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Welfare Benefits, Insurance Commissions, Fees, and PEOs

Limitations on Permissible Activities and Potential Pitfalls

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NAPEO LEGAL REVIEW

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Welfare Benefits, Insurance Commissions, Fees, and PEOs

Limitations on Permissible Activities and Potential Pitfalls

Introduction

PEOs can bring a myriad of benefits to a small business and its employees. The services to small entrepreneurs enable them to cope with the enormous complexities of being an employer today. Employees who become co-employed gain access to benefits and assistance normally beyond the reach of the small enterprise on its own.

Obviously, the business of a PEO is to profit from its services. The immediate question of most businesses is, how do I profit from a given activity? However, a PEO must understand that there are both federal and state limitations on its ability to profit from certain transactions involving employee benefit plans. Some limitations arise from its role as an employer of participants in a benefit plan, some from fiduciary duties imposed upon those offering benefit plans, and some arise from state laws concerning insurance transactions.

> CAVEAT: No PEO should enter into this thorny thicket of rules, requirements, regulations, and prohibitions without careful consideration and competent, professional advice. There are costly pitfalls any time the unwary engage in transactions with employee benefit plans.

PEOs in search of ways to increase their profit margins should not see employee benefit plans as offering opportunities. A PEO engaging in business with and expecting to profit from an employee benefit plan covered under the Employee Retirement Income Security Act (ERISA) of 1974, *et seq.* needs to understand ERISA's prohibited transaction rules. These rules are very technical. The United States Department of Labor (DOL) and a majority of courts have interpreted them as imposing per se prohibitions that violate ERISA irrespective of whether the plan suffers any harm or the parties had saintly intentions, unless a specific exemption is available.

Although ERISA's prohibited transaction rules apply to both welfare and pension plans covered by ERISA, the focus of this *NAPEO Legal Review*™ will be on transactions involving welfare plans. The short definition of a "welfare plan" is basically any benefit that is not a pension plan, the most common of which include health, dental, life, and disability plans. This publication will discuss ERISA concerns that may exist any time a PEO or its sub-

sidiary earns a commission from the sale of insurance for the type of coverage that falls within the meaning of ERISA's definition of an "employee *welfare* benefit plan."[1]

In addition to potential ERISA concerns, state insurance laws also need to be considered any time a PEO enters into a commission sharing arrangement with another party. Thus, this publication will address both ERISA and state insurance compliance matters in the context of commissions earned from the sale of hea'th and welfare type insurance coverage.

To discuss the compliance issues raised by ERISA and state insurance laws, it is necessary to distinguish between the different PEO business models to the extent that any such variation impacts the manner welfare benefits are delivered to worksite employees. The variation in the method of delivering welfare benefits affects the application of ERISA and state laws to determine whether or not a violation has occurred. This *NAPEO Legal Review*™ will address ERISA and state law compliance issues in the context of three possible PEO business models. Although there may be other models or variations within each model, the following three models were chosen because in a very broad sense, they likely represent the largest universe of PEO business models.

- Full benefits PEO — Here the PEO is the W-2 employer of all of the worksite employees and is the sponsor of the benefit program. In this traditional model of a full service PEO, the PEO is issued a group health policy and worksite employees participate in the arrangement as employees of the PEO. In its purest form, this model requires that clients purchase coverage for all worksite employees, there is no individual group underwriting, and any rate variation is only based on geographic differences, including age band variations.
- Limited services PEO — The limited service PEO is the W-2 employer for some purposes, but not for the purpose of sponsoring a plan. In this model, the PEO or an affiliate locates a willing carrier and assists in arranging the coverage for clients. These clients, however, choose to purchase or not purchase the coverage and, if they do, each client establishes its own stand-alone plan and is the named insured.
- Administrative service organization (ASO) — This model is similar to the limited services PEO model, except the PEO has no employer relationship to the worksite employees. In this model, the PEO does no more than bill and collect sufficient assets from the client to make payroll, pay federal, state, and local taxes, and pay any other payroll-associated expenses, i.e., welfare and/or pension contributions. Here, if the ASO or an affiliate assists in procuring market coverage for clients who decide they want to provide such coverage to their employees, they

1 ERISA § 3(1), 29 U.S.C. §1002(1), defines an ***employee welfare benefit plan*** as:
"any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that such plan, fund, or program was established or is maintained for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or pre-paid legal services, or (B) any benefit described in section 302(c) of the Labor Management Relations Act, 1947 (LMRA) (other than pensions on retirement, and insurance to provide such pensions)."

LMRA § 302(c)(5)(A), 29 USC § 186(c)(5)(A), includes benefits for occupational injury and illness (i.e., workers' compensation) resulting from occupational activity and holiday and severance benefits as benefits that may be provided by an employer to employees in an employee benefit plan. DOL Reg. § 2510.3-1(a)(3); DOL Advisory Opinion 2003-06A, Letter to Donald J. Siegel (Apr 25, 2003), clarify that the incorporation of § 302(c) of the LMRA into ERISA's definition of a welfare plan only covers those arrangements described in Section 302(c) that provide benefits to participants or beneficiaries; it does not incorporate every arrangement listed in Section 302(c). Thus, a labor-management cooperative organization designed to educate members on issues pertaining to workplace health and safety was deemed not to be a welfare plan. Workers' compensation would also not be covered because it is specifically excluded from coverage under ERISA § 4(b), 29 U.S.C. § 1003(b).

most likely do so as insurance producers. Like the limited services PEO model, if the client chooses the coverage, then it has very likely established a stand-alone employee welfare benefit plan.

