

## U.S. Department Of Labor Report To Congress

This report regarding the availability of computer model investment advice programs for an Individual Retirement Account or similar plan (hereinafter, an IRA) is being submitted to the House of Representatives Committee on Ways and Means, the House of Representatives Committee on Education and Labor, the Senate Committee on Finance, and the Senate Committee on Health, Education, Labor and Pensions pursuant to section 601(b)(3)(B) of the Pension Protection Act of 2006 (the PPA), Public Law 109-280, 120 Stat. 965.

### Background

Section 601(b) of the PPA amended the Internal Revenue Code of 1986 (the Code) by adding an exemption for certain transactions in connection with the provision of investment advice to a participant or beneficiary of a plan as defined in IRC section 4975(e)(1), including an IRA, if the investment advice is provided under an "eligible investment advice arrangement."<sup>1</sup> In particular, the investment advice must be provided under an arrangement which either: (1) provides that any fees received by the fiduciary adviser for investment advice or in connection with the investment of plan assets do not vary on the basis of any investment option selected; or (2) uses a computer model under an investment advice program meeting the requirements of the exemption.<sup>2</sup>

This exemption, however, does not cover the use of computer model investment advice programs to provide investment advice with respect to IRAs until the Secretary of Labor, in consultation with the Secretary of the Treasury, determines whether there is any computer model investment advice program which may be utilized by an IRA.<sup>3</sup> Such an advice program must: (1) utilize relevant information about the account beneficiary, which may include age, life expectancy, retirement age, risk tolerance, other assets or sources of income, and preferences as to certain types of investments; (2) take into account the full range of investments, including equities and bonds, in determining the options for the investment portfolios of the account beneficiary; and (3) allow the account beneficiary, in directing the investment of assets, sufficient flexibility in obtaining advice to evaluate and select investment options.<sup>4</sup>

The PPA requires that such feasibility determination be based on a solicitation of information by the Secretary of Labor, including a solicitation from: (1) the "top 50 trustees" of IRAs and similar plans, determined on the basis of assets held by such trustees; and (2) other persons offering computer model investment advice programs based on nonproprietary products.<sup>5</sup> The PPA further provides that the Secretary of Labor shall report the results of such determination to the Committee on Ways and Means and the Committee on Education and the Workforce<sup>6</sup> of the House of Representatives and the Committee on Finance and the Committee on Health, Education, Labor, and Pensions of the Senate no later than December 31, 2007.<sup>7</sup>

### Solicitations By The Department Of Labor

Pursuant to the requirements of the PPA, the Department of Labor (the Department) published on December 4, 2006 a Request For Information in the **Federal Register** regarding the feasibility of computer model investment advice programs for IRAs (71 FR 70427). Contemporaneously, as required by the PPA, the Department directly solicited comments, by mail, from: (1) the "top 50" trustees of IRAs and similar plans; and (2) persons who offer computer model investment advice programs. The Department received 62 written comments. On July 31, 2007, the Department held a public hearing to gather additional information regarding computer model investment advice programs. Thirteen commenters testified at the public hearing. All of the written comments, and a transcript of the hearing, were posted on, and are available at, [www.regulations.gov](http://www.regulations.gov).

Written and/or oral comments were received from various segments of the financial services industry. Many of the nation's largest trustees, investment advisers, insurance companies, banks, custodians, broker-dealers, and computer modelers supplied information. Collectively, the commenters provide services to employee benefit plans that, in the aggregate, represent tens of millions of participants and trillions of dollars in assets.

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<sup>1</sup> IRC section 4975(d)(17).

<sup>2</sup> Section 601(a) of the PPA added a parallel provision to the Employee Retirement Income Security Act of 1974 (ERISA) for transactions involving an individual account plan covered by Title I of ERISA. See ERISA section 408(b)(14).

<sup>3</sup> PPA section 601(b)(3)(C)(i). This restriction does not affect the availability of the exemption to an IRA of an eligible investment advice arrangement that satisfies Code section 4975(f)(8)(B)(i)(I) (describing an arrangement under which fees do not vary). Further, there is no comparable limitation with respect to the application of sections 408(b)(14) and 408(g) of ERISA. In this regard, the Department notes that IRAs are generally not subject to the provisions of Title I of ERISA. See 29 CFR Sec. 2510.3-2(d).

<sup>4</sup> PPA section 601(b)(3)(B)(i)-(iii).

<sup>5</sup> PPA section 601(b)(3)(A)(i).

<sup>6</sup> The House of Representatives Committee on Education and the Workforce was renamed the Committee on Education and Labor in the 110<sup>th</sup> Congress.

