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**INVESTMENT ADVICE TO PARTICIPANTS
AND BENEFICIARIES**

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INVESTMENT ADVICE TO PARTICIPANTS AND BENEFICIARIES

By: **Ginger B. LaChapelle, Esq.**

I. INTRODUCTION

A. OVERVIEW AND BACKGROUND

1. On March 2, 2010, the Department of Labor (“DOL”) issued proposed investment advice regulations under Sections 408 of ERISA and 4875 of the Internal Revenue Code. These proposed regulations, which replace withdrawn final regulations that were issued by the DOL on January 21, 2009, implement the statutory exemption from the prohibited transaction rules of Section 406 of ERISA for the provision of investment advice to participants in participant-directed individual account plans that was enacted as part of the Pension Protection Act of 2006 (“PPA”). Under the statutory exemption, the investment advice must be provided by a “fiduciary adviser” under an “eligible investment advice arrangement.” The proposed regulations define these terms and dictate how an “eligible investment advice arrangement” must be structured and operated.

B. EFFECTIVE DATE

1. The regulations will be effective 60 days after they are published in final form. In the meantime, all previously issued guidance remains in effect.

C. APPLICABLE DEFINITIONS

1. Designated Investment Option - The term “designated investment option” means any investment option designated by the plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. The term “designated investment option” does not include “brokerage windows,” “self-directed brokerage accounts,” or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.
2. Fiduciary Adviser – The term “fiduciary adviser” means a person who is a fiduciary of the plan by reason of the provision of investment advice referred to in Section 3(21)(A)(ii) of ERISA, and who is:

- a. Registered as an investment adviser under the Investment Advisers Act of 1940 or under the laws of the State in which the fiduciary maintains its principal office and place of business;
- b. A bank or similar financial institution, but only if the advice is provided through a trust department of the bank or similar financial institution or savings association which is subject to periodic examination and review by Federal or State banking authorities;
- c. An insurance company qualified to do business under the laws of a State;
- d. A person registered as a broker or dealer under the Securities Exchange Act of 1934;
- e. An affiliate of any person or institution described in (a)-(d), above; or
- f. An employee, agent, or registered representative of a person or entity described in paragraphs (a)-(e), above.

II. ELIGIBLE INVESTMENT ADVICE ARRANGEMENTS

A. GENERAL

- 1. Pursuant to the proposed regulations, an “eligible investment advice arrangement” may consist of:
 - a. An arrangement that provides advice through a computer model that meets specific requirements, and is periodically certified by an “eligible investment expert” (defined below); or
 - b. An arrangement that provides a “fee-leveling” approach, where the fiduciary adviser’s fees do not vary depending on the investment option selected.

B. COMPUTER MODEL ARRANGEMENTS

- 1. Section 2550.408g-1(b)(4) of the proposed regulations specifies that under a computer model arrangement the following requirements must be met:
 - a. Investment advice must be based on generally accepted investment theories that take into account the historic risk

and returns of different asset classes over defined periods of time;

- b. Investment management fees and expenses must be taken into account;
 - c. To the extent furnished by a plan, participant or beneficiary, information relating to age, time horizons (e.g., life expectancy, retirement age) risk tolerance, current investments in designated investment options, other assets or sources of income, and investment preferences of the participant or beneficiary must be taken into account;
 - d. Appropriate objective criteria must be utilized to provide asset allocations; and
 - e. The model must be operated in a way that does not inappropriately favor investment options offered by or that generate more income for the fiduciary adviser or its affiliates, or that inappropriately distinguishes among investment options based on “a factor that cannot confidently be expected to persist in the future.” (The proposed regulations provided little guidance as to what factors might be considered as not expected to persist in the future.)
2. Investment Options. The proposed regulations permit a computer model arrangement to exclude recommendations with respect to certain investment options, such as account brokerage windows, self-directed accounts or other similar arrangements offered under the plan. The arrangement does not have to make recommendations regarding investment in employer stock, target date funds or annuity options, so long as the participant is provided information describing target date funds or annuity options and how they operate at the time the investment advice generated by the computer model is given.
3. Certification. Before a computer model may be put into use, an “eligible investment expert” must certify in writing that the model meets the requirements under ERISA and the regulations. The regulations define an “eligible investment expert” as an individual who does not have a material affiliation or contractual relationship with the fiduciary adviser and who “has the appropriate technical training or experience and proficiency to analyze, determine and certify” whether the model meets the requirements of the regulations. The regulations define the selection of an “eligible investment expert” as a fiduciary act. This means that the plan Trustees must prudently select the expert taking all relevant information, experience, and qualifications into account. Pursuant

to Section 2550-408g-1(b)(4) of the proposed regulations, the certification must:

- a. Identify the methodology or methodologies applied in determining whether the computer model meets all applicable requirements;
- b. Explain how the methodology or methodologies show that the model meets the requirements;
- c. Describe any limitations that were imposed by any person on the eligible investment expert's selection or application of methodologies for determining whether the model meets the requirements; and
- d. Represent that the methodology or methodologies were applied by a person or persons with educational background, technical training or expertise necessary to analyze and determine whether the computer model meets these requirements.