Now that the three possible models have been defined, this portion of the publication will use a generic hypothetical to give readers a context in which to consider the rules set forth below, which without context can be confusing and difficult to understand. The generic hypothetical is as follows:

> Ted is owner and CEO of Acme PEO (or Acme ASO). He is also a licensed insurance agent and owns the Acme Insurance Agency, which brokers health insurance for the PEO and/or the PEO or ASO's clients, depending on the PEO business model. He receives commissions on these policies as agent for Acme Insurance.

The question addressed throughout this *NAPEO Legal Review*™ is whether the receipt of commissions by Ted, or someone affiliated with Ted or Ted's company, violates ERISA or state law.

This publication will first provide a legal framework in which to analyze the ERISA issues. It will then analyze whether or not Ted or someone affiliated with Ted or his company has violated ERISA by receiving commissions from the sale of health insurance in the context of each of the three models described above.

After the ERISA issues are analyzed, state law issues will be examined to determine what violations may arise in the context of commission payments to a PEO owner or affiliate. Because state laws on this question vary from state to state and a state-by-state analysis is beyond the scope of this publication, Florida law will be used as an example of the problems that may arise.

Federal Law Concerns

ERISA 'Prohibited Transaction' Rules and Definition of 'Party in Interest'

ERISA Section 406(a) and (b) create prohibitions against certain enumerated transactions involving a plan and specified parties related to a plan, unless a statutory or administrative exemption is available. ERISA refers to these related parties as "parties in interest." The prohibited transaction provisions of ERISA Section 406 were designed to prevent certain categories of insider transactions that Congress believed offered a high potential for abuse of plan assets. The very first concern of a PEO lies in ERISA's definition of "parties in interest," because if a PEO or an affiliate of the PEO is a party in interest to a plan from which the PEO or its affiliate expect some monetary gain, then the transaction generating the monetary gain may be prohibited.

Definition of Party in Interest

The term "party in interest" is defined in ERISA § 3(14), 29 U.S.C. § 1002(14), and includes:

1. Any fiduciary (including, but not limited to, any administrator, officer, trustee, or custodian), counsel, or employee of the employee benefit plan (ERISA 3(14)(A);
2. A person providing services to the plan (ERISA 3(14)(B));
3. An employer any of whose employees are covered by the plan (ERISA 3(14)(C));

4. An employee organization any of whose members are covered by the plan (ERISA 3(14)(D));
5. An owner, direct or indirect, of a 50 percent or more interest of any of the following:
   —The combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of a corporation;
   —The capital interest or the profits interest of a partnership; or
   —The beneficial interest of a trust or unincorporated enterprise that is an employer or an employee organization described in items 3 or 4 above (ERISA 3(14)(E));
6. A relative, a spouse, ancestor, lineal descendant, or spouse of a lineal descendant of any of the individuals in items 1, 2, 3, 4, or 5. The definition does not include siblings (ERISA 3(14)(F));
7. A corporation, partnership, trust, or estate of which (or in which) 50 percent or more of:
   —The combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of a corporation;
   —The capital interest or the profits interest of a partnership; or
   —The beneficial interest of such trust or estate is owned by, directly or indirectly, or held by persons described in items 1, 2, 3, 4, or 5 (ERISA 3(14)(G));
8. An employee, officer, director (or individual having power similar to an officer or director), or 10 percent or more shareholder directly or indirectly of a person described in items 2, 3, 4, 5, or 7 or of the employee benefit plan (ERISA 3(14)(H)); or
9. A joint venturer or partner owning at least a 10 percent interest in any of the entities described in item 2, 3, 4, 5, or 7 (ERISA 3(14)(I)).

Courts generally strictly construe the list of enumerated persons who can be parties in interest with respect to a plan under the theory that because the list is so comprehensive, Congress must have intended the list to be exhaustive.[2] Whether or not a PEO is a party in interest to an ERISA-covered plan depends greatly on the PEO's business model. As more fully discussed below, a full service PEO is probably at greater risk to be deemed a party in interest to a plan than a PEO, a PEO affiliate, or an ASO that is only assisting clients in procuring health benefits from an insurance company.

What Transactions Are Prohibited Between a Party in Interest and a Plan?

ERISA § 406(a) provides that a fiduciary with respect to an ERISA plan shall not cause the plan to engage in a transaction if he or she knows or should know that such transaction constitutes a direct or indirect:

- Sale or exchange, or leasing, of any property between the plan and a party in interest;
- Lending of money or other extension of credit between the plan and a party in interest;
- Furnishing of goods, services, or facilities between the plan and a party in interest; or
- Transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan.

2 For example, the Third Circuit rejected the DOL's argument that the trustees of a plan caused a plan to engage in an ***indirect*** prohibited transaction by transacting with an alter ego of a union that was a party in interest. The court stated that adopting the DOL's interpretation would in effect add an additional category (an alter ego of a party in interest) to ERISA's definition of party in interest. See ***Reich v. Compton***, 57 F. 3d 270 (3d Cir. 1995); ***Mertens v. Hewitt Associates Inc.***, 508 U.S. 248 (1993) (ERISA § 3(14) must be strictly construed).

In addition, ERISA § 406(b) forbids fiduciary self-dealing and provides that a fiduciary with respect to a plan shall not:

- Deal with the assets of the plan in his own interest or for his own account;
- In his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries; or
- Receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

Commission Arrangements

As noted earlier, some PEOs provide health and other benefits through a structure similar to a single-employer model. In other words, the PEO secures a group policy that covers its internal employees as well as worksite employees. Some maintain that a PEO can establish a single ERISA-covered welfare plan for the exclusive purpose of providing benefits to its internal employees and worksite employees.

