

**DEPARTMENT OF LABOR**

**Employee Benefits Security Administration**

**29 CFR 2550**

**RIN 1210-AB35**

**Investment Advice – Participants and Beneficiaries**

**AGENCY:** Employee Benefits Security Administration, Labor.

**ACTION:** Proposed rule.

**SUMMARY:** This document contains a proposed rule under the Employee Retirement Income Security Act, and parallel provisions of the Internal Revenue Code of 1986, relating to the provision of investment advice to participants and beneficiaries in individual account plans, such as 401(k) plans, and beneficiaries of individual retirement accounts (and certain similar plans).

Upon adoption, the proposed rule would implement provisions of a statutory prohibited transaction exemption, and would replace guidance contained in a final rule, published in the **Federal Register** on January 21, 2009, that was withdrawn by the Department pursuant to a Notice published in the **Federal Register** on November 20, 2009. Upon adoption, the proposed rule affects sponsors, fiduciaries, participants and beneficiaries of participant-directed individual account plans, as well as providers of investment and investment advice related services to such plans.

**DATES:** Written comments on the proposed regulations should be submitted to the Department of Labor on or before May 5, 2010.

**FOR FURTHER INFORMATION CONTACT:** Fred Wong, Office of Regulations and Interpretations, Employee Benefits Security Administration (EBSA), (202) 693-8500. This is not a toll-free number.

**ADDRESSES:** To facilitate the receipt and processing of comment letters, the EBSA encourages interested persons to submit their comments electronically by e-mail to e-ORI@dol.gov (enter into subject line: 2010 Investment Advice Proposed Rule) or by using the Federal eRulemaking portal at <http://www.regulations.gov>. Persons submitting comments electronically are encouraged not to submit paper copies. Persons interested in submitting paper copies should send or deliver their comments to the Office of Regulations and Interpretations, Employee Benefits Security Administration, Attn: 2010 Investment Advice Proposed Rule, Room N-5655, U.S. Department of Labor, 200 Constitution Avenue, NW, Washington, DC 20210. All comments will be available to the public, without charge, online at <http://www.regulations.gov> and <http://www.dol.gov/ebsa> and at the Public Disclosure Room, N-1513, Employee Benefits Security Administration, U.S. Department of Labor, 200 Constitution Avenue, NW, Washington, DC 20210.

**SUPPLEMENTARY INFORMATION:**

**A. Background**

On January 21, 2009, the Department of Labor published final rules on the provision of investment advice to participants and beneficiaries of participant-directed individual account plans and to beneficiaries of individual retirement accounts and certain similar plans (IRAs) (74 FR 3822). The rules implement a statutory prohibited transaction exemption under ERISA Sec. 408(b)(14) and Sec. 408(g), and under section 4975 of the Internal Revenue Code of 1986 (Code),<sup>1</sup> and also contain an administrative class exemption granting additional relief. As

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<sup>1</sup> Section 601 of the Pension Protection Act of 2006 (PPA) added sections 408(b)(14) and 408(g) of ERISA. The PPA also added parallel provisions to the Code at sections 4975(d)(17) and 4975(f)(8). Under Reorganization Plan No. 4 of 1978 (43 FR 47713, Oct. 17, 1978), 5 U.S.C. App. 1, 92 Stat. 3790, the authority of the Secretary of the Treasury to issue rulings under section 4975 of the Code has been transferred, with certain exceptions not here relevant, to the Secretary of Labor. Therefore, the references in this notice to specific sections of ERISA should be taken as referring also to the corresponding sections of the Code.

published, these rules were to be effective on March 23, 2009. On February 4, 2009, the Department published in the **Federal Register** (74 FR 6007) an invitation for public comment on a proposed 60 day extension of the effective dates of the final rules in order to afford the Agency the opportunity to review legal and policy issues relating to the final rules. The Department also invited public comments on the provisions of those rules and on the merits of rescinding, modifying or retaining the rules. In response to this invitation, the Department received 28 comment letters.<sup>2</sup> On March 20, 2009, the Department adopted a 60 day extension of the final rule. (See 74 FR 11847). In order to afford the Department additional time to consider the issues raised by commenters, the effective and applicability dates were further delayed until November 18, 2009 (74 FR 23951), and then until May 17, 2010 (74 FR 59092).

## **B. Comments Received**

A number of the commenters expressed the view that the final rule raises significant issues of law and policy, and should be withdrawn. Several of these commenters argued that the class exemption contained in the final rule permits financial interests that would cause a fiduciary adviser, and individuals providing investment advice on behalf of a fiduciary adviser, to have conflicts of interest, but does not contain conditions that would adequately mitigate such conflicts. They asserted that investment advice provided under the class exemption therefore might be tainted by the fiduciary adviser's conflicts. Other commenters expressed concerns about those provisions of the rule relating to the "fee-leveling" requirement under the statutory exemption. In particular, some opined that the Department's interpretation of the statutory exemption's fee-leveling requirement is incorrect for permitting the receipt of varying fees by an affiliate of a fiduciary adviser. As a result, they argued, a fiduciary adviser under such a fee-

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<sup>2</sup> These comments are available on the Department's website at: <http://www.dol.gov/ebsa/regs/cmt-investmentadvicefinalrule.html>.

leveling arrangement has a conflict of interest, and the final rule does not adequately protect against investment advice that is influenced by the financial interests of the fiduciary adviser's affiliates. Commenters who advocated retention of the final rule argued that it contains strong safeguards that would protect the interests of plan participants and beneficiaries.

### **C. Analysis and determination**

As documented in the Department's regulatory impact analysis (RIA) of the January 2009 final regulation and class exemption, defined contribution (DC) plan participants and IRA beneficiaries often make costly investment errors. Those who receive and follow quality investment advice can reduce such errors and thereby reap substantial financial benefit. The Department estimated that the PPA statutory exemption as implemented by the final regulation, together with the final class exemption, would extend investment advice to 21 million previously unadvised participants and beneficiaries, generating \$13 billion in annual financial benefits at a cost of \$5 billion, for a net annual financial benefit of \$8 billion.

In arriving at its estimates, the Department assumed that on average participants and beneficiaries who are advised make investment errors at one-half the rate of those who are not. The Department further assumed that different types of investment advice arrangements on average would be equally effective: arrangements operating without need for exemptive relief, those operating pursuant to the PPA, and those operating pursuant to the class exemption all would reduce investment errors by one-half on average.

The Department's assumptions regarding the effectiveness of different advice arrangements were subject to uncertainty, particularly as applied to its assessment of the final class exemption's effects. The Department has determined that the issues raised by commenters are sufficient to cast doubt as to whether the class exemption's conditions are adequate to

mitigate advisers' conflicts. Based on this determination regarding the class exemption, the Department has decided to withdraw the final rule. Notice of the withdrawal of the final rule was published in the **Federal Register** on November 20, 2009 (74 FR 60156).

In order to address the absence of regulatory guidance on the statutory exemption that results from withdrawal of the January 2009 final rule, the Department is publishing in this notice proposed regulations that, upon adoption, implement the statutory prohibited transaction exemption under ERISA Sec. 408(b)(14) and Sec. 408(g), and parallel provisions in the Code. The proposed regulations do not include a class exemption. The Department notes that, while relief would have been available under the withdrawn class exemption, the statutory exemption does not provide prohibited transaction relief for any individualized advice rendered to individuals following the furnishing of investment recommendations generated by a computer model described in the statute unless such advice on its own meets the requirements of the statute (i.e., is generated by a computer model under a computer-model arrangement or is rendered under a fee-leveling arrangement).

