EVIDENCE OF COMPREHENSION: MANAGING LITIGATION AND REGULATORY COMPLIANCE RISKS UNDER THE NEW DOL FIDUCIARY RULE AND ERISA

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TABLE OF CONTENTS

I. Executive Summary

Over the course of four decades, retirement products shifted from traditional, employer-funded pensions to employee-funded individual account plans such as 401(k), 457, and 403(b) plans and self-directed or broker-managed individual retirement arrangements ("IRAs"). During this period, the retirement investment industry enjoyed enormous growth of assets under management. Employees participating in these plans benefitted from the development of abundant, diverse, and often complicated investment product choices for inclusion in their plans' investment fund lineups. Both participants and the employer-sponsors of plans bore responsibility for understanding the fine-print complications, risks, and trade-offs of many retirement investments, including investment expenses, fees, commissions, and restrictions and limitations. Financial professionals, working for individual retirement investors, have added value through their expertise by helping identify investor risk propensity, with investment selection, asset allocation, retirement contributions, and retirement income solutions.

The developing complexity of retirement advice also fostered a competitive environment for garnering assets under management. Organizations and individual advisers compete for assets—sometimes aggressively. Product sales incentives, higher commissions, sales contests, loan forgiveness programs, recognition and reward programs, and benefit subsidies and reimbursements are among categories of attractive benefits used to induce higher retirement product sales and asset retention. These programs set up potential conflicts of interest, where making product recommendations based on financial adviser compensation and/or incentives may be prioritized over an investor client's best interest.

On April 8, 2016, the U.S. Department of Labor ("DOL") addressed concerns about these growing conflicts of interest by issuing final regulations defining who is a fiduciary of an employee benefit plan under ERISA[1] as a result of giving investment advice to a plan or its participants or beneficiaries (the "Fiduciary Rule").[2] In connection with the final regulations, the DOL granted a new prohibited transaction class exemption called the Best Interest Contract Exemption or "BICE."[3] Together, the fiduciary advice regulations and the BICE will affect virtually all broker-dealer firms and their registered representatives, registered investment advisors, and their individual adviser representatives, as well as insurance companies and their agents. In general, they do the following:

1. Broaden the scope of retirement advisors who are deemed to be fiduciaries under ERISA and the Code.

2. Establish a standard of conduct by which fiduciary investment advice providers must provide such advice in the "best interest" of the client in an unconflicted manner and without regard to the interests of the firm or the representative.

1 The Employee Retirement Income Security Act of 1974, as amended.

2 81 Fed. Reg. 20946, 21002 (April 8, 2016). The final regulations also apply to the definition of fiduciary of a plan under the Internal Revenue Code of 1986, as amended (the "Code"). As of the date of this white paper, the status of the Fiduciary Rule is unclear. Although it has been upheld by three federal district courts, a Presidential Memorandum signed by President Trump directed the DOL to review the rule, and if warranted, to modify or rescind it. As of this writing, the DOL has proposed a 60-day delay to the original applicability date of April 10, 2017. The DOL has further announced that if its decision is not made by April 10, 2017, it will not enforce the new Rule or the related exemptions during the "gap period," and that if the DOL decides against delay, a "reasonable period" after the publication of the decision will be allowed before enforcement begins.

3 The DOL published a technical correction on July 7, 2016, wherein the Best Interest Contract Exemption was officially designated as Prohibited Transaction Exemption 2016-01.

3. Prior to or commensurate with the execution of the recommended transaction, voluminous disclosures (including web-based disclosures) must be provided to the investor client about the fiduciary status of the firm and its representative, its standard of conduct (one element of which is that compensation for the service provided will be reasonable), material conflicts of interest, and its anti-conflict policies and procedures. For investor clients that are non-ERISA plans, such as Keogh plans, solo 401(k) plans, IRAs, and arrangements such as health savings accounts, delivery of fiduciary investment advice must be made pursuant to a written contract. The reasons for recommending a rollover must be internally documented to evidence compliance with the "best interest" standard of care.

The BICE increases the litigation risk for financial services firms and their advisors and insurance brokers.

This paper:

1. Explores a few specific areas of compliance requirements under the BICE, together with their counterparts in general ERISA principles.
2. Discusses how the duties to disclose and to ensure comprehension under ERISA combined with the requirements under the DOL Fiduciary Rule can create litigation and regulatory compliance risk.
3. Discusses the concept of *evidence of comprehension* as an underlying factor impacting litigation decisions in a variety of contexts under ERISA.
4. Discusses the document retention requirements under ERISA, and the concomitant duty to be able to retrieve those documents.
5. Proposes an independent third party solution – that includes obtaining *evidence of comprehension*, secure storage of the artifacts, and data analysis to monitor and improve business processes – to hedge against these types of significant legal risks.