> CAVEAT: It is important to note that the DOL has rejected arguments that PEO (or employee leasing) plans are single-employer plans under ERISA and has deemed them to be MEWAs (multiple employer welfare arrangements). However, the DOL has, at the same time, sought to impose single-employer plan duties or restrictions upon PEOs in the areas of self-dealing or fiduciary duties.

Because some PEOs continue to base their health plans on this single-employer model and because many basic ERISA issues are best understood in the context of this model, the first analysis applying ERISA's prohibited transaction rules will be in the context of a single-employer type arrangement.

Single-Employer Plan Model

In this model, the PEO may be deemed a party in interest to the plan by virtue of being an employer any of whose employees are covered by the plan, and by virtue of being a fiduciary because the plan document likely identifies the PEO as the plan's named fiduciary and plan administrator, titles that inherently carry fiduciary obligation. See ERISA §3(14)(A) and (C). A PEO insurance broker subsidiary or an insurance broker owned by the PEO or the PEO owner would also be prohibited from receiving commissions because in all likelihood the broker would be a party in interest within the meaning of ERISA due to the common ownership interest between the PEO or its owner and the broker.

Thus, the plan's purchase of insurance from a PEO-affiliated broker might be deemed a prohibited transaction because ERISA prohibits the exchange or sale of goods between a party in interest and a plan and the furnishing of goods or services between a party in interest and a plan. See ERISA § 406(a)(1)(A) and (C). Because the PEO is also likely a fiduciary in the single-employer context, the payment of commissions would probably also cause the transaction to be deemed a violation of one or more of ERISA's self-dealing provisions. See ERISA § 406(b).

The single-employer model presents the most restrictive scenario for any enterprise that engages in any transaction with a plan from which any compensation is paid. There are very few exemptions. In general, the available exemptions are restrictive and typically require the presence of an independent fiduciary that can determine whether the transaction is fair to the plan or that the fees generated from the transaction be used to offset administrative

cost. Absent the involvement of an independent fiduciary, in general, this model would likely preclude the plan sponsor from retaining for its own account any of the fees generated from the transaction with the plan.

In at least two opinion letters, however, the DOL has taken the position that if a fiduciary is paid by a third party in connection with transactions involving a plan and the payment is used to reduce the plan's obligations to pay the fiduciary for direct services provided to the plan, the payment of such consideration will not be construed as a violation of ERISA's prohibition against self-dealing. See DOL Advisory Opinion 97-15A (the Frost Opinion); DOL Advisory Opinion 97-16A (the Aetna Opinion). Thus, if commissions were paid from the sale of insurance to the fiduciary of a plan, but used to defray plan expenses or provide additional benefits, rather than be paid to the fiduciary, the transaction would likely not be deemed prohibited.

There is a class exemption that, under certain circumstances, offers relief to *fiduciaries* that receive commissions for the sale of insurance. (Prohibited Transaction Exemption (PTE) 84-24).[3] Howev :r, class exemptions tend to be very technical and are strictly applied. Class exemptions also expressly state who is covered by the exemption and who is not. Generally, in the single-employer context, PTE 84-24 likely would not apply to a PEO or its affiliate because the PEO likely would be the named plan administrator in the document.[4] PTE 84-24 excludes the plan "administrator" from the definition of a "covered entity." Thus, if the PEO were deemed to be the "administrator," either because it was so designated in the plan document or by operation of law, PTE 84-24 would be unavailable to exempt a transaction that might be deemed prohibited.

There are also two statutory exemptions that might be available, but the problem with both is that the DOL refuses to acknowledge that either is available when the allegation involves fiduciary self-dealing.[5] The DOL would likely deem the payment of commissions to a fiduciary or it's affiliated broker for the sale of insurance by the fiduciary or its affiliated broker to cover the PEO's "employees" a violation of ERISA's self-dealing provisions. The DOL, therefore, would argue that neither statutory exemption would be available.

Do Full Service PEOs Have Any Defenses Available?

The preceding discussion of commission payments in the context of "single-employer" plans assumes that: participation in the health plan was mandatory so that no other person made the decision on the part of the worksite employer to opt into the health plan; and the PEO truly is a single-employer plan. However, as noted before, federal and state regulators are not likely to accept that a PEO plan can be established or ma'ntained as a single-employer plan. In the preamble to the Form M-1 regulations, the DOL stated that it was unable to "conclude that group health plans maintained by PEOs, like the plans maintained by employee leasing companies, do not cover the employees

3 A class exemption is issued by the DOL under its administrative powers as set forth in ERISA § 408(a), 29 U.S.C. § 1108(a). Class exemptions are typically issued because the subject of the exemption is a common industry practice and the DOL decided that the potential for abuse is minimal. The DOL typically issues class exemptions after the public receives notice and comment on the proposed rule. PTE 84-24 is discussed in detail in the "Limited PEO" discussion later in this publication. Class exemptions typically are very technical and contain numerous requirements that must be precisely followed or they will not be available to exempt an otherwise prohibited transaction.

4 The term "administrator" when used to designate that person in a plan is a defined term of art under ERISA. Under ERISA, the "administrator is charged with, among other things, fiduciary responsibilities involving communications with participants, including responding to participant requests for plan documents, and filing the Form 5500. If the plan document fails to designate an "administrator," then the plan sponsor is deemed the "administrator" by operation of law. See ERISA § 3(16)(A)(ii).

5 ERISA § 408(b)(2), exempting an otherwise prohibited transaction if the services between the plan and the party in interest are necessary to the plan, pursuant to a reasonable contract, and the compensation is reasonable; and ERISA § 408(c)(2), allowing fiduciaries to be paid for services under limited circumstances.

of more than one employer" and therefore officially declined NAPEO's request to create an exemption or alternative filing for PEOs to the Form M-1 filing.

