

## *The Department of Labor's Proposed Investment Advice Regulations*

*by Matthew J. Renaud and Joshua Rafsky*

On February 26, 2010, the Department of Labor ("DOL") released proposed regulations regarding arrangements that provide investment advice to participants in defined contribution ("DC") plans. This Client Advisory outlines the major points of the new proposed regulations and provides some practical considerations for plan sponsors. The DOL is accepting comments from the public on the [proposed regulations](#) until May 5, 2010. Under the current proposal, these regulations will be effective 60 days after publication of final regulations in the federal register.

### **Background**

The Pension Protection Act of 2006 ("PPA") created a statutory exemption from prohibited transaction rules to allow for arrangements that provide investment advice to DC plan participants.<sup>1</sup> The proposed regulations implement the PPA's statutory exemption,

and, according to the DOL, are intended to improve retirement stability by reducing costly investment errors committed by DC plan participants.

The proposed regulations are similar to regulations the DOL drafted in 2009, which were withdrawn due to issues raised through public comments and the change in administration. The prior rules implemented both a statutory prohibited transaction exemption under ERISA and the Code, as well as an administrative class exemption that granted additional relief. The new proposed regulations eliminate the administrative class exemption.<sup>2</sup>

### **The Proposed Regulations:**

The new regulations do not impose any duty on plan fiduciaries to make investment advice available to plan participants. Furthermore, the new regulations do not invalidate any existing guidance related to investment advice and

whether such advice may or may not constitute a prohibited transaction.<sup>3</sup> Rather, the new regulations detail a permissive approach for providing investment advice to DC plan participants.<sup>4</sup>

The new regulations govern the actions of "fiduciary advisers."<sup>5</sup> There are two types of "eligible investment advice arrangements" that qualify for prohibited transaction relief. The first uses "fee-leveling," and the second makes use of computer models.

### **Fee-Leveling Arrangement**

Under the fee-leveling arrangement, the fees or compensation that a fiduciary adviser receives from any party (including the fiduciary adviser's affiliates) cannot be based on a participant's investment selections. Furthermore, the advice must (1) 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, (2) take into account investment management and other fees and expenses of the recommended investments, and (3) must take into account information furnished to the adviser by the plan, participant or beneficiary, such as age, time horizons, risk tolerance, current investments in designated investment options, other assets or sources of income, and investment preferences of the participant or beneficiary.

### **Computer Model Arrangement**

Under the second arrangement, investment advice is provided through the use of certified computer modeling. In order to qualify for prohibited transaction relief, the computer model must generally utilize the same information required under fee-leveling arrangements. The program must be designed to avoid investment recommendations that inappropriately favor investment options provided by the fiduciary adviser or its affiliates or that generate higher income for the fiduciary adviser or its affiliates, and it must generally take into account all designated investment options under the plan.<sup>6</sup> The program cannot inappropriately distinguish among investment options within a single asset class on the basis of factors that cannot confidently be expected to persist in the future.<sup>7</sup>

### **Authorization by a Plan Fiduciary**

Significantly, before either of the arrangements discussed in the new regulations can be implemented, the arrangement

must be authorized by a plan fiduciary other than the person or entity offering the arrangement or any person or entity providing designated investment options under the plan, or their affiliates.<sup>8</sup> The DOL has previously noted that plan fiduciaries are required to select fiduciary advisers in a prudent manner and periodically review those selections.

### **Audit and Plan Participant Communication Requirements**

The fiduciary adviser must engage an independent auditor to provide, at a minimum, an annual audit of the investment advice arrangement. The auditor must provide the fiduciary adviser and the fiduciaries that authorized the use of the investment advice arrangement a report of its findings. Notably, the selection of an auditor is itself a fiduciary act.

