



Management Alert

Investment Advice for Plan Participants: Department of Labor Issues Final Regulations

This fall the U.S. Department of Labor issued final regulations on *eligible investment advice arrangements*, effective on December 27, 2011, which provide tailored investment advice to participants and beneficiaries in individual account plans. The regulations describe an ERISA prohibited transaction exemption that Congress enacted as part of the Pension Protection Act of 2006. Specifically, a prohibited transaction likely would occur if an investment advisor affiliated with an entity providing services to the plan is retained to provide investment advice to participants. However, if the conditions of the Department's regulations are met, engagement of the investment advisor will not result in a prohibited transaction. On the other hand, if the investment advisor is unrelated to the plan's service providers, a prohibited transaction would not occur and the exemption (and adherence to the regulation described below) is not necessary.

It is not uncommon for plans to offer general investment *education*, but these regulations describe arrangements that go a step further and provide individualized *advice*. This is an important difference, because providing investment education generally is not a fiduciary act, while providing advice for a fee is. If a plan fiduciary is considering implementing an eligible investment *advice* arrangement pursuant to the regulations, it will be responsible for the selection and monitoring of the investment adviser and authorization of the arrangement (each as described below).

This alert describes the *eligible investment advice regulations*, and responsibilities of the investment advisor and plan fiduciaries that engage the investment advisor. Plans are not required to make eligible investment advice arrangements available. However, as participants begin receiving the comparative chart and other materials next year under the fee disclosure regulations (see our Management Alert called [Plan and Investment Disclosure Requirements](#), dated July 26, 2011), they may find the advice useful to help them apply the objective investment data they receive to their own needs and circumstances.

Eligible Investment Advice Arrangements

Fee Leveling and Computer Model

The regulations describe two types of arrangements: a fee leveling model, and computer model. Fee leveling means that the person providing the advice cannot receive compensation that varies with the participant's investment decisions. Computer modeling refers to advice provided by software programs that give advice, which are certified by investment experts (sometimes called a "black box"). Under either type of arrangement, the participants receive advice on making investment choices among the different investment funds available under the plan. The advice is generated applying "generally accepted investment theories" that take into account historic risks and returns of different asset classes over time, investment management and other fees of the recommended investments, and participants' personal information if they provide it. Following is a summary of the requirements applicable to the fee leveling arrangements, computer model arrangements, or both.

Characteristic	Applies to:
Advice is based on generally accepted investment theories that take into account the historic risks and returns of different asset classes over defined periods of time.	Fee Leveling and Computer Model
Advice takes into account investment management and other fees and expenses attendant to the recommended investments.	Fee Leveling and Computer Model
Advice takes into account, to the extent furnished, information relating to the participant's or beneficiary's 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.	Fee Leveling and Computer Model
No fiduciary adviser receives, directly or indirectly, any fee or other compensation that varies depending on a participant's or beneficiary's selection of a particular investment option.	Fee Leveling
Factors used in estimating future returns of investment options are appropriately weighted.	Computer Model
Appropriate objective criteria is utilized to provide asset allocation portfolios comprised of the plan's investment options.	Computer Model
Recommendations are avoided that inappropriately favor investment options (1) offered by the fiduciary adviser or its affiliate, or (2) that may generate greater income for the fiduciary adviser or its affiliate.	Computer Model
Takes into account all designated investment options available under the plan (with the exception of certain annuities) without giving inappropriate weight to any one option.	Computer Model
Before using the model, the fiduciary adviser obtains a written certification from an "eligible investment expert," as defined in the regulations.	Computer Model

Participant Characteristics Shape the Investment Advice

As noted in the chart above, the investment advice arrangements must have the capability to consider the participant's age, time horizons (e.g., life expectancy, retirement age), risk tolerance, current investments in the plan's investment funds, other assets or sources of income, and investment preferences. This information must be requested, but the advice does not need to take it into account if it is not provided. While not required, investment advice providers are not precluded from asking for other information, such as participant contribution rates and liquidity needs.

