

**Date:** December 14, 2011

**TCRS 2011-04: Department of Labor Issues Final Regulations on PPA's Statutory Investment Advice to Participants and Beneficiaries**

On October 25, 2011, the Department of Labor (DOL) published final regulations to implement the statutory prohibited transaction exemption added by section 601 of the Pension Protection Act of 2006 (PPA), regarding the provision of investment advice by a fiduciary adviser to participants and beneficiaries of participant-directed individual account plans and beneficiaries in Individual Retirement Accounts (IRAs). Under the regulations, a fiduciary adviser is relieved from the prohibited transaction rules of ERISA §406 and the parallel provisions of section 4975 of the Internal Revenue Code (Code) for investment-related transactions described in ERISA §408(b)(14) (listed below), provided the investment advice is given under an "Eligible Investment Advice Arrangement" ("EIAA") described in ERISA §408(g) (and which is also described further below).

**Effective Date Of Final Regulations:** These regulations are effective on December 27, 2011.

**ERISA Section 408(b)(14) Transactions:** (i) The provision of investment advice to participants or beneficiaries with respect to a security or other property available as an investment under the plan; (ii) the acquisition, holding or sale of a security or other property available as an investment under the plan pursuant to the investment advice; and (iii) 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.

**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.

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 is 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.

Note that these final regulations are limited to the implementation of PPA's statutory exemption. They do 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, or Interpretive Bulletin 96-1, which provides that investment education is not investment advice. (See footnotes 4 and 7 of 29 CFR Part 2550. See also Reg. §2550.408g-1(a)(3).)

**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 the requirements of a fee leveling arrangement, a computer model, or both.

Generally, the definition of a fiduciary adviser is a fiduciary due to providing investment advice to a participant, and who is (i) a registered investment adviser, (ii) a regulated bank or similar financial institution, (iii) a State-qualified insurance company, (iv) a registered broker/dealer, (v) an affiliate of (i) through (iv), or (vi) an employee, agent, or registered representative of (i) through (v). For more specific details, see DOL Reg. §2550.408g-1(c)(2)(i).

**Fee Leveling Arrangement**

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

- Any investment advice (i) is based on generally accepted investment theories that consider historic risks and returns of different asset classes over defined periods of time; (ii) 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. A fiduciary adviser must request this information, but is not required to take into account information requested but not furnished; and (iii) takes into account investment management and other fees and expenses of the recommended investments;
- No fiduciary adviser (including any employee, 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 varies depending upon the basis of a participant's or beneficiary's selection of an investment option; and

- The additional requirements and the records retention requirements described below are also met.

With respect to the first two requirements above, the 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.

### **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 and the records retention requirements described below are also met.

### **Design and Operation**

A computer model must be designed and operated to:

- take into account the requirements and utilize the information described in the first bullet under the Fee Leveling Arrangement;
- appropriately weight the factors used in estimating future returns of investment options;
- 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/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); and
- take into account all designated investment options under the plan (with certain exceptions) without giving inappropriate weight to any particular investment option.

### **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 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, be signed by the eligible investment expert, and 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 that the eligible investment expert has determined the computer model meets the design and operation requirements; and

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

## **Additional Requirements**

The following requirements 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 arrangement. Such fiduciary must be someone other than (i) the person offering the arrangement or providing designated investment options under the plan or (ii) any affiliate of either, unless the following exception applies. If the arrangement is offered to a plan sponsored by the person offering the arrangement or an affiliate, the plan sponsor may authorize the arrangement, provided that the person/affiliate offers the same arrangement to participants and beneficiaries of unaffiliated plans in the ordinary course of its business.

### **2) Annual Audit**

- The fiduciary adviser is required, at least annually, to engage an independent auditor, who represents in writing to the adviser that he/she has appropriate technical training or experience and proficiency, to conduct an audit of the arrangement(s) for compliance with the regulations and, within 60 days after completion of the audit, issues a written report to the fiduciary adviser and to each fiduciary authorizing the arrangement that (i) identifies the fiduciary adviser, (ii) indicates the type of arrangement (i.e. fee leveling, computer model(s), or both), (iii) if the arrangement uses computer models, indicates the date of the most recent computer model certification, and identifies the eligible investment expert that provided the certification, and (iv) specifies the auditor's findings regarding compliance of the arrangement with these regulations;
- 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; and
- 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.

An auditor is considered independent if it does not have a material affiliation or material contractual relationship with the person offering the arrangement to the plan or any designated investment options under the plan, and does not have any role in the development of the arrangement, or certification of the computer model.

These regulations make clear that the selection of an auditor is a fiduciary act.

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

The 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 the investment advice program 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 provision of advice, the sale, acquisition or holding of the security or other property pursuant to the advice, 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: (i) be written in a clear and concise manner calculated to be understood by the average participant; and (ii) be sufficiently accurate and comprehensive.

The 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 DOL Reg. §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) Disclosure to Authorizing Fiduciary.** The fiduciary adviser shall provide the fiduciary who authorized the arrangement (authorizing fiduciary) with a written notice informing such fiduciary:
- the fiduciary adviser intends to comply with these regulations;
  - the fiduciary adviser's arrangement will be audited annually by an independent auditor for compliance with these regulations; and
  - the auditor will furnish the authorizing fiduciary a copy of its findings within 60 days of the completion of its audit.

## **5) 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 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.

## **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.

## **Noncompliance with the Terms of the Statutory Exemption**

The regulations make clear that relief from the prohibited transaction rules of ERISA and the Code would not be available to a specific investment advice transaction 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 DOL's final rule on investment advice to participants and beneficiaries in individual account plans, 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.*