ERISA Regulatory Update

Roberta Ufford

By Roberta Ufford and George Sepsakos

Introduction

In recent weeks, the Employee Benefits Security Administration of the U.S. Department of Labor ("DOL") has issued new regulations and other guidance of concern to plans governed by the Employee Retirement Income Security Act of 1974 as amended ("ERISA") and financial institutions and other service providers to these plans. This article provides an update on these developments.

DOL to Re-Propose Regulation Amending Definition of "Fiduciary"

After a year of discussion relating to its proposed amendment to regulations defining the type of investment advice that results in fiduciary status for ERISA purposes (including a two-day public hearing in March 2011 and scores of meetings with Congress and other interested parties), DOL announced on September 19, 2011, that it would "re-propose" the regulation. DOL officials have suggested that some changes will be made in the re-proposal, which may be issued in early 2012. Most practitioners believe that this means that the re-proposed regulation could become final no earlier than calendar year 2013.

As background, under current regulations, a person who provides investment advice with respect to the assets of an ERISA-covered plan is a fiduciary for ERISA purposes only if the advice meets a "five part" test, under which the person provides (1) recommendations regarding the investment of plan assets in securities or other property, (2) the recommendations are provided on a regular basis, (3) the recommendations are

individualized, (4) there is a mutual agreement or understanding that the recommendations will be a primary basis for plan investment decisions, and (5) a fee is paid. 29 C.F.R. § 2510.3-21(c). This regulation also governs whether service providers are "fiduciaries" to individual retirement account (IRAs) for purposes of the prohibited transaction excise tax provisions under section 4975 of the Internal Revenue Code. On October 22, 2010, DOL proposed amendments to this regulation that would substantially broaden circumstances under which a person may provide investment advice that results in fiduciary status. 75 Fed. Reg. 65263 (Oct. 22, 2010). Among other changes, that proposal would eliminate requirements that fiduciary advice must be provided on a "regular basis" and with a "mutual understanding" that the advice would be a primary basis for plan investment decisions. The proposed regulation also would clarify that recommendations by appraisers and valuation firms, and recommendations of investment managers, would be considered investment "recommendations" that could result in fiduciary status under ERISA.

The proposed regulation would represent a significant departure from the existing five-part test, and substantially expand the range of individuals and entities that would qualify as fiduciaries under ERISA, making it easier for DOL (and plaintiffs' attorneys) to establish the fiduciary status of investment service providers in DOL enforcement and ERISA litigation matters. Further, while many financial institutions already act in a fiduciary capacity to ERISA-covered plans and IRAs, the proposed regulation still could significantly impact financial institutions because they often take the position that some services they provide are not "fiduciary" in nature – *e.g.*, assistance in selecting and monitoring investment options for 401(k) plans and preparing periodic reports showing the valuation of assets – and therefore not subject to ERISA's fiduciary standards. The proposed regulation could expand the definition of fiduciary advice to include these types of activities in some circumstances, and in that event, financial institutions would need to perform a thorough review of their retirement plan services and operations to comply with new requirements.

While the DOL's decision to re-propose the regulation is good news, it is unclear what exactly they have in mind for the re-proposal. Its press release announced that DOL will clarify within the re-proposal that "fiduciary advice" is limited to individualized advice directed towards specific parties and also will address concerns about the application of the definition to routine valuations and appraisals and the impact on long standing class exemptions that are used in connection with numerous types of plan transactions. DOL also indicated that it intends to preserve so-called "beneficial fee practices" while protecting plan participants and IRA holders from receiving conflicted advice.

Final Regulations Interpret Participant Investment Advice Exemption

The Pension Protection Act of 2006 added a new statutory exemption under ERISA sections 408(b)(14) and 408(g) from the prohibited transaction provisions under ERISA and the Internal Revenue Code that permits a "fiduciary adviser" to (1) provide investment advice to a plan participant or an IRA holder, and (2) receive direct and indirect compensation (including sales commissions) as a result of the investments made following the advice. The advice must be provided pursuant to an "eligible investment advice arrangement." For purposes of this exemption, a fiduciary adviser is a person (1) who is a fiduciary by reason of providing investment advice, and (2) who is a registered investment adviser, bank, insurance company, broker dealer, or any affiliates, employees and/or agents. An eligible arrangement is either (a) a "level fee" arrangement under which any fees received by the fiduciary adviser for investment advice or with respect to the sale, holding, or acquisition of any security or other property do not vary depending on the basis of investments selected by the participant, or (b) an arrangement under which advice is based on a objective computer model that is certified by an eligible investment expert. These models must rely on generally accepted investment theories, take into account relevant participant information, be objective and unbiased, and take into account all investment options under the plan when specifying how a participant's account balance should be invested.

On October 25, 2011, the DOL issued final regulations relating to the statutory exemption for the provision of participant investment advice under ERISA section 408(b)(14). 76 Fed. Reg. 66136 (Oct. 25, 2011). These final regulations are based on proposed regulations issued by DOL in March 2010 (which were in

turn, a re-proposal of previously proposed regulations that were withdrawn early 2009) and make some important new changes. First, with respect to level fee arrangements, the proposed regulation offered that a fiduciary adviser providing investment advice may not receive from any party, directly or indirectly, any fee or compensation that is based in whole or in part on a participant's or beneficiary's selection of an investment option. The final regulation instead provides the phrase "that varies depending on the basis of" to clarify that the exemption only proscribes fees that vary based on participant investment selections.

