds are necessary to pay a promised benefit to the employee. <=22> n21 In DC plans, the sponsoring employer contributes a fixed [*6] amount to plan investor accounts. <=23> n22

Since the early 1980s, the number of DC plans has exploded. <=24> n23 According to DOL estimates, more than four-fifths of all workers covered by employer-sponsored pension plans are participants in DC plans. <=25> n24 Perhaps the most significant event contributing to the popularity of DC plans came in late 1981 when the Treasury Department issued regulations establishing the boundaries of what have come to be known as "401(k) plans." <=26> n25 The defining quality of a 401(k) plan is that the plan investor has the right to choose to contribute, or not to contribute, pre-tax earnings to the plan investor's own plan account. <=27> n26 In most other types of DC plans, the employer determines the rate of contribution. <=28> n27 Typically, the plan investor's contribution election in a 401(k) plan is an affirmative one. <=29> n28 However, in 1998 the Internal Revenue Service (IRS) determined that 401(k) plans may automatically enroll plan investors for an assumed election so long as the plan investor has the right to revoke the deemed election at any time. <=30> n29

B. The Increasing Popularity of 401(k) Plans

While provisions permitting 401(k) plans were added to the Employee Retirement Income Security Act of 1974 (ERISA) <=31> n30 and the Internal Revenue Code (IRC) in 1978, the IRS did not issue regulations on the plans until November 1981. <=32> n31 Once employers had relatively clear guidance though, the new plan format proved to be extremely popular. Between 1984 and 1993 employer sponsorship of 401(k) plans grew by almost 900%. <=33> n32 Of course, starting from a base of essentially no plans, some might argue that expressing the early rates of growth in percentages is misleading. [*7] Yet, sponsorship, asset growth, and participation in 401(k) plans all continue to expand at a rapid pace. According to the DOL's most recent statistics, the assets held in 401(k) plans grew at an annual rate of 23%, more quickly than any other type of pension plan. <=34> n33 In fact, 401(k) plans now hold approximately 34% of all assets held by qualified pension plans. <=35> n34 Approximately one-third of the existing employer-sponsored pension plans are 401(k) plans, and 45% of the active participants in pension plans are members of 401(k) plans. <=36> n35

Several reasons have been offered to explain the shift from DB to DC plans, and, in particular, the popularity of 401(k) plans. As a general matter, many commentators believe that younger and more mobile workers prefer DC plans. <=37> n36 Another factor affecting plan sponsorship decisions is a business environment that requires employers to compete on an international basis. Because costs of DC plans are more predictable for employers, such increased competitive pressures militate for DC plans. <=38> n37 Similarly, DC plans that are structured as profit sharing plans permit employers to align employee and shareholder interests. <=39> n38 Another factor is a shift in employment from the manufacturing sector, where DB plans traditionally have been offered, to the service sector, where DC plans are more common. <=40> n39

A recent survey, summarized in Table 1, inquired into the primary motivations reported by employers who switched from a traditional DB plan to a type of DB plan that, in many ways, mirrors a DC plan. <=41> n40 The three top factors all reflect employer frustration based upon the long-held belief that employees tend not to understand and properly value their employee benefit plans, particularly pension plans. <=42> n41 According to the survey, employers believe that: (a) lump sum values, which are the typical [*8] way of reporting DC assets, but not DB assets, are easier to communicate to employees than annuity values; (b) employees understand large lump sum balances better than they understand the value of a future annuity stream; and (c) employees place a higher value on lump sum balances than on annuity streams. <=43> n42

Table 1: Top Four Factors Identified as Important by Employers
Who Have Undertaken Plan Conversions <=44> n43

[SEE TABLE IN ORIGINAL]

Finally, the regulation of DB and DC plans varies tremendously. Commentators have criticized the requirements imposed upon 401(k) plans as overly complex and burdensome. <=45> n44 DB plans, however, face much more extensive governmental reporting, insurance, and funding requirements than do 401(k) plans. <=46> n45 One economist estimated that in 1981 a DB plan cost approximately 140% more than a 401(k) plan to administer. <=47> n46 By 1996, the differential in administrative costs grew to approximately 210%. <=48> n47

C. Delegation of Investment Selection

Typically, 401(k) plans delegate to participants the choice of investments in those plans. <=49> n48 One reason for this delegation may be to provide individual plan investors with flexibility and respect their different tolerances for investment risk. <=50> n49 However, another reason is that [*9] regulations, issued in 1992, permit an employer to avoid liability for poor investment choices if the employer meets specified criteria in delegating decision making to plan investors. <=51> n50 The regulations were issued under ERISA section 404(c), <=52> n51 and, hence, are known as the 404(c) regulations. Plans that delegate investment choices in compliance with the regulations are known as 404(c) plans. <=53> n52

In the absence of section 404(c) compliance, an employer or investment adviser bears the risk of fiduciary liability for inappropriate investment decisions. Under ERISA, a fiduciary includes any person or entity who has control over asset management, <=54> n53 as well as anyone who "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 ... ." <=55> n54 Under the first prong of that definition, any employer who makes decisions about the investment of plan assets is an ERISA fiduciary. <=56> n55 Because of the perceived importance of professional investment advice, however, the statute permits an employer who engages a professional investment manager to delegate investment decisions, and the corresponding fiduciary liability, to the investment manager. <=57> n56 In such a case, the employer retains fiduciary liability for the selection and monitoring of the investment manager. <=58> n57 This is typically how investment decisions are made in DB plans.

Whether the person or entity with control over plan assets is the employer that sponsors a benefit plan or an appointed investment manager, ERISA imposes a number of specific fiduciary obligations on that person or entity. First, under what has come to be known as ERISA's exclusive benefit rule, <=59> n58 investment decisions must be made in the best interest of participants and beneficiaries. <=60> n59 One court, in a case where the employer was found to have violated its fiduciary obligation by using employee benefit plan assets to fend off a hostile tender offer, explained this duty by [*10] stating that "decisions must be made with an eye single to the interests of the participants and beneficiaries." <=61> n60 Second, ERISA requires fiduciaries to act 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 ... ." <=62> n61 This language has been construed to set a high standard of prudence - one that looks to the practices of investment professionals. <=63> n62 Third, ERISA fiduciaries must diversify plan investments. <=64> n63 Exceptions, meant to accommodate workplace incentives, permit plans to hold large percentages of assets in some employer securities. <=65> n64

An employer may avoid the fiduciary obligations associated with plan investments and the selection of an investment manager by delegating investment decision making to participants in compliance with the 404(c) regulations. <=66> n65 While the details of these regulations are complex and beyond the scope of this Article, the three basic requirements are worthy of note. First, the plan must provide plan investors with at least three investment alternatives. <=67> n66 Those alternatives must encompass a variety of risk and return characteristics so that each plan investor can select a portfolio with risk and return characteristics appropriate for that investor. <=68> n67 Second, the plan must provide plan investors with enough information about the alternatives to ensure that they are able to make informed investment choices. <=69> n68 Third, plan investors must have the right to change investments with reasonable frequency. <=70> n69 While compliance with 404(c) is not required by ERISA, plans that delegate investment decision making to plan investors in compliance with the 404(c) requirements protect the sponsoring employer from fiduciary liability associated with poor investment choices. <=71> n70

[*11]

III. Actual Investment Behavior

The increasing delegation of responsibility for investment allocations raises the question of whether plan investors make appropriate investment choices. The question is a difficult one to answer because, in one sense, "appropriateness" of individual investment choices must be viewed from the perspective of the individual making those investment decisions. As such, it would be reasonable to assume that the plan investor viewed the choice as appropriate at the point she made the choice. However, this section will utilize two other ways of evaluating plan investor asset allocation decisions. The first approach is that of the behavioral economists, and the second considers studies using empirical data on 401(k) plan investment choices.

A. Insights from Behavioral Economics Research

Behavioral economics has generated academic controversy for a number of years. <=72> n71 More recently, the popular press, <=73> n72 and self-help investment books <=74> n73 have brought behavioral economics into the mainstream. Simply stated, behavioral economists look to psychology to explain anomalies that are inconsistent with established theories of neoclassical economics. <=75> n74 For example, traditional economic modeling assumes that economic actors are unboundedly rational. <=76> n75 In contrast, behavioral economists recognize that humans have limited cognitive abilities, and as a result, adopt heuristics to solve problems. <=77> n76

Given the challenges it poses to long-standing economic theory, behavioral economics has its detractors. <=78> n77 There are signals, though, that the field is making inroads. Law and economics scholars have begun to examine its import. <=79> n78 Professor Cass Sunstein has said, "If Thaler [a [*12] prominent behavioral economist] is right, it makes the current dogmatic antipaternalism really doubtful." <=80> n79 And, in 2001, the American Economics Association awarded the prestigious John Bates Clark Award to Matthew Rabin, a behavioral economist at the University of California, Berkeley. <=81> n80 Behavioral economists believe that their discipline has implications for a broad array of fields. The decision-making process of benefit plan investors is no exception.

In a famous economics paper, Professor Paul Samuelson described a troubling fallacy associated with repetitive gambles. As the story goes, Professor Samuelson asked a colleague whether he would accept the following offer: "flip a coin, heads you win $200, tails you lose $100." <=82> n81 The colleague refused to accept the offer, but said he would accept a series of 100 such bets. <=83> n82 Scholarly economists have spent forests of trees and years of research arguing whether Professor Samuelson's colleague acted inconsistently. <=84> n83 The latest spin on the arguments has been undertaken by Professors Shlomo Benartzi of the Anderson School at the University of California, Los Angeles and Richard Thaler of the University of Chicago Business School. They use the fundamental concepts of behavioral economics to analyze benefit plan asset allocation choices. <=85> n84

Professors Thaler and Benartzi conducted a series of experiments with two groups of university employees enrolling in benefit plans. In one instance, their study group consisted of staff employees. In the other, the group consisted of faculty. <=86> n85 Members of the study were asked to allocate their retirement contributions between stocks and bonds. <=87> n86 All employees were presented with equivalent information on historic equity premiums, but the way in which the information was presented differed. Two groups received charts showing the distribution of annual rates of return on a thirty-year investment. <=88> n87 Another group received charts showing actual [*13] distributions of historic returns in one-year increments. <=89> n88 The subjects who received the charts with the distribution of one-year incremental rates invested less in equity securities than did the subjects who viewed the charts showing the distribution of annual returns on a thirty-year investment. <=90> n89 While the difference was less in the faculty group than in the staff group, the results were statistically significant in both groups. <=91> n90

As a result of the study, Professors Thaler and Benartzi argue that the way in which information is provided to benefit plan investors will influence their selection of investment vehicles. <=92> n91 This is true even if the different presentations of information reflect equivalent rates of return over time. They theorize that, consistent with Professor Samuelson's challenge to his colleague, individuals suffer from what is known as "myopic loss aversion." <=93> n92 More specifically, plan investors have an aversion to short-term losses and limited "gambles." <=94> n93

In a more recent study, Professors Benartzi and Thaler studied the effect of the 1/n heuristic on plan investor decisions. <=95> n94 The 1/n heuristic is a decision-making shortcut in which an investor divides her assets evenly among the available investment choices. <=96> n95 As an example, Benartzi & Thaler cite the Fourth Century advice given in the Talmud to divide one's money "a third into land, a third into merchandise, and ... a third at hand." <=97> n96

In a series of three experiments using questionnaires designed to elicit hypothetical retirement plan investment decisions, the authors found that as the number of equity funds offered increased, so did the percentage of assets the study participants chose to invest in equity funds. <=98> n97 The simplest experiment is the easiest to explain briefly. One group of employees had the option of allocating hypothetical pension plan investments between a stock fund and a bond fund. <=99> n98 A second group's options were a stock fund and a balanced fund, which invested half in stock and half in bonds. <=100> n99 A third group's choices were a bond fund and a balanced fund. <=101> n100 The authors [*14] found that the employees' allocation decisions were heavily dependent upon the available fund alternatives. <=102> n101 The group whose choices were the stock and the balanced fund allocated the largest percentage of assets to stock, followed by the group with the stock and bond fund. <=103> n102 The group offered the bond and balanced fund allocated the lowest percentage of assets to stock. <=104> n103 In this and in its other reported experiments, the study supports the hypothesis that investors loosely follow a 1/n heuristic and, thus, tend to vary asset allocations depending upon the available investment alternatives. <=105> n104

The findings in both of these studies raise serious questions about the actual decision making of benefit plan investors. If investment selection is affected by the way in which investment returns are presented or the number of equity funds offered, are investors truly making informed choices? What is it that is informing those choices? Participants in one of the Benartzi and Thaler studies spent on average less than an hour making asset allocation decisions and few of those participants reviewed any material other than that supplied by the investment providers. <=106> n105 This alone calls into question the nature of plan investor decision making. And, if, as the difference in results between faculty and staff may indicate, <=107> n106 the decision making of more sophisticated investors is less likely to be affected by the format of information than is the decision making of less sophisticated investors, does that militate in favor of increasing the amount of investment advice available to plan investors?

In a very different vein from Professors Bernatzi and Thaler's academic work, the authors of a recent financial decision making self-help book have mined the broader field of behavioral economics. <=108> n107 Drawing on an array of research, Gary Belsky and Thomas Gilovich discuss numerous ways in which flawed decision making negatively affects investment behavior. <=109> n108 For example, they utilize the behavioral economics theory of mental accounting to explain why, in contrast with the assumptions of traditional economics, people do not view all dollars as being equal. <=110> n109 The authors point to the tendency people have of being much more willing to spend "found money," such as a gift or a surprise federal tax rebate, than money they are paid in salary. <=111> n110 Similarly, people may be more willing to [*15] buy a fancy car stereo system at the point in time they purchase a car (after all, the stereo is such a small percentage of the expenditure), than they would be to buy even a less expensive system at another point in time. <=112> n111

Whether presented as academic research or a self-help financial technique, behavioral economics does not offer a foolproof method of choosing the ideal investment portfolio. Nor does it even purport to find that all or most investors are making poor decisions. However, the research does indicate that investors are making incoherent decisions based upon heuristics that may be inconsistent with the actual risk tolerances and retirement strategies of those investors.

B. General Empirical Data on Plan Investment Choices

Empirical data from a large sample of participant-directed 401(k) plans also indicate that the availability of specific investment choices affects the percentage of plan assets held in various categories of investments. <=113> n112 For example, plans that offer guaranteed investment contracts (GICs) tend to have lower rates of equity investments than plans that do not offer GICs. <=114> n113 In an apparent anomaly, plan investors direct more of their elective contributions to employer stock in plans where the employer mandates that its matching contributions be held in employer stock than in plans where matching contributions are held in other investment vehicles. <=115> n114 Traditional economic principles predict that a rational investor will determine how best to allocate investments based upon risk and return. Once investor X evaluates employer stock as an investment, she should not vary the total amount of her portfolio invested in employer stock on the basis of whether an employer match is made in employer stock or not.

Instead, if the employer match is in employer stock, then a rational investor would decrease the amount of her discretionary investment in employer stock. Similarly, when a plan offers its investors the option of investing in company stock, it is anomalous that investors actually make substantially lower allocations to all other investment choices, particularly to mutual funds that hold equities. <=116> n115 This tendency may reflect confirmation bias, as investors convince themselves that the employer stock their employer [*16] requires them to hold is a good investment. <=117> n116 Traditional financial theory, however, discourages overinvestment in employer stock; <=118> n117 asset diversification helps offset the diversification lost through job dependence. <=119> n118

A variety of plan investor demographic factors are correlated with the extent to which an investor will invest plan assets in equity securities. For example, the higher the family income, the more likely that both 401(k) and IRA assets will be allocated to equities. <=120> n119 Similarly, more net worth and greater education both are predictors that a plan investor will allocate more assets to equity securities. <=121> n120 Not surprisingly, empirical studies on the investment patterns of 401(k) holders are not conclusive. One of the particularly interesting open questions is the extent to which asset allocations in 401(k) plans are dependent upon the age of the plan investor. <=122> n121

Women face unique challenges in pension asset accumulation. Historically women have accumulated far less pension wealth than men. <=123> n122 The same factors of lower compensation, more part-time work, and more breaks in work history that contribute to gendered disparities in private pension plans also cause women, on average, to accumulate fewer personal assets <=124> n123 and to have lower Social Security entitlements than do men. <=125> n124 But, because women have significantly longer life expectancies than do [*17] men, <=126> n125 women actually have greater needs for longer streams of retirement income. Their longevity past normal retirement age also results in greater inflationary pressures on them. As a result of all of these factors, women aged sixty-five and over are more than twice as likely as men in that age group to subsist below the poverty level. <=127> n126 In fact, the United States allegedly has the greatest percentage of elderly women in poverty of all the major industrialized nations. <=128> n127

But, even if everything else were equal across genders, investment choices risk furthering the problem of low asset accumulation for women. Studies of plan investor behavior uniformly find that women have a lower tolerance for risk than do male investors. <=129> n128 Although there are some indications that women's progress in the workforce is narrowing the differential in retirement assets, <=130> n129 women put this progress at risk to the extent that they choose overly conservative benefit plan investment strategies.

