



New DOL Guidance on Providing Investment Advice to 401(k) Plan Participants

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Providing Investment Advice to 401(k) Plan Participants

- What Plan Sponsors Are Doing Now
- Participant Education v. Participant Advice
- New Prohibited Transaction Exemptions for Eligible Investment Advice Arrangements
- Fiduciary Exemption for Authorizing Fiduciaries
- What Plan Fiduciaries Should Do



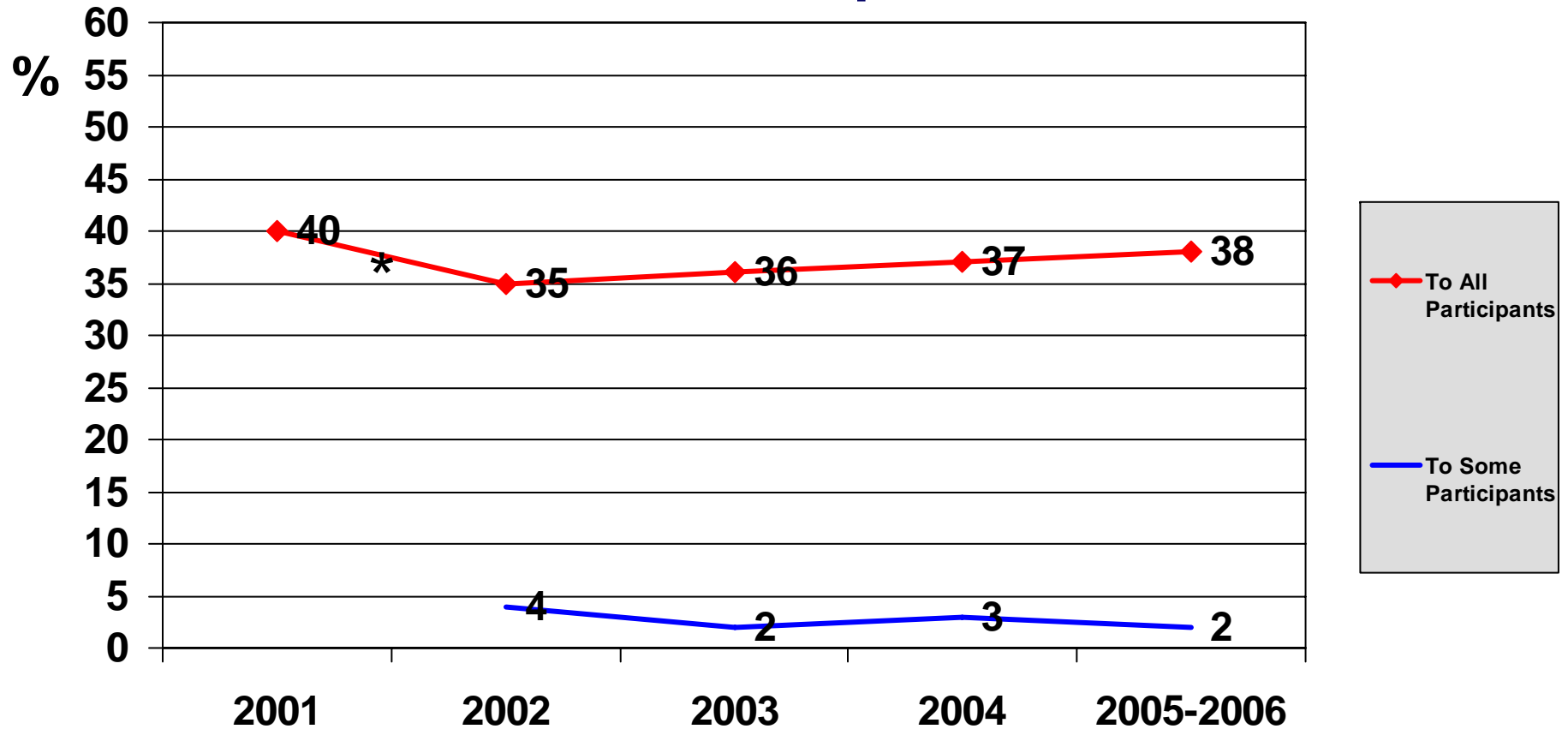
What Plan Sponsors Are Doing Now

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What Plan Sponsors Are Doing Now

