The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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DOL ISSUES FINAL INDIVIDUAL EXEMPTION ON STANDARD & POOR'S INVESTMENT ADVISORY SERVICE

[12501] August 18, 2000 TO: PENSION COMMITTEE No. 59-00 AD HOC COMMITTEE ON INVESTMENT ADVICE RE: DOL ISSUES FINAL INDIVIDUAL EXEMPTION ON STANDARD & POOR'S INVESTMENT ADVISORY SERVICE The Department of Labor has granted a final individual prohibited transaction exemption to Standard & Poor's Investment Advisory Service ("S&P"). Specifically, the final exemption permits S&P to provide "personalized asset allocation" advisory services to plan participants pursuant to arrangements with plan sponsors or service providers, so long as the exemption's requirements are met. The final exemption is substantially similar to the proposed exemption published earlier this year.1 As you are aware, the Institute filed a comment letter regarding the proposed exemption.2 In response to the Institute's comments, the Department, in the final exemption, "recognize[d] that there are many participant investment advisory programs and that these programs are structured in a variety of different ways. Some of these programs may not require exemptions from the self-dealing and conflict of interest provisions contained in the Act." The Department also noted that "the granting of this exemption does not foreclose future consideration of a class exemption, or other individual exemptions that may be issued for participant investment advisory programs that would be subject to protective conditions that may differ from those set forth in this exemption." Additionally, in response to another commentator, the Department clarified that "the granting of this exemption should not be interpreted as an endorsement by the Department of the investment program described therein." 1 See Institute Memorandum to Pension Committee No. 22-00 and Ad Hoc Committee on Investment Advice, dated March 28, 2000. The final exemption, like the proposed exemption, conditions relief upon the following notable requirements: (i) an independent plan fiduciary must authorize in writing the retention of S&P; (ii) S&P must provide specified disclosures to independent fiduciaries and participants; (iii) a service provider may not own any interest in S&P, and neither S&P nor an affiliate may own any interest in the service provider; (iv) the annual revenues received by S&P from any one service provider must not exceed 5 percent of S&P's annual revenues; (v) fees paid to S&P must not exceed "reasonable compensation"; (vi) S&P and service providers must not share fees paid by plans or plan sponsors; and (vii) any investment advice given must be implemented by the participant. 2 See Institute Memorandum to Pension Committee No. 32-00 and Ad Hoc Committee on Investment Advice, dated May 5, 2000. In the comment letter, the Institute made the broad point that the Department's approach to the provision of investment advice in the proposed exemption as well as prior individual exemptions severely restricts the availability of advice — to the detriment of participants. The Institute also noted that the Department failed to explain why an exemption was necessary in this

case, and that absent the identification of a prohibited transaction, the exemption would have a chilling effect on advisory activities. Finally, the Institute urged the Department to adopt a disclosure-based approach to the provision of investment advice, as described in the Institute's testimony submitted to the House Subcommittee on Employer-Employee Relations. See Institute Memorandum to Pension Committee No. 19-00 and Pension Operations Advisory Committee No. 18-00, dated March 17, 2000 (Institute's testimony). 2Some of the conditions imposed by the final exemption differ in certain respects from those provided in the proposed exemption. These changes are based on comments submitted by S&P. Notable modifications are as follows: • Disclosure Requirements. The Department expanded the disclosures that S&P must make to independent fiduciaries by requiring the disclosure of "all fees and expenses" S&P receives in connection with advisory services provided to a plan. The proposed exemption would have required a report on fees and expenses paid by a plan or participants only. The Department noted that disclosure of all fees from all sources with respect to a particular plan would assist an independent fiduciary in evaluating the reasonableness of an arrangement. • Service Provider Fees. The proposed exemption would have required that "all dealings" between plans and service providers participating in the program be on a "basis no less favorable" to the plans than dealings with other investors of the service provider. The Department narrowed this prohibition to differences in fees imposed; the final exemption prohibits a service provider from charging additional fees (relating to a plan's investment products) to a plan, unless such fees are also imposed on the service provider's other "similarly situated" clients. • Service Provider Definition. In lieu of prohibiting parties that have entered into settlement agreements with the IRS or the Department from becoming eligible "service providers," the final exemption requires that service providers may not have been convicted of a felony offense involving its business or an employee benefit plan. The change was based on concerns that service providers utilizing voluntary settlement programs should not be excluded from the definition. • Recordkeeping Requirements. The Department eliminated the requirement that S&P maintain records relating to participants' actual investment choices, based on S&P's representation that there is no practical way of tracking their choices or their actual use of the advice provided. • Effective Date. The Department granted S&P's request for a retroactive effective date. The final exemption is effective March 22, 2000, the publication date of the proposed exemption. The Department declined to grant a number of other requests made by commentators. For instance, the Department rejected a request to limit the transactions covered by the exemption to the "receipt of fees" resulting from the provision of advice. The Department also declined to make a finding that the conditions of ERISA section 408(b)(2) (the "service provider" statutory exemption) are satisfied in cases where fees for the advisory service are paid by a plan sponsor or a plan, rather than a service provider. The Department noted that a determination of whether the requirements of section 408(b)(2) have been met is "inherently factual in nature." Furthermore, the Department rejected S&P's request that third-party recordkeeping firms be included in the definition of a qualified "service provider." A copy of the final exemption is attached. Thomas T. Kim Assistant Counsel Attachment Attachment (in .pdf format) 3