Not all commentators believe that the empirical data indicate problems with plan investor allocation decisions. Evidence shows that plan investors have been increasing the percentage of their account balances invested, directly or indirectly, in equity securities. <=131> n130 One large data study showed that in 1999, just over three-quarters of plan assets were invested in equity securities. <=132> n131 The president of the Investment Company Institute stated that "in general 401(k) plan participants are making informed and reasonable investment decisions regarding asset allocation as they approach retirement age." <=133> n132 Professors Benartzi and Thaler argue, however, that the increase in the proportion of plan accounts held in equity investments is more likely due to the increased numbers of equity investment alternatives offered by plans than to more sophisticated allocation decisions by plan investors. <=134> n133

[*18] In sum, both behavioral economics theory and plan investment data indicate that individual employees face numerous challenges in making investment allocation decisions. As discussed further below, the current regulatory scheme discourages employers and plans from providing employees with investment advice. Instead, the current system relies on the belief that investment education will enable employees to maximize their retirement savings. But, the existing plan data raise serious questions about the efficacy of that approach, particularly for groups such as women who may face special challenges. The behavioral economics literature also calls into doubt the traditional approach. The literature shows that a variety of subtle factors impede the ability of individuals to pursue a cohesive investment strategy to maximize retirement assets.

IV. Current Status of Investment Advice Under ERISA

This part begins by examining the difference between investment advice and investment education, and why that distinction is a critical one for liability purposes. It then turns to a specific examination of the potential liability for the primary parties involved in the provision of investment advice: employers, investment advisers, and plan investors. The broad sweep of possible liability for investment advice acts as a deterrent to the provision of that advice through the medium of employee benefit plans.

A. The Tension Between Investment Advice and Investment Education

Although the relevant data and theoretical research indicate that plan investors often do not invest their retirement plan assets in ways that are consistent with current financial investment theory, few <=135> n134 benefit plans offer investment advice to plan investors. However, all 404(c) plans offer some level of investment education, at least in the sense of providing information about investment options. The reason for the all-or-nothing dichotomy is attributable to the relevant DOL regulations and a 1996 DOL interpretative bulletin. As explained above, one of the basic requirements under 404(c) is that the plan must provide plan investors with enough information about the plan's investment options that the investors are able to make informed investment choices. <=136> n135 However, ERISA also provides that anyone who, for a fee, provides investment advice regarding plan assets becomes an ERISA fiduciary with respect to that advice. <=137> n136 After the 404(c) [*19] regulations were first issued in 1992, employers were stuck between the proverbial Scylla and Charybdis.

According to Greek mythology, Scylla and Charybdis were both sea monsters that forced sailors into the no-win situation of risking a disastrous encounter with one of the monsters. Between Scylla and Charbydis was a narrow strait. According to one source:

Scylla was a horrible creature with 12 feet and 6 long necks, each bearing a head with 3 rows of teeth, with which she devoured any prey that came within reach; she lived in a cave on a cliff. Across the strait, opposite her, was a large fig tree under which Charybdis, the whirlpool, dwelt, sucking in and belching forth the waters of the sea three times daily, engulfing anything that came near. <=138> n137

On the one hand, in order to avoid the Scylla, an employee benefit plan must provide a reasonable amount of investment information to plan investors. This will qualify the plan as a 404(c) plan and protect the employer from fiduciary liability. On the other hand, steering far enough away safely to avoid the Scylla risks a disastrous encounter with the Charybdis. If the plan provides too much information on investments, the sponsoring employee will be deemed an investment adviser and will have fiduciary liability for the investment advice.

In response to employers who were seeking more certainty in this area, the DOL issued an interpretative bulletin in 1996 that attempted to distinguish between investment advice and investment education. <=139> n138 The guidance established four safe harbors for plan investor education and indicated that other activities also might fall within the parameters of education as opposed to advice, but that such other activities would not receive safe harbor protection. <=140> n139 Activities defined as education range from providing basic informational materials about the plan, at one end of the spectrum, to interactive materials that permit plan investors to estimate retirement income needs and alternative investment routes to meeting those needs, at the other end of the spectrum. <=141> n140 If an employer chooses to hire an outside service provider to provide the investment education, then the employer retains liability for the appropriate selection and monitoring of the service provider. <=142> n141

[*20] The DOL's guidance on the difference between investment education and investment advice has raised at least as many questions as it answered. One commentator argues that the burden imposed upon employers by the interpretive bulletin is so heavy that "participants are likely to receive less assistance in making investment decisions." <=143> n142 Even a member of the investment industry recently admitted that the guidance has left employers "wary" of liability associated with investment communications to plan investors. <=144> n143 Professor John Langbein's view is that "ERISA is terrifying employers from taking part in assisting their workers in getting the most out of their investments." <=145> n144

B. Employers - Risks and Issues

Of the three relevant categories of actors with an interest in investment advice, employers, investment advisers, and plan investors, perhaps the most important category is employers. It typically is the sponsoring employer that establishes the terms of an employee benefit plan. <=146> n145 In a trilogy of recent cases, the Supreme Court has made it clear that employers have no fiduciary liability for the choices they make in constituting plans. <=147> n146 Rather than being fiduciary decisions, such decisions are the equivalent of those made by trust settlors and are beyond the scope of ERISA regulation. <=148> n147 Thus, employers have no fiduciary obligation to provide plan investors with investment advice. Concomitantly, there are a number of ways in which an employer faces potential liability for offering investment advice through an employee benefits plan. Thus, under the current legal regime, rarely will an employer intentionally offer investment advice to plan investors. The barriers to investment advice are unfortunate because there are a number of reasons why employers might wish to provide advice under the benefit plans they sponsor. First, and most importantly, employers configure benefit plans to respond to the desires and needs of their workforces. Significant data indicate that employees want increased access to investment advice. <=149> n148 In the absence of the hurdles posed by current regulation, employers could react to that employee sentiment and [*21] provide investment advice within their benefit plans on a tax-favored basis. Second, it is in the interest of employers to ensure that employees have the tools to maximize their earnings in 401(k) plans. To the extent that employees enjoy high investment returns, that may decrease the pressure on employers to provide a company match or to provide other types of pension plans.

1. Affirmative Decision to Offer Advice or Limit the Plan to Education

As discussed above, if an employer directly provides investment advice through a plan that it sponsors, the employer will become a fiduciary as to the giving of that advice. <=150> n149 Fiduciary status means that the employer is subject to ERISA's fiduciary obligations. <=151> n150 The possible violations of those obligations are almost endless. For example, imprudent advice would violate ERISA's prudence requirement. <=152> n151 Investment advice that convinced plan investors not to tender shares to a hostile tender offeror would violate the exclusive benefit rule if the advice was given for the purpose of entrenching management. <=153> n152 Management typically has many reasons, ranging from personal stock options to shareholder oversight, to support the price of the company's securities. One strategy to maximize share price would be for management to convince plan investors to purchase and hold large quantities of company securities. Such a strategy, though, risks violating both the exclusive purpose rule and the diversification requirement. <=154> n153

An employer that opts to provide only education still may not be entirely safe from the dangers of Scylla and Charybdis. Even after the DOL's 1996 guidance, in order to enjoy the protective benefits of section 404(c), plans still must provide plan investors with information about their investment options. If the plan provides too little information for the plan investors to make informed choices, then the sponsoring employer will lose the section 404(c) protections and will be liable for the plan investors' investment selections. If an employer provides too much information to plan investors on how to select investments, the employer will cross the line from providing education to giving advice. Again, the sponsoring employer will have fiduciary responsibility for the investment advice. Thus, it is more than a myth that the employer must steer a perilous and narrow course through this area. The DOL's advice has provided a map for that course, [*22] but the shoals are not well-marked. And, it is up to the employer to keep the ship on course through storms that might send the ship crashing into one monster or the other. In this context, the storms that might drive the employer's ship off its intended course include plan investor questions, well-meaning employee benefit counselors, and an increasingly sophisticated set of investment choices. Imagine the employee benefit counselor who is meeting with a new employee. As the employee asks increasingly detailed and sophisticated questions about the plan's investment alternatives, the counselor may stray across the line into giving investment advice. Or, consider the situation of a financially na<um i>ve employee who asks his manager for investment advice and she gives it. Or, put yourself in the position of the employer that has just added a number of investment options to the plans. Should that employer actively encourage employees to consider the new investment vehicles?

2. Investment Advice Through an Outside Service Provider

One reasonable way for an employer to provide investment advice to plan investors is to hire an outside service provider to provide the advice. According to ERISA, such an adviser is the ERISA fiduciary as to the provision of investment advice. <=155> n154 It seems intuitive then that if an employer hires an outside expert and establishes that expert as a potentially liable fiduciary, the employer should receive some protection from liability. However, if the adviser breaches its fiduciary duty to plan investors, the employer still could face three potential types of liability.

First, the employer remains a fiduciary as to the selection and monitoring of the investment adviser. <=156> n155 If the employer does not engage in adequate selection or monitoring procedures, then the employer may be liable for any fiduciary violations by the investment adviser. Monitoring advisers may impose more risk to employers than the initial selection of those advisers. In monitoring the performance of other plan service providers, employers typically can compare the service providers' performance against objective criteria. <=157> n156 For example, for DB plan investment managers, returns from investments can be compared against market averages, the performance of other similar investments, the plan's asset allocation requirements, and so forth. Similarly, the performance and fees of the funds offered by a plan can be compared to market indices, other funds, and the like. However, investment advice is far more subjective and [*23] must be tailored to the unique goals and risk tolerances of individual plan investors. Therefore, it is unclear under current guidelines how employers could adequately monitor the ongoing provision of investment advice.

Second, the employer may have co-fiduciary liability for fiduciary breaches committed by the investment adviser. It is true as a general principle of ERISA fiduciary law that a fiduciary remains liable for delegated fiduciary duties if the delegating fiduciary knowingly participates in or conceals a breach by the lower-tier fiduciary. <=158> n157 According to the DOL, in the context of a delegation of responsibility for investment advice, co-fiduciary liability might arise in either of two ways. First, the employer might fail "to act prudently and solely in the interest of plan [investors]" <=159> n158 in its designation of the investment adviser. Alternatively, the employer might "knowingly participate[] in, conceal[] or fail[] to make reasonable efforts to correct a known breach by the investment advisor." <=160> n159

Third, among other things, the 404(c) guidelines require that plan investors receive sufficient information from their plans to exercise informed investment control. <=161> n160 Assume, however, that an investment adviser breaches its fiduciary duty to the plan investor by providing incompetent advice, and the plan investor suffers investment losses as a result. This raises the question of whether the adviser's breach means that the plan investor did not exercise the informed investment control required under 404(c). If there were a failure to comply with the 404(c) standards, then arguably, the employer could be liable for the inappropriate investment decision. <=162> n161

3. Erroneous Provision of Investment Advice

Assume that an employer intends to engage a service provider just for educational purposes, but the provider actually gives investment advice instead. The employer may be surprised to realize that it has potential fiduciary liability, as outlined above, for selection and monitoring of the provider, because that provider is actually acting as an investment adviser, as well as for co-fiduciary liability and 404(c) noncompliance. Thus, in addition to monitoring the service provider to ensure that it is providing appropriate investment education, the employer will want to monitor the provider to ensure it is not straying into the forbidden territory of investment advice. Given the lack of clarity in that distinction, as well as [*24] the stakes, it becomes easy to see why employers would be conservative in the direct and indirect provision of investment education.

On a separate note, employers also should be expected to consider the costs associated with offering investment advice. Even if offering advice does not increase an employer's fiduciary risk, there still will be some costs associated with the provision of advice. While survey data is not available, it is reasonable to assume that employers would prefer that plan investors have the ability to pay investment advisers out of plan assets or that cafeteria plans be permitted to offer investment advice. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) clarified that cafeteria plans may offer qualified retirement planning services, which includes "any retirement planning advice." <=163> n162

C. Investment Advisers - Risks and Issues

The second category of benefit plan actors affected by the existing dichotomy between investment advice and investment education is that of professional investment advisers. This section evaluates the disincentives that discourage investment advisers from providing services to benefit plan investors by looking at the liability risks for advisers.

1. The Provision of Inappropriate Advice

Advisers face potential legal liability for the provision of inappropriate investment advice. Of course, advisers cannot be guarantors of success in the securities markets. The wisdom of the following statement applies as clearly to investment advisers as it does to brokers who render advice. "Regarding trading advice, brokers[/advisers] cannot be liable for honest opinions that turn out to be wrong. Otherwise brokers[/advisers] would refuse to take discretionary accounts and would refuse to advise on nondiscretionary accounts." <=164> n163

On the other hand, federal and state law provides the only protection to investors who rely on advisers. Investment advisers are not covered by any self-regulatory structure. <=165> n164 In contrast, the National Association of Securities Dealers is active in working with the SEC to establish appropriate regulation of broker-dealers, <=166> n165 and has a significant [*25] enforcement branch. <=167> n166 This subsection evaluates the three primary substantive categories of legal claims against advisers: (1) ERISA, (2) federal securities law, and (3) state law.

a. ERISA

As explained above, when an adviser provides investment advice for a fee, the adviser becomes an ERISA fiduciary as to the giving of that advice. <=168> n167 Thus, the adviser becomes subject to liability for breaching ERISA's fiduciary standards, which subjects the investment adviser to ERISA's civil enforcement scheme. Statutory provisions establish remedies to redress fiduciary breaches in the investment and administration of plan assets. <=169> n168 As a general matter, those provisions permit monetary awards that flow to plans, <=170> n169 removal of fiduciaries who violate their duties, <=171> n170 and even injunctions barring wanton fiduciaries from providing any further fiduciary services to benefit plans. <=172> n171 Some cases against investment advisers to pension plans that do not contain participant-directed assets have involved significant liability, including criminal sentences, for advisers. <=173> n172

The limitation of these provisions, however, is that they provide only for relief that flows to a plan. As a result, relief is not available under these [*26] provisions to a former employee who no longer is a plan participant. Similarly, an employer might have terminated the plan after a fiduciary breach occurred. In the absence of an existing plan, these provisions do not provide for redress.

Given the limitations just discussed, plaintiffs sought other theories of recovery under ERISA that would permit relief to flow directly to individuals. For a period of time, the availability of such relief was the subject of considerable controversy. Then, in 1996, the Supreme Court confirmed the right of plan participants and beneficiaries to bring individual actions on their own behalves in cases of fiduciary breach, at least where no other available relief exists. <=174> n173 The bottom line for investment advisers is that they may be sued by plan investors for breach of fiduciary duty. Awards now may flow either to plan accounts or directly to the harmed plan investor.

However, the scope of any recovery that flows directly to a plan investor will be limited to what the statute terms "other appropriate equitable relief." <=175> n174 According to the Supreme Court, "other appropriate equitable relief" means only traditional equitable relief - injunction, mandamus, and restitution. <=176> n175 While restitution is the only form of relief that might afford a wronged plan investor any monetary relief, the Court has been very clear that restitution does not include monetary damages. In recent years, lower courts have struggled with what remedies are included in the Court's definition of traditional equitable relief. <=177> n176 The Supreme Court has granted certiorari on the issue, and general guidance is expected in Great-West Life & Annuity Insurance Co. v. Knudson. <=178> n177 If the Court defines restitution as narrowly in this context as it has under the relevant securities laws, <=179> n178 then direct remedies will be limited to a return of advisory fees.

