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29 CFR Part 2550

Investment Advice—Participants and Beneficiaries; Final Rule

DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

RIN 1210–AB13

Investment Advice—Participants and Beneficiaries

AGENCY: Employee Benefits Security Administration, Labor.

ACTION: Final rule.

SUMMARY: This document contains final rules under the Employee Retirement Income Security Act, and parallel provisions in the Internal Revenue Code of 1986, relating to the provision of investment advice by a fiduciary adviser to participants and beneficiaries in participant-directed individual account plans, such as 401(k) plans, and beneficiaries of individual retirement accounts (and certain similar plans). These rules affect sponsors, fiduciaries, participants and beneficiaries of participant-directed individual account plans, as well as providers of investment and investment advice-related services to such plans.

DATES: These final rules are effective on March 23, 2009.

FOR FURTHER INFORMATION CONTACT: Fred Wong, Office of Regulations and Interpretations, Employee Benefits Security Administration, (202) 693–8500. This is not a toll-free number.

SUPPLEMENTARY INFORMATION:

A. Background

Section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974 (ERISA) and section 4975(e)(3)(B) of the Internal Revenue Code of 1986 (Code) include within the definition of ''fiduciary'' a person that renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of a plan, or has any authority or responsibility to do so.[1] The prohibited transaction provisions of ERISA and the Code prohibit an investment advice fiduciary from using the authority, control or responsibility that makes it a fiduciary to cause itself, or a party in which it has an interest that may affect its best judgment as a fiduciary, to receive additional fees. As a result, in the absence of a statutory or administrative exemption, fiduciaries are prohibited from rendering investment advice to plan participants regarding investments that result in the payment of additional advisory and other fees to the fiduciaries or their affiliates. Section 4975 of the Code applies similarly to the rendering of investment advice by a fiduciary to an individual retirement account (IRA) beneficiary.

With the growth of participant-directed individual account plans, there has been an increasing recognition of the importance of investment advice to participants and beneficiaries in such plans. Over the past several years, the Department of Labor (Department) has issued various forms of guidance concerning when a person would be a fiduciary by reason of rendering investment advice and when the provision of investment advice might result in prohibited transactions.[2] Most recently, Congress and the Administration, responding to the need to afford participants and beneficiaries greater access to professional investment advice, amended the prohibited transaction provisions of ERISA and the Code, as part of the Pension Protection Act of 2006 (PPA),[3] to permit a broader array of investment advice providers to offer their services to participants and beneficiaries responsible for investment of assets in their individual accounts and, accordingly, for the adequacy of their retirement savings.

Specifically, section 601 of the PPA added a statutory exemption under sections 408(b)(14) and 408(g) of ERISA. Parallel provisions were added to the Code at sections 4975(d)(17) and 4975(f)(8).[4] Section 408(b)(14) sets forth the investment advice-related transactions that will be exempt from the prohibitions of section 406 if the requirements of section 408(g) are met. The transactions described in section 408(b)(14) are: The provision of investment advice to the participant or beneficiary with respect to a security or other property available as an investment under the plan; the acquisition, holding or sale of a security or other property available as an investment under the plan pursuant to the investment advice; and the direct or indirect receipt of compensation by a fiduciary adviser or affiliate in connection with the provision of investment advice or the acquisition, holding or sale of a security or other property available as an investment under the plan pursuant to the investment advice.

On December 4, 2006, the Department published a Request for Information (RFI) in the **Federal Register** soliciting information to assist the Department in the development of regulations under sections 408(b)(14) and 408(g).[5] Specifically, the Department invited interested persons to address the qualifications for the ''eligible investment expert'' that is required to certify that computer models used in connection with the statutory exemption meet the requirements of the statutory exemption. The Department also invited interested persons to provide information to assist the Department in developing procedures to be followed in certifying that a computer model meets the requirements of the statutory exemption. The Department also invited suggestions for a model disclosure form for purposes of the statutory exemption. In response to the RFI, the Department received 24 letters addressing a variety of issues presented by the statutory exemption. These comments were taken into account in developing the proposed regulations described below.

On February 2, 2007, the Department issued Field Assistance Bulletin 2007–01 addressing certain issues presented by the new statutory exemption. This Bulletin affirmed that the enactment of sections 408(b)(14) and 408(g) did not invalidate or otherwise affect prior guidance of the Department relating to investment advice and that such guidance continues to represent the views of the Department.[6] The Bulletin

[1] *See also* 29 CFR 2510.3–21(c) and 26 CFR 54.4975–9(c).

[2] *See* Interpretative Bulletin relating to participant investment education, 29 CFR 2509.96–1 (Interpretive Bulletin 96–1); Advisory Opinion (AO) 2005–10A (May 11, 2005); AO 2001–09A (December 14, 2001); and AO 97–15A (May 22, 1997).

[3] Public Law 109–280, 120 Stat. 780 (Aug. 17, 2006).

[4] Under Reorganization Plan No. 4 of 1978 (43 FR 47713, Oct. 17, 1978), 5 U.S.C. App. 1, 92 Stat. 3790, the authority of the Secretary of the Treasury to issue rulings under section 4975 of the Code has been transferred, with certain exceptions not here relevant, to the Secretary of Labor. Therefore, the references in this notice to specific sections of ERISA should be taken as referring also to the corresponding sections of the Code.

[5] 71 FR 70429. The Department, on the same date, also published an RFI in the **Federal Register** soliciting information to assist the Department in determining, as required by PPA section 601(b)(3), the feasibility of using computer models in connection with individual retirement accounts. 72 FR 70427.

[6] In this regard, the Department cited the following: August 3, 2006 Floor Statement of Senate Health, Education, Labor and Pensions Committee Chairman Enzi (who chaired the Conference Committee drafting legislation forming the basis of H.R. 4) regarding investment advice to participants in which he states, ''It was the goal and objective of the Members of the Conference to keep this advisory opinion [AO 2001–09A, SunAmerica Advisory Opinion] intact as well as other pre-existing advisory opinions granted by the Department. This legislation does not alter the current or future status of the plans and their many participants operating under these advisory opinions. Rather, the legislation builds upon these advisory opinions and provides alternative means for providing investment advice which is protective

also confirmed the applicability of the principles set forth in section 408(g)(10) [Exemption for plan sponsor and certain other fiduciaries] to plan sponsors and fiduciaries who offered investment advice arrangements with respect to which relief under the statutory exemption is not required. Finally, the Bulletin addressed the scope of the fee-leveling requirement for purposes of an eligible investment advice arrangement described in section 408(g)(2)(A)(i).

On August 22, 2008, the Department published in the **Federal Register** proposed regulations that would, upon adoption, implement the provisions of the statutory exemption for the provision of investment advice to participants and beneficiaries under sections 408(b)(14) and 408(g) of the Act and the parallel provisions in the Code (73 FR 49896). On the same date, the Department also published a proposed class exemption that, upon adoption, would establish alternative conditions for granting prohibited transaction relief in connection with the provision of investment advice, and thereby promote the broad availability of investment advice to both participants and beneficiaries in individual account plans and beneficiaries with individual retirement accounts (73 FR 49924). In response to these proposals, the Department received forty-three comment letters.

On October 21, 2008, the Department held a public hearing at which interested members of the public were afforded an additional opportunity to present their views on the proposals. Eight organizations testified at the hearing.

Set forth below is an overview of the final rules and an overview of the major comments received on the proposed rules and class exemption.

B. Overview of Final § 2550.408g–1 and Public Comments

1. General

As noted above, the Department published both a proposed regulation and a proposed class exemption pertaining to the furnishing of investment advice to participants and beneficiaries. In an effort to facilitate both use of and reference to the relief afforded by the statutory exemption and the class exemption, the Department has included both within a single final rule, discussed below. In this regard, a number of paragraph, subparagraph and other reference changes are reflected in the final rule to accommodate the merger of the two proposals, as well as other changes. The provisions applicable to the statutory exemption are set forth in paragraph (b) of the final rule and the provisions applicable to the class exemption are set forth at paragraph (d) of the final rule. In addition to the structural changes, the final rule, while retaining the general requirements and substance of the proposals, reflects a number of clarifying changes made in response to suggestions and concerns from commenters on the proposals. These suggestions and concerns are discussed below.

Paragraph (a)(1) of the final rule describes the general scope of the final rule, referencing both the statutory exemption under sections 408(b)(14) and 408(g)(1) of ERISA and sections 4975(d)(17) and 4975(f)(8) of the Code for certain transactions in connection with the provision of investment advice, as set forth in paragraph (b) of the final rule, and the class exemption, issued pursuant to the Department's authority under section 408(a) of ERISA and section 4975(c)(2) of the Code, for certain transactions not otherwise covered by the statutory exemption. In response to the concerns of some commenters that the conditions of the final rule might be construed as being applicable to all investment advice arrangements, without regard to whether the provision of advice pursuant to such arrangements involves prohibited transactions, paragraph (a)(1) makes clear that the requirements and conditions of the final rule apply solely for the relief described in the final rule and, accordingly, that no inferences should be drawn with respect to the requirements applicable to the provision of investment advice not addressed by the rule.

Commenters also requested that the final rule make clear that nothing in the rule establishes an obligation on the part of plans or plan sponsors to provide investment advice. Other commenters requested that the Department reaffirm its view that neither the statutory exemption under section 408(g)(1) nor the regulations issued thereunder invalidate or otherwise affect prior guidance concerning the circumstances under which the provision of investment advice would not constitute a prohibited transaction. The Department addressed these concerns in paragraphs (a)(2) and (a)(3), respectively. Paragraph (a)(2) provides that nothing contained in ERISA section 408(g)(1), Code section 4975(f)(8), the regulation or the class exemption imposes an obligation on a plan fiduciary or any other party to offer, provide or otherwise make available any investment advice to a participant or beneficiary. Paragraph (a)(3) provides that nothing contained in those same provisions of ERISA and the Code, the regulation or the class exemption invalidates or otherwise affects prior regulations, exemptions, interpretive or other guidance issued by the Department pertaining to the provision of investment advice and the circumstances under which such advice may or may not constitute a prohibited transaction under section 406 of ERISA or section 4975 of the Code.[7]

One commenter requested confirmation that the provision of investment advice pursuant to the final rule will not affect the relief accorded plan fiduciaries under section 404(c) of the Act. It is the view of the Department that there is nothing in the Act, Code, or this final rule that, in connection with the offering or provision of investment advice, would itself affect the availability of relief to plan sponsors or other fiduciaries of the plan (with the exception of the fiduciary advisers) otherwise available under section 404(c). The Department notes that, as explained in Field Assistance Bulletin 2007–1, a plan sponsor or other fiduciary that prudently selects and monitors an investment advice provider will not be liable for the advice furnished by such provider to the plan's participants and beneficiaries, whether or not that advice is provided pursuant to the statutory exemption under section 408(b)(14).[8] It is the view of the Department that section 404(c) and the Department's regulations thereunder do not limit the liability of fiduciary advisers that, pursuant to the exemptions contained in the final rule, specifically assume and acknowledge fiduciary responsibility for the provision of investment advice, within the meaning of section 3(21)(A)(ii) and the regulations issued thereunder, and related transactions; advice that clearly is intended to serve as the primary basis for investment decisions by plan participants and beneficiaries. Section 404(c) provides relief for acts which are the direct and necessary result of a participant's or beneficiary's exercise of control. The investment advice (and related transactions) covered by the exemption and furnished to participants and beneficiaries would not, in the Department's view, be the direct and necessary result of a participant's or

of the interests of plan participants and IRA owners.'' 152 Cong. Rec. S8,752 (daily ed. Aug. 3, 2006) (statement of Sen. Enzi).

