



DOL Issues Final Regulations on Participant Investment Advice

The Department of Labor issued final regulations regarding provisions under the Pension Protection Act of 2006 relating to investment advice to participants in individual account plans, such as 401(k) plans. The regulations apply to transactions occurring on or after December 27, 2011.

Background

Participant-directed individual account plans are commonplace today, but many participants do not have the investment background needed to successfully direct their investments. Individuals who provide investment advice for a fee with respect to plan assets are fiduciaries. It is a prohibited transaction for these fiduciaries to receive additional compensation from plan assets for the advice that they provide.

In the Pension Protection Act of 2006 (PPA), Congress amended the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (Code) to provide a prohibited transaction exemption to allow fiduciaries to be compensated for investment advice provided under “eligible investment advice arrangements.” Under such an arrangement, a fiduciary adviser may provide investment advice either through a fee-leveling arrangement (an arrangement where the fees the fiduciary adviser receives do not vary based on the investments the participant elects) or through a computer model. PPA also requires the fiduciary adviser to provide various disclosures to participants and select an auditor to perform annual audits of the eligible investment advice arrangement.

In August 2008, the Department of Labor (DOL) issued proposed regulations relating to the PPA investment advice provisions. (See our October 1, 2008 [For Your Information](#).) On January 21, 2009, the DOL published the final regulations and a class exemption from the prohibited transaction provisions. However, in November 2009, the DOL withdrew the final regulations (See our November 18, 2009 [For Your Information](#)) and, in March 2010, published new proposed regulations implementing the statutory prohibited transaction exemption. (See our April 1, 2010 [For Your Information](#).)

Final Regulations

In October 2011, the DOL published the [final investment advice regulations](#) (final regulations). The final regulations are effective on December 27, 2011 and apply to transactions occurring on or after that date.

Scope of the Final Regulations

The final regulations make clear that the requirements and conditions in the regulations apply only to the PPA statutory exemption. The final regulations provide that neither the PPA statutory exemption nor the final regulations require a plan fiduciary or any other party to offer, provide, or make available investment advice to a participant or beneficiary.

BUCK COMMENT. *The DOL, in the preamble to the final regulations and in a related [Fact Sheet](#), states that the final regulations do not affect prior DOL guidance relating to participant investment advice and education.*

Eligible Investment Advice Arrangements and Related Requirements

The PPA statutory exemption allows an exemption from ERISA's prohibited transaction provisions with respect to investment advice given to a participant or beneficiary if the investment advice is provided by a fiduciary adviser under an "eligible investment advice arrangement." The final regulations provide that an "eligible investment advice arrangement" is an arrangement that uses either fee leveling or computer modeling. The eligible investment advice arrangement must be authorized by the plan and annually audited. In addition, the fiduciary adviser must make certain participant disclosures and retain records related to the arrangement.

Arrangements that Use Fee Leveling

Under the final regulations, an arrangement that uses fee leveling is an eligible investment advice arrangement if:

- The investment advice is based on generally accepted investment theories that take into account the historic risks and returns of different asset classes over defined periods of time;
- The investment advice takes into account investment management and other fees and expenses relating to the recommended investments;
- The investment advice takes into account, to the extent furnished by the plan, participant, or beneficiary, information relating to age, time horizons, risk tolerance, current investments in designated investment options, other assets or sources of income, investment preferences of the participant or beneficiary, or any other information requested and provided; and
- The fiduciary adviser that provides investment advice does not receive from any party, directly or indirectly, any fee or other compensation that varies depending on a participant or beneficiary's selection of a particular investment option.

Arrangements that Use Computer Models

The final regulations require that eligible investment advice arrangements based on a computer model use a computer model designed and operated to:

- Apply generally accepted investment theories that take into account the historic risks and returns of different asset classes over defined periods of time;
- Take into account investment management and other fees and expenses related to the recommended investments;
- Appropriately weigh the factors used in estimating future returns of investment options;
- Request from a participant or beneficiary and, to the extent furnished, use information relating to age, time horizons, risk tolerance, current investments in designated investment options, other assets or sources of income, investment preferences of participants or beneficiaries, or any other information requested and provided;
- Use appropriate objective criteria to provide asset allocation portfolios comprised of investment options available under the plan;
- Avoid recommendations that inappropriately favor investment options (1) offered by the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser over other investment options; or (2) that may generate greater income for the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser; and
- Take into account all designated investment options under the plan without giving inappropriate weight to any investment option unless the participant or beneficiary requests the option be excluded from consideration.

BUCK COMMENT. *The proposed regulations did not require that a computer model take into account employer securities, target date funds, or annuity options as designated investment options. The final regulations only allow annuity options to be disregarded.*

Before using the computer model, the fiduciary adviser must obtain a written certification from an eligible investment expert that the computer model meets the requirements detailed above. If, after obtaining a certification, the computer model is modified in a way that could affect its ability to meet the above requirements, the fiduciary adviser must obtain a new certification stating that the modified model meets the requirements. In either case, the final regulations require that the certification be signed by the expert and provide details on how the expert reached his/her conclusion that the model meets the requirements of the final regulations.

BUCK COMMENT. *Under the final regulations, the eligible investment expert is not an ERISA fiduciary. However, the selection of an eligible investment expert is a fiduciary act governed by ERISA.*

Other Requirements

The following requirements apply to both fee-level and computer model investment advice arrangements.

