

## **DOL Finalizes Investment Advice Regulations and Related Class Exemption under the PPA Subject to Potential Review and Extension by Obama Administration**

**January 26, 2009**

### **Introduction**

On January 16, 2009, the Department of Labor (DOL) announced the publication of the final regulations and a prohibited transaction class exemption concerning the provision of investment advice to participants in participant-directed individual account plans such as 401(k) plans and individual retirement accounts. The final regulations essentially adopt the proposed rule, released August 22, 2008, which implemented the new statutory exemption for investment advice added to the Employee Retirement Income Security Act of 1974 as amended (ERISA), by the Pension Protection Act (PPA).

### **Effective Date of Final Regulations Postponed by Obama Administration**

The final regulations are effective March 23, 2009, which is 60 days following the regulations' publication in the *Federal Register* on January 21. However, in a memorandum dated January 20, 2009 from President Barack Obama's Chief of Staff, Rahm Emanuel, the new administration has requested the heads of executive departments and agencies consider a 60-day extension and a reopening of the comment period for regulations that have been published in the Federal Register but are not yet effective. As the investment advice regulations fall within this category, if the Employee Benefits Security Administration complies with this request, these regulations may be modified and the effective date potentially postponed until May 23, 2009. It is not clear whether the new administration will take any action, but until their effective date it is possible that these regulations could be removed completely. In addition, at least one congressman, Representative George Miller (D – California), has threatened to block implementation of the new regulations.

### **Background**

In the absence of a statutory or administrative exemption, fiduciaries are prohibited from rendering investment advice to plan participants regarding investments that result in the payment of additional advisory and other fees to plan fiduciaries or their affiliates. The final regulations allow investment advice by a "fiduciary adviser" to be provided through the use of a computer model certified as unbiased or an adviser that is compensated on a "fee-level" basis. Under the final regulations, a fiduciary adviser is a fiduciary to the plan by reason of providing investment advice to participants or beneficiaries, and must be a registered investment adviser, a bank or similar financial institution, an insurance company, a broker-dealer, an affiliate of any of the foregoing entities, or an employee, agent, or registered representative of those entities.

## **Fee-Leveling Requirement**

Under a fee-leveling approach, any fees or other compensation received by the fiduciary adviser or received directly or indirectly by any employee, agent, or registered representative that provide investment advice on behalf of the fiduciary adviser cannot vary based on the investment options selected by a participant or beneficiary. As a clarification to the proposed regulations, the final regulations indicate that fees and other compensation include investment management fees and any other fees and expenses associated with recommended investments. The investment advice must be based on generally accepted investment theories that, at a minimum, take into account the historic returns of plan investments over defined periods of time.

Additionally, the advice must consider participant-provided information relating to age, life expectancy, retirement age, risk tolerance, other assets or sources of income, and investment preferences. A fiduciary adviser may also take into account any additional information that a participant or beneficiary may provide. As a modification to the proposed regulations, the final regulations also indicate that although a fiduciary adviser is required to ask for such information, the information is only required to be considered to the extent that a participant or beneficiary actually provides it.

## **Computer Model Requirement**

The other method by which investment advice may be provided under the exemption is through the use of a computer model that is certified as unbiased. Similar to the fee-leveling approach described above, the computer model must be based on generally accepted investment theories and take information provided by individual participants into account. A computer model must use objective criteria to avoid recommendations that favor investment options offered by the fiduciary adviser or a person with a material affiliation or material contractual relationship (regardless of whether the agreement is in writing) with the fiduciary adviser. Additionally, computer models must consider all designated investment options available under the plan without giving inappropriate weight to any particular option. The final regulations confirm that the computer model need not take into account in-plan annuity options, brokerage windows, self-directed brokerage accounts, or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.

As a clarification to the proposed regulations, the final regulations indicate that absent a specific request from the participant or beneficiary to exclude qualifying employer securities from the modeled investment advice, qualifying employer securities must be taken into account under the computer model requirement. Furthermore, the final regulations do not require funds that take into account time horizons (e.g., retirement age, life expectancy), participant risk levels, or annuitized retirement benefits to be included in the computer-modeled investment advice. However, participants and beneficiaries that receive such modeled recommendations should be provided with a general description of these options and how they operate.

In order for the investment advice to qualify under the computer model requirement, an “eligible investment expert” must certify that the model meets the final regulations’ requirements. An “eligible investment expert” is defined as an individual who has the appropriate technical training or experience and proficiency to analyze, determine, and certify whether the model meets the requirements, but who does not have a material affiliation or material contractual relationship with the fiduciary adviser.

The final regulations require that the certification be in writing, signed by the eligible investment expert, and must do the following:

- Identify and explain the methodologies the eligible investment expert used in determining that the model met the regulatory requirements for computer models
- Describe any limitations placed on the expert in determining whether the model met the regulatory requirements
- Represent that the expert has the education, technical training, or experience necessary to make the certification
- State that the expert has determined that the model satisfies the final regulations

### **Additional Requirements**

**Authorization by a Plan Fiduciary.** The final regulations require that a plan fiduciary, other than the fiduciary adviser, must authorize the investment advice arrangement.

**Annual Audit.** The fiduciary adviser shall, at least annually, engage an independent auditor to determine whether the investment advice arrangement meets the final regulations by reviewing sufficient relevant information and shall provide a copy of the report to the fiduciary that authorized the arrangement within 60 days of the audit's completion (within 30 days for IRAs). The final regulations state that the independent auditor must certify in writing that he or she has the "appropriate technical training or experience and proficiency" to act as an auditor. Additionally, the final regulations emphasize that the selection of an independent auditor is a fiduciary act under ERISA.

**Fiduciary Adviser Disclosures.** The final regulations require that the fiduciary adviser must provide the following disclosures to participants, both before and while providing advice:

- 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 such information is not otherwise provided
- All fees or other compensation that the fiduciary adviser or any affiliate thereof is to receive in connection with related advice
- The manner in which, and under what circumstances, any participant or beneficiary information provided under the arrangement will be used or disclosed
- The types of services provided by the fiduciary adviser in connection with the investment advice
- A statement that the adviser is acting as a plan fiduciary in connection with the provision of the advice
- A statement that a recipient of the advice may separately arrange for the provision of advice by another adviser that has no material affiliation with and receives no fees or other compensation in connection with the security or other property.

The final regulations contain a model disclosure form that fiduciary advisers may use to assist in providing the foregoing disclosures to participants.



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