Investment advice regulations update

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This month we would like to address topics that have been part of recent conversations with clients and that should be relevant to most plan sponsors.

Investment advice regulation. First, some clients have asked if the recently reproposed investment advice regulations that differ from the prior released version will forestall the possible Congressional intervention in this area. Let's begin by noting that the latest proposal states that previously issued guidance relating to investment advice arrangements remains in effect. The old proposal would have allowed advisors under level-fee arrangements to receive compensation that varied based on the investment alternative selected, as long as the compensation received directly by the individual providing the advice did not change because of a recommendation. Under the new proposal, compensation of affiliates of the advisor will be taken into account for purposes of testing whether this fee-leveling requirement has been met.

Also, unlike the first proposal, once an advisor has given computer model advice to a participant, the advisor will not be allowed to give individualized off-model advice if a person asks for more advice after receiving the computer model advice.

Another difference between the old and new proposals is the potential regulation of the elements that may be used in constructing a computer model. Differences in performance among investment options within a single asset class, such as actively managed returns, cannot be considered on the theory that they are less likely to be replicated.

There is always the possibility of legislation in this area. However, it is more likely that issues relating to target-date funds will be addressed by legislative initiatives than the new investment advice rules.

Automatic enrollment and target-date fees. Clients have been asking about trends in the 401(k) marketplace impacting their *ability* to meet their ERISA fiduciary responsibilities. The trends mentioned include automatic enrollment and target-date funds (TDFs). These questions have probably surfaced because of the recent stock market volatility. The stock market crash of 2008 showed the devastating losses that could be experienced by target fund investors. In order to fulfill their fiduciary responsibilities, plan sponsors must be sure to adopt and implement prudent procedures for selecting and monitoring TDFs. In the words of the DOL, this process must be objective, thorough, and analytical. It must also involve consideration of the quality of competing providers and products.

A key issue that many plan sponsors may have ignored up to now is a particular TDF's glidepath, that is, the asset allocation mix that will be in effect as participants approach retirement and for some time thereafter. Plan sponsors should give some real thought as to whether a fund's glidepath is appropriate for their plan's participants.

One concern is that many mutual fund companies that offer target-date funds consisting of a fund of related mutual funds are subject to conflicts of interest that result in short-changing plan participants. Plan sponsors could be held responsible for investment losses or the unwarranted fees and expenses charged by these funds. This is essentially what the recently issued DOL Opinion to Avatar provides, making it all the more important to have a prudent selection process for plan investment options.

Prudent decision-making. In matters involving the selection of plan investments and service providers, it has always been the DOL's position that fiduciaries must engage in an objective, thorough, and analytical process. The process must consider the quality of both the provider and the product, as well as the fees and expenses. In the past, this general guidance may not have always been implemented as intended. However, 401(k) fee litigation has had the salutary effect of focusing peoples' attention. As a result, we likely will be seeing a much more strenuous effort to identify fees, probably going beyond what is required by the DOL's regulatory initiatives. Plan sponsors will want to know where the money is going. Once they get a handle on the overall amount of fees, both direct and indirect, plan sponsors probably will insist on measuring the "bang for the buck" and will apply comparative benchmarking techniques to determine if plan participants are getting what they are paying for. Plan sponsors will not want to let down their guard and the monitoring of fees will be on a continuous basis, as it should be.

Broker advice on rollovers. There is reportedly growing Congressional interest in precluding investment advisors from capturing rollovers from 401(k) participants that they have advised. Further, the Department of Labor has issued warnings about cross-selling, and its representatives have said that the Department will give further consideration to the role of advisors who are in contact with participants who are nearing retirement. One question that's been asked is if the prospects of new rules is prompting advisors to protect themselves against conflict of interest charges when they seek to attract rollover business.

While cross-selling has the potential for conflicted advice, banning rollovers to the products of investment providers whose representatives may have had contact with a plan or a participant would be an overreaction that results in eliminating a useful source of investment education. While there are unsubstantiated rumors of an interest in new legislation, we're not aware of any concrete proposal or who the sponsors might be.

The DOL should clarify its rules in this area and eliminate restrictions on those investment providers with only incidental contact with a plan participant. Moreover, there should be a distinction between recommending that a participant roll over his plan account to a particular investment and merely educating the participant as to the availability of rollovers. The latter should be viewed as benign.

DOL and lifetime income stream. The Department of Labor's recent request for information on lifetime income streams is an indication that the pendulum may be shifting from a retirement policy under which workers are primarily responsible for their own retirement income adequacy to a model under which this is more of a shared responsibility. We may be seeing new trends in the investment industry.

For example, participants are taking steps to utilize annuity products so that retirees will not outlive their savings is a topic that is on the mind of many these days. The issue was highlighted in a recent White House report and the request for information on lifetime income streams was from both the DOL and the IRS. The effort is worth it, but there are a host of ERISA, tax qualification, and securities law issues that must be considered. A critical issue is the cost of providing annuities, particularly for smaller plans. In fact, two of the information request's 39 questions relate to the cost of providing in-plan annuities. If the cost of annuities cannot be made attractive, it will only enhance the natural resistance of participants. ❖

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