II. Recordkeeping Requirements

Fee-Based Investment Advisors

The BICE requires a Financial Institution to maintain, for a period of 6 years and in a manner that is reasonably accessible for examination, records necessary to establish that the conditions of the BICE have been satisfied. Under the final DOL Fiduciary Rule, most retirement advisers are fiduciaries to their retirement clients. As such, recordkeeping must evidence the care taken by advisers when making recommendations to these clients. Examples of such records include, but are not limited to:

- An analysis of the investor's financial goals and objectives.
- A personal net worth statement or other summary of financial substance.
- An analysis of cash flows, such as a retirement income and spending plan for the investor.
- A retirement strategy for achieving retirement goals or other financial priorities.
- Evidence of the client's risk tolerance.
- Evidence of the delivery of required disclosures to the client under a Best Interest Contract.

While there are many existing platforms used for document record keeping, should the adviser organizations operate multiple sales or support channels, including call centers, retail locations such as bank offices, self-service web sites or a network of independent agents, the challenge of document retention – or, more importantly, the ability to access key documents at a later date – can be very difficult. For this reason, an important element of solid compliance processes involves the ability to securely store *and retrieve* compliance documentation.

III. Best Interest Contract Exemption

The BICE allows financial advisers to earn variable compensation on products sold so long as certain conditions are met. Variable compensation is compensation that varies based upon the recommendation provided and incudes commission-based compensation. There are many requirements under the BICE, but **a critical element involves providing written disclosures to the investor client prior to or at the same time as the execution of the recommendation.**

Compliance requires validation that disclosure and documentation processes have been adhered to. While not explicitly stated as a legal requirement under the Fiduciary Rule or the BICE, in an adversarial context, whether audit or litigation, an essential component of establishing compliance with customer disclosure requirements under the Fiduciary Rule and the BICE is *generating proof* of both the disclosure's content and its delivery (i.e., properly executed documentation as to the disclosure and its delivery), its secure storage, and most importantly, the ability to retrieve it when needed.

The requirements associated with the BICE may be summarized as follows:

Disclosures

There are four alternative forms of the BICE, depending on the type of client and other factors, two of which are discussed below. At a minimum, each form of BICE must provide a disclosure that acknowledges the firm's and advisor's fiduciary status and includes an affirmative statement that the financial institution and its advisors will comply with the BICE's Impartial Conduct Standards. The Best Interest Standard is one of the three components of the Impartial Conduct Standards and is the cornerstone of the BICE.[4]

4 The other two components are to avoid making misleading statements and to receive no more than reasonable compensation.

IV. Full Blown BICE

Under Full Blown BICE, which is applicable to non-ERISA plans and IRAs, the required disclosure must be in the form of a contract and, in addition to the above, must include warranties relating to the firm's best interest advice, including that the firm has implemented policies and procedures reasonably designed to mitigate any harmful impact of conflicts of interest. The disclosure must also include certain information about material conflicts of interest, proprietary products, and the receipt of any third-party payments.

For existing clients, a "negative consent" provision allows the financial institution to deliver an amendment to an existing contract, which complies with all the required BICE disclosures. The contract is considered effective if the investor does not terminate the contract within 30 days. The negative consent does not eliminate the other requirements of the BICE related to providing investment advice, but it eliminates the need to obtain a client's signature.

Recordkeeping practices for those relying on any "negative consent BIC" should include documentation to prove that it was provided timely to retirement clients whose investments were established prior to implementation of the Fiduciary Rule. Financial advisory firms utilizing the "negative consent" provision must establish recordkeeping capabilities that capture and track the 30-day period in which each client has the right to terminate their qualified plan or IRA relationship. It is critical that firms have the ability to take action if a client actually requests to terminate the retirement account arrangement under the "negative consent" provisions. Of course, if the existing agreement with the client provides for a termination notice period longer than 30 days (60 days, for example), the client may wish to provide for a longer negative consent period to match the length of the termination provision.

The initial and subsequent update uses of a Best Interest Contract ("BIC") with each client must be documented and preserved. An important consideration is that the exact language of a BIC disclosure document in use by a financial services firm will inevitably change over the course of time, based in part on developing guidance and the evolving views of legal and risk advisors to the firm. Of great importance is the development of recordkeeping capabilities, including the ability to capture a full record of which BIC version was used with which clients, and when. Production requests in discovery during litigation, or with the DOL during an investigation, must include preservation of all BIC versions used.