In summary, ERISA's fiduciary regulation of investment advisers [*27] includes remedial provisions that protect wronged plan investors and pose some risk of liability to advisers. Injunctive relief may flow either to the benefit plan or to individual plan investors. The statute permits significant flexibility in monetary awards payable to plan accounts. The scope of direct monetary relief that may flow to individual plan investors, however, is less clear.

b. Federal Securities-Related Law

The most obvious source of potential liability under federal securities-related laws is the Investment Advisers Act of 1940 (Advisers Act or Act). <=180> n179 The Advisers Act imposes a number of obligations on investment advisers by requiring state or federal registration, disclosures to clients as well as to the SEC, maintenance of books and records, and so forth. <=181> n180 The Act does not, however, contain any credentialing requirement for advisers. <=182> n181 Most importantly for our purposes, the Advisers Act contains an antifraud provision and regulates potentially problematic behaviors such as performance fees and advertising. <=183> n182

The language of the Act's anti-fraud provision, section 206, is similar to section 10(b)-5 of the Securities and Exchange Act of 1934 and section 17(a) of the Securities Act of 1933, both well-known anti-fraud provisions. <=184> n183 The Advisers Act's fraud provision contains two components [*28] important in this context. <=185> n184 Under the first clause, only intentional fraud is actionable. <=186> n185 Under the second clause, however, advisers are "not only prohibited from engaging in schemes or artifices to defraud, but also prohibited from engaging in practices or courses of business which operate as such." <=187> n186 Thus, advisers must provide substantial disclosure of any conflicts of interest, <=188> n187 as well as all material facts. <=189> n188

However, in a divisive five-to-four decision, the Supreme Court determined in 1979 that section 206 does not establish the basis for a private cause of action. <=190> n189 The Court's construction of the Act was contrary to the decision of every circuit that had addressed the issue. <=191> n190 In a separate provision, section 215, the Act declares investment advisory contracts to be void where those contracts would violate the Act. <=192> n191 The Supreme Court accepted that section 215 sufficiently implies a private cause of action. <=193> n192 At the same time, the Court limited the remedies obtainable in a private action under section 215 to "a suit for rescission or for an injunction against [*29] continued operation of the contract, and for restitution." <=194> n193 Given the Court's clarification in a footnote that rescission does not include "compensation for any diminution in the value of the rescinding party's investment alleged to have resulted from the adviser's action or inaction," the available relief may fall far short of compensating a defrauded advisory client. <=195> n194 And, by limiting available damages to rescission, the Court also limited the possible defendants to those who were parties to the contract, thus negating any aiding and abetting claims. <=196> n195

In order to understand the scope of the limitation that the Supreme Court imposed on remedies, consider the following hypothetical. Chris, an investment adviser, but not a broker-dealer, convinced Terry to invest $250,000 in securities of X Corp. Chris failed to disclose that she had no reasonable basis for the recommendation or that she was accepting money from X Corp. for touting its stock. The securities turned out to be virtually worthless. Chris' actions appear to violate the Act's prohibition on fraud. <=197> n196 But, while Terry appears to be entitled to rescission, he is not entitled to any relief for the loss in the value of his investment in X Corp. stock. <=198> n197 As a [*30] result, it appears that Terry's actual financial recovery under the Advisers Act would be minimal.

There are mixed indications regarding the extent to which SEC oversight is effective in constraining investment advisers from engaging in inappropriate behaviors. As the advisory industry experienced rapid growth during the 1980s and 1990s, the SEC became very concerned that it lacked adequate resources to oversee the industry. <=199> n198 The agency sought a variety of solutions, from industry self-regulation to an expansion of SEC resources, all without success. <=200> n199 Ultimately, legislation in 1996 established that, with limited exceptions, only advisers with $25 million or more in assets under management must register with the SEC. <=201> n200 Smaller advisers must register at the state level. <=202> n201 Both the states and the SEC retain anti-fraud authority over all advisers. <=203> n202

In spite of the practical and regulatory constraints on the SEC's oversight abilities, in recent years the SEC has filed significantly larger numbers of cases alleging violations of the Advisers Act than it had filed in the past. <=204> n203 The penalties imposed for violations have increased as well. <=205> n204 The range of actions against which the SEC is bringing enforcement actions varies from conflicts of interest, to issues with custody of client funds, to failure of advisers to secure best execution on client trades. <=206> n205

Another indicator of SEC activity is its inspection program. In order to maximize the effect of that program, the SEC now engages in what it refers to as "smart" examinations of investment advisers. <=207> n206 According to the SEC, that means it is targeting its attention on the advisory firms that pose the greatest risk to investors, and it varies the scope of the examination depending upon the internal controls established by the advisory firm being investigated. <=208> n207 As a result of this focused approach, the SEC issues a deficiency letter in approximately 85% of its examinations, and refers the case for enforcement action in another 5% of examinations. <=209> n208 Similarly, the SEC uses examination sweeps to target specific issues such as the extent [*31] of disclosure made to clients regarding brokerage practices <=210> n209 and soft dollar practices. <=211> n210

In sum, although ERISA's preemption provision does not preempt other federal law, such as the Advisers Act, the Act itself poses only a limited risk of liability to advisers. Although the Act contains broad anti-fraud provisions, its remedial provisions are very restricted. Even when defrauded, the relief available to private advisory clients is limited to restitution and rescission. The SEC's lack of enforcement resources limits, without totally defanging, the agency's regulatory power.

c. State Law

By way of comparison, state law often does subject investment advisers to substantial liability for inappropriate advice, fraudulent actions, and other related misfeasance. The specifics vary substantially from state to state, but, as a general matter, state law claims against investment advisers may be pursued under either state securities law or common law. This subsection briefly reviews the scope of coverage and liability under each of those categories.

Every state except Wyoming has adopted securities law provisions that require investment advisers to register with the state. <=212> n211 There is, however, considerable non-uniformity among the states. <=213> n212 Thirty-seven jurisdictions adopted all or part of the Uniform Securities Act of 1956 (1956 Act). <=214> n213 A handful of other jurisdictions adopted the Revised Uniform Securities Act of 1985 (RUSA). <=215> n214 Commentators regularly note the departures from the [*32] uniform acts made by the state securities laws of New York and California. <=216> n215

While the differences between the uniform acts are significant, <=217> n216 for purposes of this Article, both acts can be considered at the same time. Both the 1956 Act and RUSA regulate securities registration <=218> n217 and fraud. <=219> n218 In each case, the uniform act's enforcement provisions permit civil awards that include rescission, damages, prejudgment interest, costs, and attorney's fees, but not punitive damages. <=220> n219 The acts also provide for administrative enforcement <=221> n220 and criminal penalties. <=222> n221

When a securities purchaser loses money, the resulting complaint tends to name the securities professional who provided advice on the transaction. That professional frequently is the broker who handled the securities transaction and who may, or may not, also meet the relevant state or federal definition of an investment adviser. <=223> n222 Concomitantly, an investment adviser may, or may not, also meet the definition of a broker-dealer. <=224> n223 One court explained the classic case as follows:

> This case is of a type which has been referred to as the "common garden variety" suit by a customer against her stockbroker[/adviser]... . In such a case the plaintiff-customer (often a widow or orphan) typically invests a substantial amount in securities or commodities recommended by the defendant-broker. When the investment goes sour, the plaintiff alleges a wide variety of claims, state and federal, statutory and common law, in the hope of recouping the loss from the broker[/adviser]. <=225> n224

In referring to a "wide variety" of potential claims, the court may have understated actual practice. State law claims run the gamut, including [*33] breach of fiduciary duty, <=226> n225 negligence, <=227> n226 misrepresentation, <=228> n227 fraud, <=229> n228 breach of contract, <=230> n229 churning, <=231> n230 lack of disclosure, <=232> n231 as well as statutory claims based upon specific state securities law provisions. <=233> n232 Similarly, a plaintiff may rely on a range of legal principles to hold the employing firm vicariously liable along with, or instead of, the adviser. <=234> n233 And, the firm may be independently liable for securities fraud or other related violations. <=235> n234

Not only do plaintiffs enjoy an extensive menu of potential state law claims against investment advisers, the legal principles tend to be generous when it comes to damages. A court may order rescission of an advisory contract or a securities sale. <=236> n235 Under the rubric of compensatory damages, [*34] a plaintiff might receive one or more of the following: return of the profits made by the adviser, <=237> n236 recompense for a drop in the value of securities, <=238> n237 or an award to compensate for expected investment gains. <=239> n238 Punitive damages may be available under state securities laws. <=240> n239 More frequently, plaintiffs seek punitive damages by pleading claims of fraud or fiduciary duty under the state common law or under non-securities laws. <=241> n240 The availability of punitive damages under state law can be significant to plaintiffs as the awards are sometimes substantial. The availability of punitive damages helps explain the popularity of state law claims. <=242> n241 Both pre-judgment interest and attorney's fees help to offset the costs of litigation and encourage representation of claimants with small losses. <=243> n242 It is possible that ERISA's broad preemption clause may affect the availability of state claims against investment advisers who provide advice regarding benefit plan assets. The scope of ERISA's preemptive effect is [*35] evaluated below as part of the discussion of investment advice from the perspective of plan investors. <=244> n243

From a practical perspective, the typical investment advisory contract currently requires clients to arbitrate their claims against advisers. <=245> n244 While there appears to be a dearth of data regarding arbitration against investment advisers, the NASD compiles substantial information as part of its dispute resolution program in the brokerage industry. Significant scholarly work, and disagreement, addresses the fairness and efficacy of arbitration in the securities field. <=246> n245 One commentator's analysis of the empirical data found that claimants in small cases are less likely to recover in arbitration than claimants with larger cases. <=247> n246 Other factors that may affect arbitration outcomes include the retention of lawyers by claimants and the number of arbitrators used to hear the case. <=248> n247 But, when surveyed, more than 90% of the participants in the NASD arbitration program reported that the process is "fair[] and without bias." <=249> n248

2. Prohibited Transactions Complications

Most entities that provide services, other than investment advice, to an ERISA plan do not become ERISA fiduciaries. <=250> n249 Non-fiduciary status permits those providers to be paid reasonable fees from plan assets for their services. However, ERISA specifically defines investment advisers as ERISA fiduciaries. <=251> n250 This, in turn, subjects any entity that provides investment advice to the stringent prohibited transactions provisions that [*36] apply to ERISA fiduciaries. <=252> n251 The prohibited transactions provisions forbid fiduciaries from providing other services to the plan to which they owe a fiduciary duty. <=253> n252

In effect, the prohibited transactions provisions will preclude an entity that provides mutual funds from also providing investment advice to plan investors unless the entity obtains an exemption from the DOL. The expenses of seeking such an exemption can be significant. One company has cited costs of $60,000 to $100,000 per exemption and a wait of between twelve and eighteen months for DOL approval. <=254> n253 Furthermore, to date, the DOL appears willing to grant exemptions only when the financial terms are structured to eliminate any potential conflict of interest. <=255> n254 This limits the fees an adviser can charge and precludes service providers from structuring services in innovative ways.

D. Plan Investors - Risks and Issues

The prior subsection looked at regulation of investment advice from the perspective of advisers. The goal was to determine the extent to which current law discourages investment advisers from providing advice to individual benefit plan investors. This section examines the issue from the perspective of the plan investors. Advocates of investment advice for plan investors believe that such advice would be useful to those investors as they make asset allocation decisions. The remaining question, however, is whether there is a dark side to investment advice, and, if so, its scope.

1. Viability of Disclosure as a Cure for Self-Interested Investment Advice

All interested observers, from the DOL <=256> n255 to academics <=257> n256 to plan investors themselves, <=258> n257 appear to agree that many plan investors both need and want investment advice. Testimony before the House Employer- [*37] Employee Relations Subcommittee of the Committee on Education and the Workforce in both 2000 and 2001 indicated strong support for increasing benefit plan investors' access to investment advice. <=259> n258 The complexity of investment choices, as well as the importance of those choices to plan investors' retirement security, reinforces the need for increased access to investment advice. <=260> n259 And, because substantial private retirement programs relieve the pressure on the Social Security system, Congress has yet another reason to address the barriers that currently discourage employers from providing investment advice in their benefit programs. <=261> n260

While there is extensive agreement on the need for increased advice, one major area of disagreement continues to divide those with an interest in this topic. Most investment advisers have some level of self-interest that inheres in the advice they provide. For example, if the adviser also is a member of the firm whose mutual funds are offered as plan investments, there may be explicit or implicit pressure to steer plan investors to funds that generate high fees for that mutual fund company. <=262> n261 The battle that will be fought in the legislative arena is whether disclosure can suffice to offset potential conflicts of interest on the part of advisers.

The DOL's shifting positions on the issue offer a window onto the controversy. As presidential administrations changed in the last year, so did the agency's official position on whether disclosure is an appropriate way to resolve conflicts of interest. Specifically, under the Clinton administration, the DOL took the position that plan investors who lack the financial sophistication to make their own investment decisions also lack the ability properly to evaluate and react to disclosures of conflicts of interest. <=263> n262 As a result, in the Fall of 2000, the DOL opposed legislation intended to expand access to investment advice. <=264> n263 That legislation would have provided for an [*38] automatic exemption from the prohibited transaction standards for investment advice so long as the adviser complied with specific disclosure requirements. <=265> n264 In contrast, the SEC traditionally has taken the position that appropriate disclosure suffices to offset the conflict of interest, and its concern is with the necessary scope of disclosure. <=266> n265

The legislation intended to encourage the provision of investment advice was reintroduced with only minor changes in June 2001. <=267> n266 In July, the DOL announced its support of the legislation. <=268> n267 According to Ann L. Combs, who had recently been appointed as the Assistant Secretary for Pension and Welfare Benefit Administration, <=269> n268 "Investment Education, while important, is simply not enough." <=270> n269 In a dramatic change from the Department's prior position, Assistant Secretary Combs did not express any concern regarding the ability of plan investors to evaluate potential conflicts of interest by advisers. <=271> n270 In fact, she stated, "We believe the bill creates a strong, protective framework for the provision of investment advice to participants ... ." <=272> n271

2. Availability of Sufficient Remedies to Protect Against Inappropriate Investment Advice

A related issue is whether benefit plan investors who receive unprofessional, fraudulent, or self-interested advice from an adviser will have access to sufficient remedies. The reputation of the investment advisory industry has not been above reproach over the years. <=273> n272 Nor has the lack of a self-regulatory organization helped public perceptions. As discussed above, state common and statutory law typically provides an array of causes of action for investors who suffer losses at the hands of incompetent or fraudulent investment advisers, <=274> n273 and available remedies range from rescission to punitive damages. The issue for benefit plan investors who suffer damages at the hands of investment advisers, however, will be whether ERISA's preemption clause nullifies their state law claims. It will soon become clear why a full analysis of ERISA's possible preemptive effect is beyond the scope of this Article, but the basic outlines [*39] of the issue are fairly easy to sketch.

ERISA's preemption language was once described as the "most expansive preemption clause found in any federal statute." <=275> n274 The provision itself states that ERISA preempts all state laws that "relate to any employee benefit plan." <=276> n275 Thus, for a number of years, courts struck down a great many state laws as preempted by ERISA. <=277> n276 The tide began to turn in 1995. <=278> n277 In a pivotal ERISA preemption case, Justice Souter wrote for the unanimous Court that "if "relate to' were taken to extend to the furthest stretch of its indeterminacy, then for all practical purposes pre-emption would never run its course, for "really, universally, relations stop nowhere.'" <=279> n278 Recognizing that ERISA preemption has limits, however, has proven easier than establishing the parameters of those limits. The Supreme Court has continued to struggle with the scope of ERISA preemption, <=280> n279 as have the commentators. <=281> n280

The issue is further complicated when evaluating ERISA's effect on state securities laws. In addition to its broad preemption clause, ERISA contains what is known as its "savings clause," <=282> n281 which provides that it does not preempt "any law of any State which regulates insurance, banking, or securities." <=283> n282 In discussing the potential liability of those who provide investment education, one commentator ignored the potential import of the exemption for state securities law and asserted that ERISA would preempt any relevant state law. <=284> n283 While case law on the question is sparse, at least [*40] one court has gone the other way and denied a state securities law claim associated with a benefits plan on substantive grounds, rather than finding the state statute to be preempted. <=285> n284

The extent to which ERISA's savings clause will permit state law actions by benefit plan investors against investment advisers will most likely depend upon the construction of ERISA's language, which saves from preemption the "law of any State which regulates ... securities." <=286> n285 In order to give some meaning to the statutory language, at least some state statutory securities law should survive. However, significant precedent indicates that ERISA will preempt many of the general common law claims, such as fiduciary duty, negligence, misrepresentation, and fraud, that permit expansive recoveries in cases alleging problematic investment advice. <=287> n286 In another of ERISA's most prominent preemption cases, the Supreme Court held that the savings clause did not ensure the survival of a plaintiff's state common law bad faith claim against an insurance company. <=288> n287 According to the Court, "[a] common-sense view of the word "regulates' would lead to the conclusion that in order to regulate insurance, a law must not just have an impact on the insurance industry, but must be specifically directed toward that industry." <=289> n288 Because the state law of bad faith had its "roots ... in the general principles of ... tort and contract law," <=290> n289 the Court determined that the state law did not regulate insurance within the scope of the savings clause. The same analysis could easily be applied to the state common law principles often relied upon for claims against investment advisers, and if so, those claims would be preempted. On the other hand, because statutory securities laws are "specifically directed toward that industry," <=291> n290 ERISA should not be read to preempt those state laws.