In numerous individual advisory opinions, the DOL has stated that leasing company welfare plans constitute multiple employer welfare arrangements. Although the DOL did not make an express finding that PEO plans constituted MEWAs, by refusing to grant any relief from the Form M-1 filing and analogizing PEOs to staff leasing companies in the welfare plan context, the implicit assumption is that PEO plans are MEWAs. Therefore, any allegations against a PEO that it violated ERISA for receiving commissions in connection with the sale of insurance to a PEO-sponsored plan that bases the conclusion on an analysis that the PEO is operating a single-employer plan should be rejected. Rather, in defending the PEO against any such allegations by the DOL, the defense should, consistent with the DOL's assumption that PEOs likely constitute MEWAs, analyze any alleged prohibited transaction as though the PEO were a MEWA. Doing so increases the chances of successfully arguing that no prohibited transaction occurred, though many issues and pitfalls can remain.

If a PEO were deemed a MEWA, it would be a MEWA of the type that falls under the "any other arrangement" provision of the statutory definition.[6] ERISA defines a MEWA as:

> [a]n employee welfare benefit plan, or *any other arrangement* (other than an employee welfare benefit plan), which is established or maintained for the purpose of offering or providing [*inter alia* medical, dental, vision, or life benefits] to the employees of two or more employers (including one or more self-employed individuals), or to their beneficiaries. . . .

In this type of MEWA, the ERISA-covered plan is at the worksite employer level, not at the PEO level. Thus, irrespective of whether any document formally acknowledges the existence of an ERISA plan at the worksite employer level, the courts and the DOL will. See *Donovan v. Dillingham*, 688 F 2d 1367 (11th Cir 1982) (holding that subscribing employers to a MEWA created an ERISA-covered plan even though no written documents existed formalizing the arrangements).[7]

For example, the ERISA analysis in the preceding single-employer discussion assumes that the worksite employers were required to participate in the health coverage. What if rather than mandating coverage, the PEO makes the coverage available to worksite employers who in turn make the decision to purchase the coverage for the worksite employees. Does the presence of the worksite employer decisionmaker change the analysis? Maybe, it does. A DOL interpretive bulletin states that if a fiduciary provides services to a plan for a fee, but the decision to allow that fiduciary to receive a fee for those services was made by a second fiduciary independent from the fiduciary receiving the fee and providing the services, then there has been no fiduciary self-dealing as long as the first fiduciary did not use his power and authority as a fiduciary to cause the second fiduciary to approve his selection or the fee paid.[8]

Using this DOL regulatory example, it could be argued, in those cases in which the client is given the option but not required to participate in the health and welfare plan, that there has been no fiduciary self-dealing because a second fiduciary unrelated to the PEO plan "sponsor" decided for the worksite plan to participate in the arrange-

6 Multiple Employer Welfare Arrangement. For a full discussion of MEWAs and MEWA status see "PEO Plans – MEWAs or Not" ***NAPEO Legal Review,***™ available at ***www.napeo.org/members/juneo3legal_review.pdf.***

7 Every circuit court in the country has followed ***Dillingham.***

8 DOL Reg. 2550.408b-2(f), Example 7.

ment and approved the payment of the fees or commissions. This argument is strengthened when coupled with a characterization that the PEO, true to the DOL's presumption, is a MEWA, because every worksite employer, knowingly or unknowingly creates an individual plan and the worksite employers would serve as the second fiduciary deciding to purchase coverage for the plan.

These are uncharted waters, but an analysis using the MEWA structure is more consistent oftentimes with how a PEO plan operates than the single-employer construct. The argument that no prohibited transaction occurred would be further strengthened if there were full disclosure that the PEO or its subsidiary was receiving commissions for selling the insurance product.

Limited Service PEO and ASO Models

The main structural difference between a single-employer model and a MEWA or ASO model is that there is no single group health policy that covers the PEO and its clients. In the limited service PEO and ASO models, each client establishes a stand-alone plan and each is issued its own individual small employer group health policy. The relationship between the PEO and the plans established by the PEO's clients in the limited PEO and ASO models is therefore more distant.

There may be many ways of structuring an arrangement in which the PEO serves as a W-2 employer for some purposes, but not for purposes of benefit plans. For purposes of this *NAPEO Legal Review,*™ the structural assumption is that the PEO locates a willing carrier and markets the coverage, directly or indirectly through a subsidiary, to clients who establish their own plans outside any group health plan context and the clients receive certificates of coverage directly from the carriers. The PEO or its affiliate receives commissions for marketing the coverage. Because the analysis for an ASO arrangement does not differ from the limited services PEO arrangement, both will be addressed in this section.

To determine whether there is a prohibited transaction in these models, the first question is whether the PEO or its affiliate is a party in interest to the plan established by the client. If the PEO's or the affiliate's only involvement is the sale of insurance to one of its clients, then the question raised is, does the sale of an insurance product make the person selling insurance a party in interest to a plan?

If the *only* act performed is the sale of insurance, some might argue that the sale of insurance does not make the person a service provider. Very often, however, the sale of insurance may be combined with other types of consulting or active administration of the plan, and if other services are involved, then the person may be a service provider to the plan. For purposes of this publication, it is assumed that the sale of insurance may be construed as a service to a plan and that the person providing that service may be deemed a party in interest to the plan. Therefore, the discussion that follows assumes that the PEO may be deemed a party in interest to the plan, provided that a plan exists at the time of the transaction, and that the prohibited transaction rules apply to any transaction between the worksite employer plans and the PEO or a broker subsidiary.

