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Client briefing
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DOL Finalizes Regulations on Investment Advice Exemption for Retirement

The U.S. Department of Labor (the "DOL") has recently issued final regulations (the "Regulation") regarding acceptable arrangements for the provision of investment advice to participants in self-directed individual account plans, such as 401(k) plans. The Regulation will provide a welcome change under the U.S. Employee Retirement Income Security Act of 1974, as amended ("ERISA") where generally a party providing individualized advice for a fee can be viewed as a fiduciary.

Background

Section 406 of ERISA generally prohibits transactions between a plan and a fiduciary. As such, in the absence of a statutory or administrative exemption, a fiduciary is prohibited from rendering investment advice to plan participants that result in the payment of additional advisory or other fees to the fiduciary or any of its affiliates.

The Pension Protection Act of 2006 (the “PPA”) established a prohibited transaction exemption under Sections 408(b)(14) and 408(g) of ERISA (and its parallel provisions under Sections 4975(d)(17) and 4975(f)(8) of the U.S. Internal Revenue Code of 1986, as amended) permitting fiduciaries to provide investment advice to participants and beneficiaries in individual account plans (e.g., 401(k) plans) and individual retirement accounts, subject to certain safeguards and conditions. Specifically, under the PPA, arrangements that provide for level fees to the adviser notwithstanding which investment option is chosen by a participant or an arrangement that utilizes certain computer modeling would not by themselves be deemed to be fiduciary acts.

On February 2, 2007, the DOL issued Field Assistance Bulletin 2007-01 addressing certain issues presented by the new statutory exemption. On January 21, 2009, the DOL issued final regulations implementing the exemption, which were then withdrawn on November 20, 2009. The DOL then published proposed regulations in March 2010 that would implement the provisions discussed above (and which did not include the class exemption provision provided in the prior 2009 regulation).

Overview of the Regulation

As noted above, the Regulation broadly permits two types of investment advice arrangements which will not implicate the ERISA prohibited transaction rules. The first type is where the fees or other compensation (including salary,

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bonuses, awards and commissions) to be earned by an adviser or received, directly or indirectly, by any employee, agent or registered representative that provides investment advice on behalf of an adviser, do not vary based upon the particular investment alternative chosen by a participant. In addition to this so-called "level fee" arrangement, a second alternative is for a provider to offer certain computer-driven advice models. Although there have been individual exemptions granted before permitting computer modeling, such exemptions generally permitted only the use of models by third parties separate from the adviser. The Regulation would permit an adviser to use its own proprietary modeling programs to provide advice, subject to a number of conditions. Among the conditions required are that (i) the model is designed and operated to avoid investment recommendations that inappropriately favor investment options offered by the adviser, (ii) the model takes into account all designated investment options available under the plan without giving inappropriate weight to any particular investment option, and (iii) prior to utilization, the model is certified by an "eligible investment expert" as meeting the requirements of the Regulation. Both type of arrangements must (i) apply generally accepted investment theories that take into account the historic risks and returns of different asset classes over a defined period of time, (ii) take into account fees and expenses related to the recommended investments, and (iii) take into account certain information from a participant such as age, risk tolerance and investment preferences.

In addition, the Regulation establishes a variety of safeguards to protect against an investment adviser's potential conflicts of interests, which include the following:

- Requiring that the advice arrangement be authorized by a plan fiduciary that is independent of the investment adviser or its affiliates.
- Requiring that both level-fee and computer model advice arrangements be subject to annual audits by an auditor that is independent from the investment advice provider.
- Imposing certain recordkeeping requirements for investment advisers relying on the exemption.
- Requiring advisers to make detailed disclosures to plan participants and beneficiaries, including regarding the fees charged.
    - The Regulation contains a model Fiduciary Adviser Disclosure that may be used to notify participants and beneficiaries of the information required under the Regulation.

Effective Date

The Regulation is effective on December 27, 2011 and will apply to transactions occurring on or after that date.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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