Furthermore, both arrangements are required to provide plan participants certain disclosures before the initial provision of investment advice (as well as annually, upon request, and at a time reasonably contemporaneous with a material change in the information that must be disclosed).<sup>9</sup> The disclosure must include information about (1) the role of parties having a material affiliation or contractual relationship with the fiduciary adviser in the development of the program or the selection of investment options, (2) the past performance and historical rates of return of designated plan investment options, (3) the fees and compensation of the adviser and affiliates, (4) any material

affiliation or contractual relationship of the fiduciary adviser or affiliates in the security or other property, (5) the manner and circumstances under which participant information will be used or disclosed, and (6) the types of services provided by the fiduciary adviser in connection with the advice. The disclosure must also state that the adviser is acting as a plan fiduciary, and that the recipient of advice may separately arrange to obtain advice from another adviser that has no relationship with the current adviser.

### **Considerations by Plan Sponsors:**

The DOL has requested comments on the new regulations, and in particular is seeking comments regarding computer modeling arrangements. We are considering whether to submit comments to the DOL and invite you to contact us should you have any potential comments you would like us to review and possibly include.

As noted above, the regulations do not require plans to arrange for investment advice for plan participants. Consequently, plan sponsors will want to consider the impact of these new regulations and determine whether they would like to start providing an investment advice arrangement pursuant to these regulations. Plan sponsors that decide to provide an investment advice arrangement will want to consider what steps they will need to take to fulfill any applicable fiduciary duties, in light of statements made by the DOL about fiduciaries' obligations in the selection and monitoring of fiduciary advisers.

---

## Footnotes

- [1] See ERISA §§ 408(b)(14) (29 U.S.C. § 1108(b)(14)) and 408(g) (29 U.S.C. § 1108(g)); I.R.C § 4975(d) (17) (26 U.S.C. § 4975(d)(17)) and 4975(f)(8) (26 U.S.C. § 4975(f)(8)).
- [2] The proposed administrative class exemption (that is now withdrawn) would have granted relief to advisers for providing individualized investment advice to participants (upon request) after receiving recommendations provided through computer modeling. It also would have applied fee-leveling limits solely to compensation received by an employee, agent or registered representative providing advice, meaning that the investment advice company's compensation would not have been subject to fee-leveling restrictions.
- [3] For instance, the new regulations do not invalidate the DOL's previous "SunAmerica" advisory opinion, which provided relief from the prohibited transaction prohibition for certain computer-based investment modeling. See DOL Advisory Opinion 2001-09A.
- [4] Under the new regulations, all sales and acquisition of securities and other property must occur solely at the direction of participants, which means that the adviser would not be in control of how participants' accounts are invested.
- [5] Fiduciary advisers are (1) registered investment advisers, (2) banks or similar institutions (if advice is provided through a trust department), (3) licensed insurance companies, and (4) registered brokers or dealers that provide investment advice to a plan. It also includes any person who develops or markets a permissible computer model or investment advice program, unless another fiduciary adviser elects to be treated as the sole fiduciary adviser with respect to the developing or marketing of the model or program.
- [6] The model does not have to make recommendations related to certain plan investment options, such as those that invest primarily in employer securities.
- [7] The DOL noted its belief that differences in the historical performance of assets within a single asset class are less likely to persist and are therefore less likely to constitute appropriate criteria for asset allocation. However, historical performance would generally be an appropriate consideration in distinguishing between asset classes.
- [8] An exception is made where the plan sponsor is the person or entity that provides the arrangement, provided that it also provides the arrangement to participants of unaffiliated plans in the ordinary course of business.
- [9] The proposed regulations include a model disclosure.

---

## For more information, please contact the following Jenner & Block attorneys:

**William L. Scogland**

Partner, Chair of the Employee Benefits and Executive Compensation Practice and Co-chair of the ERISA Litigation Practice  
Co-chair, ERISA Litigation Practice  
Tel: 312 923-2878  
Email: wscogland@jenner.com

**Matthew J. Renaud**

Partner, Co-chair of the Employee Benefits and Executive Compensation Practice  
Tel: 312 923-2958  
Email: mrenaud@jenner.com

**Joshua Rafsky**

Associate, Employee Benefits and Executive Compensation Practice  
Tel: 312 840-8655  
Email: jrafsky@jenner.com