The question posed in this construct is, would there then be a prohibited transaction between a PEO or its affiliate and a worksite employer plan if a client purchased health coverage from the carrier the PEO located and the PEO or its affiliate received commissions in the course of that transaction? For the reasons discussed below, not necessarily.

First, if a worksite employer had no pre-existing plan at the time of the purchase of the insurance, there would be an argument that when the initial transaction occurred — the sale of insurance — there was no ERISA plan and

therefore there could not have been a prohibited transaction. The plan would only have come into existence *after* the purchase of the coverage. *Seaway Food Town Inc. v. Medical Mutual of Ohio*, 347 F.3d 610, 617 (6th Cir. 2003) (no ERISA plan prior to purchase of the health coverage). Accordingly, prohibited transaction concerns, if any, could exist only if there were to be a second transaction between the worksite employer plan and the PEO broker, as for example at renewal.

Second, assuming the client had a pre-existing plan, it could be argued that no prohibited transaction occurred because at the time of the sale neither the PEO nor its affiliate had a relationship to the plan that gave rise to a party in interest relationship to the worksite employer plan. *Brock v. Gerace*, 7 Employee Benefits Cas. (BNA) 1713, 1715 (D.N.J. 1986).[9] In other words, at the time of the transaction, the PEO was a stranger to the plan. It was only after the initial transaction that the PEO developed a relationship to the plan and therefore subsequent transactions might raise prohibited transaction issues.

In both examples, the crux of the argument is that no prohibited transaction occurred because there was no party in interest relationship between the plan and the PEO or its affiliate at the point of purchase. As noted, in both examples, the PEO or its affiliate would likely be a party in interest at renewal and prohibited transaction issues would be of concern. Because the PEO or its affiliate, however, are not likely fiduciaries of the worksite employer plans, any prohibited transaction concerns would more likely than not involve questions of whether the commissions were reasonable and not whether the payment of commissions involved fiduciary self-dealing. Thus, assuming that commissions were reasonable and the transaction did not involve fiduciary self-dealing, the two statutory exemptions discussed earlier would likely be available to exempt an otherwise alleged prohibited transaction. (See footnote 5).

Any time a person is providing services to a plan, that person runs the risk of being deemed a fiduciary. Therefore, for added protection, especially if a PEO relationship with the worksite employer develops and the PEO or its affiliate provides advice to the worksite employer about healthcare insurance or the PEO provides administrative services to the worksite employer plan, the PEO or the affiliate should attempt to comply with PTE 84-24. Keep in mind that 84-24 is designed to provide an exemption from a prohibited transaction where the PEO may be deemed a fiduciary. The first line of defense in this model should always be that the service provider did not function in a fiduciary capacity when it provided information about the insurance product or performed any administrative services to the plan.

9 ***Brock v. Gerace,*** 7 Employee Benefits Cas. (BNA) 1713, 1715 (D.N.J. 1986). In ***Gerace,*** the court agreed with the Department of Labor's position that "the plan's initial agreement with a service provider creates the 'party in interest status'. . . ." Id. Consistent with ***Gerace,*** it is only after a plan enters into a first arrangement with a service provider that a party in interest relationship is formed. Thus, any initial transaction between a service provider and a plan cannot constitute a prohibited transaction within the meaning of ERISA because, at that moment, the service provider is an unrelated party to the plan. See Id.; ***Citizens Bank of Clovis,*** 841 F.2d at 346-47; see also ***Swanson v. Commissioner of Internal Revenue,*** 106 T.C. 76, 86-87 (1996) (no prohibited transaction occurred in sale of corporate stock to IRA because at the time of sale there was no party in interest relationship between the corporation and the IRA); DOL Adv. Opinion 2000-10 (7/27/2000) (no prohibited transaction where IRA invests in partnership that does not meet definition of disqualified person); and ***United Steelworkers 2116 v. Cyclops Corp.,*** 653 F. Supp. 574, 583-85 (S.D. Ohio 1987) (no prohibited transaction where negotiating party not a party in interest to the plan).

PTE 84-24 provides that, if certain numerous and detailed conditions and qualifications are followed to the letter, the following transactions will not be considered "prohibited transactions" under 29 U.S.C. § 1106(a and b):[10]

- The receipt, directly or indirectly, by an insurance agent or broker or a pension consultant of a sales commission from an insurance company in connection with the purchase, with plan assets, of an insurance or annuity contract;
- The receipt of sales commissions by a principal underwriter for a mutual fund in connection with the purchase with plan assets of securities issued by the mutual fund;
- The effecting by an insurance agent or broker, pension consultant, or investment company principal underwriter of a transaction for the purchase, with plan assets, of an insurance or annuity contract or securities issued by an investment company; and
- The purchase, with plan assets, of an insurance or annuity contract from an insurance company. . . . .

See PTE 84-24 § III(a) through (d). Thus, if the PEO could comply with all of the conditions for this exemption, its insurance affiliate could obtain insurance policies for the employer plans, and receive commissions without violating the prohibited transaction provisions of 29 U.S.C. § 1106(a) and (b).

