

**Date:** March 11, 2010

TCRS 2010-03: Department Of Labor Reproposes Regulations On PPA's Statutory Investment Advice

On March 2, 2010, the Department of Labor (DOL) published new proposed regulations intended to implement the statutory exemption added by the Pension Protection Act of 2006 (PPA) relating to the provision of investment advice rendered by a fiduciary adviser to participants and beneficiaries in participant-directed individual account plans and beneficiaries in Individual Retirement Accounts (IRAs). If these regulations are finalized, a fiduciary adviser would get relief from the prohibited transaction rules of ERISA section 406 and the parallel provisions of section 4975 of the Internal Revenue Code (Code) for investment-related transactions described in ERISA section 408(b)(14) (listed below), provided the investment advice is given under an Eligible Investment Advice Arrangement (EIAA) described in ERISA section 408(g).

**ERISA Section 408(b)(14) Transactions**

- The provision of investment advice to participants or beneficiaries with respect to a security or other property available as an investment under the plan;
- the acquisition, holding or sale of a security or other property available as an investment under the plan pursuant to the investment advice; and
- the direct or indirect receipt of compensation by a fiduciary adviser or its affiliate in connection with the provision of investment advice or the acquisition, holding or sale of such security or property pursuant to the investment advice.

**Effective Date Of New Proposed Regulations**

These regulations are proposed to be effective 60 days after publication of the final regulations in the Federal Register. To be considered, written comments on these proposed regulations must be submitted to the DOL by May 5, 2010.

**Background**

Under the prohibited transaction rules of ERISA and the Code, a fiduciary is prohibited from rendering advice to participants and beneficiaries regarding investments that result in the payment of additional advisory and other fees to the fiduciary or its affiliates. Absent an exemption, this prohibition would have continued.

The PPA amended ERISA and the Code to add a statutory exemption from the prohibited transaction rules for investment advice provided through an EIAA. This statutory exemption was designed to permit a broader array of investment advice providers to offer their services to participants and beneficiaries in participant-directed individual account plans and IRAs.

On January 21, 2009, the DOL published final regulations (2009 final regulations) providing general guidance on the statutory exemption requirements for investment advice. The 2009 final regulations included a prohibited transaction class exemption that allowed investment advisers to provide individualized advice in addition to the investment arrangements covered by the statutory exemption. The 2009 final regulations were to be effective on March 23, 2009.

On February 4, 2009, the DOL published an invitation for public comments on a proposed 60-day extension of the effective date of the 2009 final regulations in order to afford the Obama DOL the opportunity to review legal and policy issues relating to the 2009 final regulations and on the merits of rescinding, modifying or retaining the 2009 final regulations. Subsequent to the DOL's adoption of the 60-day extension, the effective date of the 2009 final regulations was further postponed to May 17, 2010.

In response to concerns expressed in public comments received by the DOL questioning the adequacy of the class exemption's conditions to mitigate the potential for investment adviser self-dealing, the DOL proceeded to withdraw the 2009 final regulations on November 20, 2009.

***These new proposed regulations replace the 2009 final regulations and are limited to the implementation of the PPA's statutory exemption. They do not include a class exemption. However, the new proposed regulations did not change DOL pre-PPA guidance, such as DOL Advisory Opinion 2001-09A (the SunAmerica approach) in which investment advice is outsourced to an independent financial expert and Interpretive Bulletin 96-1, which provides that investment education is not investment advice.***

### **Eligible Investment Advice Arrangement (EIAA)**

For the statutory exemption to apply, the investment advice must be provided by a fiduciary adviser under an EIAA. An arrangement is an EIAA if it meets either the requirements of a Level-Fee Arrangement or a Computer Model Arrangement, or both.

#### **• Level-Fee Arrangement**

A level-fee arrangement is an EIAA if it meets all of the following requirements:

- Any investment advice is based on generally accepted investment theories that consider historic risks and returns of different asset classes over defined periods of time;
- Any investment advice considers information furnished by a plan, participant or beneficiary relating to age, time horizons (e.g. life expectancy, retirement age), risk tolerance, current investments in designated investment options, other assets or sources of income and investment preferences;

With respect to the two preceding requirements, the new proposed regulations do not preclude a fiduciary adviser from using generally accepted investment theories that take into account other considerations nor from taking into account additional information provided by the participant or beneficiary.