C. FEE-LEVELING ARRANGEMENTS

1. Section 2550.408g-1(b)(3) of the proposed regulations specifies that under a fee-leveling arrangement the following requirements must be met:
 - a. Investment advice must be based on generally accepted investment theories that take into account the historic risks and returns of different asset classes over defined periods of time;
 - b. Investment management fees and expenses for the advice must be taken into account;
 - c. To the extent furnished by a plan, participant or beneficiary, information relating to age, time horizons (e.g., life expectancy, retirement age) risk tolerance, current investments in designated investment options, other assets or sources of income, and investment preferences of the participant or beneficiary must be taken into account;
 - d. The fiduciary adviser may not receive any direct or indirect fee or compensation based in whole or in part on the selection of an investment option, including from an affiliate of the adviser.

III. ADDITIONAL REQUIREMENTS APPLICABLE TO BOTH FEE-LEVELING AND COMPUTER MODEL INVESTMENT ADVICE ARRANGEMENTS

A. AUTHORIZATION BY PLAN FIDUCIARY

1. Under Section 2550.408g-1(b)(5) of the proposed regulations, plan fiduciary must expressly authorize the investment advice arrangement. This fiduciary cannot be the investment adviser or be the individual or entity providing designated investment options under the plan, or be an affiliate of either.

B. ANNUAL AUDITS

1. Under Section 2550.408g-1(b)(6) of the proposed regulations, the fiduciary adviser must annually engage an independent auditor, who represents to the fiduciary adviser in writing that he or she has the appropriate technical training or experience proficiency, to:
 - a. Conduct an audit of the investment advice arrangements for compliance with the requirements of the regulations; and
 - b. Within 60 days following completion of the audit, issues a written report to the fiduciary adviser, and to each fiduciary who authorized the use of the investment advice arrangement setting forth the specific findings of the auditor regarding compliance with the requirements of the regulations.

C. DISCLOSURE REQUIREMENTS

1. Under Section 2550.408g-1(b)(7) of the proposed regulations, the fiduciary adviser must provide, without charge, to a participant or beneficiary before the initial provision of investment advice, a written notice describing the following:
 - a. The role of any affiliated party or party with a material affiliation or contractual relationship with the fiduciary adviser;
 - b. The past performance and historical rates of returns of the designated investment options available under the plan, to the extent such information is available;
 - c. All fees or other compensation that the fiduciary adviser or any affiliate thereof is to receive (including compensation provided by any third party) in connection with the provision

of the advice, the sale acquisition or holding of any security or any other property pursuant to such advice, or any rollover or other distribution of plan assets or the investment of distributed assets in any security or other property pursuant to such advice;

- d. Any material affiliation or material contractual relationship of the fiduciary adviser or affiliates thereof in the security or other property;
 - e. The manner, and under what circumstances, any participant or beneficiary information provided under the arrangement will be used or disclosed;
 - f. The types of services provided by the fiduciary adviser in connection with the provision of investment advice by the fiduciary adviser, including, with respect to a computer model arrangement, any limitations on the ability of the computer model to take into account an investment primarily in qualifying employer securities;
 - g. That the adviser is acting as a fiduciary of the plan in connection with the provision of the advice; and
 - h. That a recipient of the advice may separately arrange for the provision of advice by another adviser that could have no material affiliation with and receive no fees or other compensation in connection with the security or other property. (A DOL model notice, which meets all of these requirements is attached as Exhibit A).
2. Under Section 2550.408g-1(b)(7)(iv) of the proposed regulations, the fiduciary adviser, must, at all times during the provision of advisory services to the participant or beneficiary, maintain accurate, up-to-date information, regarding the notice described in paragraph 1, and provide such notice at least annually to the participant. Such notice must also be provided, without charge, upon the request of the participant or beneficiary, and any time the information therein changes.

D. RECORD MAINTENANCE

1. Under Section 2550-408g-1(d) of the proposed regulations, the fiduciary adviser must maintain all records relating to the provision of investment advice that are necessary to show compliance with the regulations for a period of at least six years.

IV. CONCLUSION

A. WHAT PLANS SHOULD DO NOW

1. Since the selection of a fiduciary adviser is a fiduciary act, sponsors of individual account plans that are participant directed, or may become participant directed in the future, should become familiar with the proposed regulations in order to familiarize themselves with the types of investment advice arrangements that qualify for the statutory exemption.