The final regulation also modifies conditions relating to the use of computer models under the exemption. Most importantly, it clarifies that the computer models may consider historical performance data in the selection of investment options. The final rule also provides that computer models must include recommendations regarding employer securities and asset allocation funds. Moreover, a new provision provides that a computer model does not fail to satisfy the regulation's requirements merely because it does not provide a recommendation that the participant or beneficiary specifically requested to be excluded from consideration.

Final regulation also includes changes to the general conditions applicable to both types of eligible investment advice arrangements. First, it clarifies that SEP and SIMPLE plans will be treated like IRAs in that the participant or beneficiary must authorize the investment arrangement. It now requires that the annual audit of each eligible advice arrangement must identify, among other things, the fiduciary adviser and the type of arrangement and provides new circumstances for determining the auditor's independence.

The final regulation became effective on December 27, 2011.

Extension of Effective Date for New Disclosure Rules

In an effort to provide greater transparency of fees and expenses paid by plans, especially within the 401(k) industry, the DOL launched a three-part disclosure initiative several years ago, including changes to service provider fee disclosure requirements on Form 5500 Schedule C, amendments to regulations under ERISA section 408(b)(2) that require additional disclosure by certain plan service providers (see 29 C.F.R. § 2550.408b-2), and new regulations governing disclosure to participants of participant-directed plans. 29 C.F.R. § 2550.404a-5. The changes to service provider disclosure on the Form 5500 Schedule C are already implemented. However, implementation of section 408(b)(2) regulation amendments have been repeatedly postponed pending issuance of a final rule. (Regulations adopted in July 2010 were published in interim final form.)

On July 13, 2011, the DOL announced further extensions to the applicability dates of the section 408(b)(2) service provider disclosure regulation and also the participant disclosure regulation. 76 Fed. Reg. 42539 (July 19, 2011). These extensions are the result of retirement plan community requests for more time to update systems and procedures for information collection and disclosure as well as further delays in the adoption of a final regulation under ERISA section 408(b)(2). As extended, service providers are required to deliver disclosure required by the interim final service provider rule by April 1, 2012. It is expected that a final service provider disclosure regulation will be issued before the end of this calendar year.

With respect to implementation of new participant disclosure requirements for participant-directed retirement plans, DOL is adopting a 60 day transition rule that is tied to the effective date of the service provider disclosure regulation. Unless the service provider rule implementation date is further extended, calendar-year plans:

(1) must receive disclosures from service providers by April 1, 2012,

(2) must provide disclosures to participants by May 31, 2012, and

(3) must provide the first quarterly statement of fees/expenses actually deducted to participants by August 14, 2012.

Use of Electronic Disclosure Formats for Participant Disclosures

In connection with its participant disclosure initiatives, DOL has been evaluating its rules governing the use of electronic formats for providing information to plan participants. In interim guidance issued on September 13, 2011, DOL addressed the permissible electronic disclosure methods under the participant disclosure rule. DOL Technical Release 2011-03 (Sept. 13, 2011). Under this guidance, the DOL will not take enforcement action against a plan administrator who complies with the conditions of the announcement. This information is timely, as plan administrators are now beginning to prepare to comply with the participant disclosure regulation.

The new guidance offers a bifurcated approach for the participant disclosures. Some information required by the participant disclosure regulations – such as general plan information and information about plan administrative changes – is permitted to be included in pension benefit statements that are delivered to plan participants, and this information may be furnished electronically in the same manner as the benefit statement. Other required disclosures (primarily relating to plan investment alternatives) may only be furnished electronically pursuant to ERISA's electronic disclosure safe harbor or by meeting the conditions set forth below:

1) Participants and beneficiaries entitled to receive disclosures voluntarily provide the employer, plan sponsor or plan administrator with an email address for the purpose of receiving disclosures;

2) An initial notice is furnished to participants which describes the information to be electronically delivered, instructs participants on how to access the information, and identifies participants' rights with respect to electronic disclosure;

3) An annual notice is provided to participants that reiterates information set forth in the initial notice;

4) The plan administrator takes appropriate steps to ensure that the electronic delivery system results in receipt of transmitted information;

5) The plan administrator takes appropriate steps to ensure that personal information remains confidential; and

6) Notices furnished to participants and beneficiaries are written in a manner calculated to be understood by the average plan participant.

Additional conditions apply for participants with plan or employer-sponsored email addresses and or those participants whose email addresses are already on file with the employer, plan sponsor, or plan administrator.

Abandoned Plans

In 2006, the DOL introduced the Abandoned Plan Program which allows asset custodians of abandoned individual account plans to terminate and wind up the plan, including making distributions to participants and beneficiaries. 71 Fed. Reg. 20280 (Apr. 26, 2006). A plan is generally considered abandoned if no contributions to or distributions from the plan have been made for a period of at least 12 consecutive months and following reasonable efforts to locate the plan sponsor it is determined that the sponsor no longer exists, cannot be located or is unable to maintain the plan. The DOL has recently confirmed within its annual regulatory agenda that it will issue proposed regulations in December 2011 amending the abandoned plan program in its current form. It is expected that these changes will align the regulation with recent changes in the Bankruptcy Code to allow plans of businesses in liquidation proceedings to use the termination and winding-up procedures under the program.

About the Authors

Roberta Ufford is a principal of Groom Law Group, Chartered, where she concentrates on ERISA's fiduciary responsibility provisions and other laws governing employee benefit plans. Ms. Ufford is admitted to practice in the District of Columbia.
George Sepakos is an attorney practicing with Groom Law Group.