[7] *See* Field Assistance Bulletin 2007–1 (Feb. 2, 2007).

[8] *See* section 408(g)(10) and Field Assistance Bulletin 2007–1 for a discussion of a fiduciary's duty to prudently select and monitor investment advisers.

beneficiary's exercise of control and, accordingly, the fiduciary adviser would not be relieved of liability for such advice. See examples at paragraphs (f)(8) and (f)(9) of § 2550.404c–1.

2. Statutory Exemption

a. General

Paragraph (b) of the final rule specifically addresses the statutory exemption and applicable conditions set forth in section 408(g)(1) of the Act. Like the proposal, these provisions generally track the requirements under section 408(g)(1) that must be satisfied in order for the investment advice-related transactions described in section 408(b)(14) to be exempt from the prohibitions of section 406.

Paragraph (b)(1) provides that for purposes of the relief afforded for transactions described in section 408(b)(14) (and section 4975(d)(17) of the Code) the investment advice must be provided by a fiduciary adviser under an ''eligible investment advice arrangement.'' The transactions described in section 408(b)(14) include the provision of investment advice to a participant or beneficiary with respect to a security or other property available as an investment under the plan; the acquisition, holding or sale of a security or other property available as an investment under the plan pursuant to the advice; and the direct or indirect receipt of fees or other compensation by the fiduciary adviser or an affiliate in connection with the provision of the advice or in connection with the acquisition, holding or sale of the security or other property.

With regard to the scope of relief, one commenter requested that the Department clarify that transactions covered by the regulation and the class exemption include extensions of credit and similar transactions necessary to the execution and settlement of trades of securities. It is the view of the Department that transactions in connection with the provision of investment advice described in section 3(21)(A)(ii) of ERISA include, for purposes of the statutory exemption and class exemption, otherwise permissible transactions necessary for the efficient execution and settlement of trades of securities, such as extensions of credit in connection with settlements.

One commenter requested that the relief afforded by the regulation and class exemption be extended to investment advice provided to plan sponsors generally. The Department notes that the transactions described in 408(b)(14), with respect to which relief is given if the requirements of section 408(g)(1) are satisfied, are specifically limited to certain transactions that involve the provision of investment advice to a participant or beneficiary of a plan. The scope of both the regulation and the related class exemption, therefore, were limited to these transactions. While advice provided to plan fiduciaries such as plan sponsors may well be similar in many respects to advice provided to participants and beneficiaries, the Department does not believe it would be appropriate, as part of this final rule, without further notice and comment, to extend relief to transactions involving investment advice provided to plan sponsors. Accordingly, the Department has not adopted this suggestion.

One commenter requested that the Department confirm that advice to a participant or beneficiary concerning the selection of an investment manager to manage some or all of the participant's or beneficiary's assets constitutes the provision of investment advice within the meaning of section 3(21)(A)(ii) of ERISA for purposes of the statutory exemption and the class exemption. It has long been the view of the Department that the act of making individualized recommendations of particular investment managers to plan fiduciaries may constitute the provision of investment advice within the meaning of section 3(21)(A). The fiduciary nature of that advice does not, in the Department's view, change merely because the advice is being given to a plan participant or beneficiary. Accordingly, it is the view of the Department that the recommending of investment managers to participants and beneficiaries may constitute the provision of investment advice for purposes of both the statutory and class exemption contained in this final rule.

Paragraph (b)(2) provides that, for purposes of section 408(g)(1) of the Act and 4975(f)(8) of the Code, an ''eligible investment advice arrangement'' is an arrangement that meets the requirements of paragraph (b)(3), applicable to arrangements that use fee-leveling, or paragraph (b)(4), applicable to arrangements that use computer models, or both.

b. Arrangements using fee-leveling

Paragraph (b)(3) sets forth the requirements applicable to investment advice arrangements that use fee-leveling under the statutory exemption. Paragraph (b)(3)(i) delineates the specific requirements that must be met. In this regard, paragraph (b)(3)(i)(A) of the final rule, like the proposal, requires that any investment advice must be based on generally accepted investment theories that take into account historic returns of different asset classes over defined periods of time, noting that additional considerations are not precluded from being taking into account.

One commenter recommended that the investment advice also take into account investment management and other fees attendant to the recommended investment(s). The Department agrees that the fees and expenses attendant to an investment are an important consideration and should be factored into individualized recommendations. Given the Department's various regulatory initiatives directed toward enhancing the consideration of investment-related fees and expenses by plan fiduciaries and plan participants and beneficiaries,[9] the Department believes that it is reasonable to expect fiduciary advisers, as well as their computer models, to take such fees and expenses into account in providing investment advice to the plan participants and beneficiaries. The Department, therefore, has added a new provision, at paragraph (b)(3)(i)(B), requiring arrangements that utilize fee-leveling to take into account investment management and other fees and expenses attendant to the recommended investments. Similar changes appear in paragraph (b)(4)(i)(B) for arrangements that use computer models, and paragraph (d)(6)(i)(B), applicable to arrangements for providing advice under the class exemption.

Paragraph (b)(3)(i)(C) of the final rule requires that arrangements utilizing fee-leveling must take into account certain personal information furnished by a participant or beneficiary. In the proposal, this information related to age, life expectancy, retirement age, risk tolerance, other assets or sources of income and investment preferences. The Department received a number of comments on this provision. Many of the commenters requested clarification that the delineated factors were not mandatory, some of the commenters noting that the fiduciary adviser may not have the information, participants may not be willing to give the information or the information they furnish may be incomplete. Other commenters recommended that the

[9] *See* ''Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans,'' 73 FR 43013 (July 23, 2008) (proposed rule); ''Reasonable Contract or Arrangement under Section 408(b)(2)—Fee Disclosure; Proposed Rule,'' 73 FR 70987 (Dec. 13, 2007); and Notice of adoption of revisions to annual return/report forms, 72 FR 64731, 64788–794, 64824–28 (Nov. 16, 2007) (form and instructions for the Schedule C (From 5500), ''Service Provider Information'').

information focus on ''time horizons'' rather than life expectancy or retirement age, noting the use of ''time horizons'' by the Financial Industry Regulatory Authority (FINRA) in its guidance on determining the suitability of a recommendation.

For purposes of the final rule, the Department retained the factors delineated in the statute, section 408(g)(3)(B)(ii) of ERISA, as examples of the information investment advice should be capable of taking into account. The Department also has included in the final rule, as an additional factor, information pertaining to the participant's or beneficiary's current investments in designated investment options. The Department believes that these factors are so fundamental to meaningful investment advice, the Department is applying the personal information requirement to all advice provided under the statutory exemption and class exemption. However, the Department notes that the information is only required to be taken into account to the extent that a participant or beneficiary actually provides such information. There is no obligation, therefore, for a fiduciary adviser to factor in personal information that it does not have or that the participant or beneficiary fails or refuses to provide. Rather, the fiduciary adviser is merely required to request the personal information described in the final rule, and utilize such information only to the extent furnished. The Department has modified the text of the final rule to provide this clarification. The Department also has modified the language of the final rule to reference ''time horizons,'' and by parenthetical citation to life expectancy and retirement age as examples of such time horizons. Similar changes are reflected in paragraph (b)(4)(i)(C), for arrangements utilizing computer models, and paragraph (d)(6)(i)(C), applicable to arrangements for providing advice under the class exemption.

Paragraphs (b)(3)(i)(D) and (E) of the final rule set forth the limitations on fees and compensation at the employee, agent and registered representative level and the fiduciary adviser level, respectively, applicable to arrangements utilizing fee-leveling under the statutory exemption. These limitations are unchanged from the proposal. Paragraph (b)(3)(i)(D) provides that any fees or other compensation (including salary, bonuses, awards, promotions, commissions or other things of value) received, directly or indirectly, by *any employee, agent or registered representative that provides investment advice on behalf of a fiduciary adviser* cannot vary depending on the basis of any investment option selected by a participant or beneficiary. Paragraph (b)(3)(i)(E) provides that any fees (including any commission or other compensation) received by *the fiduciary adviser* for investment advice or with respect to the sale, holding, or acquisition of any security or other property for purposes of investment of plan assets may not vary depending on the basis of any investment option selected by a participant or beneficiary.

While a number of commenters supported the Department's application of the fee-leveling requirement, some commenters objected to the Department's implementation of the statutory provision, arguing that Congress, in an effort to eliminate the potential for conflicts of interest, intended the fee-leveling requirement to encompass not only the fiduciary adviser but also affiliates of the fiduciary adviser. The Department disagrees with this interpretation of the section 408(g)(2)(A)(i). Shortly after enactment of the PPA, the Department issued Field Assistance Bulletin 2007–1 (February 2, 2007) setting forth its legal analysis of the fee-leveling requirements in section 408(g)(2)(A)(i) of the Act.

In that Bulletin, the Department noted that it is clear from section 408(g)(2)(A)(i) that only the fees or other compensation of the fiduciary adviser may not vary. The Department explained that, in contrast to other provisions of section 408(b)(14) and section 408(g), section 408(g)(2)(A)(i) references only the fiduciary adviser, not the fiduciary adviser or an affiliate. Inasmuch as a person, pursuant to section 408(g)(11)(A), can be a fiduciary adviser only if that person is a fiduciary of the plan by virtue of providing investment advice, an affiliate of a registered investment adviser, a bank or similar financial institution, an insurance company, or a registered broker dealer will be subject to the varying fee limitation only if that affiliate is providing investment advice to plan participants and beneficiaries. The Department further explained that, consistent with earlier guidance in this area, if the fees and compensation received by an affiliate of a fiduciary that provides investment advice do not vary or are offset against those received by the fiduciary for the provision of investment advice, no prohibited transaction would result solely by reason of providing investment advice and thus there would be no need for a prohibited transaction exemption, such as provided under sections 408(b)(14) and 408(g).[10] The Department concluded that, for purposes of section 408(g)(2)(A)(i), Congress could not have intended for the requirement that fees not vary depending on the basis of any investment options selected to extend to affiliates of the fiduciary adviser, unless, of course, the affiliate is also a provider of investment advice to a plan. This position continues to reflect the Department's legal analysis of section 408(g)(2)(A)(i) and, therefore, is reflected in the fee-leveling provisions of the final regulation.