#### **D. Overview of Proposed Regulations**

Proposed Sec. 2550.408g-1 tracks the requirements under section 408(g) of ERISA that must be satisfied in order for the investment advice-related transactions described in section 408(b)(14) to be exempt from the prohibitions of section 406. Paragraph (a) of the proposal describes the general scope of the statutory exemption and regulation. Paragraph (b) of the proposal sets forth the requirements that must be satisfied for an arrangement to qualify as an "eligible investment advice arrangement" and for the exemption to apply. Paragraph (c) of the proposal defines certain terms used in the regulation. The Appendix to the proposal contains a non-mandatory model disclosure form that may be used to satisfy certain of the requirements

contained in paragraph (b). Proposed Sec. 2550.408g-2 addresses the requirements for electing to be treated as the only fiduciary and fiduciary adviser by reason of developing or marketing a computer model or an investment advice program used in an “eligible investment advice arrangement.” See ERISA section 408(g)(11)(A).

The proposed regulations are nearly identical to the provisions of the January 2009 final rule that implement the statutory exemption. The Department’s explanations of such provisions provided in the publication of the January 2009 final rule and in the publication of the related August 2008 proposed rule (73 FR 49896 (Aug. 22, 2008)), to the extent not modified or superseded in the January 2009 publication, should be read as applicable to the regulations being proposed in this notice. The Department is not providing a new description of the provisions.

The Department notes, however, that the proposed regulations contain clarifying language intended to address comment letters, mentioned above, that expressed concerns with the provisions of the final rule that interpret the statutory exemption’s fee-leveling requirement. In particular, some commenters observed that the final rule would permit the receipt of varying fees by an affiliate of a fiduciary adviser, and further opined that this would permit an affiliate of a fiduciary adviser to establish economic incentives for either the fiduciary adviser, or individuals providing investment advice on its behalf, to recommend investments that pay varying fees to the affiliate. Therefore, commenters argued, the final rule would not adequately protect participants and beneficiaries from advice influenced by the affiliates’ interests. In response, the Department is emphasizing in the proposal that, as stated in Field Assistance Bulletin 2007-1 (February 2, 2007) (FAB 2007-1), the receipt by a fiduciary adviser of any payment from any party (including an affiliate of the fiduciary adviser), or used for the benefit of such fiduciary adviser, that is based, in whole or part, on investments selected by participants or

beneficiaries would be inconsistent with the fee-leveling requirement of the statutory exemption.<sup>3</sup> The Department also is further clarifying that this limitation applies both to an entity that is retained to render advice, and to any employee, agent, or registered representative of such an entity. Thus, even though an affiliate of a fiduciary adviser may receive fees that vary depending on investment options selected, any provision of financial or economic incentives by an affiliate (or any other party) to a fiduciary adviser or any individual employed by such fiduciary adviser (e.g., an employee providing advice on its behalf or an individual responsible for supervising such an employee) to favor certain investments would be impermissible. These are reflected in the proposal at paragraph (b)(3)(i)(D) of Sec. 2550.408g-1.

The proposed regulation also provides, in connection with investment advice arrangements that use computer models, that a computer model shall be designed and operated to avoid investment recommendations that inappropriately distinguish among investment options within a single asset class on the basis of a factor that cannot confidently be expected to persist in the future (paragraph (b)(4)(i)(E)(3)). While some differences between investment options within a single asset class, such as differences in fees and expenses or management style, are likely to persist in the future and therefore to constitute appropriate criteria for asset allocation, other differences, such as differences in historical performance, are less likely to persist and therefore less likely to constitute appropriate criteria for asset allocation. Asset classes, in contrast, can more often be distinguished from one another on the basis of differences in their historical risk and return characteristics.

## **E. Effective Date**

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<sup>3</sup> FAB 2007-1 provides that “the fees or other compensation (including salary, bonuses, awards, promotions or any other thing of value) received, directly or indirectly *from an employer, affiliate or other party*, 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.” See FAB 2007-1, footnote 11 (emphasis added).

The Department proposes that the regulations contained in this notice will be effective 60 days after publication of the final regulations in the **Federal Register**. The Department invites comments on whether the final regulations should be made effective on a different date.

#### **F. Request for Comment**

The Department invites comments from interested persons on the proposed regulations. In particular, the Department solicits comments on the conditions applicable to investment advice arrangements that use computer models under proposed § 2550.408g-1(b)(4)(i), including responses to the following questions.

What investment theories are generally accepted for purposes of § 2550.408g-1(b)(4)(i)(A), and what investment practices are consistent or inconsistent with such theories? Should this regulation specify such theories and require their application? Should the regulation dictate the bases for model parameters such as the probability distribution of future returns to assets classes or particular investments? Should the regulation specify certain practices as required by generally accepted investment theories, or certain other practices as proscribed by such theories? What are examples of investment theories that are not generally accepted? Should this regulation expressly proscribe the application of certain such theories?

What historical data should be taken into account in determining a model's expectation for future performance of asset classes and specific investment alternatives? Should the regulation specify minimum standards for the data, such as a minimum number of years of experience to be included in the data?

What types of criteria are appropriate and objective bases for asset allocation pursuant to proposed § 2550.408g-1(b)(4)(i)(D)? Should this regulation expressly designate some criteria as appropriate and objective and/or other criteria as not appropriate or not objective? Should it do

both, thereby establishing a list of criteria that models must consider to the exclusion of all others? For example, the regulation could provide that computer models must consider only the historical risks and returns of different asset classes as a whole, information about the participants, and the expenses and asset allocation of each investment option under the plan. Is a fund's past performance relative to the average for its asset class an appropriate criterion for allocating assets to the fund? Under what if any conditions would it be consistent with generally accepted investment theories and with consideration of fees pursuant to § 2550.408g-1(b)(4)(i)(B) to recommend a fund with superior past performance over an alternative fund in the same asset class with average performance but lower fees? Should the regulation specify such conditions? On what if any bases can a fund's superior past performance be demonstrated to derive not from chance but from factors that are likely to persist and continue to affect performance in the future? Should the use of a fund's superior past performance as a criterion for allocating assets to the fund be conditioned on such demonstration? How, if at all, should a model take into account investment management style? For example, all else equal, should a model ascribe different levels of risk to passively and actively managed investment options?

To facilitate the receipt and processing of comment letters, the EBSA encourages interested persons to submit their comments electronically by e-mail to e-ORI@dol.gov (enter into subject line: 2010 Investment Advice Proposed Rule) or by using the Federal eRulemaking portal at <http://www.regulations.gov>. Persons submitting comments electronically are encouraged not to submit paper copies. Persons interested in submitting paper copies should send or deliver their comments to the Office of Regulations and Interpretations, Employee Benefits Security Administration, Attn: 2010 Investment Advice Proposed Rule, Room N-5655, U.S. Department of Labor, 200 Constitution Avenue, NW, Washington, DC 20210. All

comments will be available to the public, without charge, online at <http://www.regulations.gov> and <http://www.dol.gov/ebsa> and at the Public Disclosure Room, N-1513, Employee Benefits Security Administration, U.S. Department of Labor, 200 Constitution Avenue, NW, Washington, DC 20210.

The comment period for the proposed regulations will end May 5, 2010. The Department believes that this period of time will afford interested persons an adequate amount of time to analyze the proposal and submit comments. Written comments on the proposed regulations should be submitted to the Department on or before May 5, 2010.