Plan Fiduciary Authorization Required. The final regulations generally require that a plan fiduciary expressly authorize any eligible investment advice arrangement. However, the following fiduciaries cannot authorize the arrangement:

- The person offering the arrangement;
- Any person providing designated investment options under the plan; or
- Any affiliate of either of these persons. A plan sponsor will not be treated as a person providing a designated investment option under the plan merely because an employer stock fund is one of the investment options under the plan.

Annual Audit Required. At least once a year, the fiduciary adviser must engage an independent auditor to (1) audit the investment advice arrangement to determine if it complies with the requirements of the final regulations; and (2) within 60 days of completing the audit, issue a written report to the fiduciary adviser and each other fiduciary that authorized the use of the investment advice arrangement that details the auditor's findings. A fiduciary adviser's selection of an auditor is a fiduciary act governed by ERISA.

***BUCK COMMENT.** The final regulations do not require auditors or fiduciary advisers to inform plan participants of the results of an audit. The DOL, in the preamble to the final regulations, states that it believes that providing the audit report to the authorizing plan fiduciary is sufficient to protect plan participants. In addition, the final regulations leave to the auditor's discretion the methods to use in conducting the audit. Finally, in the preamble, the DOL notes that the performance of an audit, by itself, does not cause an auditor to be an ERISA fiduciary.*

Participant Disclosures Required. The final regulations provide that a fiduciary adviser must provide participants and beneficiaries written notification of:

- The role of any party that has a material affiliation or material contractual relationship with the fiduciary adviser in the development of the investment advice program and in the selection of investment options available under the plan;
- The past performance and historical rates of return of the designated investment options available under the plan, to the extent this information is not otherwise provided;
- All fees or other compensation that the fiduciary adviser or affiliates would receive in connection with (1) the provision of advice; (2) the sale, acquisition, or holding of any investment option pursuant to such advice; or (3) any rollover or other distribution of plan assets or the investment of distributed assets in any investment option pursuant to such advice;
- Any material affiliation or material contractual relationship with the fiduciary adviser or affiliates in the investment option;
- The manner, and under what circumstances, participant and beneficiary information provided under the investment advice arrangement will be used and disclosed;

- The types of services provided by the fiduciary adviser in connection with the provision of investment advice by the fiduciary adviser;
- The fact that the adviser is acting as a fiduciary of the plan in connection with the provision of investment advice; and
- The fact that the recipients of investment advice may separately arrange for the provision of advice by another adviser that could have no material affiliation with and receive no fees or other compensation in connection with the investment option.

The notice must be given before providing investment advice relating to any investment option and must be provided free of charge. The information must also be provided to participants and beneficiaries at least annually and upon a participant's or beneficiary's request. The fiduciary adviser must also provide reasonably contemporaneous notice of any material change in the above information.

The final regulations require that the notification be written in a clear and conspicuous manner and in a manner calculated to be understood by the average plan participant. The notification must also be sufficiently accurate and comprehensive to reasonably apprise participants and beneficiaries of the information required to be included in the notification. The notice may be provided in written or electronic form. The appendix to the final regulations contains a model disclosure form.

BUCK COMMENT. *In the preamble to the final regulations, the DOL states that the investment advice participant disclosure may be distributed with other disclosures if it is clear and not compromised by including it with other materials.*

Authorizing Fiduciary Disclosure Required. Under the final regulations, fiduciary advisers must provide authorizing fiduciaries with written notice informing the fiduciaries that:

- The fiduciary adviser intends to comply with the conditions of ERISA's statutory exemption for investment advice;
- The fiduciary adviser's arrangement will be audited annually by an independent auditor for compliance with the requirements of the statutory exemption and related regulations; and
- The auditor will furnish the authorizing fiduciary a copy of the auditor's findings within 60 days of completing the audit.

Additional Requirements. In addition, the following requirements apply to fiduciary advisers who want to take advantage of the statutory exemption:

- The fiduciary adviser provides appropriate disclosure, relating to the sale, acquisition, or holding of an investment option, in accordance with all applicable securities laws;
- Any sale, acquisition, or holding of an investment option occurs solely at the direction of the recipient of the advice;

- The compensation received by the fiduciary adviser and affiliates in connection with the sale, acquisition, or holding of an investment option is reasonable; and
- The terms of the sale, acquisition, or holding of the investment option are at least as favorable to the plan as they would be in an arm's length transaction.

Record Retention Requirements. The final regulations require a fiduciary adviser to maintain, for at least six years after the provision of investment advice, all records necessary to determine whether the requirements detailed in the final regulations have been met. An ERISA prohibited transaction will not result solely because the records are lost or destroyed before the end of the six-year period if the records are lost or destroyed due to circumstances beyond the fiduciary's control.

Noncompliance

Under the final regulations, the prohibited transaction relief will not apply to any transaction that does not satisfy the requirements detailed in the final regulations. If there is a pattern or practice of noncompliance, the prohibited transaction relief will not apply to any advice.

Conclusion

The responsibility for complying with the majority of the provisions in the final regulations falls on the fiduciary advisers who wish to provide investment advice to participants in individual account plans. However, some of the rules also apply to plan sponsors. Because the selection of a fiduciary adviser is a fiduciary act, plan sponsors who wish to engage a fiduciary adviser should be familiar with these final regulations.

Buck's consultants are available to discuss the final regulations with you and to answer any questions you may have regarding selecting 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.