- Any investment advice takes into account investment management and other fees and expenses attendant to the recommended investments;
- No fiduciary adviser (including any employer, agent or registered representative) that provides investment advice receives from any party (including an affiliate of the fiduciary adviser), directly or indirectly, any fee or other compensation (including commissions, salary, bonuses, awards, promotions, or other things of value) that is based in whole or in part on a participant's or beneficiary's selection of an investment option. Therefore, the receipt by a fiduciary adviser of any payment from any party (including an affiliate of the fiduciary adviser) or any payment used for the benefit of such fiduciary adviser, that is based, in whole or in part, on investments selected by participants or beneficiaries would be inconsistent with the fee-leveling requirement of the statutory exemption. **This limitation applies to an entity that is retained to render investment advice and to any employee, agent or registered representative of such entity; and**
- The additional requirements in 1) through 4) and the records retention requirements below are also met.

#### **• Additional Requirements**

The following requirements (1) through 4)) must also be met by an investment advice arrangement in order to qualify as an EIAA:

##### **1) Arrangement Must Be Authorized By A Plan Fiduciary**

A plan fiduciary (or IRA beneficiary, in the case of an IRA), must expressly authorize the investment advice arrangement. Such plan fiduciary must be someone other than (i) the person offering the arrangement, (ii) the person providing designated investment options under the plan or (iii) any affiliate of either.

##### **2) Annual Audit**

- the fiduciary adviser is required, at least annually, to engage an independent auditor, who represents in writing to the fiduciary adviser that he/she has appropriate technical training and proficiency, who will conduct an audit of the investment advice arrangement for compliance with the regulations and, within 60 days after completion of the audit, issue a written report to the fiduciary adviser and to each fiduciary authorizing the arrangement;
- with respect to an IRA arrangement, within 30 days following receipt of the audit report, the fiduciary adviser must furnish a copy of the audit report to the IRA beneficiary or post the report

onto its website, provided the beneficiary is given information regarding the purpose of the report and how and where to locate the report that applies to his/her account. If noncompliance items are identified in the audit report, the fiduciary adviser forwards to the DOL a copy of the report within 30 days of receipt from the auditor;

- the auditor is required to review sufficient relevant information to formulate an opinion as to whether the arrangement and the advice given comply with the various requirements; and

An auditor is considered independent if it does not have a material affiliation or material contractual relationship with the person offering the investment advice arrangement to the plan or any designated investment options under the plan. These proposed regulations make clear that the selection of an auditor is a fiduciary act.

### 3) **Disclosure Requirements – Content, Form and Maintenance of Information**

The new proposed regulations require the fiduciary adviser to provide, without charge, to a participant or beneficiary before the initial provision of investment advice in connection with any security or other property offered as an investment option, a written notification of the following:

- the role of any party having material affiliation or material contractual relationship with the fiduciary adviser in the development of advice programs and selection of investment options under the plan;
- the past performance and historical rates of return of the designated investment options, to the extent this information is not otherwise provided;
- all fees or other compensation that the fiduciary adviser or any of its affiliates is to receive (including compensation provided by any third party) in connection with the advice or the sale, acquisition or holding of the security or other property pursuant to the advice or any rollover or other distribution of plan assets or the investment of distributed assets in any security or other property pursuant to the advice;
- any material affiliation or material contractual relationship of the fiduciary adviser or its affiliates in the security or property;
- the manner and under what circumstances, any participant or beneficiary information will be used or disclosed;
- the types of services provided by the fiduciary adviser in connection with the advice. If a computer model is used, any limitations on the ability of the computer model to consider an investment primarily in qualifying employer securities;
- that the adviser is acting as a fiduciary of the plan in connection with the provision of advice; and
- that a recipient of the 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 security or other property.

#### **Notification Requirements**

The required notification must:

- be written in a clear and concise manner calculated to be understood by the average participant; and
- be sufficiently accurate and comprehensive.

The new proposed regulations include a model disclosure form that may be used for this purpose, but use of the model disclosure form is not mandatory. An appropriately completed model disclosure form would be deemed to satisfy the content and form requirements of the notification.

#### **Electronic Media**

The required notification may be provided in writing, or electronically, as long as the DOL's requirements for the use of electronic media are met. For this purpose, plan sponsors should look to the DOL regulations at 29 CFR 2520.104b-1 for guidance.

## **Maintenance of Information**

With respect to the information required to be disclosed, the fiduciary adviser, at all times during the term of the advice arrangement, must:

- maintain accurate, up-to-date information in a form consistent with the above Notification Requirements;
- provide at least once a year, without charge, accurate information to the recipient of the advice;
- provide, without charge, accurate information to the recipient of the advice upon request; and
- provide, without charge, to the recipient of the advice any material change to the disclosure information described above, at a time reasonably contemporaneous to the change in the information.