## **G. Regulatory Impact Analysis**

### *Need for Regulatory Action*

As documented in the Department's regulatory impact analysis of the August 2008 proposed regulation, there is evidence that many participants in participant-directed defined contribution (DC) plans and beneficiaries of individual retirement accounts (IRAs) (collectively hereafter, "participants") make poor investment decisions due to flawed information or reasoning. These participants may pay higher fees and expenses than necessary for investment products and services, engage in excessive or poorly timed trading or fail to adequately diversify their portfolios and thereby assume uncompensated risk, take more or less than optimal levels of compensated risk, and/or pay unnecessarily high taxes. Financial losses (including foregone earnings) from such mistakes likely amounted to more than \$85 billion in 2009. These losses compound and grow larger as workers progress toward and into retirement.

The Department anticipates that full implementation of the PPA under this proposed regulation will ensure that quality, expert investment advice is provided to the greatest number of

participants. The Department further anticipates that the increased investment advice resulting from the rule will improve participants investment decisions and results and reduce investment related errors and expenses.

In the statutory exemption, Congress called on the Department to provide regulatory guidance addressing the certification of computer model investment advice programs, a model form for disclosure of fees and other compensation received by the fiduciary adviser or an affiliate, and rules under which only one fiduciary adviser may elect to be treated as a fiduciary.<sup>4</sup> This proposed regulation addressed these issues, as well as additional questions raised by employers and other fiduciaries regarding their responsibilities in connection with other provisions of the statutory exemption.

### *Alternatives*

Executive Order 12866 requires an economically significant regulation to include an assessment of the costs and benefits of potentially effective and reasonably feasible alternatives to a planned regulation, and an explanation of why the planned regulatory action is preferable to the identified potential alternatives. In formulating this proposed regulation, the Department considered two alternative approaches that are discussed below.

#### Detailed, Prescriptive Substantive Standards for Computer Model Design

To assure the quality of investment advice provided pursuant to the statutory exemption, this proposed regulation relies primarily on safeguards against bias that might otherwise arise from advisers' conflicts of interest. These safeguards include, for example, strong procedural standards for certification of computer models and audits of investment advice programs, and

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<sup>4</sup> See sections 408(g)(3)(C), 408(g)(8)(B), and 408(g)(11)(A) (flush language) of ERISA.

strict, carefully drawn standards for level-fee arrangements that broadly proscribe all manner of variable payments to advisers.

As an additional approach to ensuring that investment advice is not tainted by conflicts of interest, the Department considered requiring that a computer model consider only the historical risks and returns of different asset classes as a whole, information about the participants, and the expenses and asset allocation of each investment option under the plan. However, the Department believes that the approach it has taken will effectively ensure that advice is not tainted by conflicts of interest, so the addition of such a restriction would be unnecessary. The Department also believes that such a restriction may inhibit innovations in investment advice that utilizes additional information, which could reduce the economic benefits of the statutory exemption. Nonetheless, the Department, as reflected in questions appearing earlier in this preamble, is interested in further exploring the merits of adopting such an alternative approach.

#### Additional Exemptive Relief

The Department's January 2009 final rule included a class exemption that would establish alternative conditions for granting prohibited transaction relief in connection with the provision of investment advice. The Department considered retaining such a class exemption in this new proposed rule. However, after considering issues raised by public comments received in response to the Department's February 4, 2009, notice, the Department decided to withdraw the class exemption. As discussed earlier, a number of commenters questioned the adequacy of the final class exemption's conditions to mitigate the potential for investment adviser self-dealing. The Department decided not to retain the class exemption in this proposal, because it found that the questions raised in these comments cast sufficient doubt on the conditions'

adequacy to mitigate advisers' conflicts. The regulatory impact of the decision to withdraw the class exemption is discussed below.

#### *Withdrawal of the Class Exemption*

As documented in the Department's regulatory impact analysis (RIA) of the January 2009 final regulation and class exemption, defined contribution (DC) plan participants and IRA beneficiaries often make costly investment errors. Those who receive and follow quality investment advice can reduce such errors and thereby reap substantial financial benefit. Although the Department anticipated that the final rule would increase the availability of investment advice to DC plan participants and the use of advice by IRA beneficiaries, the Department stated that it was uncertain how changing market conditions might affect the incidence and magnitude of investment errors, as well as the availability, use, and effect of investment advice. The Department estimated that the PPA statutory exemption as implemented by the final regulation, together with the final class exemption, would extend investment advice to 21 million previously unadvised participants and beneficiaries, potentially generating as much as \$13 billion in annual financial benefits at a cost of \$5 billion, for a net annual financial benefit of \$8 billion. In the 2009 final rule's RIA, Department stated its belief that the approach used in the analysis could reflect the long-term effects of these actions.

In arriving at its estimates, the Department assumed that on average participants and beneficiaries who are advised make investment errors at one-half the rate of those who are not. The Department further assumed that different types of investment advice arrangements on average would be equally effective: arrangements operating without need for exemptive relief,

those operating pursuant to the PPA, and those operating pursuant to the class exemption all would reduce investment errors by one-half on average.

The Department's assumptions regarding the effectiveness of different advice arrangements were subject to uncertainty, particularly as applied to its assessment of the final class exemption's effects. In the preamble to the January 2009 final regulation and class exemption, the Department noted evidence that conflicts of interest, such as those that might be attendant to advice arrangements operating pursuant to the class exemption, can sometimes taint advice. Conflicted advisers pursuing their own interests, and the investment managers who compensate them, may profit at the expense of participants and beneficiaries. The conditions attached to the class exemption were intended to ensure that advisers operating pursuant to the class exemption would honor the interests of participants and beneficiaries.

In its February 4, 2009, notice proposing to extend the effective dates of the final regulation and class exemption, the Department solicited public comments on the provisions of those rules and on the merits of rescinding, modifying or retaining the rules. As discussed earlier, a number of commenters raised legal and policy issues concerning the exemption and, in particular, questioned the adequacy of the final class exemption's conditions to mitigate the potential for investment adviser self-dealing.

The Department believes that the questions raised in these comments are sufficient to cast doubt on the conditions' adequacy to mitigate advisers' conflicts. If conflicts are not mitigated, advice might be tainted. Therefore, the Department has set aside its previous assumption that participants and beneficiaries who follow advice delivered pursuant to the final class exemption will commit investment errors at one-half the rate of those who are unadvised, together with its previous conclusion that the final class exemption's benefits justify its cost. Instead, the

Department believes that doubts as to whether the final class exemption's conditions are adequate to mitigate conflicts justify withdrawal of the final class exemption.

### *Impact Assessment*

In arriving at its January 2009 estimates of the combined effects of the final regulation and class exemption, the Department assumed that the incidence of investment advice arrangements permissible prior to the PPA would remain unchanged, while investment advice arrangements operating pursuant to the PPA statutory exemption and those operating pursuant to the class exemption would claim equal shares of the estimated growth of advice arrangements.

The Department has now updated its estimates of the costs and benefits of the proposed regulation to reflect the withdrawal of the class exemption. It is likely that some previously unadvised participants and beneficiaries who would have received advice pursuant to the class exemption will instead receive advice pursuant to the PPA statutory exemption, while others will remain unadvised.