In sum, while federal remedies are available under ERISA and the Investment Advisers Act, those remedies are limited. <=292> n291 Similarly, under state law, general common law claims often provide the widest latitude for recoveries. <=293> n292 Nevertheless, it is likely that ERISA would preempt any state common law claims brought by plan investors who have received problematic advice about the investment of their benefit plan assets. Given the limited nature of ERISA's remedial scheme, its preemption of state [*41] common law may leave some investors without access to appropriate forms of relief.

V. Evaluation of Existing Proposals to Regulate Investment Advice

This part evaluates three proposals intended to increase the availability of investment advice. If adopted, each proposal would result in an improvement over the status quo, but each suffers from shortcomings that would undermine benefit plan investors' access to quality investment advice.

A. Revision of DOL Prohibited Transaction Exemption Process

In a carefully written and thorough article, Professor Colleen Medill suggests that the DOL take a number of administrative actions to increase the availability of investment advice to plan investors. <=294> n293 Specifically, Professor Medill makes five recommendations for DOL action. <=295> n294 First, she would require that in order to qualify for protection from liability under section 404(c): (a) employers be required to provide specified levels of investment education, <=296> n295 (b) plan investors not be permitted to invest more than 10% of their elective salary deferrals in employer stock or real property, <=297> n296 and (c) plans be required to inform plan investors of their right to decline to make their own investment decisions. <=298> n297 In addition, Professor Medill would seek amendment of the 404(c) regulations to clarify when an employer providing investment advice would be liable for a plan investor's investment losses. <=299> n298 Second, she suggests establishing new class exemptions similar to the individual exemptions the DOL has granted to investment advisers, as well as updating existing class exemptions. <=300> n299 Third, she would require the DOL to revise the guidance it outlined in Interpretive Bulletin 96-1 to provide that the more extensive levels of communications, which the DOL classified as investment education, are actually classified as investment advice. <=301> n300 Fourth, Professor Medill believes the DOL should issue guidance to provide comfort to employers on the scope of their fiduciary duty in the monitoring of investment advisers [*42] and their potential co-fiduciary liability. <=302> n301 Specifically, her proposal would permit employers to "rely in good faith upon the representations of the investment adviser that its advice is consistent with its duties as an ERISA fiduciary." <=303> n302 Fifth, Professor Medill's regulatory scheme would subject all individuals and entities who provide investment advice regarding ERISA benefit plan assets to financial solvency requirements. <=304> n303

As a package, Professor Medill's suggested regulatory changes would address some of the roadblocks that currently prevent employers from providing plan investors with investment advice. To put her proposal in context, she specifically sought ways to increase the provision of investment advice without the necessity of statutory amendments. Given that limitation, Professor Medill's suggestions are remarkably thorough in addressing issues faced by employers, investment advisers, and plan investors. It appears, however, that the current political climate may support legislative change in this arena. If so, broader changes than those proposed by Professor Medill can be made.

The suggestions that Professor Medill does make raise three specific concerns. First, the new requirements that she would impose on employers, such as the obligation to provide plan investors with investment education, <=305> n304 would inappropriately subject qualified benefit plans to increased regulation. Second, her proposal to establish class exemptions that mirror the existing individual exemptions <=306> n305 would not provide sufficient incentive to investment providers to engage in the provision of advice because the existing exemptions so strictly regulate the receipt of fees. Even the DOL now recognizes that the exemptions put affiliated advisers "at a competitive disadvantage," <=307> n306 and prevent them from being "at the forefront of any market innovations." <=308> n307 Third, the comfort that Professor Medill would grant to employers regarding their duty to monitor goes too far by protecting employers so long as they do not have actual knowledge of wrongdoing. <=309> n308 This type of liability standard would encourage an employer to take a "head in the sand" approach once it had selected an investment adviser.

B. A Phased Exemption Approach

In testimony before the Education and Workforce Committee, [*43] Professor Joseph Grundfest advocated varying the level of regulation of investment advisers depending on the potential for conflicts of interest. <=310> n309 In sum, Professor Grundfest suggested a trifurcated approach. At one end of this spectrum, so long as the investment adviser is independent of the plan's mutual fund provider, the adviser would be exempt from the prohibited transaction requirements. <=311> n310 The adviser would be classified as independent if it is not affiliated with the fund provider, its compensation is not contingent on the advice given, and the advice "satisfies specified objectivity and competence criteria consistent with the modern finance literature." <=312> n311 The mutual fund provider would be permitted to pay all or part of the adviser's fees without affecting the adviser's independence. <=313> n312

At the intermediate level, an exemption would still be available to any adviser who is affiliated with the plan's mutual fund provider. <=314> n313 But, the adviser would be permitted to provide investment advice only if (1) "the funds adopt a level fee structure within the plan," <=315> n314 (2) "the compensation paid to the adviser is not contingent on the advice provided," <=316> n315 and (3) "the advice satisfies objectivity and competence criteria that are consistent with the modern finance literature." <=317> n316 At the other end of the spectrum, no relief from ERISA's prohibited transaction provisions would be available to an affiliated investment adviser who does not meet these requirements.

Professor Grundfest's proposal may be more administratively efficient for investment advisers than Professor Medill's proposal. Instead of needing to fit their investment programs within the generally narrow terms of a class exemption, under Professor Grundfest's approach even affiliated investment advisers have substantial latitude in configuring a program of investment advice. This may encourage innovation and adoption of advisory programs to specific plan investor groups. And, the proposal's trifurcated structure, with more stringent requirements for investment advisers that are affiliated with a plan's mutual funds provider, recognizes and addresses some of the concerns regarding conflicts of interest.

On the other hand, Professor Grundfest's proposed definition of independence is of concern. It would permit the mutual fund provider, whose funds the adviser may be recommending, to pay the adviser's fees. <=318> n317 In such a situation, the adviser would qualify as independent and, so long as [*44] it met the other two criteria, would receive an exemption from ERISA's prohibited transaction requirements. Yet, it is unusual for a definition of "independence" to ignore fee arrangements. Furthermore, whether Professor Grundfest would require disclosure of the fee relationship is unclear from his testimony.

The intermediate level of regulation, which would apply to advisers affiliated with the plan's mutual fund provider, raises another concern. Many mutual fund families charge different fees for different funds within the family. <=319> n318 Thus, Professor Grundfest's proposal would either exclude many affiliated advisers or require substantial changes to the internal financial mechanisms of many funds. As a result, the proposal may effectively leave significant barriers in place as to the provision of investment advice by any entity that does not meet the proposal's definition of independence. And, again, Professor Grundfest's testimony did not discuss any disclosure requirements.

Whether the advisers are affiliated or not, Professor Grundfest's proposal would preclude the availability of a prohibited transaction exemption when the investment advice given is not consistent with modern finance literature. Professor Grundfest says the provision is intended to "deter the use of techniques that have no established basis in the financial or economic literature ... ." <=320> n319 However, this may generate substantial amounts of litigation as the federal courts struggle to determine whether specific advice meets this standard. The true beneficiaries of this standard could be the finance experts who would be testifying on the boundaries of finance theory in all the cases of disputed investment advice.

Finally, with respect to the employers that sponsor benefit plans, Professor Grundfest appears to take the opposite approach of Professor Medill. Professor Medill proposed a blanket exemption from liability for employers so long as they have no actual knowledge of wrongdoing. <=321> n320 In contrast, Professor Grundfest's proposal does not offer any comfort whatsoever for an employer that relies upon an investment advice provider.

C. H.R. 2269

Representative John A. Boehner has introduced almost identical bills on the subject of investment advice for benefit plan investors in the 106th and 107th Congresses. In 2000, the Subcommittee on Employer-Employee Relations of the House Education and the Workforce held hearings and a mark-up session on H.R. 4747, but the bill failed to progress beyond that [*45] point. <=322> n321 Representative Boehner reintroduced the legislation, with minor changes, in June 2001 as H.R. 2269. <=323> n322 The bill, known as the "Retirement Security Advice Act of 2001" (RSAA), <=324> n323 proposes a statutory exemption from ERISA's prohibited transaction provisions for: (a) the provision of investment advice, (b) transactions in plan assets as a result of that advice, and (c) fees received for that advice. <=325> n324

A significant number and variety of interested parties, from the DOL to TIAA-CREF, have announced their support for RSAA. <=326> n325 Encouraging as it may be that Congress is devoting serious attention to the issues associated with the provision of investment advice to benefit plan investors, RSAA, in its attempt to encourage the provision of advice, fails to resolve three significant concerns. First, it appears that RSAA will delegate substantial regulatory authority for disclosures to the DOL. Given the complexity of these disclosures and the existing SEC regulations, making DOL responsible for this oversight is inefficient and would likely cause confusion among investors. Second, RSAA provides some protection to employers who select investment advisers for their participant-directed benefit plans, but that protection may be insufficient. If so, RSAA will fail because employer plans will not offer investment advice. Third, ERISA's preemption of state law may result in inadequate remedies for plan investors who suffer injury as a result of inappropriate or fraudulent investment advice. This subsection evaluates each of these concerns.

RSAA attempts to achieve a balance between encouraging employers and advisers to provide investment advice, on the one hand, and ensuring that plan investors receive sufficient disclosure to evaluate the advice in the context of who is providing it, on the other hand. As such, RSAA permits fiduciary advisers operating under a conflict of interest to provide advice. <=327> n326 It attempts to protect plan investors from conflicts by imposing specific disclosure requirements on the fiduciary adviser. <=328> n327 RSAA pursues its disclosure goals, however, by integrating them into ERISA, where they will be interpreted and enforced by the DOL. <=329> n328 Furthermore, RSAA's [*46] provisions grant a prohibited transaction exemption to any party who meets its definition of "fiduciary adviser." <=330> n329 That definition extends significantly beyond those individuals who must register as an investment adviser under federal or state law, by also encompassing advice givers associated with banks, insurance companies, and broker-dealers. <=331> n330

Regulating the provision of investment advice through ERISA raises a number of concerns because of the states' and the SEC's existing authority over, and expertise with, investment advisers. RSAA does require that fiduciary advisers provide plan investors with disclosure "in connection with any ... acquisition or sale, in accordance with all applicable securities laws." <=332> n331 However, it separately defines, quite specifically, the disclosure that an adviser must make at the time of first providing advice. <=333> n332 Those disclosures include information about fees, compensation, affiliations, limitations on the scope of advice, and related services. <=334> n333 Therefore, it appears that RSAA intends to set the standard for conflict of interest disclosure separately from existing securities law. And, given the DOL's regulatory authority over exemptions from prohibited transactions and language in the committee report, it appears that the DOL would have responsibility to define and oversee the conflict of interest disclosures. The specificity of RSAA's conflict of interest disclosure requirements and delegation of authority to the DOL is odd given the SEC's recent and substantial efforts on equivalent advisory disclosures outside of qualified plans.

As noted above, the Advisers Act requires investment advisers with $25 million or more under management <=335> n334 to register with the SEC. <=336> n335 In April 2000, the SEC proposed substantial revisions to Uniform

Form ADV, [*47] the adviser registration form. <=337> n336 In discussing its recommended changes of Part II, which contains the client disclosure requirements, the SEC stated, "Our experience over the 15 years since Uniform Form ADV was adopted has convinced us that we need a better approach to client disclosure." <=338> n337 Specific problems with the old approach include: technically accurate but misleading disclosures, the need for clients to draw sophisticated inferences from reported facts, a lack of information about the advisers themselves, and insufficient updating requirements. <=339> n338

The SEC's suggested revisions of Part II of Form ADV turned out to be so controversial that the SEC deferred making any changes to Part II when it adopted the final rule. <=340> n339 Critical commentary continued in 2001, <=341> n340 and the SEC decided it would wait until a new Chairperson was in place before revisiting the issue. <=342> n341 For present purposes, the point is not to consider the details of the final version of Part II of Form ADV. Instead, it is that the SEC has more than fifteen years of experience in regulating the disclosures that investment advisers make to clients and has made substantial efforts to improve the quality of those disclosures. The scope of the controversy associated with the SEC's proposed revisions indicates the complexities inherent in this type of disclosure. Once the SEC finally resolves the content and form of investment adviser reporting outside of the benefit plan context, it seems inefficient for Congress to write, and the DOL to interpret and enforce, separate standards for disclosure when advice is provided regarding benefit plan assets. In the committee report on RSAA, the Committee on Education and Workforce finally acknowledged, albeit indirectly, the potential for inter-agency problems on disclosure. The report states: "The disclosure requirements are intended to be consistent with those required under applicable securities laws. Accordingly, it is intended that the disclosure provisions be construed in a manner that assures consistency between the statutory exemption and existing securities laws, ..." <=343> n342 As noted by the minority, however, this is the first and only [*48] reference to an important issue that was never discussed in committee. <=344> n343 Reconciling this guidance with the separate requirement that advisers also comply with the securities laws' disclosure provisions <=345> n344 undoubtedly will be a problem for the relevant agencies and the courts.

It is difficult to see why benefit plan investors would be so different from the population of investors that the SEC normally seeks to protect that the benefit plan investors would require a different level of disclosure. It also seems likely that investors would find it confusing to receive multiple disclosure statements from their investment adviser - one disclosure designed to meet the SEC standards and another to meet the DOL standards. Similarly, the extension of the prohibited transaction exemption to individuals who are not registered with a state or the SEC as an investment adviser further complicates the regulatory scheme. <=346> n345 In sum, there would be significant economies in regulatory effort, in investment adviser compliance, and in investor understanding, if compliance with SEC standards also fulfills the requirements for an ERISA prohibited transaction exemption.

A second problem with RSAA arises when one considers the bill from the perspective of employers who sponsor benefit plans. RSAA provides employers with two types of protection from liability. First, it specifies that an employer that provides investment advice, directly or indirectly, will not be "treated as failing to meet the requirements of [Part 4 of ERISA, which contains the fiduciary responsibility provisions] solely by reason of the provision of investment advice ... ." <=347> n346 This language appears to protect the employer from liability for causing the plan to engage in a prohibited transaction if it turns out that the fiduciary adviser does not meet RSAA's requirements. Second, RSAA confirms that an employer must meet ERISA's fiduciary requirements in the selection and monitoring of advisers. <=348> n347 It does, however, provide some comfort to employers by clarifying that there is "no duty under this part to monitor the specific investment advice given by the fiduciary adviser to any particular recipient of such advice." <=349> n348

As with disclosure, a balance needs to be achieved between protecting plan investors from investment advisers, who are subject only to limited oversight, and protecting employers from the fear of liability under monitoring standards that are too onerous or too vague. Exempting [*49] employers from all monitoring obligations so long as the employer has no actual knowledge of wrongdoing, as Professor Medill suggests, would inappropriately provide employers with an incentive to avoid any oversight, investigation, or involvement that might lead to knowledge of wrongdoing. <=350> n349 On the other hand, RSAA may fail to provide sufficient protection for employers. Evaluating whether RSAA does, in fact, achieve the right balance must be done in the context of an employer's possible liability from providing investment advice.

As we have seen, the DOL has stated that when an employer engages an advice provider, the employer might be liable for co-fiduciary liability. <=351> n350 That occurs if the employer fails to meet ERISA's prudence and exclusive benefit requirements or if it knowingly takes part in a fiduciary breach. <=352> n351 It appears that RSAA intends to protect employers from this type of liability. <=353> n352 But, if an employer knowingly takes some part, even in failing to correct, a fiduciary breach, then the employer should be held liable. Any other outcome would deprive plan investors of protection against intentional fiduciary wrongdoing. To the extent that RSAA eliminates this liability, it encourages employers to engage in intentional wrongful behavior.