Generally Accepted Investment Theories and Annual Audits

According to the preamble, the Department purposely did not define "generally accepted investment theories," nor provide

examples or safe harbors in the regulations. It explained that it did not want to restrict advisers in design and innovation of their advice arrangements, as such restrictions could potentially lower the quality of the investment advice received by the participants. Plan fiduciaries may not have the ability to independently evaluate whether an arrangement utilizes generally accepted investment theories, although the regulations provide for certifications and annual audits to assist the plan fiduciary. If the arrangement is a computer model, it will have a written certification from an independent investment expert that the model satisfies the requirements of the regulation (which incorporates the “generally accepted investment theory” standard).

Under both fee leveling and computer model arrangements, the investment advisor is required to obtain annual audits of its investment advice arrangement. The auditor must provide a copy of its audit report each year to the investment advisor and the plan fiduciary within 60 days of the audit’s completion. The reports may be part of the fiduciary’s monitoring process.

Disclosure to Participants

Participants must receive written disclosure from the investment advisor about the eligible investment advice arrangement before advice is first provided. The regulations provide a model disclosure form that may be used.

The written notice must provide information about factors that may be relevant to the provision of investment advice. For example, the notice must disclose relationships that might be relevant to the advice (e.g., other parties who had a role in developing the advice program or that have affiliations with the investment funds); fees or other compensation that the adviser or any affiliate will receive in connection with the advice (e.g., when participants buy, sell or hold securities, or request rollovers or distributions of assets); and other services provided by the investment adviser in connection with the provision of advice (e.g., investment management or shareholder services). The notice must include past performance of the plan’s investment alternatives, if not already provided. The regulations do not specify whether the past performance data is “already provided” when distributed in accordance with the fee disclosure regulations or the regulations under Section 404(c) of ERISA.

In addition to the information specific to the adviser and the investment options, the written notice also must inform participants how their information will be used or disclosed, that the adviser is a fiduciary, and that the participant can seek advice outside of the investment advice program.

Considerations For The Plan Fiduciary

Responsibilities under Regulations and General ERISA Principles

If a plan fiduciary is considering making an investment advice arrangement available to participants, the final regulations restate the Department’s previous position that the selection and monitoring of an investment adviser is subject to the fiduciary duty of prudence. Once the fiduciary has selected an investment adviser, the investment advice arrangement must be expressly authorized by the plan fiduciary. The express authorization could be accomplished by recording the review and approval of the arrangement in the minutes of the committee that functions as the plan fiduciary, though other forms of authorization would also be acceptable. In connection with the authorization, the investment advisor must provide a written notice to the plan fiduciary that (i) it intends to comply with the prohibited transaction exemption, (ii) it will obtain annual audits, and (iii) the auditor will furnish a copy of its report within 60 days of the audit’s completion.

Prudent Selection and Monitoring Process

The final regulations reference a 2007 Field Assistance Bulletin, in which the Department described items a fiduciary might consider when selecting and monitoring an investment adviser, whether or not retaining such investment adviser would be a prohibited transaction. Considerations in the selection process might include the adviser's experience and qualifications, its registration in accordance with applicable federal and state securities laws, its willingness to assume fiduciary status, and the extent which advice furnished will be based on generally accepted investment theories. During this process, the investment adviser should provide the plan fiduciary with a copy of its computer model certification, if applicable, and its most recent annual audit reports, discussed above. Considerations in a monitoring process might include any changes in the information used in selecting the adviser (e.g., whether the adviser continues to meet applicable federal and state securities law requirements and whether the advice being furnished to participants was based on generally accepted investment theories), whether the investment advice provider is complying with the contractual provisions of the engagement, how much the participants use the investment advice services relative to its cost, and participant comments and complaints about the quality of the furnished advice.

Next Steps for Plan Fiduciaries

The Department of Labor's regulations on eligible investment advice arrangements may enable the plan fiduciaries to provide welcome assistance to plan participants in managing their individual accounts for retirement. Providing such arrangements is not required, however. Time and care will be required to prudently select and authorize the arrangement, monitor it periodically, and provide for the participant disclosures before any advice is given.

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