The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 12125

June 27, 2000

REPRESENTATIVE BOEHNER INTRODUCES ERISA REFORM BILLS; CONFERENCE CALL SCHEDULED FOR JULY 10TH AT 2:00 PM EST

[12125] June 27, 2000 TO: PENSION COMMITTEE No. 43-00 AD HOC COMMITTEE ON INVESTMENT ADVICE RE: REPRESENTATIVE BOEHNER INTRODUCES ERISA REFORM BILLS; CONFERENCE CALL SCHEDULED FOR JULY 10TH AT 2:00 PM EST On June 26, 2000, Representative John Boehner (R-OH) introduced three bills that would amend Title I of ERISA. H.R. 4747, the "Retirement Security Advice Act of 2000," would establish a statutory exemption from ERISA's prohibited transaction rules for the provision of investment advice. H.R. 4748, the "ERISA Modernization Act of 2000," would change the definition of "party in interest," create a statutory exemption from sections 406(a) and (b) for certain arm's length transactions, and amend the standards under which the Department of Labor processes prohibited transaction exemption requests. The third bill, H.R. 4749, the "Comprehensive ERISA Modernization Act of 2000," combines these provisions into one consolidated bill. A conference call has been scheduled for Monday, July 10, 2000 at 2:00 p.m. EST to discuss issues raised by the proposed legislation, particularly those relating to H.R. 4747, the investment advice bill. If you would like to participate on this conference call, please fill out the attached response form and send it to Brenda Turner by Friday, July 7, 2000. As you were previously informed, the House Subcommittee on Employer-Employee Relations held hearings on "ERISA reform" earlier this year.1 These legislative proposals seek to address concerns expressed in hearing testimony, including those of the Institute. Although H.R. 4747 differs in certain respects from the Institute's legislative proposal on the provision of investment advice,2 the bill adopts the disclosure-based approach proposed by the Institute and many of its recommendations. In addition, H.R. 4748 includes the Institute's recommendation to revise the prohibited transaction exemption process.3 H.R. 4747 and H.R. 4748 are described in greater detail below.4 1 See Institute Memorandum to Pension Committee No. 19-00 and Pension Operations Advisory Committee No. 18-00, dated March 17, 2000 (Institute Testimony to House Subcommittee on Employer-Employee Relations on ERISA reform). 2 See Institute Memorandum to Pension Committee No. 17-00 and Ad Hoc Committee on Investment Advice, dated February 23, 2000 (Institute proposal on investment advice). See also Institute Memorandum to Pension Committee No. 19-00 and Pension Operations Advisory Committee No. 18-00, dated March 17, 2000. 3 See Institute Memorandum to Pension Committee No. 19-00 and Pension Operations Advisory Committee No. 18-00, dated March 17, 2000. 4 Because H.R. 4749 simply combines the provisions of H.R. 4747 and H.R. 4748 into one bill, this memorandum does not discuss that bill. 2I. H.R. 4747, The "Retirement Security Advice Act of 2000" This bill would provide a

statutory exemption from ERISA's prohibited transaction rules for the provision of investment advice and transactions related thereto. Under the exemption, "fiduciary advisers," who by definition would be ERISA fiduciaries, would be permitted to provide investment advice to employee benefit plans and participants and beneficiaries of such plans. A. Scope of Exemption The proposed statutory exemption would permit the following: (i) "the provision of investment advice referred to in section 3(21)(A)(ii) provided by a fiduciary adviser," (ii) "the sale, acquisition, or holding of securities or other property . . . pursuant to such investment advice," and (iii) "the direct or indirect receipt of fees or other compensation by the fiduciary adviser or an affiliate thereof . . . in connection with the provision of such investment advice." The bill includes a parallel exemption from the Internal Revenue Code's prohibited transaction rules. B. Definition of "Fiduciary Adviser" The bill would define "fiduciary adviser" as "a person who is a fiduciary of the plan by reason of the provision of investment advice" and who qualifies as one of the following entities: • a registered investment adviser under the Investment Advisers Act of 1940 or applicable state law, • a bank or similar financial institution "referred to in section 408(b)(4)" of ERISA, • an insurance company qualified to do business under the laws of a state, • a registered broker or dealer under the Securities Exchange Act of 1934, • an affiliate, "as defined in section 2(a)(3) of the Investment Company Act of 1940," of these qualifying institutions, or • an employee, agent, or registered representative, as "described in section 3(a)(18) of the Securities Exchange Act of 1934 or section 202(a)(17) of the Investment Advisers Act of 1940," of these qualifying institutions. C. Exemption Conditions To qualify under the statutory exemption, the fiduciary adviser would be required to satisfy the following conditions. 31. Disclosure Requirements At the time of or before the initial provision of investment advice, the fiduciary adviser must provide to the recipient of the advice a "description" of the following: • "all fees or other compensation relating to the advice that the fiduciary adviser or any affiliate is to receive (including compensation provided by any third party) in connection with the provision of" the advice or the acquisition or sale of securities or other property "for purposes of investment of amounts held by [a] plan," • "any material affiliation or contractual relationship" of the fiduciary adviser or its affiliates in such security or other property, • "any limitation placed on the scope of the investment advice to be provided by the fiduciary adviser with respect to any such sale or acquisition," and • "the types of services offered by the fiduciary adviser in connection with the provision of advice." This description may be provided in writing or "by means of electronic communication." During the 1-year period following the provision of advice or any subsequent provision of advice, the fiduciary adviser would be required to maintain the information described above in "currently accurate form for availability, upon request and without charge, to the recipient of such advice." Additionally, the fiduciary adviser must provide appropriate disclosures in accordance with all applicable securities laws. 2. Discretion of Advice Recipient Any sale or acquisition of a security or other property relating to the advice must occur "solely at the discretion of the recipient of such advice." 3. Reasonable Compensation The compensation received by the fiduciary adviser and its affiliates "in connection with such acquisition or sale" must be "reasonable." 4. Arm's-Length Transaction The terms of the acquisition or sale must be "at least as favorable to such plan as an arm's length transaction would be." 5. Recordkeeping Requirement The fiduciary adviser must maintain for a period of at least 6 years after the provision of advice, any records necessary for determining whether the requirements of the statutory exemption were met. However, a prohibited transaction would not be considered to have occurred solely because such records are lost or destroyed prior to the end of the 6-year period due to circumstances beyond the control of the fiduciary adviser. 4D. Clarification of Employer Role The bill would clarify the extent of a plan sponsor's responsibilities under ERISA if it engages a "fiduciary adviser" to provide advice under this exemption.

