

**MEMO# 12319**

July 20, 2000

## **DOL ISSUES PROPOSED INDIVIDUAL EXEMPTION FOR ASSET ALLOCATION SERVICES TO PLANS AND PARTICIPANTS**

[12319] July 20, 2000 TO: PENSION COMMITTEE No. 52-00 AD HOC COMMITTEE ON INVESTMENT ADVICE RE: DOL ISSUES PROPOSED INDIVIDUAL EXEMPTION FOR ASSET ALLOCATION SERVICES TO PLANS AND PARTICIPANTS The Department of Labor has published a proposed individual exemption regarding the provision of certain "asset allocation services" by the Bank of Oklahoma (the "Bank"). The proposed exemption would provide relief from ERISA section 406(b) for the provision of such asset allocation services with regard to employee benefit plans and from ERISA section 406(a) for the purchase or redemption by a plan of shares in both mutual funds "affiliated" with the Bank and "third-party" funds. Comments to the proposed exemption must be submitted by August 4, 2000. The proposed exemption would allow plans to participate in the Bank-sponsored "Foundations Program" under which plans may invest in certain Bank-affiliated mutual funds and third-party funds. As part of the program, the Bank would recommend asset allocation models, make "adjustments" to the models, and "rebalance" a participating plan's account.<sup>1</sup> These services would be provided to an independent fiduciary of a participating plan ("Primary Independent Fiduciary") or to a participant of a plan that authorizes participant investment direction ("Directing Independent Fiduciary"). Any recommendation or evaluation made by the Bank would be "implemented only at the express direction of these parties." Fees paid by the plan to the Bank for asset allocation and related services would be offset by investment management and administrative fees such that the recommendation of an affiliated fund or a third party fund would be "fee-neutral." With respect to the program's rebalancing feature, neither the Bank nor its affiliates would receive commissions from related sales or purchases and the participating plans would not be charged a redemption fee. A Primary Independent Fiduciary (on behalf of the plan) or a Directing Independent Fiduciary (on behalf of that individual) initially would agree to participate in the Foundations Program. The Bank would analyze "an Investor Profile" completed by the Primary or Directing Independent Fiduciary and 1 The proposed exemption does not expressly state that the Bank's activities at issue would constitute the provision of "investment advice" under ERISA; rather, the proposed exemption notes that the "Applicants are concerned that the Bank's fiduciary activities under the Foundations Program (e.g., recommending an Asset Allocation Model, making a Model Adjustment or rebalancing a participating Plan's account) will cause the Plan to pay additional fees (i.e., Advisory Fees and Administrative Fees) to the bank or an affiliate of the Bank or cause the Bank or a Bank affiliate to receive consideration from a third party in connection with a transaction involving the Plan." Given the proposed exemption's description of the program, it would appear that a recommendation of a particular asset allocation model, in

effect, could be a recommendation of particular, pre-selected funds. 2develop a recommendation of a particular asset allocation model. A description of the applicable fee structure and written materials that generally discuss market risks and other investment concepts would accompany the recommendation. The Bank would monitor the recommended asset allocation model, review its composition on at least a monthly basis, and adjust the “normal position” of the model periodically “as dictated by changing economic and market conditions.” Certain adjustments could be made unilaterally by the Bank<sup>2</sup>; others would require the consent of a Primary Plan fiduciary. As part of the Bank’s monitoring activities, the Bank would retain an “Independent Financial Analyst” to review the Bank’s selection of certain types of funds under the program. This Independent Financial Analyst would not be allowed to derive more than 5 percent of its total annual revenues from the Bank or its affiliates. As noted above, the Bank would be permitted to “rebalance” a plan’s investments. Under program guidelines, the rebalancing would occur if the allocation among the funds becomes “materially out of line” with the recommended asset allocation model.<sup>3</sup> The rebalancing would “not involve the exercise of any investment discretion by the Bank.” Furthermore, cross-trading of securities between funds would not be permitted in connection with the rebalancing. In addition to the requirements above, the proposed exemption conditions relief from sections 406(a) and (b) of ERISA on a number of other requirements, which include: • As to each plan, “the total fees paid to the Bank and its affiliates” must be no more than “reasonable compensation for the services provided”; • The terms of each purchase or redemption of shares in the program’s Funds must be “at least as favorable to an investing plan as those obtainable in an arm’s length transaction with an unrelated party”; • The Bank must provide extensive initial and continuing disclosures to the Primary Independent Fiduciary and/or the Directing Independent Fiduciary; and • The Bank must comply with recordkeeping requirements that would enable parties to determine whether the conditions of the exemption have been met. Thomas T. Kim Assistant Counsel Attachment Attachment (in .pdf format) 2 The account agreement between the parties would authorize certain unilateral adjustments; the adjustments, however, may not deviate 15 percent above or below the normal position of a given allocation model. 3 A plan would be “materially out of line” if “at least one transaction required to rebalance the participating Plan among the Funds (a) would involve a purchase or sale of securities valued at \$100 or more, or (b) the net asset value of the Fund affected would represent more than 5 percent of the Plan’s investment in such Fund.”