The two types of potential employer liability that are more troubling are monitoring liability and loss of the section 404(c) protection. <=354> n353 While RSAA exempts employers from having to monitor specific advice given to individual plan investors, it does require monitoring. It remains unclear what is expected of employers in this regard. Will they be expected to compare the returns on an adviser's average or general recommendations to market averages? That does not make sense given the individualized nature of advice. Will employers be expected to compare an adviser's recommendations to techniques "consistent with the modern finance literature," <=355> n354 as suggested by Professor Grundfest? Such a standard is likely to result in a battle of academic experts in any disputed cases. In short, the criteria for monitoring is far more amorphous in this context than in the monitoring of other plan service providers whose results typically can be compared to plan policy requirements or market averages. The risk to employers of being found to have ineffectively monitored an investment adviser is that the employer might become liable for investment losses that result from poor advice. Given the ambiguity of the standards and the scope of the liability risk, many employers may choose not to test these [*50] waters. In addition, RSAA does not appear to insulate employers against the loss of the 404(c) protections. If an adviser's breach is so egregious as to mean that plan investors did not exercise informed investment control, as required by 404(c), then the employer may be held liable for the plan investors' investment selections. <=356> n355 But, an employer cannot evaluate whether an adviser's recommendations are exposing the employer to liability for noncompliance with 404(c) without monitoring the specific advice given to individual participants. Effectively, then, RSAA does not alleviate the necessity of an employer monitoring specific investment advice.

In sum, unless employers can become comfortable that they are able, with reasonable efforts, to meet their fiduciary obligations in monitoring the provision of investment advice, they will almost certainly be unwilling to retain entities to provide that advice. Similarly, if employers risk the loss of the 404(c) protections by providing investment advice through their plans, then the true risk is that the employers may become liable for poor advice. If employers remain unwilling to provide, or arrange for the provision of, investment advice, then such advice will remain unavailable to the vast majority of benefit plan investors.

Finally, RSAA does not explicitly address the availability of remedies for benefit plan investors who receive inappropriate investment advice. The committee report indicates that RSAA's amendment to ERISA would not affect existing state securities law. <=357> n356 This, however, ignores the probable application of ERISA preemption to state common law, which often provides the basis for investor claims. <=358> n357 Furthermore, the scope of available remedies under ERISA is currently so ambiguous that it is not clear whether plan investors might be left with inadequate remedies against fraudulent or negligent advisers. <=359> n358 If so, the net result will be (1) a failure to establish proper economic incentives for investment advisers to provide appropriate advice; (2) plan investors who experience investment losses due to inappropriate advice but who are unable to recover for those losses; and (3) pressure on the courts, the relevant administrative agencies, and Congress to provide some measure of relief from the horror stories that are sure to occur.

[*51]

VI. A Proposal for a Nonexclusive Safe Harbor

So long as employers remain unwilling to provide investment advice through the benefit plans they sponsor, many plan investors will likely lack access to investment advice. Currently, employers face the specter of significant liability resulting from ill-defined obligations. In this Part, I suggest that a nonexclusive safe harbor would provide appropriate protections to employers while also balancing the interests of plan investors.

A properly configured safe harbor would provide employers with certainty in limiting liability exposure associated with a program of investment advice. At the same time, the use of a nonexclusive safe harbor would provide employers who are willing to accept increased liability risk with flexibility in configuring advice programs. Furthermore, the safe harbor should focus on the selection and monitoring of investment advisers. From the employers' perspective, those are the actions that currently pose the most uncertainty, both in terms of obligation and risk. From the plan investors' perspective, the integrity and skill of the advice provider will be critical in determining the value of the advice. Finally, in the long term, mechanisms that enhance regulatory efficiency and the professionalism of advice will benefit the advisory industry.

The goals to be met by a safe harbor must be drawn from these considerations. A successful safe harbor will provide the following: (a) increased certainty of obligation and the opportunity for decreased liability for employers that sponsor benefit plans; (b) protections for plan investors against fraud and incompetence on the part of advisers; and (c) efficiency in regulatory oversight for investment advisers.

To accomplish these objectives, I propose a nonexclusive safe harbor that would provide employers with an exemption from liability for ERISA's fiduciary selection and monitoring requirements, as well as from 404(c) noncompliance, so long as the following requirements are met. First, the plan must offer at least two choices of investment advisory firms, and at least one of the choices must qualify as an independent adviser. <=360> n359 Second, the plan fiduciary must possess a good faith belief based upon a reasonable investigation that every investment advisory firm providing services through the plan is registered as an investment adviser with the SEC at the time of selection. Third, the plan fiduciary must undertake an annual review sufficient to maintain a good faith belief that each investment advisory firm providing advice to plan investors remains registered with the SEC.

[*52] The requirement that each benefit plan offer at least two investment advisers will ensure that plan investors have some choice in the selection of an investment adviser. Establishing a competitive market for advisers within plans should enhance the quality of advice. The requirement that at least one advisory firm be independent also should militate to increase the quality of advice given by both independent and related advisers. The potential for competition from related advisers will provide incentives for independent advisers to become as knowledgeable as related advisers about a plan's investment alternatives. The presence of independent advisers should serve as a check on the self-interest of related advisers.

Requiring registration with the SEC in order to qualify for the safe harbor is probably the most controversial portion of this proposal. The requirement of federal level registration will exclude from the safe harbor all firms that do not have national practices and have less than $25 million under advisement. While the requirement will certainly disadvantage small advisory firms, the recommendation is important for three reasons. First, once employers comply with the safe harbor, they will largely be exempt from liability for self-interested or inappropriate investment advice. It is, therefore, critical that advisory firms qualified for selection under the safe harbor possess the internal controls to discourage fraud and other problematic behaviors related to the provision of investment advice. Second, given the general lack of any significant credentialing requirement for investment advisers, it is important that the safe harbor exclude wholly incompetent advisory firms. In order to register at the federal level, advisers must have either a national practice or $25 million under management. In each of those circumstances, the adviser has at least established some credibility in the marketplace. Third, advisory firms must have the financial resources to meet any liability the firms might face as a result of the provision of self-interested or inappropriate investment advice. It is rational to believe that firms with a national practice or with at least $25 million under management are more likely than smaller, more local firms to have sufficient financial assets available to fulfill a significant judgment of liability.

Admittedly, in the immediate term, federal registration alone will not necessarily ensure that every investment advisory firm meets these three criteria. Potential liability and market forces, however, should provide incentives for advisory firms to provide professional and honest advice that enhances plan investors' returns. At the same time, the exclusion of small advisory firms from the safe harbor serves some significant purposes. Consider the situation of the small business owner whose cousin has been struggling professionally in a variety of careers and now decides to open a financial planning and advisory practice. Though the cousin faces few barriers to entry in the financial advisory industry, the small business owner cannot provide the cousin with a ready-made clientele of plan investors and [*53] still receive the protection of the safe harbor. Given the nonexclusive nature of the safe harbor, however, the business owner could still select the cousin as the plan investors' advice provider, consistent with current law. In that case, the small business owner would accept the risk associated with the selection of the cousin and the monitoring of her advice.

The example is a narrow and simple one, but avoiding this type of situation is a serious concern. In many states, there are few constraints on the ability of any individual to open an advisory practice. The low barriers to entry very well may attract incompetent or unethical individuals, especially if the market expands to include the more than $1.7

trillion held in 401(k) accounts. It follows that potential advice providers may be a friend, relative, business associate, fellow union member, or other affinity group member of the employer who selects investment advisers for an employee benefit plan. The risk to plan investors increases if employers are able to select inexperienced planners and still receive the protections of the safe harbor. Some screening mechanism is necessary, and while federal registration is not the only possible mechanism, it is one that will reach this concern. <=361> n360

The nonexclusive safe harbor approach offers a number of advantages to employers that sponsor benefit plans. First, it provides clear standards for the selection and review process. This will avoid RSAA's problem of ambiguous obligation, which would leave employers with fiduciary responsibility in selecting and monitoring advisers, yet would fail to provide any guidance on how to meet those responsibilities. Second, employers can easily ascertain whether specific advisory candidates meet the safe harbor's eligibility requirements. This will decrease the transaction costs in selecting and monitoring advisers. Finally, the existence of specific standards provides employers and plan fiduciaries with clear justification for rejecting many incompetent advisers, whether those advisers are relatives of company officers, friends of union officials, promoted by a supplier company, or are otherwise well positioned, but poorly qualified.

From a disclosure standpoint, I propose that all advisers to plan investors be required to meet the SEC's standards for investment adviser disclosure as reflected in Form ADV. As discussed above, the SEC has considerable expertise in the development of advisory disclosure obligations. It is difficult to see why a plan investor should receive different types of disclosures for investments made through a benefit plan than the same investor would receive for investment advice on non-plan investments. From the perspective of regulatory efficiency and advisory compliance, a single disclosure system should minimize costs and [*54] maximize compliance.

The last issue to be considered is that of appropriate remedies for plan investors. ERISA needs to clearly provide "make-whole" relief for plan investors who experience losses as a result of an investment adviser's breach of its fiduciary duties. That relief should not be contingent upon the continuing existence of a benefit plan, the status of a former plan investor's plan account, or any other artificial limitations. The need for legislation on this point will depend upon the Supreme Court's decision on the scope of ERISA remedies in Great-West Life & Annuity Insurance Co. v. Knudson. <=362> n361 The availability of exemplary damages is a much more difficult question, but some level of capped exemplary damages may be appropriate in cases of egregious wrongdoing. <=363> n362 In order to protect employers who choose to make investment advice available through the services of a professional provider of that advice, the statutory liability should be clearly limited to the direct provider of the advice and should not extend to the employer so long as the employer has met the terms of the safe harbor and does not intentionally aid in a fiduciary breach.

VII. Conclusion

Plan investors need investment advice, and legislative changes must be made to remove the current roadblocks that discourage employers from providing that advice. At the same time, it is important to ensure that plan investors are well informed not only about their investment choices, but also about the provider of investment advice. Any legislative changes that are made need to consider the issues from the perspective of all three relevant parties: employers, investment advisers, and plan investors. Unless employers are protected sufficiently from liability, they will refuse to offer investment advice directly or indirectly through the benefit plans they sponsor. Unless investment advisers receive sufficient relief from ERISA's prohibited transactions requirements, many advisers will be precluded from offering advice through benefit plans even if employers wish to engage advisers to provide such advice. But, while both advisers and employers require reasonable protections, those protections must be balanced with the [*55] needs of benefit plan investors. After all, accessibility to investment advice may exacerbate the challenge of retirement asset accumulation if investment advisers provide incompetent, self-interested, or fraudulent advice.

FOOTNOTES:

n1. Approximately $1.7 trillion in assets are held in 401(k) plans. Sarah Holden & Jack VanDerhei, 401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 1999, EBRI Issue Brief, No. 230, Feb. 2001, at 4, available at http://www.ebri.org/0201ib.pdf.

n2. Regina T. Jefferson, Rethinking the Risk of Defined Contribution Plans, 4 Fla. Tax Rev. 607, 636 (2000). In order to simplify the terminology, this article uses the word "employer" in place of "plan sponsor."

n3. Id.

n4. In part this is a result of the trend from defined benefit to defined contribution plans. By 1998, 57.3% of all households with a pension plan reported participating only in a defined contribution plan. Jack VanDerhei & Craig Copeland, The Changing Face of Private Retirement Plans, EBRI Issue Brief, No. 232, Apr. 2001, at 5, available at http://www.ebri.org/0401ib.pdf. The delegation to individual participants of responsibility for investment choices also is a result of 1992 regulatory changes that offered protections to employers whose plans provided for such delegation. Pamela Perun & C. Eugene Steuerle, From Fiduciary to Facilitator: Rethinking the Role of Employers in Defined Contribution Plans, The Urban Institute 13-16 (Dec. 5, 2000) (unpublished manuscript, on file with this author), available at http://www.planetnow.com/pamelawork/facilitator.pdf. For a discussion of these changes, see infra text accompanying notes 50-52, 65-70.

n5. Jefferson, supra note 2, at 627.

n6. See infra Part II.

n7. 401(k) plans take their name from the Internal Revenue Code section that authorizes those plans. For a more detailed discussion of 401(k) plans, see infra Part I.B.

n8. Other plans, such as 403(b) plans, also provide for employee investment decisions. For simplicity, I limit the discussion in this article to 401(k) plans.

n9. John H. Langbein & Bruce A. Wolk, Pension and Employee Benefit Law 39 (3d ed. 2000). For an extensive discussion of the characteristics of defined benefit and defined contribution plans, see id. at 45-55.

n10. Pension Benefit Guaranty Corporation, Pension Insurance Data Book 1998 at 8 fig. 7 (1999) (showing DB plans as main provider of primary pension coverage).

n11. Michael J. Canan, Qualified Retirement Plans 3.51 (1998).

n12. (1.5% x thirty years of service) x $50,000 final average salary = $22,500.

n13. Canan, supra note 11, at 3.52. Spouses also have rights in determining the form of payment of DB plan benefits. Id. at 7.16.

n14. Dan M. McGill & Donald S. Grubbs, Jr., Fundamentals of Private Pensions 131 (1989).

n15. IRC 412 (1994). For a thorough review of minimum funding standards, see Canan, supra note 11, at 12.1 - 12.9.

n16. Canan, supra note 11, at 3.11.

n17. KPMG, Retirement Benefits in the 1990s: 1997 Survey Data 35-36 (1997).

n18. Id.

n19. But see generally Jefferson, supra note 2, at 617 (advocating protection of a minimum investment return in DC plan accounts).

n20. American Academy of Actuaries, Financing the Retirement of Future Generations 14 (1998).

n21. VanDerhei & Copeland, supra note 4, at 3-4.

n22. Id. at 3-4.

n23. ERISA Advisory Counsel, Pension & Welfare Benefit Administration, Department of Labor, Working Group on the Merits of Defined Contribution vs. Defined Benefit Plans with an Emphasis on Small Business Concerns (Nov. 13, 1997), available at http://www.dol.gov/dol/pwba/public/adcoun/dbvsdc.htm [hereinafter Advisory Counsel Study].

n24. Retirement Security Advice: Hearings Before the Employer-Employee Relations Subcommittee of the House Education and the Workforce Committee, 107th Cong. 2 (2001) [hereinafter Combs Testimony] (statement of Ann L. Combs, Assistant Secretary Pension and Welfare Benefits United States Department of Labor).

n25. Langbein & Wolk, supra note 9, at 50.

n26. Id.; Colleen Medill, The Individual Responsibility Model of Retirement Plans Today: Conforming ERISA Policy to Reality, 49 Emory L.J. 1, 86 n.23 (2000).

n27. Langbein & Wolk, supra note 9, at 47-50.

n28. Canan, supra note 11, at 3.91.

n29. Rev. Rule. 98-30, 1998-1 C.B. 1273 (1998).

n30. Employee Retirement Income Security Act of 1974 (ERISA) 1-4402, 29 U.S.C. 1001-1461 (1994).

n31. Langbein & Wolk, supra note 9, at 51.

n32. Id.

n33. Office of Policy & Research, Pension & Welfare Benefit Administration, Department of Labor, Private Pension Plan Bulletin: Form 5500 Annual Reports A (Winter 1999-2000), available at http://wwww.dol.gov/dol/pwba/public/programs/opr/bullet1996/ hilites.htm.

n34. Id.

n35. Id.

n36. See VanDerhei & Copeland, supra note 4, at 5-6.

n37. Id. at 6.

n38. Id.

n39. Advisory Counsel Study, supra note 23.

n40. The survey related to cash balance plans. Those plans have engendered substantial controversy because of the negative effect some of the plans have on older workers. For an explanation of cash balance plans and one debate on their legality, see Edward A. Zelinsky, The Cash Balance Controversy Revisited: Age Discrimination and Fidelity to Statutory Text, 20 Va. Tax Rev. 557 (2001); Richard C. Shea et al., Age Discrimination in Cash Balance Plans, 19 Va. Tax Rev. 763 (2000); Edward A. Zelinsky, The Cash Balance Controversy, 19 Va. Tax Rev. 683 (2000).

n41. Kyle N. Brown et al., The Unfolding of a Predictable Surprise: A Comprehensive Analysis of the Shift from Traditional Pensions to Hybrid Plans, Watson Wyatt Worldwide 44 (2000).

n42. Id.

n43. Id.

n44. Richard J. Kovach, Tax Complexity, Regulatory Ambivalence, and Disparate Benefits and Burdens in Deferred Compensation Planning for Small Business, 11 St. Thomas L. Rev. 141 (1998); Allen Friedland, Comment, Cash or Deferred Plans: A Case of Overregulation?, 8 Del. J. Corp. L. 297 (1984).

n45. See Advisory Counsel Study, supra note 23.

n46. VanDerhei & Copeland, supra note 4, at 6.

n47. Id.

n48. See Medill, supra note 26, at 11.

n49. See Jefferson, supra note 2, at 627.

n50. Perun & Steuerle, supra note 4, at 13.

n51. 29 C.F.R. 2550.404(c)-1 (1992).

n52. See Perun & Steuerle, supra note 4, at 13-14.

n53. ERISA 3(21)(A)(i), 29 U.S.C. 1002(21)(A)(i) (1994).