V. Streamlined BIC Documentation Must be Maintained to Prove Advice Was Given in Client's Best Interest

All necessary documentation must be retained and maintained for possible future review. For many organizations, in particular those that have multiple client-facing departments (including advisors, call centers, or other retail outlets), the ability to retain and retrieve important documents is critical to legal defense and in regulatory examinations. There are three situations in which "Streamlined BIC" might be available: (1) a rollover from an ERISA plan to an IRA, (2) a recommendation to roll over or transfer from another IRA, or (3) a recommendation to switch from a commission-based account to a level fee arrangement. With respect to a rollover from an ERISA plan to an IRA, the documentation must include consideration of the investor's alternatives to the rollover, such as leaving the money in their current employer's plan, if permitted, and also must take into account the fees and expenses associated with both the plan and the IRA, whether the employer pays for some or all of the Plan's administrative expenses, and the different level of services and options available under each option. With respect to a rollover or transfer from another IRA or a switch from a commission-based fee to a level fee arrangement, the reasons that the arrangement is considered to be in the best interest of the investor must be documented, including specifically the services that will be provided for the fee. Companies should consider as best practices specific practices for compliance documentation that are securely managed in permanent third-party storage, periodically inspected, and able to be easily retrieved.

VI. Covered Service Provider (CSP) Disclosures Under Section 408(b)(2) of ERISA, Which are Requirements Separate and Apart From BICE, are Requirements Notifying Clients That Arrangements With Third-Party Firms are Reasonable and the Costs of Such Arrangements are Reasonable

Fundamental to the ability of service providers to fulfill obligations to their retirement clients, are obtaining information sufficient to enable their clients' informed and prudent decisions about an employee benefit plan's services, the costs of such services, and the service providers.[5] All service providers, not only ERISA fiduciaries, are well-advised, when releasing disclosures of this type, to grab a "snapshot" of the actual disclosure language including a date-stamp, a version number, a reference to the retirement client population to whom the 408(b)(2) disclosure was sent, and by what means or media. Archiving and retrieval of these additional disclosures should be part of the firm's evidentiary library, in addition to the standard language in agreements that the retirement client has received it, has had the opportunity to consult with counsel, has had the opportunity to review the disclosure, and has understood the disclosure.

Ongoing disclosure requirements by CSPs must be integrated with the same recordkeeping system. This includes any secondary disclosures such as periodic updates and any requirements to timely identify any prior disclosure errors, once discovered.

The general rule is that a robust and defensive program for complying with requirements of the DOL urgently necessitates that retirement product providers, financial services firms, consultants, and others involved in the retirement product delivery chain, create the proofs-of-delivery and client acknowledgements that will increase the likelihood of withstanding legal assault or regulatory challenges, both under the Fiduciary Rule and elsewhere under ERISA.

VII. ERISA Recordkeeping Requirements

Aside from BICE, ERISA has very detailed record retention requirements.[6] Adequate record management practices under ERISA Section 107 include the labelling of electronically maintained or retained records, providing a secure storage environment, creating back-up electronic copies, selecting an off-site storage location, and observing a quality assurance program evidenced by regular evaluations of the electronic recordkeeping systems, including periodic checks of electronically maintained or retained records that cannot be clearly, accurately, or completely transferred to an electronic recordkeeping system.[7] Under ERISA Section 107, every person subject to a requirement to file any report or certify any information is required to maintain a copy of such record or report "which will provide in sufficient detail the necessary basic information and data from which the documents thus required may be verified, explained or clarified, and checked for accuracy and completeness." The types of documents required to be maintained include vouchers, worksheets, receipts, and applicable resolutions.[8] Consequently, any liability for record retention failures would rest with the plan sponsor.

The minimum record retention period under ERISA Section 107 is six (6) years measured from the filing of the applicable document, generally the Form 5500. If the plan is exempt by statute or

5 See, for example, DOL Advisory Opinion 2002-08A.

6 A failure to maintain records may not only be a statutory violation, but also a violation of the common law of trusts. See *William A. Shaver*, 332 F. 3d 1198 (9th Cir. 2002).

7 DOL Regulation Section 2520.107-1(b)(5). These requirements are consistent with those under the Internal Revenue Code. See Rev. Proc. 98-25, 1998-1 C.B. 689.

8 See DOL Advisory Opinion 82-40A (retention of "recaps" without the underlying claims information would not satisfy the records retention requirements of ERISA Section 107); DOL Advisory Opinion 84-18A (claims records are records required to be retained

regulation from filing a return, the 6-year period is measured from the date the return would have been filed if the exemption were unavailable. As will be discussed below, however, the best practices record retention policy for many documents is indefinite, because an issue can arise with respect to a plan document that was in effect decades ago or with respect to compensation data needed to calculate a plan participant's retirement benefit. In addition, ERISA Section 209(a)(1) requires that "every employer shall…maintain records with respect to each of his employees sufficient to determine the benefits due or which may become due to such employees."

