

Department of Labor Publishes Proposed Regulations for Investment Advice to Individual Account Plan Participants

The Department of Labor has proposed regulations implementing the Pension Protection Act of 2006 exemptions from ERISA's prohibited transaction rules for investment advice provided to participants and beneficiaries in an individual account plan (e.g., a qualified defined contribution plan or IRA) that allows participant investment direction. The PPA exemptions authorized two kinds of investment advice arrangements: (i) an arrangement under which compensation received by a fiduciary adviser does not vary based on the investment options chosen by plan participants (a "level fee" arrangement), and (ii) a computer model that takes into account individualized participant investment characteristics and uses objective criteria to create asset allocation portfolios for participants that do not favor investments offered by the fiduciary adviser or its affiliates.

The DOL issued final regulations for these exemptions in January 2009, on the eve of President Obama's inauguration. Citing concern that the Bush Administration's guidance did not adequately protect plan participants from a fiduciary adviser's potential conflicts of interest, the Obama Administration delayed the effective date of those final regulations several times and ultimately withdrew them altogether in November 2009. The current proposal replaces those withdrawn regulations.

The Department acknowledges in the preamble that the proposed regulations are nearly identical to the withdrawn final regulations. The proposal reiterates, for example, that it does not invalidate or otherwise affect prior DOL guidance (e.g., the SunAmerica advisory opinion letter) concerning circumstances under which investment advice to plan participants is not a prohibited transaction. Similarly, the proposal confirms that a computer model generally must take into account all designated investment options available under the plan, but it need not take into account employer securities, target date or life cycle funds, annuity options, brokerage windows, self-directed brokerage accounts or similar arrangements that allow participants to select investments beyond those specifically designated by the plan. If the computer model does not take into account annuity options or target date or life cycle funds, however, participants must be provided general descriptions of those alternatives and how they operate.

The proposed regulations also differ in some respects from their predecessor.

- The withdrawn final regulations were accompanied by a prohibited transaction class exemption that allowed individualized investment advice, without a level fee restriction, following use of a computer model. The Obama Administration's DOL concluded that the class exemption's conditions did not adequately protect plan participants from a fiduciary adviser's conflicts of interest and determined not to issue a replacement class exemption. The Department noted in the preamble to its proposed regulations that the PPA statutory exemptions for investment advice do not provide for individualized advice following use of a computer model unless that advice on its own meets the requirements of the statute (i.e., is generated by a computer model or rendered under a fee-leveling arrangement).
- The proposal confirms that the fee-leveling restriction applies at the entity level to the fiduciary adviser and its employees, agents or registered representatives, but not to affiliates of the fiduciary adviser. The proposal takes one additional step, however, and adds a clarification emphasizing that neither the fiduciary adviser nor its employees, agents or registered representatives may receive compensation from any other party, including an affiliate of the fiduciary adviser, that is based on the investment options chosen by participants.
- The proposal applies a new restriction to computer models, disallowing distinctions among investment options within a single asset class that are based on a factor that cannot confidently be expected to persist in the future. The preamble cites historical performance as an example of such a factor. Although historical performance may be a valid basis for distinguishing among different asset classes, the Department

apparently believes that it is not a valid basis for distinguishing among options within a single asset class.

If you have questions or would like additional information about these proposed regulations or fiduciary issues concerning investment advice provided to plan participants, please feel free to contact Brian Dougherty at (215) 587-5919 or bdougherty@postschell.com.

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