The exemption provided by PTE 84-24 is only available if the PEO and its insurance affiliate were to comply with numerous conditions. We address those conditions one by one below and briefly discuss their significance:

- The transaction must be completed by the insurance agent or broker in "the ordinary course of its business as such a person." PTE 84-24 § IV(a);
- The transaction must be at least as favorable to the plan as an arm's-length transaction with an unrelated party. PTE 84-24 § IV(b);
- The combined total of all fees, commissions, and consideration received by the PEO and its insurance affiliate, for providing services to the plans and in connection with the provision of insurance contracts, cannot be in excess of "reasonable compensation." PTE 84-24 § IV(c); also PTE 84-24 § VI(b) and (c) (term "insurance agent or broker" includes "affiliates");
- Neither the PEO nor its insurance affiliate can serve in any of the following capacities with respect to the plans for whom the insurance affiliate is obtaining insurance policies:
  —Trustee (except for certain "non-discretionary" trustee functions) or plan administrator;
  —Fiduciary with the authority to manage, acquire, or dispose of the assets of the plan on a discretionary basis; or
  —Employer whose employees are covered by the plan. PTE 84-24 § V(a).
- With respect to each insurance policy, the PEO's insurance affiliate would have to provide detailed disclosures in advance to a so-called "independent fiduciary" (someone not connected with the PEO or its affiliates, and someone not receiving any direct or indirect financial benefit from the transaction). These disclosures would have to include:

10 It is important to note that whether a transaction is proper under ERISA is not just a question of whether it violates the "prohibited transaction" provisions. For example, and without limitation, even if a transaction does not violate the "prohibited transaction" provisions of ERISA, it must still comply with the general fiduciary requirements of ERISA, including, but not limited to, being in the best interests of the plan and its beneficiaries, and being consistent with the terms of the plan.

—The agent's relationship with the insurance company;
—The commission to be paid to the agent; and
—All charges for holding, exchanging, terminating, or selling the insurance policy.

- The "independent fiduciary" would have to acknowledge, in writing, receipt of the disclosure and approve the transaction before the transaction was consummated. PTE 84-24 § V(b). Further, the detailed disclosure would have to be repeated every three years, if renewals of the same policies on substantially the same terms were involved, or every time a new policy was obtained, if the new policy was materially different from the prior contract. PTE 84-24 § V(d); and
- The PEO's insurance affiliate would have to maintain detailed records regarding the disclosures above, and the independent fiduciary's response, for a period of six years from the date of the transaction. PTE 84-24 § V(e).

PTE 84-24 is very technical and will be useful only if all its technical requirements are faithfully followed. The basic point is that a class exemption is available and may be useful in certain settings. To the extent that it can provide a defense from an allegation that a prohibited transaction occurred, its utility should be explored and it should be used if the circumstances seem right. Consult your counsel on this potentially useful safe harbor.

State Insurance Law Concerns

Commission Sharing

Most states have statutes that prohibit licensed insurers or agents from paying "directly or indirectly" any commission or other valuable consideration to any person for services as an agent unless that person is properly licensed as an agent. Exceptions frequently allow payment to, or sharing of, commissions with "an incorporated insurance agency" in which all employees, stockholders, directors, or officers who solicit, negotiate, or effectuate insurance contracts are qualified insurance agents holding currently valid licenses and appointments.

An insurer that pays commissions to a PEO may be violating commission-sharing statutes unless appropriate PEO personnel are licensed as insurance agents. In some states, a PEO may legally share in commissions *under state law* if it creates an insurance agency subsidiary that employs licensed agents.[11] For example, in Florida, three statutes authorize licensed agents to share commissions with incorporated insurance agencies. These are sections 626.753, relating to general lines agents; section 626.794, relating to life agents; and section 626.838, relating to health agents. All statutes are similarly worded.

Few annotations address these commission-sharing statutes, though several old Florida attorney general opinions construe the predecessor of section 626.794 and probably should be considered applicable to all three commission-sharing statutes. The most relevant is 064-48 (March 30, 1964), which makes clear that all stockholders of an incorporated insurance agency do not have to be licensed for the agency to share in commissions. Rather, only those persons *actively engaged in the life insurance business* who are either employees, stockholders, directors, or officers of the corporation are required to hold a currently valid license. This opinion also makes clear that stockholders of the agency are entitled to a share of the corporate profits in the form of dividends, *even if those stockholders are not*

11 States historically have regulated insurance agencies differently, though regulation is becoming more uniform. In most states, agencies must be licensed.

engaged in the solicitation or effectuation of life insurance contracts (and, therefore, not licensed agents). Thus, creation of a subsidiary insurance agency that employs licensed agents is an appropriate way for a PEO to share in commissions in Florida, assuming compliance with all other relevant laws.

However, as discussed earlier in this article, a PEO considering creating an insurance agency must also be concerned with federal law issues. Because these federal statutes contain provisions barring an employer or a fiduciary from profiting from employee benefits, PEOs should contact counsel qualified to provide advice on these federal issues before undertaking the creation of an agency when the goal is for the PEO to share in commissions. Moreover, insurance regulations can vary significantly from state to state. Thus, before establishing an insurance agency for purposes of facilitating commission sharing, a PEO should also consider the laws of the states where it is doing business.

Controlled Business

A potentially sticky state law problem that arises when a PEO creates an insurance agency concerns controlled business statutes. Most state insurance codes include prohibitions against "controlled business." Florida law includes provisions about the purpose of licensing general lines, life, and health agents at sections 626.730, 626.784, and 626.830, respectively. Each statute contains almost identical language. For purposes of illustration, section 626.830(1) provides in relevant part:

> The purpose of a license issued under this code to a health agent is to authorize and enable the licensee actively and in good faith to engage in the insurance business as such an agent with respect to the general public and to facilitate the public supervision of such activities in the public interest, and not for the purpose of enabling the licensee to receive an unlawful rebate of premium in the form of commission or other compensation as an agent or enabling the licensee to receive commissions or other compensation based upon insurance solicited or procured by or through the licensee upon his or her own interests or upon those of other persons with whom he or she is closely associated in capacities other than as an insurance agent.

Subsection (2) provides that the Department of Financial Services shall not "grant, renew, continue, or permit to exist any license or appointment as a health agent . . . if it finds that the license . . . has been or is being . . . used by . . . licensee, . . . *not for the purpose of holding himself or herself out to the general public as a health agent, but principally for the purpose of soliciting, negotiating, handling, or procuring "controlled business."* (Emphasis supplied).

