



DOL Releases Proposed Regulations on Participant Investment Advice

The Department of Labor recently issued guidance on provisions under the Pension Protection Act of 2006 relating to certain types of investment advice to participants in certain individual account plans, such as 401(k) plans. The guidance is in the form of proposed regulations and a proposed class exemption.

Background

Participant-directed individual account plans are commonplace today, but many participants do not have the skills or education necessary to successfully direct their investments. Under ERISA, those who provide investment advice for a fee to participants are fiduciaries, and the receipt of additional fees for such advice results in a prohibited transaction. Thus, many plan sponsors and fiduciaries have been reluctant to offer investment advice.

In 2006, the Pension Protection Act (PPA) amended ERISA and the Internal Revenue Code to provide a prohibited transaction exemption (PTE) for investment advice provided under an “eligible investment advice arrangement.” Under such an arrangement, a fiduciary adviser may provide advice for which its fees do not vary based on the investment option the participant elects or may provide advice to participants through a computer model that has been certified and audited by an independent investment expert. The fiduciary adviser must also meet other requirements such as providing participant disclosures and performing annual audits.

In August, the Department of Labor (DOL) issued [proposed regulations](#) and a [proposed class exemption](#) on the PPA investment advice provisions. The regulations are proposed to be effective 60 days after published in final form and the class exemption would be effective 90 days after published in final form. The DOL notes in the preamble that previous guidance relating to acceptable investment advice arrangements remains in effect. (See also our February 13, 2007 [For Your Information](#).)

Proposed Investment Advice Regulations

The proposed regulations closely follow PPA. However, some provisions expand upon the statute while others are left more open to allow greater flexibility.

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. Further, both PPA and the proposed regulations require that a plan fiduciary other than the fiduciary adviser expressly authorize the investment advice arrangement.*

Fiduciary Adviser

Under PPA and the proposed regulations, a fiduciary adviser is a fiduciary to the plan by reason of providing investment advice to participants or beneficiaries, and must be a registered investment adviser, a bank or similar financial institution, an insurance company, a broker dealer, an affiliate of any of the entities listed, or an employee, agent or registered representative of those entities.

In addition, any individual who develops a computer model or markets the model or the investment advice program is defined as a fiduciary adviser. In a separate section of the proposed regulations, requirements are specified for the developer or marketer of the computer model to elect to be the sole fiduciary adviser by reason of developing or marketing the investment arrangement used.

Eligible Investment Advice Arrangement

An investment arrangement eligible for the PTE is either a level-fee arrangement or a qualified computer modeling arrangement.

Level-fee Arrangement

Under a level-fee arrangement, any fees or compensation that the fiduciary adviser (or employee, agent or registered representative) receives may not vary depending on the investment option the participant selects. Further, under the proposed regulations, the advice must –

- be based on generally accepted investment theories, at least taking into account historic returns of plan investments
- take into account participant-provided information, such as age, life expectancy, retirement age, risk tolerance, other assets or sources of income and investment preferences.

Computer Model Arrangement

As under a level-fee arrangement, the computer model must be based on generally accepted investment theories and take individual participant-provided information into account. Further, the model must use objective criteria to provide asset allocation portfolios, avoid certain inappropriate investment options that could benefit the fiduciary adviser or a person with a material affiliation, and take into account all designated investment options under the plan other than any qualifying employer securities investment options, brokerage windows, self-directed brokerage accounts or other similar arrangements.

Certification of Computer Model. The proposed regulations provide guidance on the requirement that an expert certify the computer model meets the statutory and regulatory requirements. An “eligible investment expert” is defined as an individual who has the appropriate technical training or experience and proficiency to analyze,

determine and certify whether the model meets the requirements but who does not have a material affiliation with the fiduciary adviser.

BUCK COMMENT. *The proposed regulations do not list any specific academic or other credentials that would qualify an individual as an expert. However, it is the fiduciary adviser's fiduciary obligation to determine whether the individual is an expert.*

The proposed regulations do not include rigorous substantive standards for the certification process, but instead provide procedures that must be met. Under the proposed regulations, the certification must be in writing, signed by the investment expert, and must –

- identify and explain the methodologies the expert used in determining that the model met the regulatory requirements for computer models
- describe any limitations placed on the expert in determining whether the model met the regulatory requirements
- represent that the expert has the education, technical training or experience necessary to make the certification
- state that the expert has determined that the model satisfies the regulations.

The regulations specify that if the model is changed in a way that might impact whether it meets the requirements, a new certification must be obtained.

Other Requirements for Investment Advice Arrangements

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

Authorization by Plan Fiduciary. As noted above, a plan fiduciary other than the fiduciary adviser must authorize the investment advice arrangement.

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 that authorized the arrangement. The proposed regulations state that the independent auditor must have, and represent in writing that he or she has, the “appropriate technical training or experience and proficiency” to act as an auditor, but do not specify what credentials or education is necessary. The proposed regulations require that the report must be provided to the fiduciary within 60 days of the audit's completion. As to the scope of the audit, the proposed regulations require that the auditor review sufficient relevant information, and need not audit each provision of investment advice. Instead, the auditor may determine and rely on a representative sample.

Disclosure Requirements. The fiduciary adviser must provide various disclosures to participants both before and while providing investment advice, such as any fees or compensation for the advice, the types of services

provided and the investment options' past performance. The proposed regulations do not significantly expand on the statutory disclosures. However, the DOL indicates that any required disclosures could be provided electronically as long as they meet current DOL requirements. With respect to computer modeling, the proposed regulations require that the fiduciary adviser disclose any limitations on the ability of the model to take into account an investment option primarily invested in qualifying employer securities.

The appendix to the proposed regulations contains a model form for disclosing fees and compensation. Although there is no requirement to use the model form, if it is used, the fiduciary adviser will satisfy the statutory fee and compensation disclosure requirement and the requirement that the disclosure be written in a manner that is understandable to the average participant.

Record Maintenance. The fiduciary adviser must maintain records for at least six years after the investment advice is provided.

Proposed Class Exemption

Concurrent with the issuance of the proposed regulations, the DOL issued a proposed class exemption, which expands the PTE to allow individual advice to participants after computer modeling advice is given (which may vary from that advice). The computer model may either meet the statutory and regulatory exemption (including certification by an independent expert) or only meet the design requirements of the statute and regulations (without the certification) if it is designed by a person independent of the fiduciary adviser. Furthermore, the proposed class exemption would allow advice that might generate greater income for the fiduciary adviser or affiliates than would other recommendations in the same asset class if the fiduciary adviser prudently determines that the advice is in the participant's best interest and documents this determination. Finally, under a level-fee arrangement, the proposed exemption would apply only to fees received by an employee, agent or registered representative of the fiduciary adviser and not to the fiduciary adviser as an entity.

Conclusion

This guidance is useful for those fiduciary advisers wishing to provide investment advice to individual account plan participants and for those plan fiduciaries who wish to engage them. Importantly, however, plan sponsors must remember that selecting and monitoring a fiduciary adviser is a fiduciary act.

Buck's consultants would be pleased to discuss the proposed regulations with you and answer any questions you may have regarding selecting and monitoring a fiduciary adviser.

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.