With regard to those commenters concerned about potential conflicts of interest influencing the investment advice recommendations, the Department believes that, while there may always be a few individuals who, without regard to limitations imposed by law, abuse their position of trust as fiduciaries, the safeguards established by the regulation, as well as the class exemption, will, in the Department's view, remove many of the incentives and create strong deterrents for abusive behavior. In this regard, we note that, in addition to the specific fee-leveling limitations, fiduciary advisers utilizing investment advice arrangements that employ fee-leveling must comply with the requirements of paragraphs (b)(5) [authorization by plan fiduciary], (b)(6) [annual audits], (b)(7) [advance and annual disclosure], (b)(8) [other conditions], and (e) [maintenance of records] of the final rule, each of which is discussed in more detail below.

A number of commenters had questions or requested clarification of the fee-leveling requirements applicable to employees, agents, or registered representatives that provide advice on behalf of a fiduciary adviser, now set forth in paragraph (b)(3)(i)(D) of the final rule. One commenter asked for examples of things of value that an employee, agent or representative might receive, directly or indirectly, that would violate the rule. Paragraph (b)(3)(i)(D), like the proposal, delineates a number of types of compensation that, if varied based on investment options selected by a participant or beneficiary, would violate the rule, namely salary, bonuses, awards, commissions, or other things of value. Things of value would include trips, gifts and other things that while having a value, are not given in the form of cash.

A number of commenters requested confirmation that bonus programs based on the overall profitability of the fiduciary adviser or its affiliate, or a designated business unit within the adviser's business would not violate the

[10] *See* AO 97–15A and AO 2005–10A.

fee-leveling requirement. The application of the fee-leveling is intended to be very broad in order to ensure that objectivity of the investment advice recommendations to plan participants and beneficiaries is not compromised by the advice provider's own financial interest in the outcome. Accordingly, almost every form of remuneration that takes into account the investments selected by participants and beneficiaries would likely violate the fee-leveling requirement of the final rule. On the other hand, it is conceivable that a compensation or bonus arrangement that is based on the overall profitability of an organization may be permissible to the extent that it can be established that the individual account plan and IRA investment advice and investment option components were excluded from, or constituted a negligible portion of, the calculation of the organization's profitability. The Department believes, however, that whether any particular salary, bonus, awards, promotions or commissions program meets or fails this fee-leveling requirement ultimately depends on the details of the program. In this regard, the Department notes that the details of such programs will be the subject of both a review and a report by an independent auditor as a condition for relief under the statutory and class exemption.

c. Arrangements Using Computer Models

As with the general requirements for arrangements using fee-leveling, and like the proposal in most respects, the final rule requires that arrangements utilizing computer models satisfy certain basic requirements.[11] These requirements include the application of generally accepted investment theories (paragraph (b)(4)(i)(A)), the consideration of investment management and other fees and expenses attendant to recommended investments (paragraph (b)(4)(i)(B)), and the utilization of certain participant-provided information (paragraph (b)(4)(i)(C)). The changes to these requirements were discussed in connection with the fee-leveling provisions of the regulation.

Other conditions imposed on computer models require that such models utilize objective criteria to provide asset allocation portfolios (paragraph (b)(4)(i)(D)) and avoid recommendations that inappropriately favor investments options offered by the fiduciary adviser or that may generate greater income for the fiduciary adviser or those with a material affiliation or material contractual relationship with the fiduciary adviser (paragraph (b)(4)(i)(E)).

As with the proposal, the language of the final rule makes clear that a computer model would not fail to meet the requirements of paragraph (b)(4)(i)(E) merely because the only investment options offered under the plan are options offered by the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser. The language also makes clear that a computer model cannot be designed and operated to inappropriately favor those investment options that generate the most income for the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser. The final rule defines a ''material affiliation'' and ''material contractual relationship'' at paragraphs (c)(6) and (c)(7), respectively.

One commenter requested clarification that the provisions of paragraph (b)(4)(i)(E) would not be violated where an IRA beneficiary requests investment advice with the understanding that the computer model will be providing only hold or sell recommendations with respect to investment options not offered through the IRA. While the Department believes that computer models should, with few exceptions, be required to model all investment options available under a plan or through an IRA, the Department does not believe that it is reasonable to expect that all computer models be capable of modeling the universe of investment options, rather than just those investment alternatives designated as available investments through the plan or IRA. Accordingly, it is the view of the Department that a computer model would not fail to meet the requirements of paragraph (b)(4)(i)(E) merely because it limits buy recommendations only to those investment options that can be bought through the plan or IRA, even if the model is capable of modeling hold and sell recommendations with respect to investments not available through the plan or IRA, provided, of course, that the plan participant or beneficiary or IRA beneficiary is fully informed of the model's limitations in advance of the recommendations, thereby enabling the recipient of advice to assess the usefulness of the recommendations. This view would also extend to the requirements of the class exemption at paragraph (d)(3).

Paragraph (b)(4)(i)(F)(*1*) of the final rule, like the proposal, requires that a computer model take into account all ''designated investment options'' available under the plan without giving inappropriate weight to any investment option.[12] The term ''designated investment option'' is defined in paragraph (c)(1) of the final rule to mean any investment option designated by the plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. The term ''designated investment option'' does not include ''brokerage windows,'' ''self-directed brokerage accounts,'' or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.

Paragraph (b)(4)(i)(F)(*2*)(*i*) also, like the proposal, provides that a computer model shall not be treated as failing to take all designated investment options into account merely because it does not take into account an investment option that constitutes an investment primarily in qualifying employer securities. While most of the commenters on the proposal supported the exclusion of qualifying employer securities, some commenters requested clarification as to whether the computer model nonetheless had to factor in the holding of such investments by a participant or beneficiary, without regard to buy, sell or hold recommendations.

It is the view of the Department that, absent a specific request from the participant or beneficiary to exclude such assets from the modeled investment advice, a computer model must take into account the fact that the participant or beneficiary has such an investment when giving advice with respect to the participant's or beneficiaries remaining assets or investments. If, on the other hand, a participant or beneficiary elects not to have such investments factored into the modeled advice or does not provide such information and the computer model does not have such information, the model would not be required to take such assets into account in providing a recommendation. This approach, in the Department's view, is consistent with the requirement set forth in paragraph (b)(4)(i)(C) of the final rule that computer models take into account other assets and investment preferences of the participant or beneficiary. One commenter requested that the exclusion for qualifying employer securities be expanded to apply to other single asset funds, such as funds invested in stock

[11] In general, these requirements track the requirements set forth in section 408(g)(3)(B) of the Act.

[12] *See* section 408(g)(3)(B)(v) of the Act.

of prior employers or a spin-off company. The commenter did not indicate other types of single asset funds, or the extent to which they are offered as designated investment options under plans. The Department does not believe it has sufficient information at this time to extend similar treatment to any such investments.

Other commenters requested that computer models not be required to include, among other things, options from predecessor plans (referred to as ''legacy options''), managed accounts, target date funds, and in-plan annuity options, which they described as annuity purchase programs that serve as both accumulation and distribution options. With respect to legacy options, it is the view of the Department that to the extent participants continue to have an ability to further invest in such options, the options must be included within the computer model. If, on the other hand, participants are merely permitted to hold and sell investments in such options, it is the view of the Department that, as discussed above with respect to qualifying employer securities, unless a participant specifically elects to not have such investments taken into account, the model should take into account that the participant holds such assets. Similar to the above, a computer model would not, in the view of the Department, fail to meet the requirements of paragraph (b)(4)(i)(F)(*1*) merely because it limits buy recommendations only to those investment options that can be bought through the plan, even though the model is capable of modeling hold and sell recommendations with respect to other investments.

A few commenters noted that certain types of investment options, such as managed accounts, life cycle-type funds, and funds that are designed to manage assets taking into account a particular risk level for the participant, rely on an investment manager to maintain the asset allocation appropriate to its particular fund, product or service and, therefore, that it serves no purpose to have such investments included in another unrelated overlaying asset allocation analysis. The Department agrees that where an investment fund, product or service is itself designed to maintain a particular asset allocation taking into account the time horizons (retirement age, life expectancy) or risk level of a participant, such fund should not be required to be included in the computer modeled investment advice. Similarly, the Department believes that where, in connection with an in-plan annuity option, with respect to which a participant may allocate a portion of his or her assets toward the purchase of an annuitized retirement benefit and those allocated assets are no longer available for investment at the time of the advice, the participant or beneficiary has, in effect, decided to treat those assets as no longer available for investment and, accordingly, such assets should not, in the view of the Department, be required to be modeled for purposes of buy, hold or sell recommendations. On the other hand, when such options are available to participants and beneficiaries, the Department believes that participants and beneficiaries receiving modeled recommendations should at the same time be furnished a general description of these options and how they operate. This disclosure will assure that participants and beneficiaries have information concerning all of their investment choices, not merely those that can be modeled by a computer. This treatment is set forth in paragraphs (b)(4)(i)(F)(*2*)(*ii*) and (*iii*).

Thus, under paragraph (b)(4)(i)(F)(*2*)(*ii*) of the final rule, a computer model will not fail to meet the requirements of the regulation merely because it does not make recommendations relating to the acquisition, holding or sale of an investment fund, product or service that allocates the invested assets of a participant or beneficiary to achieve varying degrees of long-term appreciation and capital preservation through equity and fixed income exposures, based on a defined time horizon (such as retirement age or life expectancy) or level of risk of the participant or beneficiary (e.g., life cycle-type funds).

Similarly, paragraph (b)(4)(i)(F)(*2*)(*iii*) provides that a computer model will not fail merely because it does not make recommendations with respect to an annuity option with respect to which a participant or beneficiary may allocate assets toward the purchase of a stream of retirement income payments guaranteed by an insurance company.

As noted above, however, the foregoing exceptions from the modeling requirement apply only if participants and beneficiaries are provided, contemporaneous with the provision of investment advice generated by the computer model, information explaining the funds, products or services, or in the case of an annuity, the option.

Paragraph (b)(4)(ii) of the final rule, like the proposal, requires that, prior to utilization of the computer model, the fiduciary adviser must obtain a written certification that the computer model meets the requirements of paragraph (b)(4)(i), discussed above. If the model is modified in a manner that may affect its ability to meet the requirements of paragraph (b)(4)(i), the fiduciary adviser, prior to utilization of the modified model, must obtain a new certification. The required certification must be made by an ''eligible investment expert,'' within the meaning of paragraph (b)(4)(iii) and must be made in accordance with the requirements of paragraph (b)(4)(iv).

Paragraph (b)(4)(iii) of the final rule, like the proposal, defines an ''eligible investment expert'' to mean a person that, through employees or otherwise, has the appropriate technical training or experience and proficiency to analyze, determine and certify, in a manner consistent with paragraph (b)(4)(iv), whether a computer model meets the requirements of paragraph (b)(4)(i); except that the term eligible investment expert does not include any person that has any material affiliation or material contractual relationship with the fiduciary adviser, with a person with a material affiliation or material contractual relationship with the fiduciary adviser, or with any employee, agent, or registered representative of the foregoing.