- Most employers that provide any type of retirement plan provide a 401(k) plan
- Most plans are participant-directed
 - Only half identified as 404(c) plans on the Form 5500
- Most plan sponsors don't offer investment advice services to their participants
 - Percentage has remained fairly constant 40%

Percent of Plans Offering Investment Advice to Participants

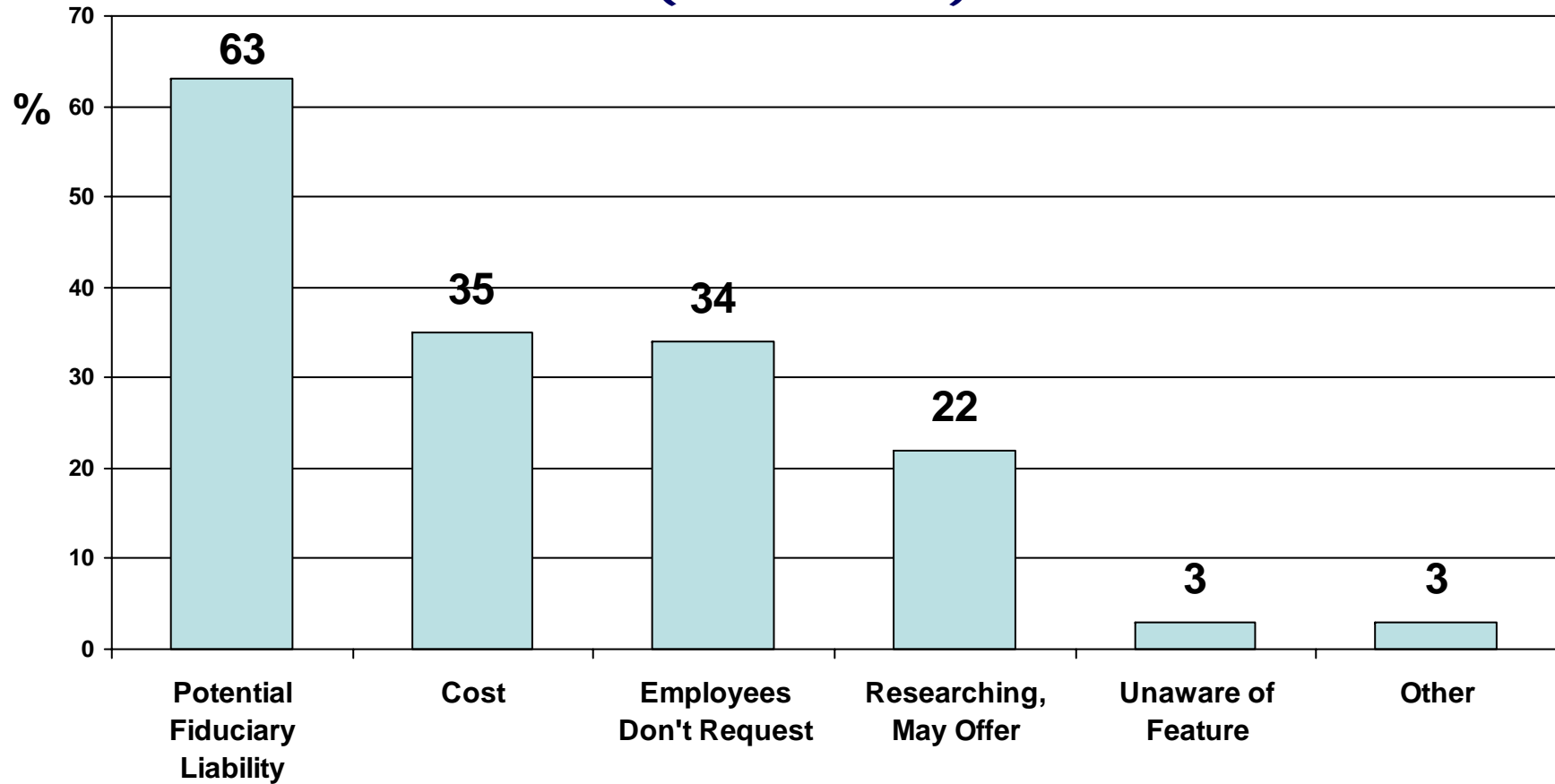


* Did not separate all and some

Source: Deloitte Consulting/ ISCEBS, *Annual 401(k) Benchmarking Surveys, 2001 – 2006*

