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Definition of Compensation: Interesting Angles on DOL’s Fiduciary Rule #27

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This is my twenty-seventh article about interesting observations concerning the fiduciary rule and exemptions.

As the readers of these articles know, one impact of the new fiduciary rule is that compensation paid to Financial Institutions and advisers must be reasonable. Reasonable, in turn, is a function of a transparent and competitive marketplace. However, where the competitive market does not work (for example, where compensation is not transparent), customary compensation may not be reasonable.

But, this article is not about reasonable compensation. Instead, the question is, what is “compensation?”

The Department of Labor partially answered that question in the fiduciary regulation:

> “The term ‘fee or other compensation, direct or indirect’ means . . . any explicit fee or compensation for the advice received by the person (or by an affiliate) from any source, and any other fee or compensation received from any source in connection with or as a result of the purchase or sale of a security or the provision of investment advice services, including, though not limited to, commissions, loads, finder’s fees, revenue sharing payments, shareholder servicing fees, marketing or distribution fees, underwriting compensation, payments to brokerage firms in return for shelf space, recruitment compensation paid in connection with transfers of accounts to a registered representative’s new broker-dealer firm, gifts and gratuities, and expense reimbursements.
>
> A fee or compensation is paid ‘in connection with or as a result of’ such transaction or service if the fee or compensation would not have been paid but for the transaction or service or if eligibility for or the amount of the fee or compensation is based in whole or in part on the transaction or service.”

Without getting into the details of that definition, suffice it to say that, if an adviser makes a recommendation and receives money (or credits toward compensation, *e.g.*, a bonus or a grid), that would be considered to be compensation. This concept is referred to as the “but for” test. That is, “but for” the recommendation, would the adviser have received the compensation or have been entitled to greater compensation? The “but for” method is a long-standing approach used by the Department of Labor in evaluating whether a payment is compensatory.

But, what if the payment is not monetary? What if it is non-cash, for example, gifts or trips or conference sponsorships or services? In addition to the quoted language above, the question was clearly answered in the 408(b)(2) regulation. That regulation defined compensation as:

> “Compensation is anything of monetary value (for example, money, gifts, awards, and trips), . . .”

In addition, the Best Interest Contract Exemption defines third party payments as including “fees for seminars and educational programs; and any other compensation, consideration or financial benefit.”

In other words, the definition of “compensation” is not limited to cash or similar payments. Instead, it includes any item of monetary value that directly or indirectly, partially or entirely, results from recommendations of investments or insurance or that is payment for advice.

The views expressed in this article are the views of Fred Reish, and do not necessarily reflect the views of Drinker Biddle & Reath.

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