Recently the Administration has taken major steps toward broad financial regulatory reform. On June 17, 2009, the President announced the Administration's proposal for "21<sup>st</sup> Century Financial Regulatory Reform." The proposal includes provisions designed to strengthen investor protections in ways that the Department believes may beneficially influence the market for investment advice. Comprehensive reforms to the market for financial products and services, together with the PPA's exemptive relief as implemented by the Department's final regulation, may promote the availability of quality, affordable investment advice more than the latter would alone.

The estimates provided in the table below show three possible impacts for the proposed regulation: "low" estimates assume that all of those who would have received advice pursuant to

the class exemption instead remain unadvised, “mid” estimates assume that one-half receive advice pursuant to the PPA statutory exemption, and “high” estimates assume that all receive such advice. The Department has updated its estimates to reflect year-end 2008 DC plan and IRA assets. Otherwise, the assumptions and calculations remain the same as presented in the preamble to the January 2009 final regulation and class exemption. The Department’s low middle, and high estimates are presented in Table 1, below.

Table 1. Effect of PPA statutory exemption as implemented by proposed regulation \$Billions, annual, in 2008 dollars and at 2008 asset levels			
	Investment errors eliminated	Cost of advice	Net effect
Low	\$5.5	\$1.5	\$3.9
Mid	8.2	2.3	5.9
High	10.9	3.1	7.8

On the basis of these estimates the Department believes that this proposed regulation, in isolation from the withdrawn class exemption, will yield benefits sufficient to justify its costs. The Department continues to believe that DC plan participants and IRA beneficiaries often make costly investment errors, and that those who receive and follow quality investment advice can reduce such errors and thereby reap substantial financial benefit.

#### **H. Executive Order 12866 Statement**

Under Executive Order 12866, the Department must designate a regulatory action it believes is “significant” and therefore subject to the requirements of the Executive Order and OMB review. Under section 3(f), the order defines a “significant regulatory action” as an action that is likely to result in a rule (1) having an annual effect on the economy of \$100 million or more, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities (also referred to as “economically significant”); (2) creating serious inconsistency

or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order.

Pursuant to the terms of the Executive Order, this action, comprising this proposed rule, is economically significant under section 3(f)(1) of the Executive Order because it is likely to have an effect on the economy of \$100 million or more in any one year. Accordingly, the Department undertook the foregoing analysis of the action's impact. On the basis of that analysis, the Department believes that the action's benefits justify its costs.

#### **I. Regulatory Flexibility Act**

As it did in the January 2009 final rule, the Department hereby certifies that this proposed rule will not have a significant economic impact on a substantial number of small entities. For purposes of the analysis, the Department proposed to continue its usual practice of considering a small entity to be an employee benefit plan with fewer than 100 participants. The Department consulted with the Small Business Administration Office of Advocacy concerning use of this participant count standard for Regulatory Flexibility Act purposes and requested public comment on this issue in the January 2009 final rule. The Department did not receive any comments that address its use of the participant count standard and continues to consider a small entity to be an employee benefit plan with fewer than 100 participants.

#### **J. Congressional Review Act**

This proposed regulation is a major rule is subject to the Congressional Review Act provisions of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801 et

seq.) and, if finalized, will be transmitted to the Congress and the Comptroller General for review.

#### **K. Unfunded Mandates Reform Act**

For purposes of the Unfunded Mandates Reform Act of 1995 (Pub. L. 104-4), as well as Executive Order 12875, the proposed rule does not include any federal mandate that will result in expenditures by state, local, or tribal governments in the aggregate of more than \$100 million, adjusted for inflation, or increase expenditures by the private sector of more than \$100 million, adjusted for inflation.

#### **L. Federalism Statement**

Executive Order 13132 (August 4, 1999) outlines fundamental principles of federalism and requires the adherence to specific criteria by federal agencies in the process of their formulation and implementation of policies that have substantial direct effects on the States, the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. This proposed rule does not have federalism implications because it has no substantial direct effect on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Section 514 of ERISA provides, with certain exceptions specifically enumerated, that the provisions of Titles I and IV of ERISA supersede any and all laws of the States as they relate to any employee benefit plan covered under ERISA. The requirements implemented in the rule do not alter the fundamental provisions of the statute with respect to employee benefit plans, and as such would have no implications for the States or the relationship or distribution of power between the national government and the States.

## **M. Paperwork Reduction Act**

In accordance with the requirements of the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3506(c)(2)), the Department submitted an ICR to OMB for its request of a new information collection for the previous final rule. OMB approved the ICR on January 9, 2009, under OMB Control Number 1210-0134, which will expire on January 31, 2012.

In connection with the issuance of this proposed rule, the Department submitted a revised ICR to OMB on October 23, 2009, reflecting information collection requirements associated with the PPA statutory exemption. In order to use the statutory exemption to provide investment advice to participants and beneficiaries in participant-directed DC plans and beneficiaries of IRAs (collectively hereafter, “participants”), investment advisory firms are required to make disclosures to participants, hire an independent auditor to conduct a compliance audit, and issue an audit report every year. Investment advice firms following the conditions of the exemption based on computer model-generated investment advice are required to obtain certification of the model from an eligible investment expert. These information collection requirements are designed to safeguard the interests of participants in connection with investment advice covered by the exemption.

This paperwork burden analysis reflects a very minor increase to the estimated number of DC plan sponsors offering advice, the number of DC plan participants utilizing advice, the labor hour rates used to estimate the hour burden, and the postage rate used to estimate the cost burden.<sup>5</sup> All other calculations remain the same as in the January 2009 final rule.

### *Statutory exemption hour and cost burden*

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<sup>5</sup> The increase in the estimated number of DC plans offering advice and DC plan participants utilizing advice is due to updating the count to reflect 2006 Form 5500 data, the latest year for which Form 5500 data is available. The counts in the 2009 Final Rule were based on 2005 Form 5500 data. The postage rate was increased to \$0.44 from \$0.42 due to the January 2009 increase. The labor hour rates were updated to reflect 2009 rates instead of 2008 rates, which were used in the 2009 Final Rule.

For purposes of determining the hour and cost burden associated with the statutory exemption, the Department’s analysis uses the “mid” estimate discussed under the *Impact Analysis* section above, which assumes that one-half of participants who would have received advice pursuant to the class exemption now will receive advice pursuant to the PPA statutory exemption. The Department estimates that the third-party disclosures, computer model certification, and audit requirements for the statutory exemption will require approximately 4.5 million burden hours with an equivalent cost of approximately \$486.7 million and a cost burden of approximately \$579.8 million in the first year. In each subsequent year, the total labor burden hours are estimated to be approximately 2.4 million hours with an equivalent cost of approximately \$252.6 million and the cost burden is estimated at approximately \$430.5 million per year.<sup>6</sup>

These paperwork burden estimates are summarized as follows:

*Type of Review:* Revised Collection.

*Agency:* Employee Benefits Security Administration, Department of Labor.

*Titles:* Statutory Exemption for the Provision of Investment Advice to Participants and Beneficiaries of Participant-Directed Individual Account Plans and IRAs

*OMB Control Number:* 1210-0134.

*Affected Public:* Business or other for-profit.