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Why Don't Sponsors Offer Financial Counseling/Advice (2005/2006)



Source: Deloitte Consulting/ ISCEBS, *Annual 401(k) Benchmarking Surveys, 2001 – 2006*
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Participant Education versus Participant Advice

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Participant Education v. Participant Advice

- Providing investment advice for a fee or other compensation makes a person a fiduciary
 - ERISA § 3(21)(A)(ii)
- Many vendors do not want to be ERISA fiduciaries
- DOL issued Interpretative Bulletin 96-1 (IB 96-1) to identify types of investment education that would not constitute “advice”
 - Recognition that participants need help in investing their retirement savings

Investment Education

- Under IB 96-1, general participant education about pension investing is not advice:
 - General financial and investment concepts
 - Historic differences in rates of return between different asset classes
 - Effects of inflation
 - Estimating future retirement income needs
 - Determining investment time horizons and
 - Assessing risk tolerance
- Rationale: Not tied to specific investments under the plan

Model Portfolios

- Under IB 96-1, model portfolios for hypothetical participants are not advice if:
 - Based on generally accepted investment theories
 - Historic returns of different asset classes
 - Participants given material facts and assumptions on which the models are based
 - If specific fund(s) identified, must include:
 - Statement that similar funds available under the plan
 - How to find information about other funds
 - Statement that participants should consider their other assets and income

Asset Allocation Software

- Under IB 96-1, computerized asset allocation models not investment advice if:
 - Based on generally accepted investment theories
 - Objective correlation between asset allocations and participant inputs
 - If specific fund(s) identified, must include:
 - Statement that similar funds available under the plan
 - How to find information about other funds
 - Takes into account participant's other investments and income (or advise participant to do so)

Experience with IB 96-1

- Generic asset allocation models developed, not tied to specific investments in plan
- Bundled providers concerned about prohibited transactions because they receive different fees depending on which options recommended

Sun America Letter

- In Advisory Opinion 2001-09A, DOL concluded a mutual fund adviser could provide an interactive asset allocation system (and automatic rebalancing following such system) if:
 - Allocations came from a computerized program
 - Methodology developed, maintained and overseen by an independent financial expert
- No prohibited transaction even though fees received by the mutual fund adviser varied depending on the funds chosen by participants



**New
Prohibited Transaction Exemptions
for
Eligible Investment Advice Arrangements**

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Pension Protection Act of 2006

- PPA added a new prohibited transaction exemption for “eligible investment advice arrangements” ERISA § 408(g)
- PPA also provides that plan fiduciaries who select the eligible investment advice arrangement are not liable for advice
ERISA § 408(g)(10)
- Effective for 2007 and later plan years
PPA § 601(a)(3)

Eligible Investment Advice Arrangements

- Two types of eligible investment advice arrangements provided by fiduciary advisers:
 - Fee leveling arrangements
 - Computer models
- Both require:
 - Fiduciary must expressly authorize the arrangement
 - Annual audit by independent auditor with written report to authorizing fiduciary
 - Disclosures about conflict, fees, etc.

Additional Requirements

- Investment adviser gives appropriate disclosures required under securities laws
- Investment decisions made by participants
- Compensation received by investment advisers or affiliates reasonable
- Terms of the securities transactions are as favorable to the plan as arm's length transactions

Fiduciary Adviser

- Fiduciary
- Must be:
 - Registered investment adviser
 - Trust department of a bank or similar institution
 - Insurance company
 - Broker or dealer
 - Affiliate of any of the above
 - Individual employee, agent or registered representative who meets requirements of banking, insurance and securities law to provide advice

Fee Leveling Arrangements

- Fees and other compensation cannot vary based on advice
- In Field Assistance Bulletin (FAB) 2007-1, DOL clarified that:
 - Fee leveling applies only to individuals that provide the advice and their employer, not affiliates
 - Fees or other compensation includes salary, bonuses, awards, promotions or any other thing of value received directly or indirectly by a fiduciary adviser (or used for the adviser's benefit)
 - May not be based, in whole or part, on the investment options selected by participants or beneficiaries