One commenter requested that the Department provide examples of adequate credentials for an ''eligible investment expert.'' The Department continues to believe that it is very difficult to define a specific set of academic or other credentials that would serve to define the appropriate expertise and experience for an eligible investment expert. Unfortunately, for the same reason it is difficult to define specific credentials for an eligible investment expert, it is difficult to provide examples of the one or a set of credentials that in every case would qualify an individual to make the required certifications. The Department also is concerned that, even if an example were possible, such an example may encourage unnecessary and inappropriate reliance on the example as a person considered by the Department to possess the necessary qualifications. For this reason, the Department has not provided any examples of credentials for eligible investment experts.

One commenter inquired whether the eligible investment expert is required to be bonded for purposes of section 412 of ERISA. In the view of the Department, an eligible investment expert, in performing the computer model certification described in the final rule, would neither be acting as a fiduciary under ERISA, nor be ''handling'' plan assets such that the bonding requirements would be applicable to the eligible investment expert.

One commenter requested confirmation that a fiduciary adviser's selection and payment of an eligible investment expert is not itself a per se prohibited transaction. It is the view of the Department that, given the structure of the statutory exemption under section 408(g)(1) and the expectation that a fiduciary adviser will obtain a certification from an eligible investment expert, the selection and payment of the fiduciary adviser is not a per se conflict, provided that the eligible investment expert has neither a material affiliation or material contractual relationship with the fiduciary adviser. Moreover, the Department has made clear that the selection of an eligible investment expert is a fiduciary act governed by section 404(a)(1) of the Act. See paragraph (b)(4)(v). Similarly, the selection and payment of an auditor to conduct the audit required under the statutory exemption or class exemption would not constitute a per se conflict of interest. As noted in the preamble to the proposal, while the rule gives latitude to a fiduciary adviser in selecting an eligible investment expert to certify a computer model, as the party seeking prohibited transaction relief under the exemption, the fiduciary adviser has the burden of demonstrating that all applicable requirements of the exemption are satisfied with respect to its arrangement.

Paragraph (b)(4)(iv) of the final rule provides that a certification by an eligible investment expert shall be in writing and contain the following: An identification of the methodology or methodologies applied in determining whether the computer model meets the requirements of paragraph (b)(4)(i) of the final rule; an explanation of how the applied methodology or methodologies demonstrated that the computer model met the requirements of paragraph (b)(4)(i); and a description of any limitations that were imposed by any person on the eligible investment expert's selection or application of methodologies for determining whether the computer model meets the requirements of paragraph (b)(4)(i). In addition the certification is required to contain a representation that the methodology or methodologies were applied by a person or persons with the educational background, technical training or experience necessary to analyze and determine whether the computer model meets the requirements of paragraph (b)(4)(i); and a statement certifying that the eligible investment expert has determined that the computer model meets the requirements of paragraph (b)(4)(i). Finally the certification must be signed by the eligible investment expert. The Department received no comments on this provision and, accordingly, has adopted the provision as proposed.

d. Authorization by a Plan Fiduciary

Paragraph (b)(5) of the final rule, consistent with section 408(g)(4) of ERISA, the proposed rule and proposed class exemption, provides that the arrangement pursuant to which investment advice is provided to participants and beneficiaries must be expressly authorized by a plan fiduciary (or, in the case of an IRA, the IRA beneficiary) other than: The person offering the arrangement; any person providing designated investment options under the plan; or any affiliate of either. The final rule, like the proposals, further provides that, for purposes of such authorization, an IRA beneficiary will not be treated as an affiliate of a person solely by reason of being an employee of such person, thereby enabling employees of a fiduciary adviser to take advantage of investment advice arrangements offered by their employer under the exemption.

A number of commenters requested that the authorizing language of both the statutory exemption and class exemption be modified to permit a fiduciary adviser to provide investment advice for the adviser's own plan. The Department does not believe it is necessary or appropriate to limit a fiduciary adviser's employee's choice of investment advice providers to only competitors of the fiduciary adviser. Accordingly, the Department has modified the authorization provisions of the final regulation and class exemption to permit a fiduciary adviser to provide advice to its own employees (or employees of an affiliate) pursuant to an arrangement under the final rule, provided that the fiduciary adviser or affiliate offers the same arrangement to participants and beneficiaries of unaffiliated plans in the ordinary course of its business. (See paragraphs (b)(5)(ii) and (d)(5)(ii) of the final rule). The Department notes, however, that neither the statutory exemption nor the class exemption provides relief for the selection of the fiduciary adviser or the arrangement pursuant to which advice will be provided. Accordingly, plan fiduciaries must nonetheless be prudent in their selection and may not, in contravention of section 406(b), use their position to benefit themselves. In this regard, the Department has indicated that if a fiduciary provides services to a plan without the receipt of compensation or other consideration (other than reimbursement of direct expenses properly and actually incurred in the performance of such services) the provision of such services does not, in and of itself, constitute an act described in section 406(b) of the Act.[13]

One commenter requested a clarification that, for purposes of the authorization provision, a plan sponsor-fiduciary would not be treated as the person providing a designated investment option under the plan with respect to an option that is designed to invest in qualifying employer securities. The Department did not intend, nor does it believe Congress intended, to exclude employer-plan fiduciaries from authorizing investment advice arrangements solely because the plan for which the arrangement is being authorized offers participants the opportunity to invest in qualifying employer securities. The Department has added a provision to both the regulation and class exemption for purposes of such clarification (see paragraphs (b)(5)(iii) and (d)(5)(iii), respectively, of the final rule).

One commenter asked for a clarification as to whether an authorizing plan fiduciary can rely on the representations of a fiduciary adviser with respect to whether a computer model meets the requirements of the regulation. Plan fiduciaries have an obligation to prudently select, and periodically review that selection, fiduciary advisers.[14] In connection with an otherwise prudent and reasonable selection and review process, the Department believes that an authorizing plan fiduciary, in the absence of any information to the contrary, may rely on the representations of a fiduciary adviser regarding the fiduciary adviser's compliance with the requirements of this rule.

e. Annual Audit

Paragraph (b)(6) of the final rule sets forth the annual audit requirements for the statutory exemption.[15] Paragraph (b)(6)(i), like the proposal, provides that the fiduciary adviser shall, at least annually, engage an independent auditor, who has appropriate technical training or experience and proficiency, and so represents in writing to the fiduciary adviser, to conduct an audit of the investment advice arrangements for compliance with the requirements of the regulation and, within 60 days

[13] *See* 29 CFR 2550.408b–2(e)(3).

[14] *See* discussion in Field Assistance Bulletin 2007–01.

[15] The audit provisions are set forth in section 408(g)(6) of ERISA.

following completion of the audit, to issue a written report to the fiduciary adviser and, except with respect to an arrangement with an IRA, to each fiduciary who authorized the use of the investment advice arrangement, setting forth the specific findings of the auditor regarding compliance of the arrangement with the requirements of the regulation.

Given the significant number of reports that an auditor would be required to send if the written report was required to be furnished to all IRA beneficiaries, the Department framed an alternative requirement for investment advice arrangements with IRAs. This alternative is set forth in paragraph (b)(6)(ii) of the final rule. The final rule, like the proposal, provides that, with respect to an arrangement with an IRA, the fiduciary adviser shall, within 30 days following receipt of the report from the auditor, furnish a copy of the report to the IRA beneficiary or make such report available on its Web site, provided that such beneficiaries are provided information, along with other required disclosures (*see* paragraph (b)(7) of the final rule), concerning the purpose of the report, and how and where to locate the report applicable to their account. With respect to making the report available on a Web site, the Department believes that this alternative to furnishing reports to IRA beneficiaries satisfies the requirement of section 104(d)(1) of the Electronic Signatures in Global and National Commerce Act (E–SIGN) [16] that any exemption from the consumer consent requirements of section 101(c) of E–SIGN must be necessary to eliminate a substantial burden on electronic commerce and will not increase the material risk of harm to consumers. The Department solicited comments on this finding in the proposal, and received no comments in response.

Obtaining consent from each IRA holder or participant before publication on the Web site would be a tremendous burden on the plan or IRA provider. This element, along with the broad availability of internet access and the lack of any direct consequences to any particular participant for a failure to review the audit for the participants and beneficiaries, supports these findings.

Paragraph (b)(6)(ii) of the final rule also provides, like the proposal, that, when the report of the auditor identifies noncompliance with the requirements of the regulation, the fiduciary adviser must send a copy of the report to the Department. The final rule, like the proposal, requires that the fiduciary adviser submit the report to the Department within 30 days following receipt of the report from the auditor. This report will enable the Department to monitor compliance with the statutory or class exemption.

For purposes of paragraph (b)(6), an auditor is considered independent if it does not have a material affiliation or material contractual relationship with the person offering the investment advice arrangement to the plan or any designated investment options under the plan. *See* paragraph (b)(6)(iii). The terms ''material affiliation'' and ''material contractual relationship'' are defined in paragraphs (c)(6) and (7) of the final rule, respectively.

With regard to the scope of the audit, paragraph (b)(6)(iv) of the final rule provides that the auditor shall review sufficient relevant information to formulate an opinion as to whether the investment advice arrangements, and the advice provided pursuant thereto, offered by the fiduciary adviser during the audit period were in compliance with the regulation. Paragraph (b)(6)(iv) further provides that it is not intended to preclude an auditor from using information obtained by sampling, as reasonably determined appropriate by the auditor, investment advice arrangements, and the advice pursuant thereto, during the audit period. The final rule, like the proposal, does not require an audit of every investment advice arrangement at the plan or fiduciary adviser-level or of all the advice that is provided under the exemption. In general, the final rule appropriately leaves to the auditor the determination as to the appropriate scope of its review and the extent to which it can rely on representative samples for determining compliance with the exemption.

While the audit provisions contained in the final rule are, with respect to both the statutory exemption and the class exemption, identical to the proposed audit requirements, the final rule does contain new provisions making clear that, like the selection of an eligible investment expert to certify a computer model, the selection of the required auditor, for purposes of both the statutory exemption and the class exemption, is a fiduciary act governed by section 404(a)(1) of ERISA. *See* paragraphs (b)(6)(v) and (d)(9)(v) of the final rule.

A number of commenters raised issues or requested clarifications regarding various aspects of the audit requirements.

One commenter requested that the Department establish that the first annual audit required by the statutory exemption would not be required to be completed until the end of 2009. Inasmuch as the audit and other provisions of the regulation relating to the statutory exemption closely track the provisions of the statutory exemption, the Department is not persuaded that there is a basis for deferring the completion of any otherwise required annual audit until the end of 2009. However, for purposes of any audits required to be completed prior to the effective date of the final rule, the auditor may take into account good faith compliance with the statute in the absence of regulatory guidance.

One commenter requested that the Department should lessen the burden on small advisers by modifying the audit requirement by, for example, requiring an audit only every three years, rather than annually. It is the view of the Department that the audit requirements of both the statutory and class exemption are critical protections for participants and beneficiaries in investment advice arrangements with respect to which there is a possibility that an adviser may act in its own self-interest rather than the interest of the plan's participants and beneficiaries. No information or data has been furnished to the Department that would support a finding that this risk to participants and beneficiaries is any less from small advisers than large adviser. Thus, the Department has no basis on which to determine what, if any, special relief should be afforded small advisers. The final rule, therefore, contains no special provisions for small advisers.