The phrase "controlled business" is defined as:

> Health insurance covering [the agent] or family members; the officer, directors, stockholders, partners, *employees*, or debtors of a partnership, association, or corporation of which he or she or a family member is an officer, director, stockholder, partner or employee; or members of an association of which he or she is a director, officer, or employee. (Emphasis supplied).

Subsection (3) provides that a violation shall be deemed to exist if in any one year an agent's commission from "controlled business" is 50 percent or more of the agent's total commission from all insurance business.

Thus, insurance written by a PEO's employee-agents could constitute "controlled business" because it is written to cover client company employees, who also are employees of the PEO. This problem would only arise in the true PEO context when the PEO is serving as the employer of the client company's employees. Significantly, the controlled business statutes apply only to *agents*, not corporate agencies. It does not appear that payment of commissions to the agency from insurance policies issued to the PEO would violate the controlled business statutes. Therefore, the controlled business statutes would appear to prevent the agents employed by the agency from being paid by commission if more than 50 percent of their business was written to cover client company employees, but the agency itself could receive the commissions and pay the agents a straightforward salary. However, this interpretation of the controlled business statutes is not clear from the face of the statutes, and it is difficult to predict how regulators may interpret controlled business statutes in the context of a PEO.

Conclusion

Receiving commissions for the sale of insurance is a complicated issue under either state or federal law. Under state law, the sale of insurance is a highly regulated industry requiring that persons selling insurance and receiving commissions be licensed. State law also restricts commission-sharing arrangements under certain circumstances. ERISA outright prohibits transactions between a party in interest and a plan. Persons engaging in business with an ERISA-governed plan need to be well versed on ERISA's prohibited transaction rules and exemptions to those rules. So, even though the PEO or its affiliate may be in compliance with state laws, there are very important, complicated, and confusing ERISA issues that may nonetheless create problems for PEOs receiving commissions for the sale of insurance products. Given the complexities of these regulations and the potential penalties, PEOs are well advised to seek counsel knowledgeable in both state and federal law before receiving commissions for selling insurance products.

Appendix A

Statutory exemptions to ERISA provisions that would bar commissions in a single-employer context:

(i) ERISA § 408(b)(2).

ERISA § 408(b)(2) exempts a transaction otherwise prohibited by § 406(a)(1)(C), if: the services are necessary for the administration of the plan; the services are provided pursuant to a reasonable arrangement; and the party in interest receives reasonable compensation. ERISA does not define reasonable compensation. In this context reasonable compensation would mean the customary fees paid to broker/dealers for selling insurance. Even assuming the criteria of § 408(b)(2) are satisfied and available to exempt a transaction otherwise prohibited under the provision forbidding consultants and other service providers from transacting business with a plan,[12] the department takes the position that § 408(b)(2) is unavailable to exempt an alleged violation of ERISA § 406(b).[13] It is impossible to square the department's interpretation with the statutory language of § 408(b)(2), which unambiguously and without limitation states that the "prohibitions provided in Section 406 shall not apply" to the transactions described in § 408(b), including 408(b)(2). Nothing in the statutory language limits the availability of Section 408(b)(2) to Section 406(a) transactions. There are a few, mostly lower, court decisions, however, that have accepted the department's interpretation of ERISA § 408(b)(2). Each of those cases, however, involved gross wrongdoing by the plan fiduciaries. See, *Lowen v. Tower Mgmt., Inc.*, 829 F.2d 1209 (2d Cir. 1987) 829 F.2d 1209 (2nd Cir. 1987); *Donovan v. Daugherty*, 550 F. Supp. 390, 404 n.3 (S.D. Ala. 1982); *Gillian v. Edwards*, 492 F. Supp. 1255, 1262-62 (D.N.J. 1980); and *Marshall v. Kelly*, 465 F. Supp. 341, 353-54 (W.D. Okla. 1978); but see *Marshall v. Carroll*, 2 EBC 2491 (N.D. Cal. 1980) (making no distinction between 406(a) and (b) for purposes of the 408(b)(2) exemption.).

No court opinions have surfaced in which the court has reviewed the department's interpretation in a case in which the facts involve an inadvertent transaction that did not result in a loss to the plan, profit a fiduciary, or unjustly enrich a non-fiduciary party in interest. Nonetheless, the department has, to date, not budged from its position irrespective of the harm or benefit to the plan.

(ii) ERISA § 408(c)(2).

ERISA section 408(c)(2) is the second statutory exemption that, under certain circumstances, allows a fiduciary to be paid for rendering services to a plan. Shortly after ERISA was enacted, the DOL issued a regulation stating that ERISA § 408(c)(2) does not provide a separate exemption for transactions involving fiduciary self-dealing. Instead, the regulation states that § 408(c)(2) merely clarifies when compensation paid to a fiduciary is reasonable. Like the DOL's regulation under ERISA § 408(b)(2), it is difficult to square the DOL's interpretation with the statutory language and one court now has finally agreed.

In 2002, the Eighth Circuit in *Harley v. Minnesota, Mining and Manufacturering Company*, 284 F.3d 901 (8th Cir. 2002), rejected the department's interpretation of ERISA section 408(c)(2) and held that the plain language of

12 See ERISA § 406(a)(1)(C).
13 See 29 C.F.R. 2550.408b-2(a).

the statute supports the conclusion that section 408(c)(2) is a separate exemption available to insulate a fiduciary from liability when the fiduciary's compensation is reasonable. *Harley*, 284 F.3d at 909.