Computer Models

- Applies generally accepted investment theories that take into account historic returns of different asset classes
- Utilizes relevant information about participant - age, life expectancy, retirement age, risk tolerance, other assets or sources of income
- Utilizes objective criteria
- Takes into account all investment options in plan
- Not inappropriately weighted to any option
- Only investment advice is computer generated
- Transactions occur only at participant direction

Certification of Computer Models

- Eligible investment expert must certify that the computer model meets the requirements
 - Before model is used
 - After any material modification
- Eligible investment expert cannot have any material affiliation or contracts with investment adviser or any related person
- DOL to provide rules for certification and qualifications of eligible investment expert

Disclosures by Fiduciary Adviser

- Participants must be provided with written notification, which describes:
 - Role of any party with material affiliations or contractual relationships involved in
 - Developing model or
 - Selecting investment options under the plan
 - Past performance or investment options
 - All compensation received by fiduciary or affiliates
 - Any material affiliations or contractual relationships in the securities or other property
 - Uses and disclosure of participant information
 - Services provided by investment adviser
 - That the adviser is acting as a fiduciary
 - That participant may select another investment adviser

Disclosure Standards

- Written in clear and conspicuous manner
- Calculated to be understood by the average participant
- Sufficiently accurate and comprehensive to apprise participants of required information
- DOL to provide model form for disclosure of fees and other compensation
- Notice may be delivered electronically

Fiduciary Exemption for Authorizing Fiduciaries

Fiduciary Exemption for Authorizing Fiduciaries

- Applies to plan sponsor and other authorizing plan fiduciaries
- Applies not only to prohibited transactions but also other fiduciary requirements
- In FAB 2007-1, DOL stated that standards for selection and monitoring by plan fiduciaries is same for investment advice permitted under PPA guidance
 - No statutory protection

Requirements for Fiduciary Exemption

- Applies only to eligible investment advice arrangements
- Agreement with fiduciary adviser must:
 - Require adviser to comply with requirements
 - Include written acknowledgement that adviser is a fiduciary
- Prudent selection
- Periodic review of fiduciary adviser but no duty to monitor specific advice given to any particular participant

Existing Exemptions

- PPA § 601(c) provides that the new statutory exemption does not alter existing exemptions
 - E.g., Citigroup's TRAK exemption
 - Originally PTE 92-77, 55 Fed. Reg. 45833 (Oct. 5, 1992); most recently revised in PTE 2000-45, 65 Fed. Reg. 54315 (Sept. 7, 2000)
- Existing exempt arrangements are not eligible investment advice arrangements, however
 - Plan fiduciaries do not get statutory protection



What Plan Fiduciaries Should Do

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What Should Plan Sponsor Do?

If already offering investment advice:

- Ask vendor whether they meet the requirements of one of the new exemptions
- Amend contracts to:
 - Require adviser to comply with requirements
 - Include written acknowledgement that adviser is a fiduciary
- Establish procedures for monitoring compliance with requirements for eligible investment advice arrangements
 - Obtain copies of annual audits and certifications of models
 - Consider having plan's investment consultant review periodically (if qualified) and report to plan committee