Another commenter suggested that rather than furnishing copies of the audit report to authorizing fiduciaries and IRA beneficiaries, fiduciary advisers should be required to inform the parties of the availability of the reports and furnish such reports only in response to requests. The Department did not adopt this suggestion. The Department believes that, as with the audit, the reports of the auditor are important and should be furnished to each authorizing plan fiduciary. On the other hand, the Department recognizes that, in the case of IRAs, furnishing a report to every IRA beneficiary may be unduly burdensome and expensive, and, accordingly, provided a special rule that permits the making available of the report on the fiduciary adviser's Web site.

One commenter requested that fiduciary advisers have an additional 30 days to furnish the audit report to the authorizing plan fiduciaries. Another commenter requested that the final rule provide 60 days for the furnishing of IRA-related audit reports. The Department did not adopt these

[16] 15 U.S.C. 7004(d)(1) (2000).

suggestions. The Department notes, however, that the 60-day period referenced in paragraphs (b)(6)(i)(B) and (d)(9)(i)(B) of the final rule is the period following completion of the audit during which *the auditor* is required to furnish its report to the fiduciary adviser and, with the exception of an arrangement with an IRA, to each authorizing fiduciary. The exception for arrangements with IRAs serves to relieve the auditor from furnishing reports to the authorizing IRA beneficiaries. Paragraphs (b)(6)(ii)(A) and (d)(9)(ii)(A) of the final rule, applicable to arrangements with IRAs, place the obligation to furnish the auditor's report on the fiduciary adviser and, in that regard, require that the fiduciary adviser furnish the report or make it available on its Web site within 30 days following receipt of the report from the auditor. The Department did not receive any information or data that would indicate that the aforementioned time frames afforded the auditor and the fiduciary adviser are inadequate.

With regard to the qualifications of an auditor, one commenter recommended that the auditor should be treated as a fiduciary. Other commenters requested clarification that the audit is not required to be conducted by an accountant or a lawyer. Another commenter requested clarification as to the credentials necessary to conduct an audit. As with the requirements for an ''eligible investment expert,'' the Department does not believe that there is necessarily one set of credentials, such as certified public accountant, auditor, or lawyer, that is required or, conversely, by themselves qualifies an individual to conduct the required audits. In addition to any licenses, certifications or other evidence of professional or technical training, a fiduciary adviser will want to consider the relevance of that training to the required audit, as well as the individual or organization's experience and proficiency in conducting similar types of audits. In this regard, it is the view of the Department that the selection of an auditor is a fiduciary act and, therefore, must be carried out in a manner consistent with the prudence requirements of section 404(a)(1), taking into account the nature and scope of the audit and the expertise and experience necessary to conduct such an audit. The Department also notes that, in its view, the performance of an audit under the final rule would not, by itself, cause an auditor to be a fiduciary under ERISA.

A number of comments requested clarification of the scope of the audit, as now set forth in paragraphs (b)(6)(iv) and (d)(9)(iv) of the final rule. In this regard, commenters requested clarification that the permissible sampling of audits would be conducted at the fiduciary adviser level and not the plan level, such that a sampling of each plan's or IRA's transactions would not have to be audited. One commenter requested clarification as to whether the audit could be performed by a review of the audits conducted by the fiduciary adviser's own personnel. As discussed above, the audit provisions of the final rule require that the auditor review sufficient information to formulate an opinion as to whether the investment advice arrangements, and the advice provided pursuant thereto, are in compliance with the final rule. In the case of the class exemption, the auditor is further required to review compliance with the fiduciary adviser's policies and procedures, adopted in accordance with paragraph (d)(7), designed to assure compliance with the exemption's requirements. Accordingly, the precise nature and scope of the audit, as well as how it is conducted, is to be determined by the auditor. The Department does note, however, that nothing in these provisions precludes the auditor from using sampling, as determined reasonably appropriate by the auditor, of investment advice arrangements and investment advice.

While the Department believes that internal audits conducted by the personnel of a fiduciary adviser are important to reducing the risks of noncompliance with the conditions of the final rule, the Department does not believe that it would be appropriate for an auditor to limit, in any way, the scope of its audit based on such audits. Moreover, in the view of the Department, the fiduciary adviser has a fiduciary duty in selecting and monitoring an auditor to ensure that the required audits are complete and fully independent of any audits conducted internally by personnel of the fiduciary adviser. The Department notes, however, that there is nothing in the final rule that would preclude the independent auditor from working with the fiduciary adviser to establish policies and procedures designed to enhance or ensure compliance with the requirements of the statutory or class exemption, provided that determinations of compliance with the statutory and class exemption can be made without regard to such services.

Some commenters asked for a clarification of the ''independence'' requirements applicable to the auditor. Paragraphs (b)(6)(iii) and (d)(9)(iii) of the final rule provide that an auditor is considered independent if it does not have a material affiliation or material contractual relationship with the fiduciary adviser or any person offering designated investment options.

One commenter requested clarification that independence would not be lost merely because the auditor performs other services for the fiduciary adviser or its affiliates, such as performing audits or certifying computer models, as an eligible investment expert. In defining the term ''material contractual relationship,'' the Department contemplated that there may be instances in which an auditor might be performing other services for a fiduciary adviser or affiliates. While one commenter recommended that the definition of material contractual relationship be revised to preclude receipt of any compensation, the Department believes that the 10% test set forth in paragraph (c)(7) of the final rule, defining ''material contractual relationship,'' is sufficient to minimize any influence on the part of the fiduciary adviser that would serve to compromise the independence of the auditor. Accordingly, the Department has not changed the final rule in this regard.

A number of commenters expressed concern about the requirement, now at paragraphs (b)(6)(ii)(B) and (d)(9)(ii)(B) of the final rule, that, in the case of arrangements involving IRAs, the fiduciary adviser must send a copy of the auditor's report to the Department if that report identifies instances of noncompliance. Some commenters recommended that reports only be required to be filed with the Department when there is ''material'' noncompliance, other commenters recommended that fiduciary advisers be afforded a period within which to self-correct prior to the reporting of noncompliance. As explained in the preamble to the proposal, this filing requirement will enable the Department to monitor compliance with the exemptions in those instances where there is no authorizing ERISA plan fiduciary to carry out that function. While the Department recognizes that not every instance of noncompliance would, itself, affect the quality of the advice provided, the Department also believes that, given the overall significance of the audit as a protection for participants and beneficiaries, all reports that identify noncompliance in this area should be furnished to the Department for review, thereby, leaving to the Department the opportunity to evaluate the significance of the noncompliance, the function that an authorizing plan fiduciary would carry out for its plan. Accordingly, the

Department is adopting the filing requirement as proposed.

f. Disclosure

The disclosure provisions are set forth in paragraph (b)(7) of the final rule as they relate to the statutory exemption and paragraph (d)(8) as they relate to the class exemption. In general, the disclosure requirements for both the statutory and class exemption are identical,[17] and the provisions of the final rule, like the proposal, track the requirements set forth in section 408(g)(6) of ERISA.

The final rule, at paragraphs (b)(7)(i) and (d)(8)(i), generally requires that the fiduciary adviser provide to participants and beneficiaries, prior to the initial provision of investment advice with regard to any security or other property offered as an investment option, a written notification describing: The role of any party that has a material affiliation or material contractual relationship with the fiduciary adviser in the development of, in the case of the statutory exemption, the investment advice program or, in the case of the class exemption, if applicable, the computer model or materials described in paragraph (d)(3)(i) or (ii) of the final rule, and in the selection of investment options available under the plan; the past performance and historical rates of return of the designated investment options available under the plan, to the extent that such information is not otherwise provided; all fees or other compensation relating to the advice that the fiduciary adviser or any affiliate thereof is to receive (including compensation provided by any third party) in connection with the provision of the advice or in connection with the sale, acquisition, or holding of the security or other property pursuant to such advice; and any material affiliation or material contractual relationship of the fiduciary adviser or affiliates thereof in the security or other property.

The notification to participants and beneficiaries also is required to explain: The manner, and under what circumstances, any participant or beneficiary information provided under the arrangement will be used or disclosed; the types of services provided by the fiduciary adviser in connection with the provision of investment advice by the fiduciary adviser, including, with respect to an arrangement utilizing a computer model, any limitations on the ability of the model to take into account an investment primarily in qualifying employer securities; that the adviser is acting as a fiduciary of the plan in connection with the provision of the advice; and that a recipient of the advice may separately arrange for the provision of advice by another adviser that could have no material affiliation with and receive no fees or other compensation in connection with the security or other property.

Paragraphs (b)(7)(ii)(A) and (d)(8)(ii)(A) of the final rule require that the notification furnished to participants and beneficiaries must be written in a clear and conspicuous manner and in a manner calculated to be understood by the average plan participant and must be sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of the information required to be provided in the notification.

Paragraphs (b)(7)(ii)(B) and (d)(8)(ii)(B) of the final rule reference the availability of a model disclosure form in the appendix to the final rule. As with the proposals, the model disclosure form may be used for purposes of satisfying the requirements set forth in paragraphs (b)(7)(i)(C) and (d)(8)(i), as well as the requirements of paragraphs (b)(7)(ii)(A) and (d)(8)(ii)(A) of the final rule. The final rule, like the proposals, makes clear, however, that the use of the model disclosure form is not mandatory. In response to several comments addressing the general readability of the model form, the Department has made minor changes to the form's organization and language.

Other commenters also made specific suggestions regarding the content of the model disclosure form. Four commenters made suggestions relating to the disclosure of fiduciary adviser cross-selling practices, such as fees received by an adviser in connection with rollovers to IRAs. As discussed below, given the potential for abuse in this area, the text of the final rule has been modified to require the disclosure of all fees or other compensation that a fiduciary adviser or any affiliate might receive in connection with any rollover or other distribution of plan assets or the investment of distributed assets. Language has been added to the model form to reflect this disclosure requirement.

Commenters presented a number of issues concerning the timing and content of the proposed disclosure requirements. With regard to the timing of the required disclosures, some commenters suggested that the notifications be provided whenever advice is rendered; other commenters argued that the annual disclosures should be required only when there are material changes to the information furnished in advance of the advice. Other commenters recommended that required notifications be furnished quarterly. The Department did not adopt these recommendations. The Department believes that the statutory disclosure framework, reflected in both the proposal and final rule, strikes the appropriate balance in terms of ensuring participants and beneficiaries have the information to assess the potential for conflicts of interest and compensation of the fiduciary adviser. In this regard, the final rule, like the proposal, requires notifications to be furnished in advance of the advice, and annually thereafter, except that material changes to such information are required to be furnished at a time reasonably contemporaneous with the change in the information.