## **4) Other Conditions**

- The fiduciary adviser is required to provide disclosure in connection with the sale, acquisition or holding of security or other property (“transaction”) in accordance with all applicable securities laws;
- All the transactions must occur solely at the direction of the recipient of the advice;
- All the compensation received by the fiduciary adviser and its affiliates in connection with the transaction must be reasonable; and
- The terms of the transaction must be at least as favorable to the plan as an arm’s length transaction would be.

## **Retention of Records**

The fiduciary adviser must maintain, for a period of at least 6 years (certain exceptions apply), any records necessary for determining whether the requirements of these regulations have been met.

- **Computer Model Arrangement**

A computer model arrangement is an EIAA, if :

- the only advice provided under the arrangement is advice generated by the computer model;
- the advice occurs solely at the direction of the participant or beneficiary;
- the design and operation and certification requirements, below are met; and
- the additional requirements in 1) through 4) and the records retention requirements that apply to the Level-Fee Arrangement above, are also met.

- **Design and Operation**

A computer model must be designed and operated to:

- take into account the requirements described in the first bullet under the Level-Fee Arrangement;
- utilize information described in the second bullet under the Level-Fee Arrangement to the extent furnished;
- take into account the requirements described in the third bullet under the Level-Fee Arrangement;
- utilize appropriate objective criteria to provide asset allocation portfolios comprised of investment options available under the plan;
- avoid investment recommendations that inappropriately favor (i) investment options offered by the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser over any other investment options under the plan, or (ii) investment options that may generate greater income for such fiduciary adviser or such other person described in (i), or (iii) inappropriately distinguish among investment options within a single asset class on the basis of a factor that cannot confidently be expected to persist in the future; and
- take into account all designated investment options under the plan (with certain exceptions) without giving inappropriate weight to any particular investment option. A computer model need not make a recommendation relating to the acquisition, holding or sale of certain investment options, such as qualifying employer securities or annuity options.

- **Certification**

Before using a particular computer model, the fiduciary adviser is required to obtain a written certification that meets the requirements below, from an eligible investment expert (defined in the proposed regulations) that the computer model meets the design and operation requirements described above. In certain situations, if changes to a previously certified computer model are made, a new certification may be required.

- A certification by an eligible investment expert shall:

- be provided in writing;
- contain the following information:
  - identification of the methodology or methodologies applied in determining whether the computer model meets the design and operation requirements described above;
  - an explanation of how the applied methodology or methodologies demonstrated that the computer model met such design and operation requirements;
  - a description of any limitations imposed on the selection or application of methodologies for determining if the computer model meets the design and operation requirements;
  - a representation that the methodology or methodologies were applied by persons with the educational background, technical training or experience necessary to analyze and determine if the computer model meets the design and operation requirements; and
  - a statement certifying that the eligible investment expert has determined that the computer model meets the design and operation requirements; and
- be signed by the eligible investment expert.

The new proposed regulations state that the selection of an eligible investment expert is a fiduciary act.

### **Noncompliance With The Terms Of The Statutory Exemption**

The new proposed regulations make clear that relief from the prohibited transaction rules of ERISA and the Code would not be available to a specific investment advice if the conditions of the statutory exemption are not satisfied, or, in the case of a pattern or practice of noncompliance with any of the applicable conditions of the statutory exemption, such relief would also not be available for any investment advice provided by a fiduciary adviser during the period over which the pattern or practice extended.

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*This Summary is designed to provide an overview of the Department of Labor's new proposed regulations regarding investment advice and is not intended to be comprehensive. The Transamerica Center for Retirement Studies® ("The Center") is a non-profit corporation and private foundation. The Center may be funded by contributions from Transamerica Life Insurance Company and its affiliates or other unaffiliated third-parties. For more information about The Center, please refer to [www.transamericacenter.org](http://www.transamericacenter.org). The Center and its representatives cannot give ERISA, tax or legal advice. This material is provided for informational purposes only and should not be construed as ERISA, tax or legal advice. Interested parties must consult and rely solely upon their own independent advisors regarding their particular situation and the concepts presented here. Although care has been taken in preparing this material and presenting it accurately, The Center disclaims any express or implied warranty as to the accuracy of any material contained herein and any liability with respect to it.*