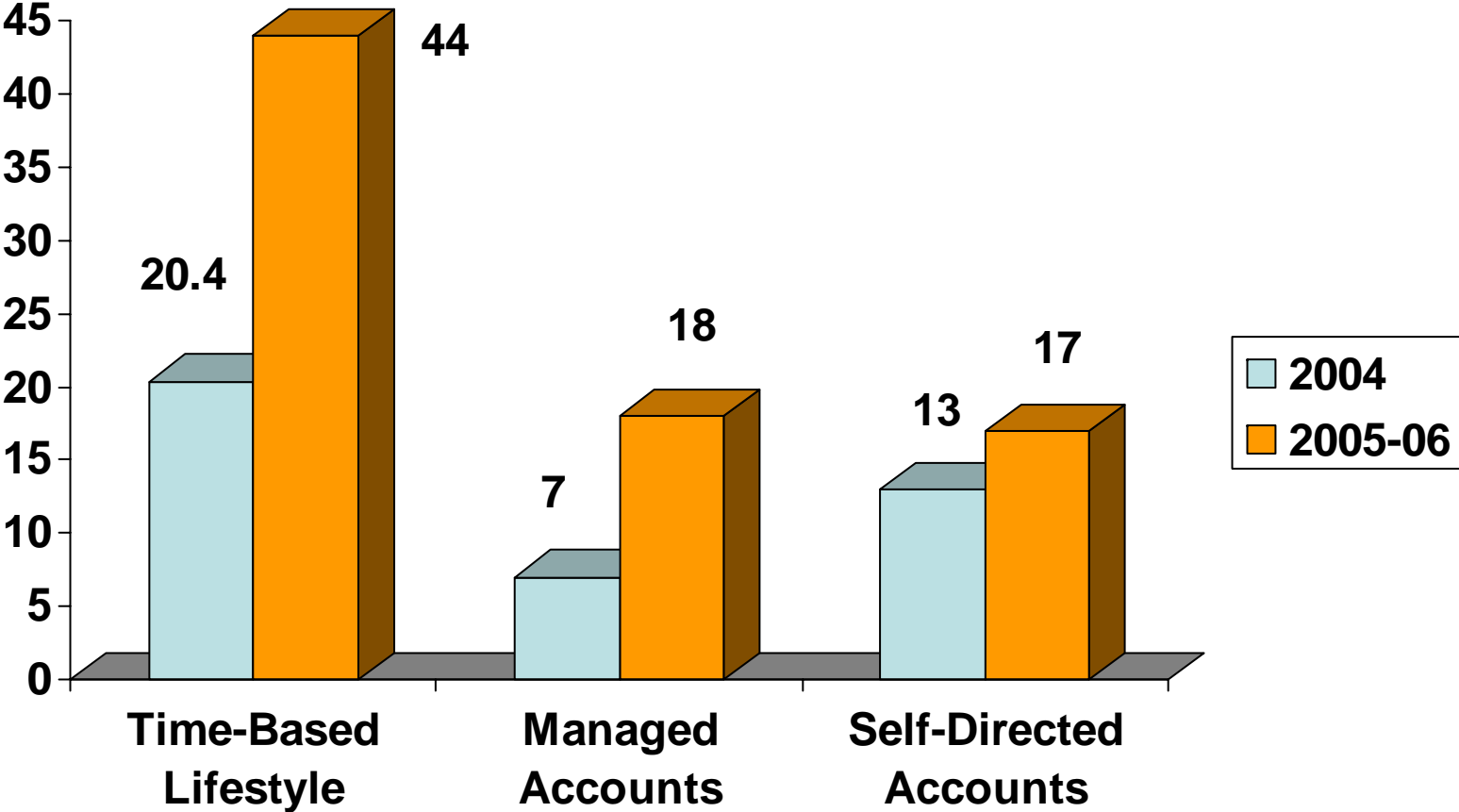
Comparing Investment Advice Products

- Do cost/benefit analysis if fees are paid from the plan
- Consider conflicts of interest carefully and determine what safeguards are in place if adviser is affiliated with those offering investment products in the plan
- If plan committee doesn't have requisite expertise to evaluate, use outside adviser (preferably one that acknowledges fiduciary responsibility)

Consider Other Alternatives

- Default investments
 - DOL will issue regulations later this year
 - Proposed regulations create safe harbor for
 - Balanced funds
 - Life cycle funds
 - Target date funds
 - Managed accounts
- Plan fiduciaries get 404(c) protection
- Similar fiduciary rules for prudent selection and monitoring

Plans Offering Actively Managed Investments Have Increased Significantly



Source: Deloitte Consulting/ ISCEBS, *Annual 401(k) Benchmarking Surveys, 2001 – 2006*
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If Considering Investment Advice

- Wait for DOL guidance before selecting investment advice provider affiliated with parties offering investment products in plan
 - New products likely as soon as DOL issues guidance
- Existing arrangement with unaffiliated investment advisers or programs covered by existing exemptions should continue to be OK

QUESTIONS????

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