n54. ERISA 3(21)(A)(ii), 29 U.S.C. 1002(21)(A)(ii) (1994).

n55. See, e.g., Jane K. Stanley, The Definition of a Fiduciary Under ERISA: Particular Persons and Entities, 27 Real Prop. Prob. & Tr. J. 711 (1993) (discussing fiduciary status of plan sponsors, plan administrators, and many others).

n56. ERISA 405(d), 29 U.S.C. 1105(d) (1994).

n57. Lee H. Robinson, Investment Management by Fiduciaries, in ERISA Fiduciary Law 122-23 (Susan P. Serota ed., 1995).

n58. Daniel Fischel & John H. Langbein, ERISA's Fundamental Contradiction: The Exclusive Benefit Rule, 55 U. Chi. L. Rev. 1105, 1108 (1988) ("ERISA's exclusive benefit rule, ... imports into pension fiduciary law one of the most fundamental and distinctive principles of trust law, the duty of loyalty.").

n59. ERISA 404(a)(1)(A), 29 U.S.C. 1104(a)(1)(A) (1994).

n60. Donovan v. Bierwirth, 680 F.2d 263, 271 (2d Cir. 1982). When LTV Corporation offered a significant per share premium in a hostile tender offer for Grumman Corporation stock, the Grumman pension plan fiduciaries rejected the offer without engaging in any significant analysis of the potential benefit to the plan. In addition, in an attempt to defeat the hostile tender offer, the fiduciaries arranged for the plan to purchase more than one million additional shares of Grumman stock. Id. at 264.

n61. ERISA 404(a)(1)(B), 29 U.S.C. 1104(a)(1)(B) (1994).

n62. Robinson, supra note 57, at 122.

n63. ERISA 404(a)(1)(C), 29 U.S.C. 1104(a)(1)(C) (1994).

n64. Robinson, supra note 57, at 133.

n65. Nell Hennessy & Frank Daniele, Participant-Directed Retirement Plans Under Section 404(c), in ERISA Fiduciary Law 175-77 (Susan P. Serota ed., 1995).

n66. 29 C.F.R. 2550.404(c)-1(b)(3) (1992).

n67. Id.

n68. 29 C.F.R. 2550.404(c)-1(b) (1992).

n69. 29 C.F.R. 2550.404(c)-1(b)(2)(ii) (1992).

n70. Hennessy & Daniele, supra note 65, at 176.

n71. See Rethinking Thinking, The Economist, Dec. 18, 1999 (discussing the disagreements between the rationalists and the behavioralists); Richard H. Thaler, The End of Behavioral Finance, Ass'n For Inv. Mgmt. & Res., Nov./Dec. 1999, at 12-15 (discussing academic challenges to behavioral economics findings on stock market overreaction).

n72. Roger Lowenstein, Exuberance is Rational, N.Y. Times, Feb. 11, 2001, at Sun. Mag. 68; Louis Uchitelle, Following the Money, But Also the Mind, N.Y. Times, Feb. 11, 2001, at 1C; Charles J. Whalen, Putting a Human Face on Economics, Bus. Wk., July 31, 2000, at 76.

n73. Gary Belsky & Thomas Gilovich, Why Smart People Make Big Money Mistakes and How to Correct Them (1999).

n74. See Sendhil Mullainathan & Richard H. Thaler, Behavioral Economics, 1 Nat'l Bureau of Econ. Research, Working Paper No. 7948 (2000); Uchitelle, supra note 72, at 1C; Whalen, supra note 72, at 76.

n75. Mullainathan & Thaler, supra note 74, at 5.

n76. Id.

n77. Lowenstein, supra note 72; Mullainathan & Thaler, supra note 74, at 1.

n78. Samuel Issacharoff, Can There Be a Behavioral Law and Economics?, 51 Vand. L. Rev. 1729 (1998); Christine Jolls, Behavioral Economic Analysis of Redistributive Legal Rules, 51 Vand. L. Rev. 1653 (1998); Mark Kelman, Behavioral Economics as Part of a Rhetorical Duet: A Response to Jolls, Sunstein, and Thaler, 50 Stan. L. Rev. 1577 (1998); Richard A. Posner, Rational Choice, Behavioral Economics, and the Law, 50 Stan. L. Rev. 1551 (1998); Thomas S. Ulen, The Growing Pains of Behavioral Law and Economics, 51 Vand. L. Rev. 1747 (1998).

n79. Lowenstein, supra note 72.

n80. Rich Thomas, Honors and Rewards for a Young Economist Who Discovers ... the Obvious, Newsweek, May 14, 2001, at 37.

n81. Shlomo Benartzi & Richard H. Thaler, Risk Aversion or Myopia? Choices in Repeated Gambles and Retirement Investments, 45 Mgmt. Sci. 364 (1999) (discussing Paul Samuelson, Risk and Uncertainty: A Fallacy of Large Numbers, 98 Scientia 108-13 (1963)).

n82. Id.

n83. See id. at 367.

n84. Id.

n85. Id. at 374, 377.

n86. Id.

n87. Id. at 375.

n88. Id.

n89. Id. at 377, 380.

n90. Id. at 378.

n91. Id. at 378-80.

n92. Id. at 380.

n93. Id.

n94. Shlomo Benartzi & Richard H. Thaler, Naive Diversification Strategies in Defined Contribution Saving Plans, Am. Econ. Rev. 79 (Mar. 2001).

n95. Id. at 79.

n96. Id. (quoting Talmud Bavli, Baba Metzia 42a).

n97. Benartzi & Thaler, supra note 94, at 92.

n98. Id. at 82.

n99. Id.

n100. Id.

n101. Id.

n102. Id.

n103. Id.

n104. Id. at 92.

n105. Benartzi & Thaler, supra note 94, at 375.

n106. Id.

n107. Belsky & Gilovich, supra note 73.

n108. Id.

n109. Id. at 31-49.

n110. See id. at 36.

n111. Id. at 38.

n112. Holden & VanDerhei, supra note 1, at 4.

n113. Id. Insurance companies developed and offer GICs as investment vehicles that purport to offer a guaranteed rate of return. Roberta Romano, Public Pension Fund Activism in Corporate Governance Reconsidered, 93 Colum. L. Rev. 795, 844 (1993). A spate of lawsuits followed the demise of Executive Life Insurance Company, which had sold GICs to numerous pension plans. See, e.g., In re Unisys Sav. Plan Litig., 173 F.3d 145, 160 (1999) (ruling that the decision to purchase GICs from Executive Life Insurance Company did not violate ERISA's fiduciary standards).

n114. Id. at 13.

n115. Id. at 11.

n116. Belsky & Gilovich, supra note 73, at 129-35 (discussing confirmation bias). Confirmation bias theory predicts that once people develop a belief or opinion, they will interpret new data to best support the prior belief or opinion. Richard A. Posner, An Economic Approach to the Law of Evidence, 51 Stan. L. Rev. 1477, 1495 (1999).

n117. Jeffrey N. Gordon, Employees, Pensions, and the New Economic Order, 97 Colum. L. Rev. 1519, 1552 (1997); Medill, supra note 26, at 16; Deborah M. Weiss & Marc A. Sgaraglino, Prudent Risks for Anxious Workers, 1996 Wis. L. Rev. 1175, 1178 (1996).

n118. Gordon, supra note 117, at 1552; Medill, supra note 26, at 16; Weiss & Sgaraglino, supra note 117, at 1178.

n119. Craig Copeland, Asset Allocation: IRAs and 401(k)-Type Plans, EBRI Notes, Oct. 2000, at 7; Olivia S. Mitchell & James F. Moore, Can Americans Afford to Retire? New Evidence on Retirement Saving Adequacy, 65 J. Risk & Ins. 371, 387 (1998).

n120. Copeland, supra note 119.

n121. Compare Copeland, supra note 119, at 7 (finding allocations to be relatively consistent across age groups), with Lori Lucas, Under the Microscope: A Closer Look at the Diversification and Risk Taking Behavior of 401(k) Participants and How Plan Sponsors Can Address Key Investing Issues, Benefits Q., Fourth Qtr. 2000, at 29 (finding that, if company stock holdings are excluded, younger plan investors appear to choose riskier portfolios than do older plan investors); Mitchell & Moore, supra note 119, at 387 (discussing a survey showing older plan investors to invest in equities at lower rates than younger investors).

n122. Richard W. Johnson, The Gender Gap in Pension Wealth: Is Women's Progress in the Labor Market Equalizing Retirement Benefits?, The Urb. Inst. 1 (Mar. 1999).

n123. T.J. Elher & Wallace Fraser, Asset ownership of Households: 1993 U.S. Bureau of the Census, Current Population Reports 29, table B-9 (1995).

n124. Karen C. Burke & Grayson M.P. McCouch, Women, Fairness, and Social Security, 82 Iowa L. Rev. 1209, 1217-18 (1997).

n125. Lawrence A. Frolik & Alison P. Barnes, An Aging Population: A Challenge to the Law, 42 Hastings L.J. 683, 689 (1991) (discussing gendered differences in life expectancies); see also Kenneth S. Abraham, Efficiency and Fairness in Insurance Risk Classification, 71 Va. L. Rev. 403, 434-37 (1985) (discussing some of the challenges to using life expectancies for risk classification); Martha Chamallas, The Architecture of Bias: Deep Structures in Tort Law, 146 U. Pa. L. Rev. 463, 481 (1998) (comparing work-life expectancies and life expectancies).

n126. Hearings on Pension Issues Before the Subcomm. on Oversight of the House Ways and Means Comm., 105th Cong. (1998) (statement of Gail S. Shaffer, Executive Director, Business and Professional Women/USA).

n127. 144 Cong. Rec. H1419 (daily ed. March 24, 1998) (statement of Rep. Maloney).

n128. Lucas, supra note 121, at 27; Mitchell & Moore, supra note 119, at 387.

n129. Johnson, supra note 122, at 5-6.

n130. Mitchell & Moore, supra note 119, at 386-87.

n131. Holden & VanDerhei, supra note 1, at 10.

n132. New Data Indicate Growth, Proper Investment in 401k Assets, Sec. L. Daily (BNA) (Feb. 9, 2001).

n133. Benartzi & Thaler, supra note 94, at 97. Research indicates that the average number of investment vehicles offered by 401(k) plans increased from eight in 1997 to eleven in 2000. Lucas, supra note 121, at 24.

n134. Actual numbers of plans offering investment advice are impossible to obtain. The proposed legislation and other commentary on this problem indicate that the availability of investment advice remains a problem. See infra text accompanying Part IV; Medill, supra note 26, at 4.

n135. See supra text accompanying note 68.

n136. See supra text accompanying note 54.

n137. Scylla and Charybdis, Microsoft(R) Encarta(R) Online Encyclopedia 2001, available at http://encarta.msn.com.

n138. DOL I.B. 96-1; Participant Investment Education, 29 C.F.R. 2509 (1996).

n139. Id. at 2509.96-1(d).

n140. Id. The details of the safe harbors are reasonably complex, but can be summarized briefly. Communications constitute investment education if they (1) provide information about the plan or its investment alternatives, (2) explain general information about financial and investment decision making, (3) make available a variety of potential asset allocation models, or (4) supply plan investors with interactive investment materials that meet the limitations specified in I.B. 96-1. Id.

n141. Id. at 2509.96-1(d).

n142. Medill, supra note 26, at 66.

n143. John M. Kimpel, Education and Advice Under ERISA for Employee-Directed 401(k) Plans, Ben. Q., Fourth Qtr. 2000, at 12.

n144. Elizabeth A. White, House Panel Hears Suggestions for Improving ERISA in Changing World, Pen. & Ben. Daily (BNA) (Feb. 16, 2000).

n145. In theory, an employer's choice of a benefit plan and its terms will be affected by the value employees place upon the offered benefits. But, in the end, for single employer plans, the choice is the employer's to make.

n146. See Dana M. Muir, The Plan Amendment Trilogy: Settling the Scope of the Settlor Doctrine, 15 The Lab. Law. 205 (1999).

n147. Id. at 210-11.

n148. See infra note 257.

n149. See supra text accompanying notes 53-57.

n150. See supra text accompanying notes 58-63.

n151. ERISA 404(a)(1)(B), 29 U.S.C. 1104(a)(1)(B) (1994).

n152. ERISA 404(a)(1)(A), 29 U.S.C. 1104(a)(1)(A) (1994).

n153. ERISA 404(a)(1)(A) & (C), 29 U.S.C. 1104(a)(1)(A) & (C) (1994).

n154. 29 C.F.R. 2510.3-21(c) (1975).

n155. Robinson, supra note 57, at 123.

n156. Mark A. Vogel, Named Fiduciaries, in ERISA Fiduciary Law 112-14 (Susan P. Serota ed., 1995).

n157. Id. at 115.

n158. 29 C.F.R. 2509.96-1(e) (1996).

n159. Id.

n160. See supra text accompanying note 68.

n161. See Medill, supra note 26, at 67.

n162. See EGTRRA 665 (codified as IRC 132(a)(7) and 132(m) (defining, in conjunction with 125(f), benefits that may be provided under a cafeteria plan); 26 C.F.R. 1.125-2T Q&A-1 (1986) (listing specifically benefits that may be provided under a cafeteria plan).

n163. Hill v. Bache Halsey Stuart Shields, Inc., 790 F.2d 817, 824-25 (10th Cir. 1986).

n164. Clifford E. Kirsch, Investment Adviser Regulation: A Step-by-Step Guide to Compliance and the Law 1-2 (1998); James H. Walsh, Federal Regulation of Financial Planners After the Investment Advisers Supervision Coordination Act, 10 DePaul Bus. L.J. 259, 278-79 (1998).

n165. Thomas L. Hazen, The Law of Securities Regulation 466-69 (3d ed. 1985). Periodically the question arises as to whether the NASD should assume regulatory authority over investment advisers, but to date that has not occurred. Tracey Longo, Keeping the NASDR in Bounds, On Wall Street, Sept. 1, 1999; David G. Tittsworth, NASD Plate Full Already, Pens. & Inv., Aug. 23, 1999, at 12; Walsh, supra note 164, at 278.

n166. Hazen, supra note 165, at 461; Louis Loss & Joel Seligman, Securities Regulations 7-c-2 & 7-c-4 (3d ed. 1999).

n167. See supra text accompanying notes 53-57.

n168. ERISA 409, 29 U.S.C. 1109 (1994).

n169. Felber v. Estate of Regan, 117 F.3d 1084, 1087-88 (8th Cir. 1997) (ordering payment of $275,652.27 plus interest and attorney's fees); Donovan v. Robbins, 752 F.2d 1170, 1185 (7th Cir. 1985); Katsaros v. Cody, 744 F.2d 270, 277-83 (2d Cir. 1984) (ordering payment of $2,530,599 plus costs and attorney's fees); PBGC v. Morin, No. 99-246-P-C, 2000 U.S. Dist. LEXIS 8059, at 16-17 (D. Me. Apr. 24, 2000) (ordering payment of $142,960 plus investment losses); Laborers Nat'l Pension Fund v. ANB Inv. Mgmt. & Trust Co., No. 3:95-CV-2504-T, 1997 U.S. Dist. LEXIS 12962, at 15-16 (N.D. Tex. Aug. 15, 1997) (ordering payment of $7,161,548.91 plus interest).

n170. Katsaros, 744 F.2d at 281-82; Marshall v. Snyder, 572 F.2d 894, 899-902 (2d Cir. 1978).

n171. Beck v. Levering, 947 F.2d 639, 640-42 (2d Cir. 1991); Brock v. Gillikin, 677 F. Supp. 398, 403 (E.D.N.C. 1987); see also Donovan v. Bryans, 566 F. Supp. 1258, 1268 (E.D. Pa. 1983) (barring fiduciary service for five years).

n172. See, e.g., United States v. Nolan, 136 F.3d 265, 269-73 (2d Cir. 1998) (sentencing investment manager to prison term of 87 months); United States v. Glover, 101 F.3d 1183, 1185 (7th Cir. 1996) (sentencing investment manager to multiple lengthy prison terms); In the Matter of Howe Barnes Invs., Inc., Securities Act Release No. 37,707, 1996 SEC LEXIS 2552 (Sept. 23, 1996) (noting sentence of fifty-seven months in prison); Misuse of Pension Fund Assets Leads to Eight-Year Prison Sentence for Investor, Pens. & Ben. Daily (BNA) (June 5, 2001) (discussing adviser sentenced to eight years in prison for receiving illegal commissions and using investor's funds to repay plan for investment outside a profit-sharing plan's guidelines).