The potentially relevant time period for retaining records under ERISA Sections 107 and 209, if not unlimited, is very substantial. For example, if a plan sponsor maintains a tax-qualified defined benefit pension plan under which benefits are based upon final average compensation and years of service determined on an hours of service basis, a participant could become vested in their benefit in their mid 20s, yet not receive a distribution from the plan until age 65. If there was a question with respect to their service in one of the relevant years, the plan administrator could be reviewing records almost 40 years old. Another situation that may arise involves a participant claiming that they never received a distribution from the plan, a problem that is especially vexing for large employers who may have been involved in a series of merger and acquisition transactions. The acquiring company may have little or no information with respect to the plan from which the individual is claiming entitlement to a benefit. Indeed, the plan may have been terminated decades ago. Even in the absence of a merger or acquisition transaction, the practice of reporting undistributed benefits on Form SSA, or its designated successor, Form 8955-SA, causes the participant to be notified of the possibility of a benefit entitlement when they later apply for Social Security, and many employers have had the experience of having long terminated participants ask about a benefit that the employer believes was long since paid.

Additionally, one of the requirements under the DOL's claims review procedures is that claims be handled in a consistent manner. To help ensure consistency, a claimant is entitled to receive, as part of relevant materials, copies of all decisions made by a plan administrator with respect to similarly situated claimants. Further, in the event that a voluntary correction procedure will need to be undertaken under the Internal Revenue Service's Employee Plans Compliance Resolution System,[9] even operational defects in closed tax years will need to be corrected, so the records regarding any violation triggering such a change will need to have been retained. Nor is it solely plan sponsors who need to be concerned about retention of records. Accounting firms who perform annual audits for plans with 100 or more participants, actuarial firms, trustees, and custodians for defined benefit pension plans, and third-party recordkeepers for 401(k) plans would also have records that need to be maintained.

VIII. Disclosure and Understanding

Duty to Disclose

Section 404(a) of ERISA sets forth some of the core duties of a fiduciary - the duty of loyalty, the duty of prudence, the duty to diversify plan assets, and the duty to administer a plan in accordance with its terms. However, ERISA did not attempt to set forth *all* of the fiduciary duties required under the common law of trusts, and the courts have sometimes imposed these common law obligations as part of the common law of ERISA. One of those common law duties, the full extent of which is outside the scope of this white paper, is the duty to disclose or the duty to inform. In *Eddy v. Colonial Life Insurance Co.*,[10] the Court of Appeals for the D.C. Circuit explained that the duty of loyalty may impose a duty to speak without being asked—the duty to disclose material information is the core of a fiduciary's

under ERISA Section 107).

9 Rev. Proc. 2016-51.2016-42 I.R.B. 465.

10 919 F. 2d. 747(D.C. Cir. 1990).

responsibility. In *Bixler v. Central Pa. Teamsters Health and Welfare Fund*,[11] the Court of Appeals for the Third Circuit explained that this duty is a constant thread in the relationship between beneficiary and trustee. The duty entails not only a negative duty not to misinform, but also an affirmative duty to inform when the trustee or plan administrator knows that silence may be harmful. As a final illustration of this point, in *Kenseth v. Dean Health Plan, Inc.*[12] the Court of Appeals for the Seventh Circuit has indicated that "once an ERISA beneficiary has requested information from an ERISA fiduciary who is aware of the beneficiary's status and situation, the fiduciary has an obligation to convey complete and accurate information [that is] material to the beneficiary's circumstances, even if that requires conveying information about which the beneficiary did not specifically inquire."

But what if there is no inquiry at all? Would there nonetheless be a duty to disclose when the meaning of a written document is clear? There are limits to the duty of loyalty and the duty to disclose or inform. As a general rule, in the absence of any inquiry by a plan participant, a plan fiduciary has no duty to disclose, although a fiduciary does have an affirmative duty to inform when the fiduciary knows that silence may be harmful. Further, as the Court of Appeals for the Seventh Circuit stated in *Killean v. Concert Health Plan*,[13] "ERISA does not require a fiduciary to set out on a quest to uncover some kind of harm that might befall a beneficiary." However, there will be circumstances in which a plan fiduciary, in the absence of any inquiry will know with a high degree of certainty that plan participants did not understand the language of a document.

