



plan investment advisor rules increase employer obligations

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For the first time this year, retirement plans fiduciaries can provide investment advice to participants and get an additional fee for doing so. Plan sponsors and fiduciaries that want to offer this service will have to satisfy new rules enacted as part of the Pension Protection Act of 2006 and Department of Labor guidance issued earlier this month. Prior to 2007, the provision of such advice for an additional advisory fee by a plan fiduciary would have resulted in a prohibited transaction under ERISA and the Internal Revenue Code.

Plan sponsors generally will not be liable for the advice offered to the participants; however, plan sponsors (or some other fiduciary appointed by them) will have substantial responsibility with respect to the appointment of the investment advisor and ongoing monitoring of its services. It is unclear just yet to what extent plans will offer this service. In some cases, plan sponsors may feel that the obligations associated with appointing and monitoring the investment advice provider are too onerous and decide not to offer the service.

Background

In recent years, it has become increasingly common for individual account plans, such as 401(k) plans, to provide participants with a choice of investment options and leave it to the participant to determine how his or her account is invested. Although these investment decisions will have a major impact on the amount of retirement income participants will receive, many plan participants lack the knowledge necessary to make informed decisions. As a result, employers and financial services companies that act as the plan fiduciaries sought changes in the law so that greater levels of investment advice could be provided to plan participants.

New law

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Under the new law, a fiduciary investment advisor can receive an additional fee for providing investment advice to participants as to the allocation of his or her plan contributions among different investment options provided certain requirements are met including the following:

- Either the fees received by the fiduciary must not vary depending on the investment option selected or the advice must be provided through a computer model under an investment advice program.
- If the computer model is used, it must: apply generally accepted investment theories that take into account historic returns of different investment classes as well as the participant's age, life expectancy, risk tolerance, retirement age and other personal information; use objective criteria; and operate without bias toward investments affiliated with the advisor.
- The arrangement with the investment advisor must be approved by another plan fiduciary who is unrelated to the investment advisor or the provider of any of the plan investment options.
- The arrangement must be audited to assure compliance with these requirements.
- Participants must receive detailed disclosure including: information on any relationship between the investment advisor and the investment options under the plan; past performance of the investment options; fees payable to the advisor and other information.
- The compensation paid to the advisor must be reasonable and the transaction costs must be at least as favorable as would apply under an arm's length transaction.
- The appointment of the investment advisor and ongoing monitoring of the investment advisor's performance are treated as fiduciary acts by the plan sponsor or other fiduciary that are subject to the prudence standards of ERISA.

Obligations of plan sponsors

This last requirement warrants special attention from plan sponsors, which in most cases will be doing the appointing and monitoring, and was fleshed out in the recent guidance from the DOL.

Plans are not required to offer these investment advice services. If the plan sponsor wishes to offer the service, the plan sponsor must prudently select and monitor the investment advice provider in order for the plan sponsor to avoid being liable for the advice provided. In making the decision whether this is a service they wish to offer to plan participants, plan sponsors should take into account their ongoing obligations with respect to appointment and monitoring of these advisors. (Although plan sponsors can designate other fiduciaries to handle the selection and monitoring process, in most cases the plan sponsor will bear this responsibility. Therefore, when I refer to the obligations of the plan sponsor below, I am also including the obligations of any fiduciary appointed by the plan sponsor to carry out these functions.)



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The DOL prescribes the following process for the **appointment** of the investment advice provider:

- First, the plan sponsor must assess the provider's qualifications, quality of services offered and reasonableness of fees charged.
- The process must avoid self-dealing, conflicts of interest or improper influence.
- The process should take into account the advisor's experience and qualifications, the advisor's registration in accordance with applicable securities laws, the willingness of the investment advisor to assume responsibility under ERISA and the extent to which the advice is based on "generally accepted investment theories." To accomplish this, plan sponsors will need to understand the "investment theories" on which the advice provided will be based.

Then, as part of the ongoing **monitoring** process:

- Plan sponsors will be expected to monitor changes in the information that served as the basis for the initial selection of the advisor, including continuing compliance with applicable securities laws and whether the advice was based on the "generally accepted investment theories" first stated.
- Plan sponsors will also have to take into account the extent to which the advisor is complying with the terms of its agreement, utilization of the advice services by participants in relation to the cost of the services, and participant comments and complaints about the service. These complaints will in many cases need to be investigated and, to the extent that the comments and the questions raise issues about the advice offered, the plan sponsor may have to review the specific advice with the advisor.

The selection and monitoring of advisors providing investment advice to participants will require procedures on the part of plan sponsors to assure that the above requirements are satisfied. Plan sponsors will have to determine whether the burdens of these procedures are worth the possible benefits to plan participants.

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