Nonetheless, 408(c)(2) would likely not apply in a truly single-employer context if the commissions were paid directly to an individual also paid by an employee by the employer-sponsor. The statutory exemption specifically provides:

> (2) ...; except that no person so serving who already receives full time pay from an employer . . . shall receive compensation from such plan. . . . .

Whether the provision might be available to protect a subsidiary of the PEO not receiving full time pay from the PEO from an allegation of self-dealing has not been tested. But see *Lowen v. Tower Mgmt., Inc.*, 829 F.2d 1209 (2d Cir. 1987) 829 F.2d 1209 (2nd Cir. 1987) (suggesting without deciding that § 408(:)(2) does not appear to address commissions paid to a subsidiary of a fiduciary).

About the Authors

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Prior to entering private practice, Ferrera was a staff attorney in the U.S. Department of Labor in the division that specializes in ERISA litigation. While at the DOL, she litigated numerous cases raising issues of first impression, and led the DOL's efforts in several cases involving fraudulent multiple employer welfare arrangements (MEWAs). She also litigated cases involving financial institutions, investment advisers, and ESOPs.

Ferrera is the main author of the Fifth Edition of Panel Publishers' "Fiduciary Answer Book," as well as several earlier editions of the book and annual supplements. She is a senior editor for the *Journal of Pension Benefits*, and she is a frequent speaker on numerous topics addressing ERISA and Department of Labor issues. Ferrera was recognized as a leading attorney in the field of employee benefits in the District of Columbia in 2006, 2005, and 2004 by Chambers and Partners, USA.

Tighe Patton Armstrong Teasdale's is a Washington, D.C., law firm of experienced lawyers who engage in a diverse local, national, and international practice. The firm prides itself in providing high quality, result-oriented, practical and cost-effective service to clients with needs in a broad range of areas, including, ERISA, white-collar crime, antitrust, employment law, commercial counseling and transaction, government relations, and government contracts.

Radey Thomas Yon & Clark, P.A. shareholder **Donna E. Blanton** practices in the areas of Florida administrative law and appellate advocacy, with an emphasis on cases involving energy, telecommunications and public utility law; insurance regulation; public procurement; and election law.

A former law clerk to the chief justice of the Florida Supreme Court, Blanton has been involved in appeals on behalf of a number corporate clients, including BellSouth Telecommunications, Inc., Health Options, Inc. (a subsidiary of Blue Cross Blue Shield of Florida), General Electric Company, Bristol-Myers Squibb Co., American Bankers Insurance Co., Service Insurance Co., United Wisconsin Insurance Co., and Flo-Sun, Inc. She has prepared amicus briefs on behalf of a number of clients, including Florida Power & Light Company, the Florida Homebuilders Association, the Florida Association of Realtors, and the Florida Trucking Association.

Several of Blanton's appeals have involved controversial amendments to the Florida Constitution. See, e.g., *Florida Ass'n of Realtors, Inc. v. Smith*, 825 So. 2d 532 (Fla. 1 st DCA 2002) (striking a proposed constitutional amendment that would have revamped Florida's tax structure); Advisory Opinion to the Governor — 1996 Amendment 5 (Everglades), 706 So. 2d 278 (Fla. 1997) (construing the "polluter pays" constitutional amendment). Others involved constitutional issues relating to state taxation (*Fuchs v. Robbins*, 818 So. 2d 460 (Fla. 2002)), to the state's ability to enjoin political advertisements on behalf of candidates for statewide office (*Republican Party of Florida v. The Florida Elections Commission*, 658 So. 2d 653 (Fla. 1 st DCA 1995)), and to the creation of Florida's hurricane catastrophe fund (*American Bankers Insurance Co. v. Chiles*, 675 So. 2d 922 (Fla. 1996)).

Much of Blanton's appellate experience has been in high profile cases, including the 2000 Florida presidential election controversy on behalf of then-Secretary of State Katherine Harris. She participated extensively in all of the major state court cases involving the 2000 presidential election, including *Palm Beach Canvassing Bd. v. Harris*,

772 So. 2d 1220 (Fla. 2000); *Fladell v. Palm Beach County Canvassing Bd.*, 772 So. 2d 1240 (Fla. 2000); *Gore v. Harris*, 2000 WL 1770257 (Fla. 2d Jud. Cir. Ct., December 4, 2000); *Palm Beach Canvassing Bd. v. Harris II*, 772 So. 2d 1273 (Fla. 2000); *Jacobs v. Seminole County Canvassing Bd.*, 773 So. 2d 519 (Fla. 2000); and *Taylor v. Martin County Canvassing Bd.*, 773 So. 2d 517 (Fla. 2000).

Blanton has written a number of scholarly articles about Florida administrative procedure, several of which have been cited by Florida appellate courts. See, e.g., *Florida Dep't of Business & Prof. Reg. v. Investment Co. of Palm Beach*, 747 So. 2d 374, 383 n.7 (Fla. 1999); *State Bd. of Trustees of the Internal Improvement Trust Fund v. Day Cruise Ass'n*, 794 So. 2d 696, 700 n.4 (Fla. 1 st DCA 2001); *Department of Corrections v. Saulter*, 742 So. 2d 368, 370 (Fla. 1 st DCA 1999). In 1995-96, Blanton served as executive director of the Governor's Administrative Procedure Act Review Commission, which recommended a rewrite of the Florida APA that was adopted by the legislature in 1996.

Blanton graduated with high honors from the Florida State University College of Law in 1992, where she was editor-in-chief of the law review. She earned her undergraduate degree in journalism, with honors, from the University of Florida in 1977. Blanton was recently named by *Florida Trend Magazine* as one of the 2005 Florida Legal Elite, which represents the top 2 percent of lawyers practicing in Florida.