Perhaps the clearest example of this is the reservation of rights clauses in collective bargaining agreements, which allow employers to eliminate welfare benefits to retirees. For example, in *Cherry v. Auburn Gear, Inc.*[14] the Court of Appeals for the Seventh Circuit stated: "The distinction between lifetime benefits and vested benefits is a legal distinction that understandably escaped many of the retirees. It is difficult to imagine that someone without legal training would be able to fully comprehend a reservation of rights clause and how a court would interpret such a clause." A dissenting opinion in *Sullivan v. CUNA Mutual Ins. Society*,[15] suggested that plan sponsors relying upon reservation of rights clauses might be breaching their fiduciary duties: "Federal courts have often recognized that ERISA imposes duties on fiduciaries not to mislead a plan participant. ERISA's fiduciary duties are implicated here because the duty not to mislead applies when the fiduciary should know that the participant is laboring under a material misunderstanding of plan terms and benefits. In cases like this one, I submit, the plan fiduciaries should know very well that plan participants were [literally] laboring based on material misunderstandings of plan benefits." Although other courts have not followed this suggestion, it is not inconsistent with the case law in this area. In *Bixler*, the Court of Appeals indicated that fiduciaries have a duty to fully and accurately disclose and explain material information to plan participants, and in *Kenseth*, the Court of Appeals for the Seventh Circuit stated that "the most important way in which the fiduciary complies with its duty of care is to provide accurate and complete explanations of the benefits available to plan participants and beneficiaries."

If plan fiduciaries have a legal obligation to explain plans and other documents to plan participants and beneficiaries, particularly when the failure to explain is potentially harmful to plan participants and beneficiaries, it is not a large step to conclude that fiduciaries have an obligation to ensure, or at least attempt to confirm, that the explanation of the plan provision or other document was understood. (And, even in situations where a court might hold that the fiduciary was not on notice of the participant's need for information, there could be a risk of litigation alleging that the fiduciary had in-

11 12 F. 3d. 1292 (3rd Cir. 1993).

12 610 F. 3d. 462(7th Cir. 2010).

13 742 F. 3d. 651 (7th Cir. 2013).

14 441 F. 3d. 476 (7th Cir. 2006).

15 2011 WL 3487414 (7th Cir. 2011).

formation that it should have proffered to the participant.) Therefore, while not currently a stated legal requirement in all circumstances, it could well be a best practice from a risk management perspective, in any circumstance in which a plan sponsor believes that language in a plan document or notice may be confusing to plan participants, to attempt to undertake some measures to explain that language to plan participants generally.

IX. Duty to Ensure Comprehension

Law may lag behind technology, and there clearly is no statutory duty under ERISA to attempt to ensure that a participant or beneficiary has comprehended a contract or notice or other document with which they have been provided. In some limited circumstances, a plan fiduciary would have an obligation to be proactive in ensuring that an action by a participant or beneficiary should be recognized. For example, if one of the options offered under a plan was a qualified joint and survivor annuity or qualified optional survivor annuity, which the spouse was being asked to waive so that the participant could receive a different form of benefit under the plan, and the plan fiduciary was aware that, possibly because of illness or the infirmities of old age, there was a question as to whether the spouse fully understood the action that was being requested of him or her, the plan sponsor would need to take some action, in a neutral capacity, to determine if the spouse understood the options that were available to him or her. The same type of analysis might be required in a participant-directed defined contribution plan, if the plan fiduciary became aware that there were questions as to the competence of the individual to manage his or her own affairs.

While such cases do occur, the more frequent situation that arises for a plan fiduciary will be a communication or document that is intended to be received by all participants and beneficiaries in the plan. In certain instances, the regulations make clear that the document is intended to be understandable. The DOL Regulations with respect to the style and format of summary plan descriptions requires that these documents be "written in a manner calculated to be understood by the average plan participant".[16] Code Section 432(e)(9)(f)(iii)(II) requires a suspension of benefits notice for multiemployer plans in a rehabilitation period "to be written in a manner to be understood by the average plan participant." In Revenue Procedure 2005-23,[17] a notice of the option to commence the receipt of benefits in connection with an amendment to respond to a Supreme Court decision with respect to vesting and the cutback of accrued benefits, needed to "be designed to be readily understood by the average plan participant." Under Department of Treasury Regulation 1.411(d)-3(e)(2)(i)(C), one of the conditions for eliminating an early retirement benefit is "whether the terms and conditions applicable to the plan's early retirement benefits are difficult to summarize in a manner that is concise and readily understandable to the average plan participant."

While "average plan participant" is not a term of art under ERISA or the Code, issues with respect to whether a particular document is likely to be understandable by a plan participant is an issue that could arise on an audit of the plan. For example, a DOL auditor might request a copy of a summary plan description ("SPD") for a plan and, if the auditor believed that the underlying plan was complex or the SPD seemed too lengthy or appealed to a more sophisticated or learned audience than an "average plan participant," the auditor could request some confirmation of its understandability. A similar analysis would be required if the IRS questioned the elimination of an "early retirement benefit."

