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DOL Issues New Proposed Regulations on Participant Investment Advice

The Department of Labor has again issued proposed regulations on provisions under the Pension Protection Act of 2006 (PPA) designed to facilitate offering investment advice to participants in individual account plans, such as 401(k) plans.

Background

Participant-directed individual account plans are commonplace today, but many participants do not have the investment background needed to successfully direct their investments. Recognizing this, Congress amended ERISA and the Internal Revenue Code in the Pension Protection Act of 2006 to provide a prohibited transaction exemption (PTE) allowing fiduciary advisors to give participants investment recommendations under “eligible investment advice arrangements.” Under these arrangements, fiduciary advisors could provide investment advice on a level-fee basis or through the use of certain computer models. In addition, the fiduciary adviser would have to provide various disclosures to participants and engage an independent auditor to perform annual compliance audits of the investment advice arrangements.

In August 2008, the Department of Labor (DOL) issued proposed regulations and a proposed class exemption on the PPA investment advice provisions. (See our October 1, 2008 [For Your Information](#).) On January 21, 2009, The DOL published [final regulations](#), which included a class exemption allowing certain individualized investment advice after recommendations were provided through a computer modeling arrangement, and permitting certain investment recommendations that could result in different fees to the advisor’s employer or its affiliates. These regulations were first put on hold by the Obama administration, and were later [withdrawn](#).

The DOL has now issued [proposed regulations](#), which are largely similar to the January 2009 regulations. However, significantly, they no longer include the class exemption.

Proposed Investment Advice Regulations

In the preamble, the DOL notes that it is providing minimal explanation of the new proposed regulations because the explanations provided in the 2009 final regulations are still generally applicable. Further, the regulations state that previously issued guidance relating to acceptable investment advice arrangements remains in effect. (See our February 13, 2007 [For Your Information](#).) The regulations specify that they do not require a plan sponsor to offer investment advice, but provide guidance on arrangements that qualify for the PPA statutory PTE.

Eligible Investment Advice Arrangements

Under PPA, an eligible investment advice arrangement is one that uses fee leveling or a computer model. The regulations outline rules that apply separately to each type of arrangement and those that apply to both.

Fee-Leveling Arrangement

The regulations provide that under a fee-leveling arrangement –

- Investment advice must be “based on generally accepted investment theories that take into account the historic risks and returns of different asset classes over defined periods of time.”
- Investment management fees and expenses for the advice must be taken into account.
- Individual participant information must be taken into account.
- The fiduciary adviser may not receive any direct or indirect fee or compensation based in whole or in part on the selection of an investment option, including from an affiliate of the adviser.

BUCK COMMENT. *The January 2009 class exemption would have allowed an adviser to receive compensation that varied based on the investment option selected as long as the compensation received by the individual directly providing the advice did not change because of the option recommended. It should also be noted that the DOL has asked for comments about whether it should provide regulations on what constitute generally accepted investment theories.*

Participant Information. The regulations specify that individual participant information includes information relating to age, time horizons (e.g., life expectancy, retirement age), risk tolerance, other assets or sources of income, investment preferences, and current investments. The regulations clarify that a fiduciary adviser has the obligation to request participant information. However, the fiduciary adviser is only required to take these factors into account if the plan, participant or beneficiary actually provides the information.

Computer Model Arrangement

The regulations specify that under a computer model arrangement –

- Investment advice must be based on generally accepted investment theories (as under the fee-leveling arrangement).
- Investment management fees and expenses for the advice must be taken into account.
- Individual participant information must be requested from a participant or beneficiary and, if furnished, taken into account (as discussed above).
- Appropriate objective criteria must be utilized to provide asset allocations.

- The model must be operated in a way that does not inappropriately favor investment options offered by or that generate more income for the fiduciary adviser or its affiliates, or that inappropriately distinguishes among investment options based on “a factor that cannot confidently be expected to persist in the future.”
- All investment options must be taken into account without giving weight to any one.

BUCK COMMENT. *It is unclear what is meant by “a factor that cannot confidently be expected to persist in the future.” It is likely that this will be a subject of further discussion and many comments.*

Investment Options. The proposed regulations allow a computer model arrangement to exclude recommendations with respect to certain investment options, such as account brokerage windows, self-directed accounts or other similar arrangements offered under the plan. The arrangement does not have to make recommendations regarding investment in employer stock, target date funds or annuity options. These latter two exclusions are conditioned on the participant having been provided information describing the options and how they operate at the time the investment advice generated by the computer model was given.

