

# Fact Sheet



U.S. Department of Labor  
Employee Benefits Security Administration  
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## Final Rule to Increase Workers' Access to High Quality Investment Advice

*The Pension Protection Act of 2006 (PPA) amended the Employee Retirement Income Security Act of 1974 (ERISA) to create a new statutory exemption from the prohibited transaction rules to expand the availability of fiduciary investment advice to participants in 401(k)-type plans and individual retirement accounts (IRAs), subject to safeguards and conditions. The Department of Labor's Employee Benefits Security Administration (EBSA) has recently released a final rule to implement these PPA provisions and make fiduciary investment advice more accessible for millions of Americans in 401(k) type plans and individual retirement arrangements (IRAs).*

### Background

- EBSA is responsible for administering and enforcing the fiduciary, reporting, and disclosure provisions of Title I of the ERISA.
- The agency oversees approximately 718,000 private sector retirement plans covering more than 86 million active participants and holding over \$4.7 trillion in assets.
- Of these retirement plans, defined contribution plans that allowed participants to direct at least a portion of their investments (hereafter "401(k) type plans"), account for over 498,000 plans, covering more than 60 million active participants and holding almost \$2.2 trillion in assets.
- In 2010, approximately 48.6 million households owned some type of IRAs, with estimated total assets of approximately \$4.7 trillion.
- ERISA and the Internal Revenue Code generally prohibit fiduciary investment advisers from receiving compensation from the investment vehicles that they recommend to plan participants and IRA holders. This protects participants in 401(k) plans and IRAs from conflicts of interest, but sometimes can limit their access to quality professional investment advice.
- Given the rise in participation in 401(k) type plans and IRAs, the retirement security of millions of America's workers increasingly depends on their investment decisions. Thus, there is increased recognition of the importance of quality investment advice in helping participants avoid costly investment errors.
- The PPA amended ERISA and the Internal Revenue Code to create a new statutory exemption from the prohibited transaction rules to expand the availability of fiduciary investment advice to participants in 401(k)-type plans and IRAs. It allows fiduciary advisers to receive fees from investment providers whose products are recommended to participants, but subject to safeguards and conditions preventing investment advisers from slanting their advice for their own financial benefit.

- The Department published a Notice of Proposed Rulemaking in March 2010 to implement the PPA provisions.

## Overview of the Final Investment Advice Regulation

- The statutory exemption allows fiduciary investment advisers to receive compensation from investment vehicles they recommend if either (1) the investment advice they provide is based on a computer model certified as unbiased and as applying generally accepted investment theories, or (2) the adviser is compensated on a "level-fee" basis (i.e., fees do not vary based on investments selected by the participant). The final regulation provides detailed guidance to advisers on compliance with these conditions.
- The regulation also shows advisers how to comply with other conditions and safeguards in the statutory exemption, including:
  - Requiring that a plan fiduciary (independent of the investment adviser or its affiliates) authorize the advice arrangement.
  - Imposing recordkeeping requirements for investment advisers relying on the exemption.
  - Requiring that computer models must be certified in advance as unbiased and meeting the exemption's requirements by an independent expert.
  - Establishing qualifications and a selection process for the investment expert who must perform the above certification.
  - Clarifying that the level-fee requirement does not permit investment advisers (including their employees) to receive compensation from any party (including affiliates) that vary on the basis of the investments participants select.
  - Establishing an annual audit of both computer model and level-fee advice arrangements, including the requirement that the auditor be independent from the investment advice provider.
  - Requiring disclosures by advisers to plan participants.
- The final rule does not affect the applicability of the Department's prior guidance on the application of the prohibited transaction rules and existing prohibited transaction exemptions to investment advice arrangements.
  - For example, the guidance contained in Advisory Opinion Nos. 2011-08A, 2005-10A (Country Trust Bank), 2001-09A (SunAmerica Retirement Markets) and 1997-15A (Frost National Bank) continue to apply.

## Affected Entities

- The Department estimates that approximately 134,000 defined contribution plans covering 17 million participants and beneficiaries will offer investment advice pursuant to the statutory exemption and that approximately 3.5 million of these participants and beneficiaries will seek advice from investment advisory firms servicing their employer-sponsored retirement investment plan. The Department also estimates that 17 million IRA beneficiaries will seek investment advice pursuant to the statutory exemption.
- The Department estimates that 16,000 investment advisory firms will provide investment advice pursuant to the statutory exemption.

## **Benefits and Costs of Final Investment Advice Regulation**

- The final regulation will provide important benefits to society by extending quality, expert investment advice to more participants, leading them to make fewer investment mistakes.
- The Department believes that participants, after having received advice covered by the exemption, may pay lower fees and expenses, engage in less excessive or poorly timed trading, more adequately diversify their portfolios and thereby assume less uncompensated risk, achieve a more optimal level of compensated risk, and/or pay less excess taxes.
- The Department estimates that increased use of investment advice under the PPA and the final rule will reduce investment mistakes by between \$7 billion and \$18 billion annually at a cost of between \$2 billion and \$5 billion, thereby producing a net financial benefit of between \$5 billion and \$13 billion.
- The estimated costs in the first year for the statutory exemption include approximately \$274 million to prepare and distribute disclosures to plan participants and beneficiaries and authorizing plan fiduciaries, approximately \$290 million for independent auditors to audit investment advice arrangements, and approximately \$619 million for eligible investment experts to certify computer models used by fiduciary advisers to generate investment selections. The costs in all subsequent years for the statutory exemption include approximately \$146 million to prepare and distribute disclosures, approximately \$290 million to audit investment advice arrangements, and over \$309 million to certify computer models used in investment advice arrangements.

## **Effective and Applicability Dates**

- The final rule will become effective on December 27, 2011, and will be applicable to transactions occurring on or after that date.

## **Contact Information**

For questions about the rule, contact EBSA's Office of Regulations and Interpretations at 202-693-8500.