<sup>7</sup> PPA section 601(b)(3)(B).

Four commenters (the Four Commenters) identified existing computer model investment advice programs that, in their view, meet all three of the criteria set forth in section 601(b)(3)(B) of the PPA.<sup>8</sup> Each of the Four Commenters identified a different model. These and other comments are further discussed below.

Regarding the first PPA criterion that a computer model investment advice program utilize relevant information about an account beneficiary (as described in section 601(b)(3)(B)(i) of the PPA), each of the Four Commenters stated that the existing program it identified currently utilizes an account beneficiary's age, retirement age, risk tolerance, other assets or sources of income, and preferences as to certain types of investments in formulating the advice provided to the account beneficiary. Many other commenters stated generally that computer models are capable of utilizing relevant information about an account beneficiary. No commenters took a contrary view on this point.

Some commenters interpreted the second PPA criterion, that a computer model "tak(e) into account the full range of investments, including equities and bonds" (as described in PPA section 601(b)(3)(B)(ii) of the PPA), as requiring that the computer model address all of the generally recognized asset classes in determining the recommended asset mix for the account beneficiary's investment portfolio. Others read this criterion as requiring that the computer model address the entire universe of financial instruments (i.e., every stock, bond, swap, etc.) available for investment by an IRA. Most commenters indicated that no computer model programs exist that can take into account the entire universe of financial instruments that may be available to IRAs and no commenters disputed this contention. The Department believes that a computer model investment advice program satisfies section 601(b)(3)(B)(ii) of the PPA if it takes into account all of the generally recognized asset classes that are necessary for an account beneficiary to construct a diversified investment portfolio. This interpretation is consistent with the intent of the statutory exemption, which is to provide IRA beneficiaries with greater access to investment advice from computer model investment advice programs, where such programs are capable of narrowing the universe of investments into an appropriate mix of investment options.

Each of the Four Commenters stated that the existing computer model program it had identified takes into account a broad range of mutual funds that collectively represent all of the major asset classes. Other commenters further identified or described existing computer models that, in addition to modeling the major asset classes, take into account a beneficiary's "outside" investments (e.g., spousal assets). Many commenters stated generally that computer model investment advice programs are capable of taking into account all of the major asset classes.

With respect to a computer model's ability to allow an account beneficiary sufficient flexibility in obtaining advice to evaluate and select investment options (as described in section 601(b)(3)(B)(iii) of the PPA), each of the Four Commenters stated that the computer model program it had identified currently permits an account beneficiary to: (1) change the information inputted by the account beneficiary into the model, which necessarily changes the model's output; (2) bypass, in whole or in part, the model's advice; and/or (3) seek other advice. Numerous other commenters represented generally that computer models are capable of providing account beneficiaries with sufficient flexibility in obtaining investment advice. Several of these commenters clarified that account beneficiaries may not change the computer models themselves (i.e., the internal computer coding of the models).

## Finding

Based upon the comments received by the Department and the public hearing testimony, and after consultation with the Secretary of the Treasury, the Secretary has determined that there are computer model investment advice programs which meet all the criteria set forth in section 601(b)(3)(B) of the PPA. Specifically, the Secretary has identified computer models that: (1) utilize relevant information about the account beneficiary; (2) take into account the full range of investments, including equities and bonds, in determining the options for the investment portfolio of the account beneficiary; and (3) allow the account beneficiary sufficient flexibility in obtaining advice to evaluate and select investment options. As noted in section 601(b)(3)(C)(i)(II) of the PPA, this determination by the Secretary lifts the restriction in section 601(b)(3)(C)(i)(I) on the availability of the statutory exemption for the provision of computer model investment advice to IRAs, as of this date.

We further note that, during the Department's consideration of this matter, it became aware of investment advice arrangements that, while not covered by the new statutory exemption, may be beneficial to participants and beneficiaries of individual account plans and IRAs. To assure that plan participants and IRA beneficiaries may have access to these investment advice programs, the Department has under consideration an administrative class exemption from the prohibited transaction provisions of ERISA and the Code for certain additional investment advice arrangements pursuant to its authority under section 408(a) of ERISA and section 4975(c)(2) of the Code. The proposed class exemption will be published in the August 22, 2008 issue of the **Federal Register**. Comments received in connection therewith will be posted on, and will be available at, [www.regulations.gov](http://www.regulations.gov).

August 21, 2008

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<sup>8</sup> The Four Commenters are: (1) Financial Engines, Inc.; (2) Metropolitan Life Insurance Company; (3) Morningstar Associates, LLC; and (4) Vanguard.