Commenters also raised issues concerning the content of the required notifications. One commenter recommended that the Department clarify that the required disclosure of fees and compensation was not limited to designated investment options, but included fees and compensation received in connection with investments made through open brokerage windows and directed brokerage accounts. The disclosure obligation set forth in paragraph (b)(7)(i)(C)(*2*) of the final rule is very broad and includes any fees and other compensation that the fiduciary adviser or affiliate might receive in connection with the sale, acquisition, or holding of *any* security or other property pursuant to the investment advice. There is nothing in this provision which limits or is intended to limit the required disclosures to compensation and fees in connection with designated investment options. It is clear, therefore, that any compensation and fees to be received in connection with investments through an open brokerage window or directed brokerage account must be included in the required disclosures.

Some commenters suggested that the required disclosure be required to contain information pertaining to compensation and fees in connection with rollovers or other distributions or the investment of assets in connection with a rollover or other distribution. Given the potential for abuse in this area, the Department agrees that such information should be furnished to participants and beneficiaries. In this regard, the final rule contains a specific provision that serves to require the disclosure of all fees or other compensation that a fiduciary adviser or any affiliate might receive in connection

[17] *See* paragraph (d)(8)(i)(C) that incorporates in the class exemption compliance with the disclosure requirements under the statutory exemption provisions as set forth in paragraphs (b)(7)(i)(A) through (E), (G) and (H).

with any rollover or other distribution of plan assets or the investment of distributed assets in any security or other property pursuant to the investment advice. See paragraph (b)(7)(i)(C)(*3*) of the final rule, and paragraph (d)(8)(i)(C) of the final rule, which applies several disclosures required for the statutory exemption to the class exemption.

With regard to the practice of ''cross-selling,'' i.e., using existing clients, plan participants and beneficiaries in this case, to market additional services or products, the Department notes that, while advising a participant or beneficiary to take an otherwise permissible plan distribution would not normally constitute ''investment advice'' within the meaning of 29 CFR 2510.3–21(c), the Department has taken a different position with respect to such activities when the person making such recommendations is already a plan fiduciary, as would be the case with a fiduciary adviser.[18] When a person is already acting in a fiduciary capacity with respect to the plan, the Department has indicated that recommendations relating to the taking of a distribution or the investment of amounts withdrawn from the plan would constitute the exercise of discretionary authority respecting management of the plan and, therefore must be undertaken prudently and solely in the interest of the participant or beneficiary, consistent with section 404(a)(1). The Department further notes that if, for example, a fiduciary exercises control over plan assets to cause a participant or beneficiary to take a distribution and then to invest the proceeds in an IRA account managed by the fiduciary, the fiduciary may be using plan assets in his or her own interest, in violation of ERISA section 406(b)(1). The prohibited transaction relief offered by the statutory and class exemption, which apply to transactions related to the provision of investment advice to plan participants or beneficiaries, would not cover such a violation. Moreover, the Department is unable to conclude that the mere disclosure of fees or other compensation received in connection with such a distribution and investment, by itself, would be sufficient to avoid a violation of section 406(b)(1). Because a fiduciary adviser, in making recommendations related to the taking of a distribution or the investment of amounts so withdrawn from the plan, may violate ERISA section 404(a)(1) and/or 406(b)(1), authorizing plan fiduciaries, in carrying out their duties under section 404(a)(1) in selecting and periodically reviewing the adviser, may need to understand the extent to which such recommendations will be made.

[18] *See* AO 2005–23A (Dec. 7, 2005).

A commenter also suggested that the Department require disclosure of information about the profitability of various plan investment options to the fiduciary adviser. In addressing the need for disclosure regarding plan investments being recommended by a fiduciary adviser under the statutory exemption, Congress appears to have concluded that the interests of participants and beneficiaries would be adequately protected, in the context of the exemption's other conditions, by information on all fees or other compensation that the fiduciary adviser or any affiliate is to receive. The conditions of the exemption, in general, focus on fees and compensation received in connection with investments recommended rather than profitability of those investments. Disclosures with respect to profitability of investments options may require significantly more information and effort to prepare than disclosures of fees and compensation, without adding significant benefits. The Department does not believe it would be appropriate, as part of this final rule, without further notice and comment, to include such a disclosure obligation. Accordingly, the Department has not adopted this suggestion.

A number of commenters requested that the Department confirm that to the extent that the required disclosures are contained in disclosure materials required to be prepared under securities and other laws, such materials may be used for purposes of the exemptions. It is the view of the Department that nothing in the final rule forecloses the use of other materials for making the disclosures required by the final rule, so long as the understandability and clarity of the disclosures is not compromised by virtue of their inclusion in such other materials and the requirements of paragraphs (b)(7)(ii)(A) and (d)(8)(ii)(A) are satisfied.

The proposed regulation and class exemption provided that the required notifications may, in accordance with 29 CFR 2520.104b–1, be furnished in either written or electronic form. Several commenters requested that the Department provide greater flexibility for notices by electronic means, noting that the safe harbor for electronic distributions, at § 2520.104b–1(c), is not workable. The Department currently is reviewing its rules relating to the use of electronic media for disclosures under title I of ERISA. The Department notes that, pending the issuance of further guidance, its current rule, at 29 CFR 2520.104b–1(c), is a safe harbor and, accordingly, represents merely one permissible means by which documents under title I of ERISA may be furnished to participants and beneficiaries electronically. Nothing in that rule, therefore, forecloses other means by which documents may, consistent with ERISA and the E–SIGN Act, be furnished to participants and beneficiaries electronically.

Paragraphs (b)(7)(iv) and (d)(8)(iv) of the final rule set forth miscellaneous recordkeeping and furnishing responsibilities of the fiduciary adviser under the statutory and class exemption. Specifically, these paragraphs require that, at all times during the provision of advisory services to the participant or beneficiary pursuant to the arrangement, the fiduciary adviser must: maintain the information required to be disclosed to participants and beneficiaries in accurate form; provide, without charge, accurate, up-to-date disclosures to the recipient of the advice no less frequently than annually; provide, without charge, accurate information to the recipient of the advice upon request of the recipient; and provide, without charge, to the recipient of the advice any material change to the required information at a time reasonably contemporaneous to the change in information. These provisions are being adopted in the final rule without substantive change from the proposal.

g. Other Conditions

Paragraphs (b)(8) and (d)(10) of the final rule, like the proposals, incorporate a series of miscellaneous, although important, conditions set forth in section 408(g)(7) of ERISA. These requirements are as follows: the fiduciary adviser must provide appropriate disclosure, in connection with the sale, acquisition, or holding of the security or other property, in accordance with all applicable securities laws; any sale, acquisition, or holding of a security or other property occurs solely at the direction of the recipient of the advice; the compensation received by the fiduciary adviser and affiliates thereof in connection with the sale, acquisition, or holding of the security or other property is reasonable; and the terms of the sale, acquisition, or holding of the security or other property are at least as favorable to the plan as an arm's length transaction would be.

The Department received a number of comments requesting clarification of the requirement that sales, acquisitions, or the holding of securities or other property occurs solely at the direction of the recipient of the advice. In particular, commenters requested that the Department confirm that the ''solely at the direction'' requirement is not violated solely by virtue of a participant or beneficiary providing advance authorization for a fiduciary adviser to periodically take steps to rebalance the portfolio of the participant or beneficiary. One commenter requested clarification that the ''solely at the direction'' requirement would not be violated where, pursuant to an agreement with the participant or beneficiary, investment advice recommendations will be acted upon by the fiduciary adviser unless the participant or beneficiary objects with the allotted period of time, typically 30 days.

In general, it is the view of the Department that a pre-authorization for a fiduciary adviser to maintain a particular asset allocation structure for a participant's portfolio by periodic rebalancing of investments would not violate the ''solely at the direction'' requirements of the final rule, provided that such maintenance does not involve the exercise of discretion on the part of the fiduciary adviser, that is, when a participant is informed of and approves, at the time of the authorization, the specific circumstances under which a rebalancing of his or her portfolio will take place and the particular investments that will be utilized for such rebalancing. If, on the other hand, the particular investments that might be utilized for purposes of rebalancing a participant's account are not known and the fiduciary adviser is given the discretion to select the required investments, it is the view of the Department that the participant must be afforded advance notice of the fiduciary adviser's intended investments and a reasonable opportunity, at least 30 days, to object to the investments in order to comply with the ''solely at the direction'' requirements of the final rule. With respect to a recommendation involving a different asset allocation structure, the Department believes that the participant or beneficiary must make an affirmative direction for its implementation.

3. Definitions

Paragraph (c) sets forth definitions applicable to both the statutory exemption and class exemption contained in the final rule. Paragraph (c)(1) defines the term ''designated investment option.'' Paragraph (c)(2) defines the term ''fiduciary adviser.'' Paragraph (c)(3) defines the term ''registered representative.'' Paragraph (c)(4) defines the terms ''individual retirement account'' or ''IRA'' for purposes of the final rule. Paragraph (c)(5) defines the term ''affiliate.'' And, paragraphs (c)(6) and (c)(7) define the terms ''material affiliation'' and ''material contractual relationship,'' respectively. Lastly, paragraph (c)(8) defines the term ''control.'' With the exception of a clarification in the definition of ''material contractual relationship'' in paragraph (c)(7), the definitions were adopted without change from the proposals.

One commenter requested that the Department clarify that the term ''agent'', as that term is used in the definition of ''fiduciary adviser'' (see paragraph (c)(2)(i)(F) of the final rule), is not limited to insurance agents. Another commenter requested that the Department clarify that ''agents'' must be registered under the Investment Advisers Act of 1940, unless otherwise exempt from registration. It is the view of the Department that the term ''agent'' as used in the fiduciary adviser definition is not limited to insurance agents or necessarily those registered under the Investment Advisers Act, but rather encompasses persons acting on behalf of a fiduciary adviser, applying agency law principles. The Department notes that the definition, consistent with the statutory definition, requires that any such agent satisfy the requirements of applicable insurance, banking and securities laws relating to the provision of advice.

One commenter recommended a separate provision for investment adviser representatives. It was not clear how such a separate definition would substantively change the application of the fiduciary adviser definition, at paragraph (c)(2); accordingly, the Department did not adopt this suggestion.

One comment recommended that the Department adopt the definition of ''affiliate'' as set forth in 29 CFR 2510.3–21, rather than the definition contained in the proposed rule. Section 408(g)(11)(C) of ERISA provides that an ''affiliate'' of another entity means an affiliated person of the entity as defined in section 2(a)(3) of the Investment Company Act of 1940. The Department, therefore, adopted, as discussed in the preamble to the proposal, the Investment Company Act definition for purposes of both the proposal and this final rule, not the definition set forth in § 2510.3–21.

Finally, in order to clarify that the 10% gross revenue test, applied for purposes of determining whether persons have a ''material contractual relationship'' under the final rule, is not limited to amounts paid pursuant to contracts or arrangements that have been reduced to writing, the Department has deleted the word ''written'' from the definition contained in paragraph (c)(7).

