

Qualified Retirement Plans
Practice Alert
March 2009

Investment Advice to Participant

Any individual or entity that provides investment advice to participants in a self directed retirement plan, e.g. a 401(k) plan, for a fee is considered a fiduciary under ERISA and the Internal Revenue Code. In the position of a fiduciary you are prohibited from using that position to increase your compensation. As a result of this adverse result many plan sponsors were reluctant to offer or provide investment advice for their employees. The adviser could avoid this result if their fees did not vary based on the advice given, i.e. a level fee. That option is still available. In addition the Pension Protection Act of 2006 (PPA) added new rules to encourage plan sponsors to offer investment advice to their employees. The requirements of the new rule the adviser must:

1. Provide that any fees charged by the individual adviser or their firm will not vary based on any investment options offered and selected by the participant, or
2. Use a computer model that is independently certified as not favoring options offered by the adviser that would generate higher income than any other option

Although option “1” appears to be the same as the pre PPA rule it is somewhat less inclusive. The prior rule, which is still valid, requires that the adviser, the adviser’s firm and any affiliates of the adviser comply with the level fee rule while the PPA rule only extends to the adviser and the adviser’s firm. The second option above does not require level fees. In both cases the adviser must accept their position as a fiduciary and provide specific information regarding their fees and compensation. The adviser must also participate in an annual audit that would evaluate compliance with the above rules. The final rules provide guidance on the annual audit and certification of the computer model.

In addition to the two options above the PPA also includes a class exemption to avoid the adviser’s services to be considered a prohibited transaction. The class exemption offers two methods to avoid a prohibited transaction. The class model exemption the advice must be generated by a computer model that meets the requirements of the statutory exemption above or is designed and maintained by a person independent of the adviser. In this case the level fee rule does not apply. The second method is a variation of the level fee rule above that only applies to the adviser providing the investment advice. In this case the adviser must determine that the advice is prudent and in the best interest of the participant and must explain the reasoning for that conclusion. In addition the adviser must explain how and why the advice varies from the computer model and, if applicable, why the advice includes options with higher fees than other options. These explanations must be documented within thirty days of the date the advice is provided.

It is the hope of the Department of Labor and the Internal Revenue that these expanded rules will encourage plan sponsors to offer investment advice to their employees and improve the long term performance of their retirement accounts.

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