n173. Varity Corp. v. Howe, 516 U.S. 489, 507-15 (1996).

n174. ERISA 502(a)(3)(B), 29 U.S.C. 1132(a)(3)(B) (1994).

n175. Mertens v. Hewitt Assocs., 508 U.S. 248 (1993).

n176. Compare In re Unisys Corp. Retiree Med. Ben. "ERISA" Litig., 57 F.3d 1255 (3d Cir. 1995) (denying monetary damages but granting an injunction ordering specific performance of lifetime benefits and restitutionary reimbursement for past benefits), and Varity Corp., 36 F.3d 746 (denying compensatory damage, but awarding "restitution" for benefits that participants had lost), with Buckley Dement, Inc. v. Travelers Plan Adm'rs Inc., 39 F.3d 784, 788-89 (7th Cir. 1994) (denying recovery of the participant's medical bills because such relief would constitute "damages," not "appropriate equitable relief"), and McLeod v. Or. Lithoprint Inc., 102 F.3d 376 (9th Cir. 1996) (denying award of the amount of benefits that plaintiff would have been paid had she elected coverage under a cancer policy).

n177. No. 98-56472, 2000 U.S. App. LEXIS 1771 (9th Cir. Feb. 7, 2000), cert. granted, 531 U.S. 1124 (2001) (addressing the question of whether a plan's recovery of benefits from a participant under the plan's subrogation agreement constitutes equitable relief under ERISA 502(a)(3)(B)).

n178. See infra text accompanying notes 189-97.

n179. 15 U.S.C. 80b-1 - 80b-18a (1994).

n180. Clifford E. Kirsh, Investment Adviser Regulation: A Step-by-Step Guide to Compliance and the Law 1-6 - 1-7 (Supp. 1998); Walsh, supra note 164, at 268-69.

n181. Kirsh, supra note 180, at 1-7. In contrast, in order to become licensed as a broker-dealer, a candidate must (1) submit fingerprints and undergo a background check, (2) be sponsored by an existing NASD or exchange member firm, (3) complete a U-4 application, which includes disclosure of prior work history and any criminal background, and (4) demonstrate competency by passing relevant qualification examinations. This generally means passing the NASD

Series 7 (General Securities Representative) and the Series 63 (Uniform Securities Agent State Law Examination), although not all states require the Series 63. Series 7/63 Information Page, at http://www.preparer.com/series7 (last visited Nov. 18, 2001). The North American Securities Administrators Association has developed a uniform examination for advisers. But, ERISA defines adviser so broadly that, even in the jurisdictions that do require the examination, there is no assurance that an ERISA adviser will have passed even this threshold of competency.

n182. Kirsh, supra note 180, at 1-7; Walsh, supra note 164, at 268-69.

n183. Section 10b of the Securities & Exchange Act of 1934 reads as follows:

It shall be unlawful for any person, directly or indirectly, ... to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. 78j (1934)

Section 17 of the Securities Act of 1933 reads as follows:

It shall be unlawful for any person in the offer or sale of any securities ... directly or indirectly -

(1) to employ any device, scheme, or artifice to defraud;

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. 77q(a) (1933)

In comparison, section 206 of the Investor Advisers Act reads as follows:

It shall be unlawful for any investment adviser ... directly or indirectly -

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity

in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction;

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

15 U.S.C. 80b-6 (1994)

n184. Walsh, supra note 164, at 269.

n185. Id.

n186. Id.

n187. Id. at 270-72.

n188. Muller v. M.D. Sass Assocs., No. 91-3762, 1992 U.S. Dist. LEXIS 5736, at 34-36 (D.N.J.Apr. 22, 1992) (finding failure to disclose a material fact states a cause of action).

n189. Transamerica Mortgage Advisers v. Lewis, 444 U.S. 11, 19-25 (1979). For a contemporaneous discussion of the case, see The Supreme Court, 1979 Term, 94 Harv. L. Rev. 75, 279-88 (1980).

n190. 444 U.S. at 25 (White, J., dissenting).

n191. 15 U.S.C. 80b-15 (1994).

n192. 444 U.S. at 18-19.

n193. Id. at 19 (footnote omitted).

n194. Id. at 25 n.14.

n195. Wellington Int'l Commerce Corp. v. Retelny, 727 F. Supp. 843 (S.D.N.Y. 1989); Washington v. Baenziger, 656 F. Supp. 1176 (N.D. Cal. 1987).

n196. 15 U.S.C. 80b-6 (1994).

n197. See 444 U.S. at 25 n.14 (noting the unavailability of a damages remedy); Laird v. Integrated Res., Inc., 897 F.2d 826, 841-42 (5th Cir. 1990) (permitting recission only of the advisory contract, not of each transaction); Conrardy v. Ribadeneira, No. 86-1745-C, 1990 U.S. Dist. LEXIS 6036, at 15-16 (D. Kan. Apr. 19, 1990) (defining consideration paid to exclude expenditures for securities); Wellington Int'l Commerce Corp., 727 F. Supp. at 845-56 (same); Randall W. Quinn & Paul Gonson, Development of the Securities Law in the Supreme Court: The Definition of "Security" and the Implication of Private Rights of Action, 35 How. L.J. 319, 338 (1992) (stating "if your investment adviser fraudulently induces you to invest $100,000 in worthless securities, you cannot bring an action to recover your damages under the Investment Advisers Act, but you can sue for rescission to get the $500 you paid for the advice."). But see Payne v. Wood, No. 94-1230, 1995 U.S. App. LEXIS 22551 (6th Cir. Aug. 2, 1995) (upholding award for the amount of investment and promised return). Some articles have discussed the limitation on recovery imposed by Transamerica. See H. Miles Foy, III, Some Reflections on Legislation, Adjudication, and Implied Private Actions in the State and Federal Courts, 71 Cornell L. Rev. 501, 575-78 (1986) (arguing that the Court's decision was internally inconsistent because it implied a private cause of action under one section and not the other); William F. Schneider, Implying Private Right and Remedies Under the Federal Securities Acts, 62 N.C. L. Rev. 853, 890 (1984) (arguing that the Transamerica decision is inconsistent with its prior decisions on private causes of action); Charity Scott, A Broker-Dealer's Civil Liability to Investors for Fraud: An Implied Private Right of Action Under Section 15(c)(1) of the Securities Exchange Act of 1934, 63 Ind. L.J. 687, 714 (1988) (suggesting that Congress disapproved of the Transamerica decision); Susan J. Stabile, The Role of Congressional Intent in Determining the Existence of Implied Private Rights of Action, 71 Notre Dame L. Rev. 861 (1996) (criticizing the use of congressional intent in implied cause of action decisions); Sean G. Blackman, Note & Comment, An Analysis of Aider and Abettor Liability Under Section 10(b) of the Securities Exchange Act of 1934: Central Bank of Denver v. First Interstate Bank of Denver, 27 Conn. L. Rev. 1323, 1326 (1995) (arguing Transamerica was rightly decided based upon the statutory language); Glen Shu, Comment, Take a Second Look: Central Bank After the Private Securities Litigation Reform Act of 1995, 33 Hous. L. Rev. 539, 576-83 (1996) (tracing the Court's changing attitude toward inferring private causes of action).

n198. Walsh, supra note 164, at 276-77.

n199. Id. at 277-80.

n200. Id. at 281-83.

n201. Id. at 282.

n202. Id.

n203. Richard D. Marshall, Trends in SEC Enforcement and Inspections of Investment Advisers, ALI-ABA Course of Study Materials (Oct. 2000), available in LEXIS, CLE Library, ALLCLE File (noting 42, 45, and 48 total cases filed in 1996, 1997, and 1998, respectively as compared to 16, 28, and 19 cases in 1983, 1984, and 1985)

n204. Id.

n205. Id.

n206. Id.

n207. Id.

n208. Id.

n209. Rachel Witmer, Investment Advisers: Advisers Make Inadequate Disclosures to Clients, SEC Staff Exam Sweep Finds, Sec. L. Daily (BNA), Mar. 27, 2001 (noting sweep that disclosed problems with disclosures).

n210. Kirsch, supra note 180, at 13-12.

n211. Thomas E. Geyer, An Overview of Amended Substitute House Bill 695's Amendments to the Ohio Securities Act and a Guide to Ohio's New Investment Adviser Provisions, 28 Cap. U. L. Rev. 359, 362 n.20 (2000).

n212. See Thomas L. Hazen, The Law of Securities Regulation 391 (3d ed. 1996) (There has been a major effort toward uniformity, promoted by the American Law Institute's Uniform Securities Act, from which there were significant departures in many states); Kenneth I. Denos, Comment, Blue and Gray Skies: The National Securities Markets Improvement Act of 1996 Makes the Case for Uniformity in State Securities Law, 1997 Utah L. Rev. 101, 126 (1997) ("Although a number of states have securities laws that are practically verbatim adoptions of the Uniform Securities Act, the interpretations given to these provisions have varied as much as the judges, regulators, and legislators who have attempted to interpret them.").

n213. National Conference of Commissioners on Uniform State Laws, Draft of Uniform Securities Act, at http://www.law.upenn.edu/bll/ulc/securities/USA601.html (last visited July 17, 2001).

n214. Id.; Douglas M. Branson, Chasing the Rogue Professional After the Private Securities Litigation Reform Act of 1995, 50 SMU L. Rev. 91, 116 (1996); Joseph C. Long, Developments and Issues in Civil Liability Under Blue Sky Laws, 62 U. Cin. L. Rev. 439, 444 n.30 (1993). For a history of the development of the 1956 Act and RUSA, as well as current developments, see Loss & Seligman, supra note 166, at 1-B-2.

n215. Hazen, supra note 165, at 391 n.19; Branson, supra note 214, at 116.

n216. See Loss & Seligman, supra note 166, at 1-B-2.

n217. Unif. Sec. Act of 1985 203-15 (amended 1988), 7C U.L.A. 1 (2000); Unif. Sec. Act of 1956 201-04, 7C U.L.A. 102 (2000).

n218. Unif. Sec. Act of 1985 503 (amended 1988), 7C U.L.A. 1 (2000); Unif. Sec. Act of 1956 102(a), 7C U.L.A. 102 (2000).

n219. Unif. Sec. Act of 1985 605 (amended 1988), 7C U.L.A. 1 (2000); Unif. Sec. Act of 1956 410, 7C U.L.A. 102 (2000).

n220. Unif. Sec. Act of 1985 602-03 (amended 1988), 7C U.L.A. 1 (2000); Unif. Sec. Act of 1956 408, 7C U.L.A. 102 (2000).

n221. Unif. Sec. Act of 1985 604 (amended 1988), 7C U.L.A. 1 (2000); Unif. Sec. Act of 1956 409, 7C U.L.A. 102 (2000).

n222. RUSA defines both broker-dealer and investment adviser. Unif. Sec. Act of 1985 101(2) & (7) (amended 1988), 7C U.L.A. 1 (2000).

n223. See Susan R. Finneran, Investment Advisory Regulatory Muddy Waters: Registration and Control Issues are Confused With Issues of Disclosure and Anti-Fraud, 19 Campbell L. Rev. 349, 363-69 (1997) (discussing the overlapping definitions of broker-dealer and investment adviser under federal law).

n224. Shorrock v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 74-24, 1977 U.S. Dist. LEXIS 12872, at 1 (D. Or. Nov. 18, 1977).

n225. McAdam v. Dean Witter Reynolds, Inc., 896 F.2d 750, 755 (3d Cir. 1990) (alleging breach of fiduciary duty); Hill v. Bache Halsey Stuart Shields, Inc., 790 F.2d 817, 823-24 (10th Cir. 1986) (discussing claim for breach of fiduciary duty claim under state common law); Leboce v. Merrill Lynch, Pierce, Fenner & Smith, 709 F.2d 605, 607 (9th Cir. 1983) (rejecting on the facts plaintiff's fiduciary claim); McCutcheon v. Kidder, Peabody & Co., 938 F. Supp. 820, 822 (S.D. Fla. 1996) (alleging breach of fiduciary duty); Shorrock, 1977 U.S. Dist. LEXIS 12872, at 6 (alleging breach of fiduciary duty under Oregon common law); Beckstrom v. Parnell, 730 So. 2d 942, 943 (La. Ct. App. 1988) (claiming breach of fiduciary duty).

n226. Silverberg v. Paine, Webber, Jackson, & Curtis, Inc., 710 F.2d 678, 687 (11th Cir. 1983) (upholding jury finding of common law negligence); Shorrock, 1977 U.S. Dist. LEXIS 12872, at 19 (alleging negligence in violation of Oregon common law).

n227. Hill, 790 F.2d at 821 (using misrepresentation to show violation of state law fiduciary duty); Hatrock v. Edward D. Jones & Co., 750 F.2d 767, 770 (9th Cir. 1984) (alleging common law misrepresentation).

n228. McAdam, 896 F.2d at 755 (alleging fraud); Hatrock, 750 F.2d at 770 (alleging common law misrepresentation); Silverberg, 710 F.2d at 687 (upholding jury finding of common law fraud); McCutcheon, 938 F. Supp. at 822 (alleging common law fraud).

n229. McAdam, 896 F.2d at 755 (alleging breach of contract); Beckstrom, 730 So. 2d at 943 (same).

n230. Hill, 790 F.2d at 821 (using churning to show violation of state law fiduciary duty).

n231. Leboce v. Merrill Lynch, Pierce, Fenner & Smith, 709 F.2d 605, 606-07 (rejecting on the facts plaintiff's fiduciary claim based in lack of disclosure); see also Hill, 790 F.2d at 821 (implying use of lack of disclosure to show violation of state law fiduciary duty).

n232. McAdam, 896 F.2d at 755 (alleging violation of New Jersey statutory securities law); Hatrock, 750 F.2d at 770 (alleging violation of Idaho securities laws); Silverberg, 710 F.2d at 690-91 (upholding jury determination of violation of fraud provision under Florida securities law); McCutcheon, 938 F. Supp. at 822 (alleging breach Florida statutory securities law); Shorrock v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 74-24, 1977 U.S. Dist. LEXIS 12872, at 19 (D. Or. Nov. 18, 1977) (alleging negligence in violation of Oregon Blue Sky Law); Beckstrom, 730 So. 2d at 943 (claiming violation of Louisiana statutory securities law).

n233. McAdam, 896 F.2d at 755 (alleging vicarious liability of Dean Witter); Hatrock v. Edward D. Jones & Co., 750 F.2d 767, 771-72 (9th Cir. 1984) (affirming vicarious liability based on agency law); Community Hosp., Inc. v. Kidder, Peabody & Co., 81 F. Supp. 2d 863, 875 (S.D. Ohio 1999) (holding apparent agency authority to be grounds for liability).

n234. Martin v. Shearson Lehman Hutton, Inc., 986 F.2d 242, 243 (8th Cir. 1993) (alleging direct violation of state securities law and common law principles); McAdam, 896 F.2d at 755 (alleging direct liability of Dean Witter on basis of fraud, negligent supervision, and violation of New Jersey state securities law); De Kwiatkowski v. Bear Stearns & Co., 126 F. Supp. 2d 672, 677 (S.D.N.Y. 2000) (affirming award based on breach of fiduciary duty and negligence); Community Hosp., Inc., 81 F. Supp. 2d at 875 (holding breach of duty of disclosure to be grounds for liability).

n235. McAdam, 896 F.2d at 756 (affirming punitive damages of $800,000 against Dean Witter and $500,000 against Midlantic); Dean Witter Reynolds, Inc. v. Bork, No. 91-0392, 1991 U.S. Dist. LEXIS 11907, at 3-4 (E.D. Pa. Aug. 21, 1991) (affirming arbitration award of $176,000 in recissory damages).

n236. See Hatrock, 750 F.2d at 773-74 (noting that in a churning case an investor may recover "excessive commissions charged by the broker"); Community Hosp., Inc., 81 F. Supp. 2d at 873-74 (affirming $17.3 million compensatory award comprised, in part, of excess commissions); Beckstrom, 730 So. 2d at 952 (awarding the plaintiff the commissions charged by the defendants).

n237. Hatrock, 750 F.2d at 773-74 (noting that in a churning case an investor may recover "the decline in value of the investor's portfolio resulting from the broker's fraudulent transactions"); Silverberg, 710 F.2d at 684-87 (affirming jury instruction resulting in $530,000 award based on drop in securities' value); Community. Hosp., Inc., 81 F. Supp. 2d at 873-74 (affirming $17.3 million compensatory award comprised, in part, of diminution in value of securities); Beckstrom, 730 So. 2d at 952 (amending damages to reflect loss in investment).

