

DOL proposes new regulations for investment advice

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This month we will summarize important regulatory guidance impacting the providing of investment advice to participants in qualified plans.

On February 26, 2010, the U.S. Department of Labor (the "DOL") issued newly proposed regulations concerning the manner in which a fiduciary advisor may provide investment advice to participants of defined contribution retirement plans under ERISA. These proposed regulations are intended to replace the controversial "final" regulations published by the DOL on January 21, 2009, which were withdrawn on November 20, 2009, before ever having taken effect.

Background: The Pension Protection Act of 2006.

Under the Pension Protection Act of 2006, Congress intended to encourage the availability of participant-level investment advice by enacting a new prohibited transaction exemption to provide relief from fiduciary liability for providing such advice under certain conditions. To qualify for fiduciary relief under the terms of the statutory exemption (the "PPA Statutory Exemption"), a fiduciary advisor (e.g., investment advisor, broker-dealer) is required to ensure that either (1) the fiduciary advisor's fees for its investment advice will not vary based on any investment options that are selected by participants (the "Fee-Leveling Safe Harbor"), or (2) the investment advice will be provided through an objective computer model that is independently certified not to favor investment options that would result in greater fees for the fiduciary advisor (the "Computer Model Safe Harbor").

With respect to the Fee-Leveling Safe Harbor under the PPA Statutory Exemption, the DOL announced in its Field Assistance Bulletin ("FAB") 2007-1 that the applicable fee-leveling requirement applies to both the individual representative of the fiduciary advisor and the fiduciary advisor itself. However, the compensation payable to the fiduciary advisor's affiliates (e.g., affiliated investment advisors managing mutual fund options for a plan) may vary based on the investment options selected by plan participants. Thus, in the DOL's view, the PPA Statutory Exemption gives fiduciary advisors a new type of self-dealing relief that was not previously available under ERISA. Prior to the enactment of the PPA Statutory Exemption, with certain narrow exceptions, ERISA would have imposed fee-leveling on the individual representative of the fiduciary advisor, the fiduciary advisor itself, and the fiduciary advisor's affiliates.

Inclusion of class exemption in final regulations triggers withdrawal. The DOL had finalized its first iteration of the investment advice regulations during the last days of the Bush administration, issuing them on January 21, 2009. This early 2009 release was highly unusual in that it included both (1) interpretive guidance with respect to the PPA Statutory Exemption, and (2) a separate but related

administrative exemption (the "Withdrawn Class Exemption") concerning investment advice.

The Withdrawn Class Exemption mirrored the PPA Statutory Exemption's Fee-Leveling and Computer Model Safe Harbors in many respects. However, the Withdrawn Class Exemption provided for significantly more expansive fiduciary relief as follows:

- **Additional fee-leveling safe harbor.** The Withdrawn Class Exemption would have created a similar but new safe harbor, mandating fee-leveling for the individual representative of the fiduciary advisor only (and not for the individual representative and the fiduciary advisor as required under the PPA Statutory Exemption). Thus, the compensation payable to the fiduciary advisor and its affiliates would be able to vary with the investment options selected by plan participants. For example, the Withdrawn Class Exemption would have allowed the individual representative of a broker-dealer to provide investment advice to participants, so long as the individual representative received a level fee. Conversely, the broker-dealer itself and its affiliates would have been able to receive variable compensation, including 12b-1 fees and revenue sharing payments.
- **Additional computer model safe harbor.** Once investment advice based on an objective computer model had been provided to a participant, the Withdrawn Class Exemption would have allowed the fiduciary advisor to follow up with subjective, individualized advice to the participant. Any such individualized advice would not have been subject to any fee-leveling requirement.

The DOL, under the incoming Obama administration, postponed on multiple occasions the effective date for both its interpretive guidance with respect to the PPA Statutory Exemption and the Withdrawn Class Exemption. Due to concerns over the Withdrawn Class Exemption and the perceived inadequacy of certain conditions, the DOL withdrew its final regulations in their entirety on November 20, 2009.

DOL proposes second iteration of its investment advice regulations. The second iteration of the DOL's investment advice regulations, which were proposed on February 26, 2010 (the "Newly Proposed Regulations"), are substantially similar to the interpretive portion of the DOL's withdrawn regulations relating to the PPA Statutory Exemption. However, the Newly Proposed Regulations do not re-introduce any kind of new administrative exemption akin to the Withdrawn Class Exemption that had previously been incorporated into the DOL's withdrawn regulations.

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Thus, the Fee-Leveling and Computer Model Safe Harbors under the Newly Proposed Regulations are consistent with the existing safe harbors under the PPA Statutory Exemption. Under the Newly Proposed Regulations:

- With respect to the Fee-Leveling Safe Harbor, participant investment advice may only be provided if the fees earned by both the individual representative of the fiduciary advisor and the fiduciary advisor itself (and not including the fiduciary advisor's affiliates) do not vary with the investment options selected by participants, and
- With respect to the Computer Model Safe Harbor, a fiduciary advisor may

only provide investment advice to participants based on an objective computer model, and may not supplement such advice with subjective, individualized advice.

However, in the preamble to the Newly Proposed Regulations, the DOL highlighted one new interpretive requirement that it was proposing for the Computer Model Safe Harbor. Although it is not expressly required under the PPA Statutory Exemption, the Newly Proposed Regulations state that the computer model advice must not "[i]nappropriately 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." In the preamble, the DOL clarified that differences in investment options' fees and management styles are likely to persist in the

future. However, unlike the historical performance of asset classes, the historical performance of investment options in the same asset class are less likely to persist and therefore are less likely to constitute appropriate criteria for advice. Because many advisory computer models consider the historical performance of investment options (rather than asset classes), the DOL is expected to receive significant commentary with respect to this proposed interpretive requirement, which had not been surfaced previously with the interpretive portion of the DOL's withdrawn regulations. The comment period for the Newly Proposed Regulations ends on May 5, 2010. ❖

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