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<sup>6</sup> If the ‘low’ estimate were used, which assumes that all of the participants who would have received advice pursuant to the class exemption instead remain unadvised, the statutory exemption will require approximately 4 million burden hours with an equivalent cost of approximately \$444.7 million and a cost burden of approximately \$579.4 million in the first year. In each subsequent year, the total labor burden hours are estimated to be approximately 2.2 million hours with an equivalent cost of approximately \$229.9 million and the cost burden is estimated at approximately \$430.1 million per year. If the ‘high’ estimate were used, which assumes that all of the participants who would have received advice pursuant to the class exemption will receive advice under the statutory exemption, the statutory exemption will require approximately 4.9 million burden hours with an equivalent cost of approximately \$528.7 million and a cost burden of approximately \$580.2 million in the first year. In each subsequent year, the total labor burden hours are estimated to be approximately 2.7 million hours with an equivalent cost of approximately \$275.3 million and the cost burden is estimated at approximately \$430.9 million per year.

*Estimated Number of Respondents:* 16,000

*Estimated Number of Annual Responses:* 15,156,000

*Frequency of Response:* Initially, Annually, Upon Request, when a material change.

*Estimated Total Annual Burden Hours:* 4,453,000 hours in the first year; 2,428,000 hours in each subsequent year.

*Estimated Total Annual Burden Cost:* \$579,808,000 in the first year; \$430,508,000 for each subsequent year

#### List of Subjects in 29 CFR Part 2550

Employee benefit plans, Exemptions, Fiduciaries, Investments, Pensions, Prohibited transactions, Reporting and recordkeeping requirements, and Securities.

For the reasons set forth in the preamble, Chapter XXV, subchapter F, part 2550 of Title 29 of the Code of Federal Regulations is proposed to be amended as follows:

#### **PART 2550--RULES AND REGULATIONS FOR FIDUCIARY RESPONSIBILITY**

1. The authority citation for part 2550 is revised to read as follows:

**Authority:** 29 U.S.C. 1135; and Secretary of Labor's Order No. 6-2009, 74 FR 21524 (May 7, 2009). Secs. 2550.401b-1, 2550.408b-1, 2550.408b-19, 2550.408g-1, and 2550.408g-2 also issued under sec. 102, Reorganization Plan No. 4 of 1978, 5 U.S.C. App. Sec. 2550.401c-1 also issued under 29 U.S.C. 1101. Sections 2550.404c-1 and 2550.404c-5 also issued under 29 U.S.C. 1104. Sec. 2550.407c-3 also issued under 29 U.S.C. 1107. Sec. 2550.404a-2 also issued under 26 U.S.C. 401 note (sec. 657(c)(2), Pub. L. 107-16, 115 Stat. 38, 136 (2001)). Sec.

2550.408b-1 also issued under 29 U.S.C. 1108(b)(1). Sec. 2550.408b-19 also issued under sec. 611(g)(3), Public Law 109-280, 120 Stat. 780, 975 (2006).

2. Add § 2550.408g-1 to read as follows:

**§ 2550.408g-1 Investment advice – participants and beneficiaries**

**(a) In general.** (1) This section provides relief from the prohibitions of section 406 of the Employee Retirement Income Security Act of 1974, as amended (ERISA or the Act), and section 4975 of the Internal Revenue Code of 1986, as amended (the Code), for certain transactions in connection with the provision of investment advice to participants and beneficiaries. This section, at paragraph (b), implements the statutory exemption set forth at sections 408(b)(14) and 408(g)(1) of ERISA and sections 4975(d)(17) and 4975(f)(8) of the Code. The requirements and conditions set forth in this section apply solely for the relief described in paragraph (b) of this section and, accordingly, no inferences should be drawn with respect to requirements applicable to the provision of investment advice not addressed by this section.

(2) Nothing contained in ERISA section 408(g)(1), Code section 4975(f)(8), or this regulation imposes an obligation on a plan fiduciary or any other party to offer, provide or otherwise make available any investment advice to a participant or beneficiary.

(3) Nothing contained in ERISA section 408(g)(1), Code section 4975(f)(8), or this regulation invalidates or otherwise affects prior regulations, exemptions, interpretive or other guidance issued by the Department of Labor pertaining to the provision of investment advice and the circumstances under which such advice may or may not constitute a prohibited transaction under section 406 of ERISA or section 4975 of the Code.

**(b) Statutory exemption. (1) General.** Sections 408(b)(14) and 408(g)(1) of ERISA provide an exemption from the prohibitions of section 406 of ERISA for transactions described in section 408(b)(14) of ERISA in connection with the provision of investment advice to a participant or a beneficiary if the investment advice is provided by a fiduciary adviser under an “eligible investment advice arrangement.” Sections 4975(d)(17) and (f)(8) of the Code contain parallel provisions to ERISA sections 408(b)(14) and (g)(1).

**(2) Eligible investment advice.** For purposes of section 408(g)(1) of ERISA and section 4975(f)(8) of the Code, an “eligible investment advice arrangement” means an arrangement that meets either the requirements of paragraph (b)(3) of this section or paragraph (b)(4) of this section, or both.

**(3) Arrangements that use fee-leveling.** For purposes of this section, an arrangement is an eligible investment advice arrangement if –

(i)(A) Any investment 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, although nothing herein shall preclude any investment advice from being based on generally accepted investment theories that take into account additional considerations;

(B) Any investment advice takes into account investment management and other fees and expenses attendant to the recommended investments;

(C) Any investment advice takes into account, to the extent furnished by a plan, 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. A fiduciary adviser shall request such information, but nothing in this paragraph (b)(3)(i)(C) shall require

that any investment advice take into account information requested, but not furnished by a participant or beneficiary, nor preclude requesting and taking into account additional information that a plan or participant or beneficiary may provide;

(D) No fiduciary adviser (including any employee, agent, or registered representative) that provides investment advice receives from any party (including an affiliate of the fiduciary adviser), directly or indirectly, any fee or other compensation (including commissions, salary, bonuses, awards, promotions, or other things of value) that is based in whole or in part on a participant's or beneficiary's selection of an investment option; and

(ii) The requirements of paragraphs (b)(5), (6), (7), and (8) and paragraph (d) of this section are met.

**(4) Arrangements that use computer models.** For purposes of this section, an arrangement is an eligible investment advice arrangement if the only investment advice provided under the arrangement is advice that is generated by a computer model described in paragraphs (b)(4)(i) and (ii) of this section under an investment advice program and with respect to which the requirements of paragraphs (b)(5), (6), (7), and (8) and paragraph (d) are met.

(i) A computer model shall be designed and operated to --

(A) 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 herein shall preclude a computer model from applying generally accepted investment theories that take into account additional considerations;

(B) Take into account investment management and other fees and expenses attendant to the recommended investments;

(C) Request from a participant or beneficiary and, to the extent furnished, utilize 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; provided, however, that nothing herein shall preclude a computer model from requesting and taking into account additional information that a plan or a participant or beneficiary may provide;

(D) Utilize appropriate objective criteria to provide asset allocation portfolios comprised of investment options available under the plan;

(E) Avoid investment recommendations that:

(1) Inappropriately favor investment options offered by the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser over other investment options, if any, available under the plan;

(2) Inappropriately favor investment options that may generate greater income for the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser; or

(3) Inappropriately distinguish among investment options within a single asset class on the basis of a factor that cannot confidently be expected to persist in the future; and

(F)(1) Except as provided in paragraph (b)(F)(2) of this section, take into account all designated investment options, within the meaning of paragraph (c)(1) of this section, available under the plan without giving inappropriate weight to any investment option.

