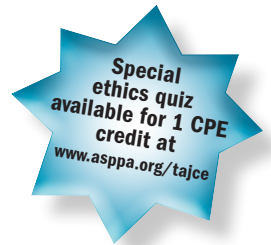


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The Ethics of Conflict of Interest

by Lauren Bloom



The past two years have been tough for the financial services industry. In hindsight, the crash of 2008 that triggered a deep recession was not only foreseeable, but probably inevitable. Too many people were looking for ways to beat the market, seeking out ever-more risky investments in the hope of generating ever-increasing returns. Investor expectations for growth became so unreasonable that they were bound to encourage fraud (think Bernie Madoff and his ilk) and the proliferation of chancy investments like subprime mortgages. It was only a matter of time before the whole precarious mess came crashing down.

At this point, investors both large and small are suffering from a profound lack of trust in their professional advisors. Those investors include pension plans, and they have a point. Far too many plan design and funding decisions were made based on unrealistic expectations and, in some cases, imprudently optimistic advice from pension professionals. Despite their expertise, too many pension advisors failed either to anticipate the coming crash or to help their clients avoid its consequences.

It also appears that some pension plans may have been the victims of intentional misconduct on the part of their advisors. Recent claims that public plans across the US have been targets of nationwide “pay-to-play” schemes have called the integrity of public plan advisors into question. If those allegations turn out to be true, the pension community’s reputation will be severely damaged and calls for increased regulatory oversight are sure to follow.

If pension professionals want to regain the trust of their clients and retain their independence, they



will need to recommit to strong professional ethics. They will also need to be able to demonstrate that commitment to their clients and regulators. ASPPA members can do both by reacquainting themselves with ASPPA’s Code of Professional Conduct (and, for actuaries, the Code of Professional Conduct for Actuaries) as well as IRS Circular 230, and then taking steps to ensure that their professional practices fully comply.

Historically, many professional advisors have focused on disclosure as the key to addressing conflicts of interest, but disclosure alone is not enough.

ASPPA's Code of Professional Conduct provides comprehensive guidance on ethics in professional pension practice, and all of its requirements are important. In the current climate, however, one ethical issue in particular stands out: conflicts of interest. It will be essential for pension professionals to deal appropriately with such conflicts if they are to maintain credibility and restore their clients' trust.

Conflicts of interest can present a major problem for pension professionals, who often provide a range of services to various parties associated with particular plans. In an ideal world, the interests of the plan sponsor, administrators, fiduciaries, participants and practitioners would be the same; in practice, that is all too often untrue. In some situations it can be difficult for the pension professional even to identify his or her client. Is the client the sponsoring company's management, its Board of Directors, the plan administrator, the participants or the pension professional's firm? And whom has the professional been hired to serve? In many cases, one party—for example, a plan sponsor—may hire a pension professional to provide services that are intended to benefit someone else, such as the plan's participants. Diverging goals, internal plan politics and conflicting requests for confidentiality from the many parties associated with a plan can put a pension professional in an ethically untenable position unless potential conflicts of interest are carefully considered and successfully resolved.

ASPPA's Code addresses conflicts of interest and provides guidance on how to resolve them. First, an ASPPA member must recognize when an actual or potential conflict of interest exists, not only with respect to the member's principal (*i.e.*, the person or entity with authority to hire and fire the ASPPA member) but also other interested parties. That requires the ASPPA member to think carefully about the implications of an engagement not only for the principal requesting services, but for the member's other clients, other parties with an interest in the plan, the ASPPA member's firm and, in some situations, the federal government.

Section 10.29 of IRS Circular 230 offers clarifying guidance, stating that a conflict of interest exists if:

- The representation of one client will be directly adverse to another client; or
- There is a significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibilities to another client, a former client or third person, or by a personal interest of the practitioner.

Circular 230 permits the practitioner to make a professional judgment that a particular assignment will not be *directly* adverse to the interests of another client or create a *significant* risk of conflict. However, such judgments can carry real risk. Conflicts of interest often seem less serious at the beginning of an engagement than they do with the benefit of hindsight, and failure to properly identify and address a conflict can do real harm to a professional's credibility. These days, an ASPPA member is prudent to take potential conflicts of interest very seriously, more so than he or she might have even a year or two ago.