Specifically, under the bill, a “plan sponsor or other person who is a fiduciary” would not be treated as failing to meet the requirements of Part 4 of ERISA (including the fiduciary duties under ERISA section 404) “solely by reason of the provision of investment advice,” if (i) the advice is provided by a fiduciary adviser “pursuant to an arrangement” between the plan sponsor (or other fiduciary) and the fiduciary adviser, and (ii) the terms of the arrangement require the fiduciary adviser to meet the requirements of the statutory exemption. Furthermore, the plan sponsor or other fiduciary would have no duty to “monitor the specific investment advice given by the fiduciary adviser to any particular recipient of such advice.” The “plan sponsor or other person who is a fiduciary,” however, would be responsible for the prudent selection and periodic review of a fiduciary adviser that it has engaged. E. Use of Plan Assets The bill would clarify that plan assets may be used to pay for “reasonable expenses in providing investment advice referred to in section 3(21)(A)(ii).” F. Effective Date The bill would apply to investment advice provided on or after January 1, 2001. II. H.R. 4748, The “ERISA Modernization Act of 2000” This bill would modify Title I of ERISA in four respects. The bill would (i) establish a prohibited transaction exemption for “arms-length transactions,” (ii) modify the definition of “party in interest,” (iii) revise the standards under which the Department of Labor would issue administrative exemptions under the prohibited transaction rules, and (iv) direct the Department to clarify existing regulations regarding the definition of “plan assets.” A. Exemption for Arm’s-Length Transactions The bill would create a statutory exemption from the prohibited transaction rules under ERISA sections 406(a) and (b) for certain arm’s length transactions. Specifically, the exemption would permit fiduciaries to engage in a transaction otherwise prohibited by section 406(a) if the transaction is subject to a “written contract or arrangement which includes the material terms and conditions” of the transaction, (ii) the transaction is in the “interest of the plan and its participants and beneficiaries,” and (iii) the terms and conditions of the transaction, “including any direct or indirect compensation, are at least as favorable to the plan as an arm’s length transaction.” The bill also would provide relief from section 406(b) if, in addition to meeting the three conditions above, “written disclosure of potential conflicts of interest associated with the transaction” are provided to a plan fiduciary, and the transactions have been authorized by the terms of the plan or by a written contract with an independent plan fiduciary. In addition, the bill would permit fiduciaries and their affiliates that are in the business of entering into particular transactions with the general public to provide such services to their own plans if the conditions above are satisfied, and if the transaction is “entered into under substantially the same terms and conditions as those under which such transactions with the general public are entered into.” The bill 5also includes a parallel “arm’s length transaction” exemption from the Internal Revenue Code’s prohibited transaction rules. B. Definition of “Party in Interest” The bill would narrow the definition of “party in interest.” Under the bill, fiduciaries would be parties in interest only if they are the fiduciary that “personally directed or actively participated in the plan’s entry” into a transaction described in ERISA section 406(a). Furthermore, service providers would no longer be per se parties in interest. A person that is an “administrator, officer or counsel, or employee of the plan,” however, would remain a per se party in interest. Additionally, the bill would narrow the scope of “affiliates” of parties in interest by excluding employees and 10-percent shareholders of parties in interest. The bill also includes a parallel amendment to the Internal Revenue Code. C. Standards for Issuing Exemptive Relief The bill would revise ERISA section 408(a) to require the Department of Labor, in granting an exemption, to determine “that the conditions or requirements set forth in the exemption are necessary additions to the existing Federal and State laws and regulations and the protections they afford to address concerns unique to employee benefit plans.” The bill also would eliminate the current requirement that the Department determine an exemption to be “in the interests of the

plan and of its participants and beneficiaries.” The requirements that an exemption be “administratively feasible” and “protective of the rights of participants and beneficiaries of such plan” would be retained. D. Definition of “Plan Assets” The bill would direct the Department of Labor to propose regulations by March 31, 2001 that would provide additional guidance to clarify when assets in which an employee benefit plan has invested become “plan assets.” The bill would require that such regulations broaden the existing regulatory exemption from the “plan asset” definition for plan investments in other entities. Additionally, the bill would require regulatory changes to clarify the exemption for “venture capital operating companies.” The Department would be required to issue final regulations by September 30, 2001. E. Effective Date The provisions of H.R. 4748 generally would be effective for transactions occurring on or after January 1, 2001. 6Copies of H.R. 4747, H.R. 4748, and a statement by Representative Boehner are attached. Thomas T. Kim Assistant Counsel Attachments Attachment (in .pdf format)