(2) A computer model shall not be treated as failing to meet the requirements of this paragraph merely because it does not make recommendations relating to the acquisition, holding or sale of an investment option that:

(i) Constitutes an investment primarily in qualifying employer securities;

(ii) Constitutes an investment fund, product or service that allocates the invested assets of a participant or beneficiary to achieve varying degrees of long-term appreciation and capital preservation through equity and fixed income exposures, based on a defined time horizon (such as retirement age or life expectancy) or level of risk of the participant or beneficiary, provided that, contemporaneous with the provision of investment advice generated by the computer model, the participant or beneficiary is also furnished a general description of such funds, products or services and how they operate; or

(iii) Constitutes an annuity option with respect to which a participant or beneficiary may allocate assets toward the purchase of a stream of retirement income payments guaranteed by an insurance company, provided that, contemporaneous with the provision of investment advice generated by the computer model, the participant or beneficiary is also furnished a general description of such options and how they operate.

(ii) Prior to utilization of the computer model, the fiduciary adviser shall obtain a written certification, meeting the requirements of paragraph (b)(4)(iv) of this section, from an eligible investment expert, within the meaning of paragraph (b)(4)(iii) of this section, that the computer model meets the requirements of paragraph (b)(4)(i) of this section. If, following certification, a computer model is modified in a manner that may affect its ability to meet the requirements of paragraph (b)(4)(i), the fiduciary adviser shall, prior to utilization of the modified model, obtain a new certification from an eligible investment expert that the computer model, as modified, meets the requirements of paragraph (b)(4)(i).

(iii) The term “eligible investment expert” means a person that, through employees or otherwise, has the appropriate technical training or experience and proficiency to analyze,

determine and certify, in a manner consistent with paragraph (b)(4)(iv) of this section, whether a computer model meets the requirements of paragraph (b)(4)(i) of this section; except that the term “eligible investment expert” does not include any person that has any material affiliation or material contractual relationship with the fiduciary adviser, with a person with a material affiliation or material contractual relationship with the fiduciary adviser, or with any employee, agent, or registered representative of the foregoing.

(iv) A certification by an eligible investment expert shall –

(A) Be in writing;

(B) Contain –

(1) An identification of the methodology or methodologies applied in determining whether the computer model meets the requirements of paragraph (b)(4)(i) of this section;

(2) An explanation of how the applied methodology or methodologies demonstrated that the computer model met the requirements of paragraph (b)(4)(i) of this section;

(3) A description of any limitations that were imposed by any person on the eligible investment expert’s selection or application of methodologies for determining whether the computer model meets the requirements of paragraph (b)(4)(i) of this section;

(4) A representation that the methodology or methodologies were applied by a person or persons with the educational background, technical training or experience necessary to analyze and determine whether the computer model meets the requirements of paragraph (b)(4)(i); and

(5) A statement certifying that the eligible investment expert has determined that the computer model meets the requirements of paragraph (b)(4)(i) of this section; and

(C) Be signed by the eligible investment expert.

(v) The selection of an eligible investment expert as required by this section is a fiduciary act governed by section 404(a)(1) of ERISA.

**(5) *Arrangement must be authorized by a plan fiduciary.*** (i) Except as provided in paragraph (b)(5)(ii), the arrangement pursuant to which investment advice is provided to participants and beneficiaries pursuant to this section must be expressly authorized by a plan fiduciary (or, in the case of an Individual Retirement Account (IRA), the IRA beneficiary) other than: the person offering the arrangement; any person providing designated investment options under the plan; or any affiliate of either. Provided, however, that for purposes of the preceding, in the case of an IRA, an IRA beneficiary will not be treated as an affiliate of a person solely by reason of being an employee of such person.

(ii) In the case of an arrangement pursuant to which investment advice is provided to participants and beneficiaries of a plan sponsored by the person offering the arrangement or a plan sponsored by an affiliate of such person, the authorization described in paragraph (b)(5)(i) may be provided by the plan sponsor of such plan, provided that the person or affiliate offers the same arrangement to participants and beneficiaries of unaffiliated plans in the ordinary course of its business.

(iii) For purposes of the authorization described in paragraph (b)(5)(i), a plan sponsor shall not be treated as a person providing a designated investment option under the plan merely because one of the designated investment options of the plan is an option that permits investment in securities of the plan sponsor or an affiliate.

**(6) *Annual audit.*** (i) The fiduciary adviser shall, at least annually, engage an independent auditor, who has appropriate technical training or experience and proficiency, and so represents in writing to the fiduciary adviser, to:

(A) Conduct an audit of the investment advice arrangements for compliance with the requirements of this section; and

(B) Within 60 days following completion of the audit, issue a written report to the fiduciary adviser and, except with respect to an arrangement with an IRA, to each fiduciary who authorized the use of the investment advice arrangement, in accordance with paragraph (b)(5) of this section, setting forth the specific findings of the auditor regarding compliance of the arrangement with the requirements of this section.

(ii) With respect to an arrangement with an IRA, the fiduciary adviser:

(A) Within 30 days following receipt of the report from the auditor, as described in paragraph (b)(6)(i)(B) of this section, shall furnish a copy of the report to the IRA beneficiary or make such report available on its website, provided that such beneficiaries are provided information, with the information required to be disclosed pursuant to paragraph (b)(7) of this section, concerning the purpose of the report, and how and where to locate the report applicable to their account; and

(B) In the event that the report of the auditor identifies noncompliance with the requirements of this section, within 30 days following receipt of the report from the auditor, shall send a copy of the report to the Department of Labor at the following address: Investment Advice Exemption Notification, U.S. Department of Labor, Employee Benefits Security Administration, Room N-1513, 200 Constitution Ave., NW, Washington, DC, 20210.

(iii) For purposes of this paragraph (b)(6), an auditor is considered independent if it does not have a material affiliation or material contractual relationship with the person offering the investment advice arrangement to the plan or with any designated investment options under the plan.

(iv) For purposes of this paragraph (b)(6), the auditor shall review sufficient relevant information to formulate an opinion as to whether the investment advice arrangements, and the advice provided pursuant thereto, offered by the fiduciary adviser during the audit period were in compliance with this section. Nothing in this paragraph shall preclude an auditor from using information obtained by sampling, as reasonably determined appropriate by the auditor, investment advice arrangements, and the advice pursuant thereto, during the audit period.

(v) The selection of an auditor for purposes of this paragraph (b)(6) is a fiduciary act governed by section 404(a)(1) of ERISA.

**(7) Disclosure.** (i) The fiduciary adviser must provide, without charge, to a participant or a beneficiary before the initial provision of investment advice with regard to any security or other property offered as an investment option, a written notification of:

(A) The role of any party that has a material affiliation or material contractual relationship with the fiduciary adviser in the development of the investment advice program, and in the selection of investment options available under the plan;

(B) The past performance and historical rates of return of the designated investment options available under the plan, to the extent that such information is not otherwise provided;

(C) All fees or other compensation that the fiduciary adviser or any affiliate thereof is to receive (including compensation provided by any third party) in connection with –

(1) The provision of the advice;

(2) The sale, acquisition, or holding of any security or other property pursuant to such advice; or

(3) Any rollover or other distribution of plan assets or the investment of distributed assets in any security or other property pursuant to such advice;

(D) Any material affiliation or material contractual relationship of the fiduciary adviser or affiliates thereof in the security or other property;

(E) The manner, and under what circumstances, any participant or beneficiary information provided under the arrangement will be used or disclosed;

(F) The types of services provided by the fiduciary adviser in connection with the provision of investment advice by the fiduciary adviser, including, with respect to a computer model arrangement referred to in paragraph (b)(4) of this section, any limitations on the ability of a computer model to take into account an investment primarily in qualifying employer securities;

(G) The adviser is acting as a fiduciary of the plan in connection with the provision of the advice; and

(H) That a recipient of the advice may separately arrange for the provision of advice by another adviser that could have no material affiliation with and receive no fees or other compensation in connection with the security or other property.