Even though case law may not specifically refer to a duty to ensure comprehension, there are doctrines that have the same objective. One such doctrine is the reasonable expectations doctrine, which "requires an ERISA benefit plan to be interpreted in accordance with the reasonable expectation

16 DOL Regulation 2520.102-2(a), a rule observed more in the breach.
17 2005-18 I.R.B. 991.

of a participant."[18] In another Ninth Circuit case, the Court of Appeals explained that "under the reasonable expectations doctrine, as a matter of federal law governing ERISA contracts, even an unambiguous exclusion may be unenforceable, unless it is sufficiently 'clear, plain, and conspicuous' to overcome a layperson's reasonable expectations."[19] *Spinedex Physical Therapy v. United Health Care of Arizona, Inc.*[20] provides an example of how a plan lost the benefit of a risk management tool by failing to comply with the reasonable expectations doctrine. In that case, even though the United States Supreme Court has recognized that a plan may contain a reasonable internal statute of limitations,[21] the Court of Appeals for the Ninth Circuit would not enforce an internal statute of limitations that was buried deep inside an SPD, "holding that a contrary holding would require a plan participant seeking to determine if a plan had an internal statute of limitations to read every page of an SPD." In a Third Circuit case, *Mirza v. Insurance and Investments of America, Inc.*,[22] the Court, in addition to rejecting on technical grounds defendant's argument that an internal statute of limitations did not need to be included in an adverse benefit determination letter, also rejected it on practical grounds, stating that "were we to endorse Defendants' position, plan administrators could easily hide the ball and obstruct access to the courts. The ERISA plan at issue here is 91 pages. The one-year time limit is buried on page 77 of the plan. The August 12th letter denying Mirza's final appeal is only five (5) pages. Which is a claimant more likely to read - a ninety-one page description of the entire plan, or a five page letter that just denied thousands of dollars in requested benefits?" In each of these cases, it is important for the affected participant or beneficiary to have knowledge of those rules that apply to him or her. Other contract doctrines, such as unconscionability,[23] the rules applicable to adhesion contracts and the contra proferentum doctrine requiring an agreement to be construed against an insurer and, in certain circumstances, against a plan administrator, have a similar policy objective.

Another area in which a participant's or beneficiary's understanding of the terms of a document may need to be established is in connection with the waiver of ERISA rights. To determine whether the waiver of an ERISA claim is knowing and voluntary, among the factors that a court will take into account are the employee's education and business sophistication, the amount of time the employee was given to review the agreement, and the clarity of the agreement.[24]

The above discussion is intended to be illustrative rather than exhaustive, and to indicate the variety of circumstances in which establishment of an individual's understanding (or, perhaps in one instance, how difficult it was to confirm a plan participant's understanding of a particular plan feature). *In each of these instances, third-party verification may help in establishing that a participant understood the applicable document.*[25]

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18 *Saltarelli v. Bob Baker Group Medical Trust*, 35 F. 3d 382 (9th Cir. 1994).

19 *Peterson v. American Life and Health Ins. Co.*, 48 F. 3d. 404,411 (9th Cir. 1995).

20 770 F. 3d 1282 (9th Cir. 2014).

21 *Heimeshoff v. Hartford Life and Accident Insurance Co.*, 134 S. Ct. 604 (2013).

22 800 F. 3d 129 (3rd Cir. 2015).

23 One of the classic indicia of unconscionability is fine print that is so fine as to be impossible to read; this is particularly so when an insurance giant such as Aetna is dealing with a layperson." *Granville v. Aetna Life Insurance Co.,* 2015 WL 9026025. (M.D. Pa. December 15, 2015).

24 O'Shea through *O'Shea v. UPS Retirement Plan*, 2016 WL 4750214 (1st Cir. 2016).

25 There are other circumstances in which a third-party verification might be useful, but that generally will not be able to be obtained, such as whether a designation of beneficiary was the result of undue influence or duress. Third-party verification may not be the only evidence that a court or an auditor might consider in determining whether a document was understandable. For example, readability formulae might be taken into account. However, while no opinion is expressed regarding the overall advantages and disadvantages of each approach, third-party verification may be better able to focus on individual differences in how individuals comprehend.

X. Underlying Fiduciary Risks and Remedies

What factors prompt litigation, and what approaches exist that can reduce or contain the risks of being sued, and create the most responsible posture in regulatory examinations to establish thorough compliance? We believe that documenting the transaction, and capturing acknowledgement of disclosure using efficient and technologically contemporary methods, is the answer.

To understand these risks, we first explore the concepts of "agreements." At a high level, agreements or contracts detail the expectations and obligations of both parties in a transaction. Agreements can be oral or written, and reflect a *shared understanding* of the terms of an arrangement.[26]

Typically disputes arise when there is a disconnect between the expectations of the parties to the agreement. This misalignment may be based on either written or oral information. In short, having a clear and aligned understanding of mutual expectations - and complying with agreed to commitments - is the best defense against litigation risks.

A standard practice in the investment industry is to rely heavily on written communication in the form of agreements, illustrations, and disclosures to communicate important information - in some cases documentation of 50 pages or more. This is true despite federal efforts such as the U.S. Paperwork Reduction Act of 1980, and the more recent initiatives by the SEC under Chairman Arthur Levitt to institute a "plain English" approach to writing investment documentation.