4. Class exemption

A number of the issues pertaining to the conditions applicable to the class exemption were raised and addressed in the above discussion of the rules implementing the statutory exemption. The following overview, therefore, will focus on those provisions and comments unique to the class exemption and not previously addressed.

a. Authority and Findings

A number of commenters questioned the Department's authority to grant the proposed class exemption arguing, in effect, that the proposed class exemption is inconsistent with Congressional intent, suggesting that enactment of the statutory exemption for investment advice precluded or otherwise limited the Department's authority to grant an administrative exemption under section 408(a). The Department has carefully considered this issue and in so considering has been unable to find anything in ERISA, the PPA, the Technical Explanation of the PPA prepared by the staff of the Joint Committee on Taxation,[19] or the case law that would serve to limit or otherwise restrict the Department's ability to grant, in accordance with its authority in section 408(a), an administrative exemption relating to the provision of investment advice.

In fact, the Department has very broad authority under section 408(a) to grant conditional or unconditional exemptions for any fiduciary or transaction or class of fiduciaries or transactions, from all or part of the restrictions imposed by sections 406 and 407(a), provided that the Secretary finds that such exemption is administratively feasible, in the interests of the plan and its participants and beneficiaries, and protective of the rights of participants and beneficiaries.

The Department views the class exemption as necessary to provide more comprehensive relief for fiduciary investment advice and to address certain aspects of the statutory exemption that were unclear or that did not extend relief to certain arrangements. For example, the flush language in section 408(g)(3)(D) of

[19] Technical Explanation of H.R. 5, The ''Pension Protection Act of 2006'', as passed by the House on July 28, 2006, and as considered by the Senate on August 3, 2006, prepared by the Staff of the Joint Committee on Taxation, August 3, 2006, JCX 38–06.

ERISA specifically permits participants to request individualized advice after receipt of computer model-based advice, but does not indicate whether any prohibited transaction relief would apply. In addition, although the Department concluded that computer model-based advice was feasible for IRAs to the extent that the advice takes into account generally recognized asset classes, some IRAs do not limit investment choices in this fashion. The class exemption therefore provides substitute relief for advisers that may not be able to take full advantage of computer model-based advice as to some IRAs.

Taking into account the intent of the Congress and the administration to dramatically expand the availability of affordable, quality investment advice for millions of America's workers participating in participant-directed individual account plans and IRAs, the Department concluded that the best approach to addressing the ambiguities and issues presented by the PPA and statutory exemption was to exercise its authority under section 408(a) of ERISA, building on the carefully crafted safeguards of the statutory exemption established by the Congress, safeguards that the Congress itself determined to be administratively feasible, in the interests of the plan and its participants and beneficiaries, and protective of the rights of participants and beneficiaries.

A few commenters questioned whether the Department could make the findings required by section 408(a) with respect to the class exemption. As noted above, section 408(a) conditions exemptive relief on a finding by the Department that the exemption is administratively feasible, in the interests of the plan and its participants and beneficiaries, and protective of the rights of participants and beneficiaries. With regard to the class exemption contained in this document, the Department finds that the exemption is administratively feasible with respect to both compliance by fiduciary advisers electing to provide investment advice to participants and beneficiaries and enforcement by the Department. The Department finds that the exemption is in the interest of plans and their participants and beneficiaries because the availability of the exemption will significantly expand the opportunities for millions of participants and beneficiaries in participant-directed individual account plans and IRAs to obtain affordable, quality investment advice that might otherwise not be available to them. The Department further finds that the exemption is protective of the rights of participants and beneficiaries because of the conditions contained in the exemption intended to mitigate conflicts of interest that might otherwise affect the quality of investment advice. As noted above, the conditions of the class exemption build on the protections Congress determined to be administratively feasible, in the interest of plans and their participants and beneficiaries, and protective of the rights of those participants and beneficiaries for purposes of the statutory exemption set forth in section 408(g). The specifics of these conditions are discussed below, if not previously addressed in connection with the statutory exemption provisions.

b. General

The final class exemption, like the statutory exemption described in paragraph (b) of the final rule, provides relief from otherwise prohibited transactions relating to the provision of investment advice to a plan participant or beneficiary or IRA beneficiary; the acquisition, holding or sale of a security or other property pursuant to the investment advice; and the direct or indirect receipt of compensation by a fiduciary adviser or affiliate in connection with the provision of investment advice or the acquisition, holding or sale of a security or other property pursuant to the investment advice.

Unlike the statutory exemption, however, the final class exemption, like the proposed class exemption, provides relief for investment advice provided to individuals following the furnishing of recommendations generated by a computer model or, in instances where computer modeling under the statutory exemption is not feasible, the furnishing of investment education material. As explained in the preamble to the proposal, the computer generated advice recommendations and investment education materials are intended to provide individual account plan participants and beneficiaries and IRA beneficiaries with a context for assessing and evaluating the individualized investment advice contemplated by the class exemption. Also, unlike the statutory exemption, the final class exemption, like the proposal, applies the fee-leveling limits solely to the compensation received by the employee, agent or registered representative providing the advice on behalf of the fiduciary adviser, as distinguished from compensation received by the fiduciary adviser on whose behalf the employee, agent or registered representative is providing such advice.

In general, the class exemption is intended to complement the adoption of regulations implementing the statutory exemption by furthering the availability of individualized investment advice to both participants and beneficiaries in participant-directed individual account plans and IRA beneficiaries under circumstances not clearly encompassed by the statutory exemption or implementing regulations, as described below.

c. Scope of Exemption

Paragraph (d)(1) of the final rule sets forth the scope of the class exemption. Specifically paragraph (d)(1)(i) provides that, with respect to the provision of advice to participants and beneficiaries of individual account plans, the restrictions of sections 406(a) and 406(b) of ERISA and the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A) through (F) of the Code, shall not apply to the provision of investment advice described in section 3(21)(A)(ii) of the Act by a fiduciary adviser to a participant or beneficiary of an individual account plan that permits such participant or beneficiary to direct the investment of their individual accounts; the acquisition, holding, or sale of a security or other property pursuant to the investment advice; and, except as otherwise provided in the exemption, the direct or indirect receipt of fees or other compensation by the fiduciary adviser (or any employee, agent, registered representative or affiliate thereof) in connection with the provision of the advice or in connection with an acquisition, holding, or sale of a security or other property pursuant to the investment advice. Paragraph (d)(1)(ii) of the final rule provides the same relief with respect to the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A) through (F) of the Code, for investment advice to beneficiaries of IRAs.

d. Conditions for Relief

Paragraph (d)(2) of the final rule provides that the relief described in paragraph (d)(1) is available if a fiduciary adviser provides advice in accordance with paragraph (d)(3), relating to the use of computer models and investment education materials, or paragraph (d)(4), relating to the use of fee-level arrangements, or both. In addition the fiduciary adviser must satisfy the conditions described in paragraphs: (d)(5), requiring authorization by a plan fiduciary or IRA beneficiary; (d)(6), relating to the basis for advice; (d)(7), requiring policies and procedures; (d)(8), requiring disclosure of specified information; (d)(9), requiring an annual audit; and (d)(10), specifying other miscellaneous conditions. With the exception of paragraph (d)(7), relating to the adoption of policies and procedures, the aforementioned requirements are modeled after, and were discussed in conjunction with, the conditions of the statutory exemption and, accordingly, will not again be described or reviewed in this section.

e. Post-computer Model—Investment Education Advice

Paragraph (d)(3) of the final rule, like the provision of the proposed class exemption, requires that, in advance of a participant or beneficiary being provided individualized investment advice, the participant or beneficiary must be furnished investment recommendations generated by either a computer model that meets the requirements of the statutory exemption or a computer model developed by a person independent of the fiduciary adviser. The proposal contained an exception to the general computer modeling requirement for IRAs with respect to which types or number of investment choices reasonably precludes the use of a computer model that meets certain requirements of the regulations under the statutory exemption.

The Department received a number of comments on this condition of the proposal. One commenter requested that the Department clarify whether a fiduciary adviser providing individualized advice to a participant can utilize the recommendations generated by the computer model of another fiduciary adviser. For example, according to this commenter, a plan recordkeeper might offer participants access to a proprietary computer model that complies with the statutory exemption, and the plan sponsor might also provide access through a second advice provider. The commenter asked whether the second advice provider could, for purposes of the class exemption, rely on the computer model advice furnished to a participant by the plan recordkeeper. The Department does not believe one fiduciary adviser would necessarily be precluded from using another fiduciary adviser's computer modeled recommendations for a particular participant, provided that the requirements of exemption for both the computer model and individualized advice are otherwise satisfied and the individualized advice is reasonably contemporaneous with the computer modeled advice.

One commenter suggested that, given the other safeguards contained in the exemption, the requirement for computer modeled advice in advance of individualized advice should be eliminated, noting that the computer modeled advice will only confuse participants and limit the advisers. The Department disagrees. The Department continues to believe that the furnishing of computer modeled investment recommendations is an important protection and tool for participants in assessing and evaluating the individualized recommendations of the fiduciary adviser. The computer modeled advice provides participants and beneficiaries a means by which they can assess and question, in advance of an investment decision, the extent to which the recommendations of the fiduciary adviser deviate from modeled advice. For this reason, the Department did not adopt the commenter's suggestion.

One commenter recommended that post-model/education advice be subject to a fee-leveling requirement. The Department did not adopt this suggestion. First, the Department believes that the class exemption contains sufficient safeguards without a fee-leveling requirement to protect participants and beneficiaries against biased, inappropriate investment advice. Second, given such safeguards, the Department does not believe it is appropriate to favor one business model for providing investment advice over another business model, i.e., those fiduciary advisers that use fee-leveling over those that do not, particularly when doing so may only serve to limit the availability of investment advice to participants and beneficiaries.

Several commenters argued that the exception from the class exemption's computer modeling requirement that was provided to certain IRAs (i.e., where the types or number of investment choices reasonably precludes use of computer model meeting the requirements of the statutory exemption) be extended to brokerage windows and similar arrangements with respect to which the computer modeling of investment recommendations is not feasible and that, without such an exception, plan participants and beneficiaries utilizing such windows or accounts may not have access to the investment advice they need. The Department is persuaded that brokerage windows and similar arrangements that permit participants to invest beyond a plan's designated investment options present the same computer modeling difficulties that are encountered by IRAs that impose few restrictions on a beneficiary's investment choices. However, with regard to plans that offer participants and beneficiaries both designated investment options and a brokerage window or similar arrangement, the Department believes participants and beneficiaries electing to utilize such arrangements would, in addition to investment education materials, also benefit from receiving computer modeled investment recommendations with respect to the plan's designated investment options in advance of being provided individualized investment advice. As with those participants and beneficiaries whose investment options, either by plan design or choice, are limited to designated investment options, the Department believes that computer modeled investment recommendations will help participants and beneficiaries considering the use of a brokerage window or similar arrangement assess the investment choices available through both the brokerage window and the plan, as well as the individualized investment recommendations and strategies of the fiduciary adviser. The exception contained in the final class exemption, at paragraph (d)(3)(ii)(A) of the final rule, reflects this position.

