

FIDUCIARY ADVICE REGS FINALIZED

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Effective December 27, 2011 the DOL has published a new final regulation which will govern fiduciary advice provided to participants and beneficiaries in qualified plans. Technically, the regulation provides relief from the prohibited transaction rules contained in ERISA Section 406 and Internal Revenue Code Section 4975. The final reg implements ERISA and Code provisions relating to the provision of investment advice to participants and beneficiaries -- ERISA Sections 408(b)(14) and (g)(I) and Code Sections 4975(d)(17) and (f)(8).

Nothing in the regulations requires a plan or a plan fiduciary to provide investment advice to any participant or beneficiary. However, if such advice is provided, compliance with the final reg can provide relief from the prohibited transaction rules. In addition, the reg makes clear that it is not intended to invalidate prior guidance, such as the so-called Sun America Advisory Letter (ERISA opinion no. 2001-09A, 2001), which may also offer relief from the prohibited transaction rules.

Relief under the final reg is available only for an "eligible investment advice arrangement," which is defined to require compliance with one or both of two fundamental approaches: **arrangements that use fee leveling**, and **arrangements that use computer models**. The reg makes it clear that the advice arrangement must be expressly authorized by a disinterested plan fiduciary.

Fiduciary Adviser Requirements

Under either arrangement, there must be a "fiduciary adviser" who is a fiduciary of the plan. No fiduciary adviser is allowed to receive any compensation that could vary depending upon the basis of a participant's or beneficiary's selection of a particular investment option. Any fee charged must be neutral and not based upon the investment recommended.

The fiduciary adviser is required to provide written disclosures to participants or beneficiaries. The reg requires those disclosures to include, for example,

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notification of affiliation or contractual relationships, past performance and historical rates of return for investment options available under the plan, fees and compensation to be received by the fiduciary adviser, the manner in which participant or beneficiary information will be used or disclosed, that in providing advice the adviser is acting as a fiduciary of the plan, that an advice recipient can arrange for another adviser. The reg contains a model disclosure.

In addition, the fiduciary adviser is required to provide written disclosures to the plan fiduciary, including notice that the fiduciary adviser intends to comply with the reg, that the arrangement will be audited annually by an independent auditor for compliance with the reg, and that the auditor will provide the plan fiduciary with a copy of the audit within 60 days after its completion.

The fiduciary adviser is also required to maintain for not less than 6 years records regarding compliance with the reg.

The reg specifically provides that the term “fiduciary adviser” includes any person who develops the computer model, or markets the computer model or investment advice program. Otherwise, a “fiduciary adviser” must be a registered investment adviser, a bank, an insurance company, a broker or dealer, or certain affiliates, employees or agents of such persons or entities.

Arrangement Requirements

A fee leveling investment advice arrangement must be based on, and a computer model arrangement must be designed and operated to apply, “generally accepted investment theories that take into account the historic risks and returns of different asset classes over defined periods of time,” although nothing in the reg precludes any investment advice from being based on, or a computer model from applying, “generally accepted investment theories that take into account additional considerations.” Both arrangements must take into account investment management and other fees and expenses attendant to the recommended investments.

Arrangements that use fee leveling require the financial adviser to request, and the investment advice to take into account, to the extent furnished by the plan, the 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. The reg makes it clear that it does not require any investment advice to take into account information requested, but not furnished; nor does the reg preclude requesting and taking into account additional information that a plan or participant or beneficiary may provide.

Computer models must be designed and operated to request such information from a participant or beneficiary and, to the extent furnished, must utilize that information, and the reg makes it clear that nothing

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precludes a computer model from requesting and taking into account additional information that a plan or a participant or beneficiary may provide.

A computer model must be designed and operated to utilize appropriate objective criteria to provide asset allocation portfolios comprised of investment options available under the plan; must avoid investment recommendations that inappropriately favor investment options offered by a fiduciary advisor over other investment options, if any, available under the plan, or that inappropriately favor investment options that may generate greater income for the fiduciary adviser.

The new reg allows the modeling to address investments in employer securities as well as asset allocation funds. The reg makes clear that a computer model will not fail to meet the requirements if it does not make recommendations relating to an annuity option involving a stream of retirement income payments guaranteed by an insurance company, or options which the participant or beneficiary has requested to be excluded from consideration in such recommendations.

A fiduciary adviser using a computer model must obtain a written certification from an “eligible investment expert” who certifies in writing that the computer model meets the requirements of the regulations. The reg makes clear that the selection of the eligible investment expert is a fiduciary act under ERISA.

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