

Department of Labor Issues Proposed Regulations and Class Exemption Relating to Investment Advice Arrangements

September 11, 2008

On August 22, 2008, the Department of Labor (“DOL”) issued proposed regulations (the “Proposed Regulations”) that clarify and supplement the provisions of the statutory prohibited transaction exemption for the provision of investment advice with respect to participant-directed individual account plans (“Individual Account Plans”) and individual retirement accounts (“IRAs”). In conjunction with the issuance of the Proposed Regulations, the DOL also proposed a prohibited transaction class exemption (the “Class Exemption”) that would extend relief to certain investment advice arrangements not covered by the statutory exemption. Both the statutory exemption, as supplemented by the Proposed Regulations, and the Class Exemption are expected to significantly expand the opportunities for financial services providers to furnish investment advice to participants and beneficiaries of Individual Account Plans and IRAs to which they also provide investment options.

The Proposed Regulations and the Class Exemption would become effective 60 days and 90 days, respectively, after publication in final form. The DOL has requested that written comments be submitted no later than October 6, 2008.

Background

The prohibited transaction provisions of ERISA and the Internal Revenue Code prohibit a plan fiduciary from using the authority, control or responsibility that makes it a fiduciary to cause additional fees to be paid to itself or related parties. As a result, unless a statutory or administrative exemption is available, a fiduciary would be prohibited from rendering investment advice to plan participants or beneficiaries regarding investments that would result in the payment of additional advisory or other fees to the fiduciary and its affiliates.

The Pension Protection Act of 2006 amended Section 408 of ERISA, and the parallel provisions of the Internal Revenue Code, to provide an exemption from the prohibited transaction rules for (i) the provision of investment advice by a fiduciary (the “fiduciary adviser”) to participants and beneficiaries of Individual Account Plans and IRAs, (ii) the acquisition, holding or sale of investments pursuant to such advice, and (iii) the receipt of fees or other compensation by the fiduciary adviser and its affiliates in connection with the provision of the investment advice and any related investment transactions. Pursuant to the statutory exemption, such investment advice must be given pursuant to one of the following investment advice arrangements:

- A “level fee” arrangement, where the fees or other compensation received by the fiduciary adviser does not vary based on the investment option selected; and

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- A “computer model” arrangement that is certified by an eligible investment expert as meeting certain requirements set forth in the exemption, including requirements that the model apply generally accepted investment theories, utilize relevant information about the participant, take into account all investment options available under the plan and operate in a manner that is not biased in favor of investments offered by the fiduciary and its affiliates.

The relief provided with respect to computer model arrangements was initially limited to Individual Account Plans, subject to a determination by the DOL as to the feasibility of using such arrangements to provide investment advice to IRA beneficiaries.

Each of the investment advice arrangements described in the statutory exemption must also satisfy the following additional requirements:

- The arrangement must be expressly authorized by a plan fiduciary other than the person offering the arrangement to the plan, any person providing investment options under the plan or any of their respective affiliates;
- An independent auditor with appropriate technical training or expertise must conduct an annual audit of the arrangement for compliance with the requirements of the exemption;
- The fiduciary adviser must disclose certain information to the participants and beneficiaries in a written notification before the initial provision of investment advice, including all fees and other compensation the fiduciary adviser and its affiliates will receive in connection with the provision of investment advice and any related investment transactions; and
- The fiduciary adviser must maintain, for a period of not less than six years after the provision of investment advice, any records necessary to determine whether the requirements of the exemption have been met.

Proposed Regulations

The provisions of the Proposed Regulations relating to “level fee” arrangements, while generally tracking the statutory requirements, impose the following additional requirements:

- The advice provided under the arrangement must be based on generally accepted investment theories and on certain relevant information regarding the participant or beneficiary; and
- Fees or other compensation received by any employee, agent or registered representative that provides investment advice on behalf of the fiduciary adviser (in addition to any fees received by the fiduciary adviser itself) may not vary depending on the investment option selected by the participant or beneficiary receiving the investment advice.

The provisions of the Proposed Regulations relating to “computer model” arrangements also track the statutory requirements, but clarify and supplement these requirements in the following respects:

- The Proposed Regulations extend the relief provided under the statutory exemption to the provision of investment advice to IRA beneficiaries;
- The Proposed Regulations clarify that a computer model is not required to take into account an investment option that constitutes an investment primarily in qualifying employer securities;
- The Proposed Regulations provide that an “eligible investment expert” must have the appropriate technical training or experience and proficiency to analyze, determine and certify whether a computer model meets the applicable regulatory requirements;
- The Proposed Regulations specify the form and content of the certification provided by the eligible investment expert; and
- The Proposed Regulations establish a procedure pursuant to which a person who develops a computer model used in a computer model arrangement, or who markets the computer model or arrangement, may elect to be treated as the sole fiduciary adviser with respect to such arrangement.

The Proposed Regulations also clarify certain aspects of the statutory exemption’s fiduciary authorization and compliance audit requirements. In addition, an appendix to the Proposed Regulations contains a model fee disclosure form. While use of the model form is optional, a fiduciary adviser who uses this form will be deemed to satisfy the written disclosure requirements with respect to such information.

Proposed Class Exemption

The Class Exemption would extend the relief provided under the statutory exemption to arrangements where participants and beneficiaries of Individual Account Plans or IRAs are given individualized investment advice following the receipt of investment recommendations generated by a computer model (or, in the case of an IRA whose investment choices preclude the use of a computer model, following the receipt of certain educational materials), provided that:

- The computer model satisfies the requirements of the statutory exemption relating to computer models, except that the computer model does not need to be certified by an eligible investment expert if it is developed or maintained by a person independent of the fiduciary adviser and its affiliates;
- The individualized investment advice does not recommend investment options that may generate greater income for the fiduciary adviser (or any employee, agent, registered representative or affiliate thereof), or certain persons having ma-

terial contractual relationships with the fiduciary adviser, unless the fiduciary adviser prudently concludes that the recommendation is in the best interest of the participant or beneficiary and explains the basis for such conclusion to the participant or beneficiary; and

- Within 30 days following the provision of investment advice, the employee, agent or registered representative providing the advice on behalf of the fiduciary adviser documents the basis of any investment options recommended to the participant or beneficiary.

The Class Exemption would also apply to the provision of investment advice pursuant to a “level fee” arrangement where the fees or other compensation received, directly or indirectly, by an employee, agent or registered representative providing advice on behalf of the fiduciary adviser does not vary depending on the basis of any investment option selected by a participant or beneficiary. Unlike the statutory exemption, the Class Exemption would not impose a level fee requirement on the compensation received by the fiduciary adviser itself on whose behalf the employee, agent or registered representative is acting.

If you have any questions regarding the Proposed Regulations or Class Exemption, please contact Andrew J. Fawbush at 904-630-5340 (or 212-259-6907) or afawbush@dl.com, David C. Olstein at 212-259-6255 or dolstein@dl.com, Mitchel C. Pahl at 212-259-6720 or mpahl@dl.com, Martha N. Steinman at 212-259-8093 or msteinman@dl.com, or your Dewey & LeBoeuf relationship lawyer.