Certification of Computer Model. Before using a computer model, an “eligible investment expert” must certify that the model meets the requirements under ERISA and the regulations. The regulations define eligible investment expert as an individual who does not have a material affiliation or contractual relationship with the fiduciary adviser and “has the appropriate technical training or experience and proficiency to analyze, determine and certify” whether the model meets the requirements of the regulations. As under previous regulations, no specific academic or other credentials that would qualify an individual as an expert are provided.

BUCK COMMENT. *The determination that the eligible investment expert is qualified to certify the model is a fiduciary act. Therefore, the fiduciary adviser must prudently select the expert and take all relevant information, experience and qualifications into account.*

The regulations specify that the certification must be in writing, and signed by the eligible investment expert. Further it must –

- identify the methodology or methodologies applied in determining whether the computer model meets all applicable requirements
- explain how the methodology or methodologies show that the model meets the requirements
- describe any limitations that were imposed by any person on the eligible investment expert’s selection or application of methodologies for determining whether the model meets the requirements
- represent that the methodology or methodologies were applied by a person or persons with the educational background, technical training or experience necessary to analyze and determine whether the computer model meets the requirements.

Other Requirements for Investment Advice Arrangements

Both types of investment advice arrangements must meet the following requirements.

Authorization by Plan Fiduciary. A plan fiduciary must expressly authorize the investment advice arrangement. However, this fiduciary cannot be the investment adviser or provide the designated investment options under the plan, or be an affiliate of either.

***BUCK COMMENT.** Although the majority of the rules in PPA and the proposed regulations apply to fiduciary advisers, it is the plan fiduciary's responsibility to select and monitor the fiduciary adviser. The DOL noted previously that unless there is contrary information, a plan fiduciary may rely on the fiduciary adviser's representation that the computer model meets the legal and statutory requirements.*

The regulations allow an investment adviser to provide investment advice to its own employees (or employees of an affiliate) if the fiduciary adviser provides the same arrangement to participants in unaffiliated plans.

Annual Audits. An independent auditor must annually determine whether the investment advice arrangement meets the statutory requirements and provide a copy of the report to the fiduciary adviser and the plan fiduciaries that authorized the arrangement. The regulations require the independent auditor to have the "appropriate technical training or experience and proficiency" to act as an auditor, and to represent this in writing. Again, the regulations do not specify the credentials or education necessary to act as an auditor. However, they do describe what is meant by independent, i.e., no material affiliation or material contractual relationship with the person offering the investment advice arrangement or any designated investment option under the plan.

As to the scope of the audit, the regulations do not require the auditor to review each provision of investment advice, but instead the auditor may review "sufficient relevant information to formulate an opinion" as to whether the investment advice arrangement is in compliance.

***BUCK COMMENT.** Again, the regulations specify that the selection of an auditor is a fiduciary act, and it is the fiduciary adviser's responsibility to select the auditor.*

Disclosure Requirements. The fiduciary adviser must provide various disclosures to participants both before and while providing investment advice. Before providing investment advice, the fiduciary adviser must provide the participant a written notice describing, among other things, the role of any affiliated party or party with a material affiliation or contractual relationship with the fiduciary adviser, the past performance and historical rates of returns of the designated investment options, all fees and compensation relating to the investment advice, and the services to be provided. The regulations also require the notice to include any fees the fiduciary adviser might receive in connection with the acquisition of any security or any rollover or other distributions under the plan because of the investment advice.

The regulations include a model notice that the fiduciary adviser may use. While not mandatory, use of the model notice will satisfy the requirements. The regulations indicate that the notice can be provided electronically.

Record Maintenance. The fiduciary adviser must maintain for at least six years all records relating to the provision of investment advice that are necessary to show compliance with the regulations.

Effective Date

The regulations will be effective 60 days after they are published in final form. In the meantime, all previously issued guidance remains in effect.

Conclusion

For the most part, the regulations apply to fiduciary advisers providing investment advice to participants in individual account plans, although some provisions apply to the plan sponsors that engage them. Importantly, because the selection of a fiduciary adviser is a fiduciary act, plan fiduciaries should be familiar with these regulations. Even though the selection of auditors and eligible investment experts are fiduciary acts of the investment adviser, plan sponsors should be aware of the requirements for these selections as well.

Buck's consultants would be pleased to discuss these latest regulations with you.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.