n238. Keck v. Union Bank, No. 94-4912, 1997 U.S. Dist. LEXIS 12591, at 12 (S.D.N.Y. 1997) (permitting claim for benefit of the bargain damages to go forward).

n239. Douglas M. Branson, Choosing the Appropriate Default Rule - Insider Trading Under State Law, 45 Ala. L. Rev. 753, 775 (1994) (discussing punitive damage awards against defendants who had engaged in insider trading); Richard W. Painter, Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action, 84 Cornell L. Rev. 1, 71 (1998); Walter C. Somol, Dredging the Safe Harbor for Forward-Looking Statements-An Analysis of the Private Securities Litigation Reform Act's Safe Harbor for Forward-Looking Statements, 32 Suffolk U. L. Rev. 265, 281-82 (1998).

n240. C. Edward Fletcher, III, Privatizing Securities Disputes Through the Enforcement of Arbitration Agreements, 71 Minn. L. Rev. 393, 400-01 n.57 (1987); Mary E. Bierman, Note, Mixed Arbitrable and Nonarbitrable Claims in Securities Litigation: Dean Witter Reynolds, Inc. v. Byrd, 34 Cath. U. L. Rev. 525, 557 (1985).

n241. Hatrock, 750 F.2d at 772-73 (affirming award of $250,000 in punitive damages); Silverberg, 710 F.2d at 689-90 (affirming award of $75,000 in punitive damages); Dean Witter Reynolds, Inc. v. Bork, No. 91-0392, 1991 U.S. Dist. LEXIS 11907, at 6-11 (E.D. Pa. Aug. 21, 1991) (affirming award of $500,000 in punitive damages).

n242. Hatrock, 750 F.2d at 776 (upholding award of $12,293.33 in attorneys' fees); Silverberg v. Paine, Webber, Jackson & Curtis, Inc., 724 F.2d 1456, 1456 (11th Cir. 1983) (remanding for award of attorneys fees); De Kwiatkowski v. Bear Stearns & Co., 126 F. Supp. 2d 672, 677 (S.D.N.Y. 2000) (affirming award of $60 million in pre-judgment interest); Dean Witter Reynolds, Inc., 1991 U.S. Dist. LEXIS 11907, at 15-20 (affirming award of $16,000 in interest and $57,000 in attorney's fees); see also Martin v. Shearson Lehman Hutton, Inc., 986 F.2d 242, 245 (8th Cir. 1993) (reversing award of attorney's fees).

n243. See infra text accompanying notes 274-92.

n244. Margo E.K. Reder, Securities Law and Arbitration: The Enforceability of Predispute Arbitration Clauses in Broker-Customer Agreements, 1990 Colum. Bus. L. Rev. 91, 92 (1990) ("Customer agreements in virtually all instances contain a predispute arbitration clause providing that any controversy relating to the account shall be settled by arbitration, in accordance with the rules of an agreed upon exchange or association.").

n245. See Kenneth R. Davis, The Arbitration Claws: Unconscionability in the Securities Industry, 78 B.U. L. Rev. 255 (1998); Steven A. Ramirez, Arbitration and Reform in Private Securities Litigation: Dealing with the Meritorious as Well as the Frivolous, 40 Wm. & Mary L. Rev. 1055 (1999); Reder, supra note 243, at 110-16 (discussing the controversy); David S. Ruder, Elements of a Fair and Efficient Securities Arbitration System, 40 Ariz. L. Rev. 1101 (1998); Lynn Katzler, Comment, Should Mandatory Written Opinions Be Required in All Securities Arbitrations?: The Practical And Legal Implications to the Securities Industry, 45 Am. U. L. Rev. 152 (1995).

n246. Shelly R. James, Note, Arbitration in the Securities Field: Does the Present System of Arbitration Between Small Investors and Brokerage Firms Really Protect Anyone?, 21 Iowa J. Corp. L. 363, 378 (1996).

n247. Id. at 379-80.

n248. Press Release, NASD Dispute Resolution, NASD Launches New Dispute Resolution Subsidiary (July 17, 2000), at http://www.nasdadr.com/news/pr2000/ne<uscore>section00<uscore>160.html. (July 17, 2000)

n249. See Stanley, supra note 55, at 722 n.44.

n250. See supra text accompanying notes 53-64.

n251. For a discussion of ERISA's complex prohibited transactions requirements and individual exemptions, see William P. Wade & Richard I. Loebl, Individual Prohibited Transaction Exemptions, in ERISA Fiduciary Law (Susan P. Serota ed., 1995).

n252. See Combs Testimony, supra note 24.

n253. Elizabeth A. White, Retirement Policy: Subcommittee Members Cite Accord on ERISA Retirement Security Issues, Pens. & Ben. Daily (BNA) (Mar. 13, 2000).

n254. See Medill, supra note 26, at 57-63.

n255. See, e.g., Tom Gilroy, Labor Department Official Opposes Easing Restrictions on Pension Financial Advice, Pens. & Ben. Daily (BNA), Sept. 18, 2000.

n256. White, supra note 144 (discussing Professor John Shoven's support of investment advice for benefit plan investors).

n257. See Elizabeth A. White, Boehner Subcommittee Plans Hearings for March 9-10 on ERISA Modernization, Pens. & Ben. Daily (BNA), Mar. 6, 2000 ("As defined contribution plans gain popularity and participants are afforded more options, they are asking for more specific information... .").

n258. Combs Testimony, supra note 24; Retirement Security Advice, Hearings Before the Employer-Employee Relations Subcommittee of the House Education and the Workforce Committee, 107th Cong. (2001) [hereinafter Hiller Testimony] (statement of Richard A. Hiller, Vice President, Western Division, Teachers Insurance and Annuity Association College Retirement Equities Fund (TIAA-CREF)); Retirement Security Advice: Hearings Before the Employer-Employee Relations Subcommittee of the House Education and the Workforce Committee, 107th Cong. (2001) [hereinafter Shepard Testimony] (statement of Betty Shepard, Human Resources Administrator, Mohawk Industries, Inc.); Retirement Security Hearings Continue in House Employer-Employee Relations Subcommittee, Committee on Education and the Workforce, Mar. 10, 2000, available at http://edworkforce.house.gov/press/press106/erisa31000.htm. (Mar. 10, 2000).

n259. Combs Testimony, supra note 24.

n260. Dana M. Muir, Fiduciary Status as an Employer's Shield: The Perversity of ERISA Fiduciary Law, 2 U. Pa. J. Lab. & Emp. L. 391, 402-03 (2000).

n261. A More Secure Retirement for Workers: Proposals for ERISA Reform: Hearings Before the House Subcommittee on Employer-Employee Relations of the Committee on Education and the Workforce, 106th Cong.

(2000) [hereinafter Grundfest Testimony] (statement of Joseph A. Grundfest, William A. Franke Professor of Law and Business and co-founder of Financial Engines, Inc.).

n262. Gilroy, supra note 255.

n263. Id.

n264. H.R. 4747, 106th Cong. 2(1)(1)(14) (2000).

n265. See infra text accompanying notes 326-33.

n266. H.R. 2269, 107th Cong. (2001).

n267. Combs Testimony, supra note 24.

n268. Alison Bennett, In Brief, Pens. & Ben. Daily (BNA) (May 14, 2001).

n269. Combs Testimony, supra note 24.

n270. Id.

n271. Id.

n272. See supra Part III.C. (discussing litigation against and regulation of investment advisors).

n273. See supra Part III.C.iii.

n274. Jay Conison, Federal Common Law of ERISA Plan Attorneys, 41 Syracuse L. Rev. 1049, 1083 (1990) n275. ERISA 514(a), 29 U.S.C. 1144(a) (1994).

n276. Stephen F. Befort & Christopher J. Kopka, The Sounds of Silence: The Libertarian Ethos of ERISA Preemption, 52 Fla. L. Rev. 1, 10-12 (2000).

n277. Id. at 12-13.

n278. N.Y. State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 655 (1995) (quoting H. James, Roderick Hudson xli (New York ed., World's Classics 1980)).

n279. Here one example should suffice. In a most unlikely pairing, Justices Scalia and Ginsburg concurred in one ERISA preemption case, but, after noting that between 1974 and 1996, the Supreme Court had decided 14 ERISA preemption cases and the stream of cases continued unabated, wrote that they thought it "would greatly assist our function of clarifying the law if we simply acknowledged that our first take on this statute was wrong ..." Cal. Div. of Labor Standards Enforcement v. Dillingham Constr., Inc., 519 U.S. 316, 336 (1997) (Scalia, J., concurring).

n280. For one excellent recent article on ERISA preemption, see Befort & Kopka, supra note 276. Other articles abound. See, e.g., Margaret G. Farrell, ERISA Preemption and Regulation of Managed Health Care: The Case for Managed Federalism, 1997 23 Am. J. L. & Med. 251 (1997); Catherine L. Fisk, The Last Article about the Language of ERISA Preemption? A Case Study of the Failure of Textualism, 33 Harv. J. on Legis. 35 (1996); Justin Goodyear, Note, What Is an Employee Benefit Plan?: ERISA Preemption of "Any Willing Provider" Laws after Pegram, 101 Colum. L. Rev. 1107 (2001).

n281. Unum Life Ins. Co. v. Ward, 526 U.S. 358, 363 (1999) ("The saving clause, 514(b)(2)(A), ... phrased with similar breadth, exempts ... .").

n282. ERISA 514(b)(2)(A), 29 U.S.C. 1144(b)(2)(A) (1994) (emphasis added).

n283. See Medill, supra note 26, at 27, 62, 77-78.

n284. Matassarin v. Lynch, 174 F.3d 549, 561-62 (5th Cir. 1999), cert. denied, 528 U.S. 1116 (2000).

n285. ERISA 514(b)(2)(A), 29 U.S.C. 1144(b)(2)(A) (1994).

n286. For a discussion of those claims, see supra text accompanying notes 225-32.

n287. Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41, 57 (1987).

n288. Id. at 50.

n289. Id. at 51.

n290. Id. at 50.

n291. See supra text accompanying notes 173-75, 191-96.

n292. See supra text accompanying notes 223-41.

n293. Medill, supra note 26, at 5.

n294. Id. at 74-77.

n295. Id. at 74-75.

n296. Id. at 75.

n297. Id. at 76.

n298. Id. at 77.

n299. Id. at 77-80.

n300. Id. at 80-81.

n301. Id. at 81-83.

n302. Id. at 82.

n303. Id. at 83-84.

n304. Id. at 75.

n305. Id. at 77-79.

n306. Combs Testimony, supra note 24.

n307. Id.

n308. Medill, supra note 26, at 81-82.

n309. Grundfest Testimony, supra note 261.

n310. Id.

n311. Id.

n312. Id.

n313. Id.

n314. Id.

n315. Id.

n316. Id.

n317. Id.

n318. John P. Freeman & Stewart L. Brown, Mutual Fund Advisory Fees: The Cost of Conflicts of Interest, 26 J. Corp. L. 609, 634-35, 639-40 (2001); Medill, supra note 26, at 44.

n319. Grundfest Testimony, supra note 261.

n320. Medill, supra note 26, at 81-82.

n321. Bill Summary & Status for the 106th Congress, available at http://thomas.loc.gov/cgi-bin/bdquery/D?d106:1:./temp/<diff>bdWf4x:£££L&summ2=m& <abval1>/bss/d106query.html (last visited Nov. 19, 2001).

n322. H.R. 2269, 107th Cong. (2001). Because of the lack of significant differences between H.R. 4747 and H.R. 2269, in general I do not distinguish between them when discussing commentary.

n323. Id. 1.

n324. Id. 2.

n325. Combs Testimony, supra note 24; Hiller Testimony, supra note 258; Shepard Testimony, supra note 258; Press Release, Committee on Education and the Workforce, Retirement Security Hearings Continue in House Employer-Employee Relations Subcommittee (Mar. 10, 2000), available at http://edworkforce.house.gov/press/press106/erisa31000.htm.

n326. H.R. 2269, 107th Cong. 2(g)(1)(A) & (4) (2001).

n327. See id. at 2(g)(1)(A).

n328. See id. at 2; H.R. Rep. No. 107-262, at 28 (2001) ("The Committee expects the Department of Labor to implement the changes to the law...").

n329. Id. at 2(g)(4).

n330. Id.

n331. Id. at 2(g)(1)(C).

n332. Id. at 2(g)(1)(A).

n333. Id.

n334. It is true that investment advisers who manage assets of less than $25 million typically would be precluded from registering with the SEC. However, the SEC permits pension consultants who provide investment advice to pension plans to register so long as they provide advice on at least $50 million worth of plan assets as well as multi-state advisers who must register in at least thirty states. 17 C.F.R. 275.203A-2(b)(1) & (e)(1) (1998).

n335. Committee on Education and the Workforce Investment advisers with less than $25 million must register at the state level. Amendments to the prohibited transactions requirements could make either of two provisions for them and for others who meet ERISA's definition of providing investment advice but are not required to register with the SEC. One alternative is to preclude from the statutory exemption any investment advisers who do not meet the SEC's standards for federal registration. A second possibility is to provide a prohibited transaction exemption to any investment adviser registered with the appropriate state or federal authority. However, becoming comfortable with the level of disclosure required at the state level would require substantial effort in evaluating and continuing to track the requirements of each state.

n336. Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV, Advisers Act Release No. IA-1862, 72 S.E.C. Docket 200 (Apr. 5, 2000).

n337. Id.

n338. Id.

n339. Electronic Filing by Investment Advisers; Amendments to Form ADV, Advisers Act Release No. IA-1897, 73 S.E.C. Docket 595 (Sept. 12, 2000). For the SEC's summary of the many comments it received on Form ADV, see Summary of Comments on Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV Under the Investment Advisers Act of 1940, July 27, 2000, at http://www.sec.gov/rules/extra/iardsumm.htm. (July 27, 2000).

n340. Investment Advisers: ICAA Recommends Major Modifications to SEC's Proposed Adviser Registration Form, Sec. L. Daily (BNA) (May 30, 2001).

n341. Investment Advisers: SEC Staff Probes Online Advisers for Unregistered Investment Companies, Sec. L. Daily (BNA) (Mar. 27, 2001).

n342. H.R. Rep. No. 107-262, at 18-19 (2001).

n343. Id. at 39.

n344. Id. at 19.

n345. See Investment Advisers: Financial Planners ask Lawmakers to Narrow Proposed Exemption to ERISA, Pens. & Ben. Daily (BNA) (July 10, 2001).

n346. H.R. 2269, 107th Cong. 2(g)(3)(A) (2001).

n347. Id. at 2(g)(3)(B).

n348. Id.

n349. See Medill, supra note 26, at 82-83.

n350. Supra Part III.B.2.

n351. See supra text accompanying notes 157-59.

n352. H.R. Rep. No. 107-262, at 20 (2001).

n353. See supra text accompanying notes 154-56, 160-61.

n354. Grundfest Testimony, supra note 261.

n355. See supra text accompanying notes 160-61.

n356. H.R. Rep. No. 107-262, at 16 (2001) ("The Committee intends existing state and federal law to continue to govern the qualifications and actions of the entities subject to the exemption... .").

n357. Supra text accompanying notes 273-88.

n358. Compare H.R. Rep. No. 107-262, at 15 (stating the majority's position that ERISA's original legislative history called for "the full range of legal and equitable remedies"), with id. at 41-43 (stating the minority's position that, in spite of the wording in past legislative history, the jurisprudence has looked to the statutory text and significantly constrained the availability of ERISA remedies). See supra text accompanying notes 173-78 & 273-89.

n359. The current definition of independence used for purposes of ERISA's prohibited transactions requirements may be retained for this purpose.

n360. To the extent the investment advisory industry is able to develop appropriate credentialing and self-regulatory practices, the safe harbor could be expanded to include individuals who meet the industry standards.

n361. No. 98-56472, 2000 U.S. App. LEXIS 1771 (9th Cir. Feb. 7, 2000), cert. granted, 121 S. Ct. 876 (2001) (addressing the question of whether a plan's recovery of benefits from a participant under the plan's subrogation agreement constitutes equitable relief under ERISA 502(a)(3)(B)). For extended analysis of the redress available as equitable relief under ERISA 502(a)(3)(B), see Dana M. Muir, ERISA Remedies: Chimera or Congressional Compromise?, 81 Iowa L. Rev. 1 (1995).

n362. In 1996 a task force established by the NASD recommended capping punitive damages in arbitrations at the lesser of two times the compensatory damages or $750,000. David S. Ruder, Securities Arbitration in the Public Interest: The Role of Punitive Damages, 92 Nw. U. L. Rev. 69, 69 (1997).