Identifying real or potential conflicts of interest does not necessarily prevent the ASPPA member from accepting the assignment, but it does require him or her to determine whether he or she can act fairly or, in the words of Section 10.29 of IRS Circular 230, "be able to provide competent and diligent service to each affected client." This obligation should not be taken lightly, and the determination should be made before the ASPPA member requests the affected principals' consent to having the member complete the engagement. The ASPPA member needs to think long and hard about whether he or she can be objective in serving his or her principal. Even if he or she is convinced that he or she can act fairly, the ASPPA member is wise to consider whether third parties would agree. An appearance of bias can seriously harm a professional's credibility even if that professional is certain that his or her conduct is entirely appropriate.

The ASPPA member must also consider whether the law permits him or her to provide professional services in a situation where a real or potential conflict of interest exists. Section 10.29 specifically addresses this point, as does the requirement in ASPPA's Code that members comply with applicable law. Some situations (for example, certain contingency fee arrangements) present so great a risk of conflict of interest that the law prohibits a pension professional from entering into them regardless of whether he or she can maintain objectivity or not. The ASPPA member should be sufficiently familiar with applicable law to comply with this requirement, obtaining legal advice as necessary.

If the ASPPA member concludes that he or she can act fairly and in compliance with law, he or she should disclose the conflict to all principals involved and obtain their consent to him or her performing the engagement. Section 10.29 requires practitioners to obtain clients' confirmation of their consent in writing within 30 days, to keep the written confirmation for three


years, and to provide the confirmations to the IRS upon request. (Nothing prevents ASPPA members from keeping such confirmations longer, consistent with their firms' document retention policies.) If one or more of the affected principals refuses to consent, the ASPPA member should decline the engagement even if he or she believes that he or she could have provided unbiased advice.

Additionally, ASPPA's Code requires members to disclose to their principals any significant conflict between their principals' interests and those of a third party, and to make appropriate qualifications or disclosures in any related communications. Again, this requirement gives the member discretion to determine that a particular conflict of interest is insignificant enough that there is no need to disclose it, but such determinations require careful thought. In most cases, the member is probably wise to err on the side of caution, disclosing a seemingly minor conflict with a third party's interest to the principal, rather than neglecting to do so only to discover later than the conflict was more significant than it first appeared.

ASPPA's Code also requires members to keep appropriate control over their work product. Members should decline engagements if they have reason to believe that their work would be used to mislead or to violate or evade the law. They should also take appropriate steps to make sure that their work products are clear and presented fairly, with sources of the material clearly identified. These requirements complement the Code's conflict of interest provisions by reducing the risk that the member's work will harm the legitimate interests of third parties, and should be kept in mind as the member addresses conflicts of interest.

Conflicts of interest are not always apparent at the beginning of an engagement. If a conflict of interest emerges during the course of an ASPPA member's work on a particular assignment, the ASPPA member should resolve the conflict consistent with the Code and Circular 230. This is true regardless of when the conflict becomes apparent.

If an ASPPA member is faced with a conflict of interest, he or she may wish to document the analysis he or she conducted to resolve it. Such documentation can be useful if questions arise later about the member's compliance with the Code or Circular 230. Documentation concerning resolution of conflicts of interest should usually be created and maintained consistent with the document retention policy of the member's firm and, if necessary, in consultation with an attorney.

Historically, many professional advisors have focused on disclosure as the key to addressing conflicts of interest, but disclosure alone is not enough. An ASPPA member is much more likely to be successful in dealing with conflicts of interest if he or she complies fully with all aspects of the Code. While rigorous compliance with the Code's conflict of interest requirements may sometimes cause an ASPPA member to make painful decisions in the short-term, it will go a long way toward helping that member maintain professional credibility and strong relationships with clients and regulators. 



Lauren Bloom is an attorney who speaks, writes and consults on business ethics and responsible litigation risk management. She is the author of the award-winning book, The Art of the Apology—How to Apologize Effectively to Practically

Anyone and a contributing columnist on TheStreet.com. Her consulting firm, Elegant Solutions Consulting, is dedicated to helping professionals incorporate strong ethics into their business practices. (lauren@businessethicsspeaker.com)