Notwithstanding such efforts, the question remains as to whether instruments relating to investment advice services and related investment materials, including the newly required BICE contract and disclosures, in fact foster understanding and clarity of the arrangement.

Many other industries rely on written agreements with consumers. Examples include software agreements for mobile applications (end user license agreements, EULA's), Terms of Use, Privacy Disclosures and permissions, and mortgage loan documents. In each case, it is common for consumer agreements to be signed or electronically "accepted" even if they are unread or not well understood.

Should retirement investors find themselves in the same situation as consumers in other industries - that is, entering into agreements that are lengthy, legally complex, and difficult to understand, and largely unread, and relying on verbal communication by financial advisers and call center representatives for their understanding of the arrangements - we believe this significantly increases legal and regulatory compliance risk.

Approaches to Risk Mitigation - Evidence of Comprehension

A central intent of the Fiduciary Rule is to drive greater transparency and understanding regarding investment terms and costs (agreements) with investors. While it is necessary to use written agreements, obtaining further supplementary confirmation of the consumer's understanding of, and agreement with, key disclosure provisions provided by an independent third party, could well provide protection in the event of a dispute or legal challenge. Third-party confirmation of the disclosures and the transaction terms evidences a retirement investor's comprehension of the arrangement.

Historical Context in Other Industries

Other industries have been impacted by government regulations in efforts to protect consumers.

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26 Because it is outside the scope of this white paper, the continued vitality of the concept of a subjective "meeting of the minds" under any state's contract law jurisprudence is not addressed.

For example, in 1996, in response to a practice called "slamming and cramming" whereby telecommunications operators would illegally switch a consumer's phone service or add charges for services without a consumer's permission, the Federal Trade Commission and the Federal Communications Commission enacted rules (Section 258 of the Telecommunications Act of 1996) requiring all providers of wired voice communications lines to *obtain reliable proof that a consumer requested a change of service or ordered new service*. Over time, the same process has been used to capture a consumer's acknowledgement of the risks associated with emergency 911 services should the communications equipment not be set up properly. Acquiring this proof proved extremely difficult, given that most of these types of transactions happen over the phone.

As a result, the FTC and FCC recognized telephone verifications as legally binding, provided that recordings: (1) are captured by an independent third party who does not have interest in the transaction; (2) are available for audit for a minimum of 24 months; and (3) include the verification of the identity of the authorizing person (i.e. by driver's license number, date of birth, or other unique identifier, etc.).[27]

Companies in the telecommunications and mortgage lending industries have found that written agreements have not always been clearly understood, but that using an independent third-party verification service to confirm the important terms of a transaction, and generate a "proof of comprehension evidentiary artifact" can be extremely effective in defending individual customer disputes, lawsuits, and regulatory compliance challenges. For the major companies that Istonish has provided this service for have used this process, in every case where a valid verification record existed, the inquiry was favorably resolved on behalf of the company.

In the mortgage lending industry, after the global financial crisis of 2008 as triggered by the home mortgage crisis, it has become apparent that one of the problems involves situations where a lender's mortgage loan terms, as communicated by the lender, are not fully understood by the borrower. As result, the borrower may not have fully understood the terms of the financial contract they were entering into. As an indication of the problem, between the time of the establishment of the Consumer Financial Protection Bureau ("CFPB") in 2011 and October 2016, 638,757 complaints were filed with the CFPB.[28] While not all complaints involved lending practices, mortgage-related complaints reflected a lack of understanding and agreement of key terms by the borrower. . In an effort to ensure clear and accurate disclosures by lenders, and to ensure that borrowers clearly understand key terms of their loans, mortgage lending third party verification has become a standard practice for many lenders. The regulatory environment also allows for the use of independent third parties to provide data and confirmation of the borrower's ability to pay. Services include verification of employment and income, "ability to pay" (Qualified Mortgage) and verifications of identity and undisclosed debt (Fannie Mae Loan Quality Initiative). With continued federal consumer protection mandates and investor requirements for mortgage lending, a new mantra of INDEPENDENT, 3rd PARTY VERIFICATION is here to stay.

This solution involves selecting a series of the most important terms to be verbally confirmed via a voice call using either live agents or voice automation. For example, the consumer confirms that they are eligible to make a purchase commitment, that they understand how much they are paying per month, and that they are entering into a contract that is subject to penalties if broken. Consumers may also confirm their understanding of potential risks associated with their purchase decision.

