INVESTMENT COMPANY INSTITUTE

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October 31, 2011

DOL Issues Final PPA Investment Advice Rule

[25601]

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TO: BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 65-11
BROKER/DEALER ADVISORY COMMITTEE No. 71-11 RE: DOL ISSUES FINAL PPA INVESTMENT ADVICE RULE

The Department of Labor adopted a final rule [1] implementing the investment advice provisions of the Pension Protection Act of 2006 which were designed to provide a prohibited transaction exemption to allow service providers to plans and IRAs to offer investment advice to retirement savers under certain conditions. [2] The final rule incorporates many of the suggestions made by the Institute in its comment letter and in the comment letter we filed jointly with the American Benefits Council and the American Council of Life Insurers. [3]

The final rule largely retains the format of the March 2010 proposal but adopts a number of important clarifications and changes, detailed below. The final rule makes clear that neither the PPA nor this rule invalidates prior guidance on investment advice programs, such as the SunAmerica advisory opinion. [4]

Use of Historical Performance in Computer Models

The proposal included a provision, not reflected in the statute, requiring that computer models not "[i]nappropriately 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." Statements in the proposing release suggested DOL intended that a computer model generally should ignore the relative historical performance of any investment but may consider the historical performance of the asset class in which the fund invests.

In response to comments from the Institute and others, the Department changed the provision to state that a computer model must "[a]ppropriately weight the factors used in estimating future returns of investment options."

In the March 2010 proposal, DOL asked a series of questions suggesting it might seek to define generally accepted investment theories and detail in the final rule the types of information that a computer model should (and should not) consider in making recommendations and the conclusions that the computer model must draw from that information. The Institute and others strongly argued that DOL should not embark on a process to define the generally accepted investment theories under which plan assets should be invested. DOL agreed with this recommendation.

Investments Excluded from Consideration

Generally, a computer model is required to take into account all the investment options available in a plan. The proposal allowed a computer model not to take into account asset allocation funds (such as target date funds), qualifying employer securities, and annuities.

The final rule removes the exception for asset allocation funds and qualifying employer securities. That is, if these investments are offered in a plan, a computer model under the PPA exemption must take these investments into account in making recommendations. DOL concluded it is feasible to develop a computer model capable of addressing these investments. DOL did not remove the exception for in-plan annuities, reasoning it is less certain that computer models are able to give adequate consideration to in-plan annuity products that permit a participant to allocate a portion of the assets in his or her account towards the purchase of an annuitized retirement benefit. [5]

The final rule, however, includes a provision allowing a participant to request that an investment option be excluded from consideration by the computer model in making recommendations.

Fee-Leveling Condition

DOL did not modify its position that the fee-leveling condition is applied at the fiduciary adviser level only and not also at the level of affiliates. As requested by the Institute, the final rule clarifies that the fee-leveling condition requires that compensation may not vary based on the investment selected by a participant. [6]

As requested by the Institute, DOL reiterated in the preamble that a compensation or bonus arrangement that is based on the overall profitability of an organization may be permissible if investment advice and investment option components are excluded from, or constitute a negligible portion of, the calculation of the organization's profitability. Whether or not a particular bonus program meets or fails the fee-leveling condition ultimately depends on the details of the program.

Information that Must be Requested

The final rule retains a requirement that a fiduciary adviser, whether using the fee-leveling or computer model approach, request 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. The fiduciary adviser is required to take into account only the information actually furnished and may consider additional information that a participant provides. In the preamble, DOL states that a fiduciary adviser or computer model making an information request may also provide a participant with an opportunity to "direct the use of information previously provided."

SEP and SIMPLE IRAs

DOL clarified that the term IRA includes a SEP and SIMPLE IRA. This means that the required authorization of the arrangement by a fiduciary would be given by the participant or beneficiary to whom the account belongs and who receives the advice. DOL states it is interested in further public comment on the operation of the regulation in the context of SIMPLE IRA and SEP plans and may consider adjustments to the rule in the future.

Eligible Independent Experts and Audits

The final rule includes some clarifications to the conditions that apply to an eligible independent expert that certifies a computer model and to an auditor that performs the required annual audit.

The final rule includes a new provision requiring a fiduciary adviser to provide the authorizing fiduciary with written notification that (a) the fiduciary adviser intends to comply with the statutory exemption and the regulations; (b) the fiduciary adviser's investment advice arrangement will be audited annually by an independent auditor; and (c) the auditor will furnish the authorizing fiduciary with a copy of the auditor's findings within 60 days of its completion of the audit.

As in the proposal, in the context of IRAs, a fiduciary adviser must send a copy of the auditor's report to DOL if that report identifies instances of noncompliance. The final rule includes a provision allowing electronic submission to DOL.

Effective Date

The regulation is effective December 27, 2011 and will apply to transactions occurring on or after that date.

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endnotes

[1] The final rule is available here: http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=25414.

[2] The new rule as adopted replaces rules that were adopted in January 2009, withdrawn in November 2009, and reproposed in March 2010. See Memorandum to Pension Members No. 56-09 [23965], dated November 20, 2009; see also Memorandum to Pension Members No. 8-10 [24160], dated March 2, 2010. For a description of the previous final regulation, see Memorandum to Pension Members No. 9-09 [23239], dated February 9, 2009.

[3] See Memorandum to Pension Members No. 13-10 [24282], dated May 4, 2010.

[4] See DOL Advisory Opinion 2001-09A, available at http://www.dol.gov/ebsa/programs/ori/advisory2001/2001-09A.htm.

[5] DOL states in the preamble that computer models may take into account and make recommendations to allocate amounts to in-plan annuity options, provided the other conditions of the exemption are satisfied. DOL also states that if a participant has already allocated some or all of his or her account to an in-plan annuity, these amounts must be taken into account by the computer model in developing the recommendation with respect to the investment of the participant's remaining available assets.

[6] The March 2010 proposal suggested that compensation to a fiduciary adviser could not

be based on an investment selected by the participant, even if the compensation did not vary regardless of the investment selected.