(ii)(A) The notification required under paragraph (b)(7)(i) of this section must be written in a clear and conspicuous manner and in a manner calculated to be understood by the average plan participant and must be sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of the information required to be provided in the notification.

(B) The appendix to this section contains a model disclosure form that may be used to provide notification of the information described in paragraph (b)(7)(i)(C) of this section. Use of the model form is not mandatory. However, use of an appropriately completed model disclosure form will be deemed to satisfy the requirements of paragraphs (b)(7)(i) and (ii) of this section with respect to such information.

(iii) The notification required under paragraph (b)(7)(i) of this section may, in accordance with 29 CFR 2520.104b-1, be provided in written or electronic form.

(iv) With respect to the information required to be disclosed pursuant to paragraph (b)(7)(i) of this section, the fiduciary adviser shall, at all times during the provision of advisory services to the participant or beneficiary pursuant to the arrangement, —

(A) Maintain accurate, up-to-date information in a form that is consistent with paragraph (b)(7)(ii) of this section,

(B) Provide, without charge, accurate, up-to-date information to the recipient of the advice no less frequently than annually,

(C) Provide, without charge, accurate information to the recipient of the advice upon request of the recipient, and

(D) Provide, without charge, to the recipient of the advice any material change to the information described in paragraph (b)(7)(i) at a time reasonably contemporaneous to the change in information.

**(8) *Other Conditions.*** The requirements of this paragraph are met if—

(i) The fiduciary adviser provides appropriate disclosure, in connection with the sale, acquisition, or holding of the security or other property, in accordance with all applicable securities laws,

(ii) Any sale, acquisition, or holding of a security or other property occurs solely at the direction of the recipient of the advice,

(iii) The compensation received by the fiduciary adviser and affiliates thereof in connection with the sale, acquisition, or holding of the security or other property is reasonable, and

(iv) The terms of the sale, acquisition, or holding of the security or other property are at least as favorable to the plan as an arm's length transaction would be.

(c) **Definitions.** For purposes of this section:

(1) The term "designated investment option" means any investment option designated by the plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. The term "designated investment option" shall not include "brokerage windows," "self-directed brokerage accounts," or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.

(2)(i) The term "fiduciary adviser" means, with respect to a plan, a person who is a fiduciary of the plan by reason of the provision of investment advice referred to in section 3(21)(A)(ii) of ERISA by the person to the participant or beneficiary of the plan and who is –

(A) Registered as an investment adviser under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.) or under the laws of the State in which the fiduciary maintains its principal office and place of business,

(B) A bank or similar financial institution referred to in section 408(b)(4) of ERISA or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1))), but only if the advice is provided through a trust department of the bank or similar financial institution or savings association which is subject to periodic examination and review by Federal or State banking authorities,

(C) An insurance company qualified to do business under the laws of a State,

(D) A person registered as a broker or dealer under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.),

(E) An affiliate of a person described in paragraphs (c)(2)(i)(A) through (D), or

(F) An employee, agent, or registered representative of a person described in paragraphs (c)(2)(i)(A) through (E) of this section who satisfies the requirements of applicable insurance, banking, and securities laws relating to the provision of advice.

(ii) Except as provided under 29 CFR 2550.408g-2, a fiduciary adviser includes any person who develops the computer model, or markets the computer model or investment advice program, utilized in satisfaction of paragraph (b)(4) of this section.

(3) A “registered representative” of another entity means a person described in section 3(a)(18) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(18)) (substituting the entity for the broker or dealer referred to in such section) or a person described in section 202(a)(17) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(17)) (substituting the entity for the investment adviser referred to in such section).

(4) “Individual Retirement Account” or “IRA” means-

(i) An individual retirement account described in section 408(a) of the Code;

(ii) An individual retirement annuity described in section 408(b) of the Code;

(iii) An Archer MSA described in section 220(d) of the Code;

(iv) A health savings account described in section 223(d) of the Code;

(v) A Coverdell education savings account described in section 530 of the Code; or

(vi) A trust, plan, account, or annuity which, at any time, has been determined by the Secretary of the Treasury to be described in any of paragraphs (c)(4)(i) through (v) of this section.

(5) An “affiliate” of another person means –

(i) Any person directly or indirectly owning, controlling, or holding with power to vote, 5 percent or more of the outstanding voting securities of such other person;

(ii) Any person 5 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person;

(iii) Any person directly or indirectly controlling, controlled by, or under common control with, such other person; and

(iv) Any officer, director, partner, copartner, or employee of such other person.

(6)(i) A person with a “material affiliation” with another person means –

(A) Any affiliate of the other person;

(B) Any person directly or indirectly owning, controlling, or holding, 5 percent or more of the interests of such other person; and

(C) Any person 5 percent or more of whose interests are directly or indirectly owned, controlled, or held, by such other person.

(ii) For purposes of paragraph (c)(6)(i) of this section, “interest” means with respect to an entity –

(A) The combined voting power of all classes of stock entitled to vote or the total value of the shares of all classes of stock of the entity if the entity is a corporation;

(B) The capital interest or the profits interest of the entity if the entity is a partnership; or

(C) The beneficial interest of the entity if the entity is a trust or unincorporated enterprise.

(7) Persons have a “material contractual relationship” if payments made by one person to the other person pursuant to contracts or agreements between the persons exceed 10 percent of the gross revenue, on an annual basis, of such other person.

(8) “Control” means the power to exercise a controlling influence over the management or policies of a person other than an individual.

**(d) Retention of records.** The fiduciary adviser must maintain, for a period of not less than 6 years after the provision of investment advice under this section any records necessary for determining whether the applicable requirements of this section have been met. A transaction prohibited under section 406 of ERISA shall not be considered to have occurred solely because the records are lost or destroyed prior to the end of the 6-year period due to circumstances beyond the control of the fiduciary adviser.

**(e) Noncompliance.** (1) The relief from the prohibited transaction provisions of section 406 of ERISA and the sanctions resulting from the application of section 4975 of the Code described in paragraph (b) of this section shall not apply to any transaction described in such paragraphs in connection with the provision of investment advice to an individual participant or beneficiary with respect to which the applicable conditions of this section have not been satisfied.

(2) In the case of a pattern or practice of noncompliance with any of the applicable conditions of this section, the relief described in paragraph (b) shall not apply to any transaction in connection with the provision of investment advice provided by the fiduciary adviser during the period over which the pattern or practice extended.

**(f) Effective date and applicability date.** This section shall be effective [ENTER DATE 60 DAYS AFTER THE DATE OF PUBLICATION OF THE FINAL RULE]. This section shall apply to transactions described in paragraph (b) of this section occurring on or after [ENTER DATE 60 DAYS AFTER THE DATE OF PUBLICATION OF THE FINAL RULE].

**APPENDIX to § 2550.408g-1**

**FIDUCIARY ADVISER DISCLOSURE**

**This document contains important information about [enter name of Fiduciary Adviser] and how it is compensated for the investment advice provided to you. You should carefully consider this information in your evaluation of that advice.**

[enter name of Fiduciary Adviser] has been selected to provide investment advisory services for the [enter name of Plan]. [enter name of Fiduciary Adviser] will be providing these services as a fiduciary under the Employee Retirement Income Security Act (ERISA). [enter name of Fiduciary Adviser], therefore, must act prudently and with only your interest in mind when providing you recommendations on how to invest your retirement assets.