In the example of confirming terms of a mortgage loan, third-party verification questions re-

27 See FCC Regulation 47 C.F.R. §64.1120.

28 http://www.pymnts.com/news/cfpb/2016/the-cfpb-5-years-in-consumer-complaints/

quire that the borrower revalidate their understanding of the interest on the mortgage note, associated monthly payments, rate adjustments (where applicable), any penalty interest in the event of default, additional late fees, and other terms. *A voice recording that captures the reiterated disclosures and consumer responses is generated and stored for future reference.*

The telecommunications industry, which has literally millions of "verbal, recorded contractual verifications" with consumers, sports an attractive track record. To the knowledge of Istonish, frequently when a consumer dispute occurred where a valid third-party verification recording was available, the confirmation effectively defended the actions of the company and their employees.

In addition to significantly bolstering the evidence of compliance, third-party confirmation provides other benefits including:

1. Validation by an unbiased third-party organization, which receives no sales or customer-retention-based compensation, but is solely motivated to ensure that the consumer understands key provisions and disclosures required to be provided. This independent validation reflects the highest standard of truth and reliability.

2. Third-party validation can identify gaps or misunderstandings that the investor may have, requiring that the advisor clarify and confirm that all important disclosures and terms are better understood. This feedback can be independently provided back to the advisors or their compliance organization- highlighting areas for training. In addition, the customer assurance capabilities using third-party verification tend to enhance the consumer experience and bolster the brand promise of companies employing independent verification methods.

3. Secure storage and retention of customer acknowledgements - the evidentiary artifacts - is of paramount importance to discovery processes and defense in litigation. In the digital age, there is no shortage of data logs and documentation available that track everything consumers do. However, identifying and retrieving this critical information can be extremely difficult, even with the most advanced data retrieval platforms. Call centers that handle thousands of calls per month struggle to extract important parts of recorded conversations when needed for future problem resolution, or to support legal or regulatory evidence. There is technology available from highly capable third-party firms, specializing in the storage, indexing, and retrieval of disclosure proofs, customer acknowledgements, and evidentiary artifacts. When needed, rapid retrieval and cataloging of corporate compliance with consumer disclosure provisions is extremely valuable.

4. For retirement investors who are making their own investment decisions or using "robo-advice" or other automated investment programs, confirmation that these investors know they are fully responsible for their investment choices is highly valuable. Obtaining this acknowledgement by independent third-party verification is of high value.

5. Independent verification enables organizations to be very clear with customers about business rules. For example, if an investor is unwilling to confirm their comprehension of the required business rules and disclosures, a retirement services provider or financial adviser has the ability to provide additional information or potentially delay a transaction.[29] Or it can be sent back to the advisor to clarify their understanding. A risk analysis can be done, and a decision can be made as to whether the investment will be processed in spite of investor confusion. Additionally, to the extent that there is evidence that some aspect of disclosures is unclear, retirement plan advisers can modify them and enhance their policies and procedures under BICE.

6. In many industries, third-party verification solutions provide customers with a feeling of security and peace of mind, reinforcing the professional interaction they have with employees, sales people, call centers, and other advisers.

29 Efforts to require customers to review, understand, and acknowledge transactions, including retirement investment decisions, are also subject to SEC rules regarding transaction execution. Firms may consider that the absence of third-party acknowledgement will constitute "not-in-good-order" instructions from the customer.

About Istonish

Established in 1990, Istonish delivers technology solutions for companies, government agencies, and not-for-profits throughout the Mountain West. Headquartered in Denver, Colorado, the company employs more than 100 employees and many contract employees.

For more than 15 years, Istonish has provided regulatory compliance solutions for industries relying on oral and written contractual disclosures with consumers in the cable and telecommunications employing technologically advanced, highly efficient third-party verification systems and processes. Using the proprietary Aprisi platform, Istonish handles more than 10,000,000 voice, text, email, chat, and documentary transactions for corporate clients annually. These evidentiary artifacts are securely stored for 6-10 years and are easily retrieved in the event of a regulatory inquiry.

About The Wagner Law Group

The Wagner Law Group is a nationally-recognized practice in the areas of ERISA and employee benefits, estate planning, employment, labor and human resources, and investment management. Established in 1996, The Wagner Law Group is dedicated to the highest standards of integrity, excellence, and thought leadership and is considered to be amongst the nation's most exceptional ERISA and employee benefits law firms. The firm has six offices across the country, providing unparalleled legal advice to its clients, including large, small, and nonprofit corporations, as well as individuals and government entities worldwide. The Wagner Law Group's 27 attorneys, 3 paralegals, and a senior benefits consultant combine many years of experience in their fields of practice with a variety of backgrounds. Seven of the attorneys are AV rated by Martindale-Hubbell and six are fellows of the American College of Employee Benefits Counsel, an invitation-only organization of nationally-recognized employee benefits lawyers. Six of the firm's attorneys have been named to the prestigious Super Lawyers list for 2016, which highlights outstanding lawyers based on a rigorous selection process.