



ERISA ALERT

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DOL Issues Proposed Regulations for Participant Investment Advice for IRAs and 401(k) Plans

The Department of Labor has issued proposed regulations¹ to make it easier for investment advisers to help their clients make informed investment decisions about their individual account plans (such as 401(k) plans and IRAs), without running afoul of the “prohibited transaction” rules. The regulations interpret the prohibited transaction exemption under ERISA’s Section 408(g) and Section 4975(f)(8) of the Internal Revenue Code.

The problem. ERISA and the Code prohibit self-dealing and conflicts of interest by fiduciaries providing advice to 401(k) and IRA plan participants. They allow advisers to provide investment education to plan participants, but prohibit them from providing fiduciary-type investment advice to plan participants that would result in participants making investments that pay fees to, or would otherwise benefit, the adviser or its affiliates (so-called “prohibited transactions”).

When Congress enacted the Pension Protection Act of 2006, it added an exemption to the prohibited transaction rules to help 401(k) and IRA participants get investment advice. Investment advice that qualifies as an “eligible investment advice arrangement” won’t run afoul of the prohibited transaction rules.

The solution. The newly proposed regulations implement this legislation. There are two kinds of eligible investment advice arrangements:

- **Fee-leveling exemption:** A fiduciary advisor (and its employees, agents and representatives) is prohibited from receiving, directly or indirectly, any fee or other form of compensation that varies based on the selection of an investment option by a participant. For example, a fiduciary cannot receive economic incentives to favor or promote investments offered by an affiliate.
- **Computer model exemption:** A fiduciary advisor may render its advice based on a computer model that is designed and operated to: (i) apply generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time, (ii) use information furnished by a participant relating to age, life expectancy, retirement age, risk tolerance, other assets or sources of income and investment preferences, and (iii) use appropriate objective criteria to provide asset allocation portfolios comprised of investment options available under the plan. Prior to the use of a computer model (or after a modification of the computer model), a written certification from an independent “eligible investment expert” must be obtained certifying that the computer model satisfies the requirements of the regulation.

Both exemptions are more detailed and have more provisions than we have room for here, so we encourage you to read the proposed regulations in their entirety or contact us for additional information.

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Additional requirements. The proposed regulations also provide that the investment advice must be implemented solely at the beneficiary's direction. They confirm that existing investment advice arrangements do not affect prior guidance relating to the provision of investment advice. Accordingly, use of an eligible investment advice arrangement is not the exclusive method for providing investment advice without violating the prohibited transaction rules.

In addition to qualifying for the fee-leveling exemption or computer model exemption, the investment advice arrangement must: (i) be authorized by a plan fiduciary independent of the fiduciary providing the investment advice, (ii) be subject to an annual audit to determine if the arrangement satisfies the statutory requirements, (iii) be disclosed in writing to the participants by the fiduciary providing the investment advice including, among other things, the past performance of the investment options and the fees and compensation that the fiduciary will receive in connection with the advice; and (iv) require that the fiduciary providing the investment advice retain any records necessary to determine whether the requirements for the exemption have been met for at least six years.

What to do. The DOL is accepting comments to the proposed regulations until May 5, 2010. Once finalized, the regulations will be effective 60 days after publication in the Federal Register. The proposed regulations represent a reissuance of regulations that were issued under President Bush's administration and are similar to the prior regulations except that they do not include a class exemption that would have provided a broader exemption from the prohibited transaction rules than the exemption available under Sections 408(g) of ERISA and 4975(f)(8) of the Code.

While we cannot be certain, we expect that the final regulations will be substantially similar to the proposed regulations. Now is an opportune time to consider adding an investment advice arrangement to help participants re-build retirement accounts gutted by recent market conditions. It also gives plan sponsors who have not yet done so the opportunity to provide participants with access to professional investment advice. Financial institutions which have not yet developed investment advice arrangements ought to consider offering such arrangements now that the regulatory landscape is being clarified.

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¹ DOL Proposed Regulation § 2550.408g-1 and 2550.408g-2 (75 FR 9360).

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