**Compensation of the Fiduciary Adviser and Related Parties**

[enter name of Fiduciary Adviser] (is/is not) compensated by the plan for the advice it provides. (if compensated by the plan, explain what and how compensation is charged (e.g., asset-based fee, flat fee, per advice)). (If applicable, [enter name of Fiduciary Adviser] is not compensated on the basis of the investment(s) selected by you.)

Affiliates of [enter name of Fiduciary Adviser] (if applicable enter, and other parties with whom [enter name of Fiduciary Adviser] is related or has a material financial relationship) also will be

providing services for which they will be compensated. These services include: *[enter description of services, e.g., investment management, transfer agent, custodial, and shareholder services for some/all the investment funds available under the plan.]*

When *[enter name of Fiduciary Adviser]* recommends that you invest your assets in an investment fund of its own or one of its affiliates and you follow that advice, *[enter name of Fiduciary Adviser]* or that affiliate will receive compensation from the investment fund based on the amount you invest. The amounts that will be paid by you will vary depending on the particular fund in which you invest your assets and may range from \_\_\_% to \_\_\_%. Specific information concerning the fees and other charges of each investment fund is available from *[enter source, such as: your plan administrator, investment fund provider (possibly with Internet website address)]*. This information should be reviewed carefully before you make an investment decision.

*(if applicable enter, [enter name of Fiduciary Adviser] or affiliates of [enter name of Fiduciary Adviser] also receive compensation from non-affiliated investment funds as a result of investments you make as a result of recommendations of [enter name of Fiduciary Adviser]. The amount of this compensation also may vary depending on the particular fund in which you invest. This compensation may range from \_\_\_% to \_\_\_%. Specific information concerning the fees and other charges of each investment fund is available from [enter source, such as: your plan administrator, investment fund provider (possibly with Internet website address)]. This information should be reviewed carefully before you make an investment decision.*

*(if applicable enter, In addition to the above, [enter name of Fiduciary Adviser] or affiliates of [enter name of Fiduciary Adviser] also receive other fees or compensation, such as commissions, in connection with the sale, acquisition or holding of investments selected by you as a result of recommendations of [enter name of Fiduciary Adviser]. These amounts are: [enter description of all other fees or compensation to be received in connection with sale, acquisition or holding of investments]. This information should be reviewed carefully before you make an investment decision.*

*(if applicable enter, When [enter name of Fiduciary Adviser] recommends that you take a rollover or other distribution of assets from the plan, or recommends how those assets should subsequently be invested, [enter name of Fiduciary Adviser] or affiliates of [enter name of Fiduciary Adviser] will receive additional fees or compensation. These amounts are: [enter description of all other fees or compensation to be received in connection with any rollover or other distribution of plan assets or the investment of distributed assets]. This information should be reviewed carefully before you make a decision to take a distribution.*

### **Consider Impact of Compensation on Advice**

The fees and other compensation that [enter name of Fiduciary Adviser] and its affiliates receive on account of assets in [enter name of Fiduciary Adviser] *(enter if applicable, and non-[enter name of Fiduciary Adviser])* investment funds are a significant source of revenue for the [enter name of Fiduciary Adviser] and its affiliates. You should carefully consider the impact of any such fees and compensation in your evaluation of the investment advice that [enter name of

Fiduciary Adviser] provides to you. In this regard, you may arrange for the provision of advice by another adviser that may have no material affiliation with or receive no compensation in connection with the investment funds or products offered under the plan. This type of advice is/is not available through your plan.

## **Investment Returns**

While understanding investment-related fees and expenses is important in making informed investment decisions, it is also important to consider additional information about your investment options, such as performance, investment strategies and risks. Specific information related to the past performance and historical rates of return of the investment options available under the plan (has/has not) been provided to you by [*enter source, such as: your plan administrator, investment fund provider*]. (*if applicable enter, If not provided to you, the information is attached to this document.*)

For options with returns that vary over time, past performance does not guarantee how your investment in the option will perform in the future; your investment in these options could lose money.

## **Parties Participating in Development of Advice Program or Selection of Investment Options**

*Name, and describe role of, affiliates or other parties with whom the fiduciary adviser has a material affiliation or contractual relationship that participated in the development of the investment advice program (if this is an arrangement that uses computer models) or the selection of investment options available under the plan.*

### **Use of Personal Information**

*Include a brief explanation of the following –*

*What personal information will be collected;*

*How the information will be used;*

*Parties with whom information will be shared;*

*How the information will be protected; and*

*When and how notice of the Fiduciary Adviser's privacy statement will be available to participants and beneficiaries.*

Should you have any questions about [enter name of Fiduciary Adviser] or the information contained in this document, you may contact [enter name of contact person for fiduciary adviser, telephone number, address].

3. Add § 2550.408g-2 to read as follows:

**§ 2550.408g-2 Investment advice – fiduciary election**

**(a) General.** Section 408(g)(11)(A) of the Employee Retirement Income Security Act, as amended (ERISA), provides that a person who develops a computer model or who markets a computer model or investment advice program used in an “eligible investment advice arrangement” shall be treated as a fiduciary of a plan by reason of the provision of investment advice referred to in ERISA section 3(21)(A)(ii) to the plan participant or beneficiary, and shall be treated as a “fiduciary adviser” for purposes of ERISA sections 408(b)(14) and 408(g), except that the Secretary of Labor may prescribe rules under which only one fiduciary adviser may elect to be treated as a fiduciary with respect to the plan. Section 4975(f)(8)(J)(i) of the Internal Revenue Code, as amended (the Code), contains a parallel provision to ERISA section 408(g)(11)(A) that applies for purposes of Code sections 4975(d)(17) and 4975(f)(8). This section sets forth requirements that must be satisfied in order for one such fiduciary adviser to elect to be treated as a fiduciary with respect to a plan under an eligible investment advice arrangement.

(b)(1) If an election meets the requirements in paragraph (b)(2) of this section, then the person identified in the election shall be the sole fiduciary adviser treated as a fiduciary by reason of developing or marketing the computer model, or marketing the investment advice program, used in an eligible investment advice arrangement.

(2) An election satisfies the requirements of this subparagraph with respect to an eligible investment advice arrangement if the election is in writing and such writing –

(i) Identifies the investment advice arrangement, and the person offering the arrangement, with respect to which the election is to be effective;

(ii) Identifies a person who –

(A) Is described in any of 29 CFR 2550.408g-1(c)(2)(i)(A) through (E),

(B) Develops the computer model, or markets the computer model or investment advice program, utilized in satisfaction of 29 CFR 2550.408g-1(b)(4) with respect to the arrangement, and

(C) Acknowledges that it elects to be treated as the only fiduciary, and fiduciary adviser, by reason of developing such computer model, or marketing such computer model or investment advice program;

(iii) Is signed by the person identified in paragraph (b)(2)(ii) of this section;

(iv) Is furnished to the fiduciary who authorized the arrangement, in accordance with 29 CFR 2550.408g-1(b)(5); and

(v) Is maintained in accordance with 29 CFR 2550.408g-1(d).

Signed at Washington, DC, this 24th day of February, 2010.

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**Phyllis C. Borzi,**

*Assistant Secretary, Employee Benefits Security Administration, Department of Labor.*

**BILLING CODE 4510-29-P**