Specifically, paragraph (d)(3)(ii)(A) provides that, in the case of a plan that offers a ''brokerage window'', ''self-directed brokerage account'' or similar arrangement that enables participants and beneficiaries to select investments beyond those designated by the plan, if any, before providing investment advice with respect to any investment utilizing such arrangement, the participant or beneficiary shall be furnished the investment education material described in paragraph (d)(3)(ii)(B) and, if the plan offers designated investment options, the participant or beneficiary also shall be furnished the recommendations generated by a computer model, as required by paragraph (d)(3)(i), with regard to such options.

Some commenters, while supporting the exception from computer modeling for IRAs, requested that the Department provide further guidance concerning when the types or number of investment choices would reasonably preclude the use of a computer model to generate investment recommendations. The Department believes that there are a variety of factors that may serve to reasonably preclude use of a computer model for generating recommendations with respect to the investments available under an IRA, including the number of investment options offered, the type of investment options (such as investments in individual securities), and the relative costs of developing and maintaining such computer models and benefits of offering such model-generated advice services to IRA beneficiaries. The Department believes this will be an evolving, rather than static, standard. As computer modeling of investment advice develops, the Department anticipates that the feasibility of developing models to take into account a wider variety of investment choices also will change. The Department has retained the IRA exception without change from the proposal. See paragraph (d)(3)(ii)(B) of the final rule.

The investment education material required to be furnished under the final rule is identical to that described in the proposal. Specifically, paragraph (d)(3)(ii)(B) of the final rule requires that participants and beneficiaries be furnished with material, such as graphs, pie charts, case studies, worksheets, or interactive software or similar programs, that reflect or produce asset allocation models taking into account the age (or time horizon) and risk profile of the beneficiary, to the extent known. As with the proposal, the final rule makes clear that nothing precludes the furnishing of material, in addition to the foregoing, reflecting asset allocation portfolios of hypothetical individuals with different time horizons and risk profiles.

Also like the proposal, the final rule also requires that: (A) Models must be based on generally accepted investment theories that take into account the historic returns of different asset classes (e.g., equities, bonds, or cash) over defined periods of time; (B) such models must operate in a manner that is not biased in favor of investments offered by the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser; and (C) all material facts and assumptions on which such models are based (e.g., retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, and rates of return) accompany the models.

The proposal further required that the provided individualized, rather than computer modeled, investment advice (post-model/investment education advice) not recommend investment options that may generate for the fiduciary adviser, or certain other persons, greater income than other options of the same asset class, unless the fiduciary adviser prudently concludes that the recommendation is in the best interest of the participant or beneficiary and explains the basis for that conclusion to the participant or beneficiary. The proposal further required that the advice provider document the basis of any advice given to the participant or beneficiary within 30 days following the provision of the advice.

One commenter objected to the requirement that the furnished advice be documented, arguing that the advisers are required to comply with both ERISA prudence standards and FINRA suitability standards and that the documentation requirement does not add any additional protection. Another commenter argued that such explanations were not sufficiently protective of participants and beneficiaries. The Department disagrees with these comments. One of the many protections encompassed in the class exemption is the audit requirement. The Department expects that a critical part of the audit will involve a review of the explanations required to be documented by the fiduciary adviser. Without such documentation, auditors would have no basis for assessing compliance with a number of the conditions of the class exemption, including those set forth in paragraphs (d)(3)(ii)(A) and (B) and (d)(6) of the final rule.

One comment misconstrued the requirement, reading the proposal as not requiring the fiduciary adviser to provide an explanation regarding investments that might generate higher fees until 30 days after the provision of the advice. Under the proposal, the explanation was required to be provided in advance of the advice, but that explanation was not required to be documented for the fiduciary adviser's records, as well as for the required audit, until 30 days after the provision of the advice. The Department believes that it may not always be practical for a fiduciary adviser to document the advice they provide contemporaneously with the provision of that advice and, therefore, provided a limited period within which such advice must be documented.

In an effort to address both ambiguity and confusion with respect to the aforementioned requirement, the Department has combined and simplified the requirement for purposes of the final class exemption. Further, because the Department believes that this requirement, in its revised form, would offer additional protections to participants and beneficiaries without being unnecessarily burdensome on fiduciary advisers, the Department is making it a general requirement of the final class exemption. In this regard, paragraph (d)(6)(ii) of the final rule provides that, in connection with the provision of any investment advice covered by the class exemption, the fiduciary adviser must conclude that the advice to be provided is prudent and in the best interest of the participant or beneficiary, and explain to the participant or beneficiary the basis for the conclusion, including, if applicable, why and how the advice deviates from or relates to the computer modeled recommendations or investment education materials furnished in satisfaction of paragraph (d)(3)(i) or (ii), and why the advice includes an option(s) with higher fees than other options in the same asset class(es) available under the plan. Further under paragraph (d)(6)(ii), not later than 30 days following such explanation, the employee, agent or registered representative providing the advice on behalf of the fiduciary adviser must document the explanation. The final rule, like the proposal, also requires this documentation to be retained in accordance with the record retention requirements of paragraph (e) of the final rule. See paragraph (d)(6)(ii)(C) of the final rule.

f. Use of Fee-Leveling

Paragraph (d)(4) of the final rule addresses the fee-leveling requirement of the class exemption. As proposed, the class exemption applied the fee-leveling requirement only to the individuals who provide the investment advice on behalf of the fiduciary adviser, namely, employees, agents, and registered representatives. This is in contrast to the fee-leveling requirement under the statutory exemption, as described above with respect to paragraph (b) of the final rule, which applied the fee-leveling requirement at both the entity (fiduciary adviser)-level and the individual (employee, agent, registered representative)-level. In this regard, the Department was persuaded that the additional safeguards provided for in the class exemption were sufficient to permit the application of the fee-leveling requirement at the individual-level, rather than fiduciary adviser-entity level, without compromising the availability of informed, unbiased, and objective investment advice for participants and beneficiaries. As explained in the discussion relating to the fee-leveling provisions of the statutory exemption, some commenters objected to the limited scope of the fee-leveling requirement and other commenters requested that the breadth of the fee-leveling requirement be narrowed. The Department continues to believe it reached the appropriate balance of protections and flexibility in the proposal and, accordingly is adopting the fee-leveling framework of the proposed class exemption without modification in the final rule.

g. Policies and Procedures

The proposed exemption contained a requirement that the fiduciary adviser adopt and follow written policies and procedures that are designed to assure compliance with the conditions of the exemption. As explained in the preamble to the proposal, the Department believes that the maintenance of such policies and procedures will help ensure compliance with the exemption, as well as support a finding that, for purposes of section 408(a)(1), the exemption is administratively feasible. The Department has not changed its view in this regard and, in the absence of any comments objecting to this provision of the proposal, is adopting this requirement without change in the final rule. See paragraph (d)(7). The Department also notes that the auditor engaged to conduct an audit pursuant to paragraph (d)(9) of the final rule, discussed earlier, is required, as part of that audit, to review a fiduciary adviser's compliance with its policies and procedures.

5. Retention of Records

Both the proposed regulation implementing the statutory exemption and the proposed class exemption had record retention requirements, with respect to which there were no comments. Paragraph (e) of the final rule sets forth the record retention requirements now applicable to both investment advice arrangements relying on the statutory exemption, as set forth in paragraph (b), and investment advice provided pursuant to the class exemption, as set forth in paragraph (d), of the final rule. Paragraph (e) provides that the fiduciary adviser must maintain, for a period of not less than 6 years after the provision of investment advice under the section any records necessary for determining whether the applicable requirements of the final rule have been met, noting that a transaction prohibited under section 406 of ERISA shall not be considered to have occurred solely because the records are lost or destroyed prior to the end of the 6-year period due to circumstances beyond the control of the fiduciary adviser.

6. Noncompliance

The proposed class exemption specifically addressed the effects of noncompliance with the exemption. In this regard, the proposal explained that the class exemption would not apply to any covered transaction in connection with the provision of investment advice to an individual participant or beneficiary with respect to which the conditions of the exemption have not been satisfied. The proposal also indicated that, in the case of a pattern or practice of noncompliance with any of the conditions, the exemption would not apply to any transaction in connection with the provision of investment advice provided by the fiduciary adviser during the period over which the pattern or practice extended.

Several commenters objected to the ''pattern or practice'' provision, arguing that because non-compliant advice is already subject to an excise tax under the Code, extending the penalty to all advice provided during a period, without regard to it being compliant advice, is unnecessary and punitive. Commenters also argued that the concept of a ''pattern or practice'' was unclear. Some commenters suggested the penalty should be prospective only, while others argued there should be a de minimus rule or period for correcting such noncompliance before losing the relief of the exemption for compliant advice. On the other side, one commenter argued that increased penalties for noncompliance would make the exemption more protective.

The Department believes that one of the most significant deterrents to noncompliance with the conditions of the statutory and class exemption is the potentially significant excise taxes applicable to transactions that fail to satisfy the conditions of the exemptions. The Department believes that the ''pattern or practice'' provision creates additional incentives on the part of fiduciary advisers taking advantage of the exemptive relief to be vigilant in designing and following policies, procedures and practices that will assure compliance. The Department, therefore, has retained this provision in the final rule. Unlike the proposal, however, the provision now applies to both relief under the statutory exemption and the class exemption. As revised, paragraph (f) of the final rule provides that: (1) The relief from the prohibited transaction provisions of section 406 of ERISA and the sanctions resulting from the application of section 4975 of the Code described in paragraphs (b) and (d) of the final rule shall not apply to any transaction described in such paragraphs in connection with the provision of investment advice to an individual participant or beneficiary with respect to which the applicable conditions of the final rule have not been satisfied; and (2), in the case of a pattern or practice of noncompliance with any of the applicable conditions of the final rule, the relief described in paragraph (b) or (d) shall not apply to any transaction in connection with the provision of investment advice provided by the fiduciary adviser during the period over which the pattern or practice extended.

With respect to what the Department might view as a ''pattern or practice'' of noncompliance with the exemptions, the Department believes that it is important to identify both individual violations and patterns of such violations. Isolated, unrelated, or accidental occurrences would not themselves constitute a pattern or practice. However, intentional, regular, deliberate practices involving more than isolated events or individuals, or institutionalized practices will almost always constitute a pattern or practice. In determining whether a pattern or practice exists, the Department will consider whether the noncompliance appears to be part of either written or unwritten policies or established practices, whether there is evidence of similar noncompliance with respect to more than one plan or arrangement, and whether the noncompliance is within a fiduciary adviser's control.

7. Effective Date

The Department proposed that the regulation would be effective 60 days after the date of publication of the final rule and that the class exemption would be effective 90 days after the date of publication of the final exemption. One commenter suggested that the 60 day effective date would not constitute sufficient time to comply with the final rule. One commenter suggested that the final rule should be effective no earlier than the later of July 1, 2009, or 180 days after publication of the final rule. Another commenter requested that rule be made effective upon publication.

Given the importance of investment advice to participants and beneficiaries generally and given that the exemptions contained in this final rule will expand the opportunity for participant and beneficiaries to obtain affordable, quality investment advice, the Department believes that the final rule should be effective on the earliest possible date. Accordingly, the final rule contained in this document will be effective 60 days after the date of publication in the **Federal Register** and will apply to transactions described in paragraphs (b) and (d) of the final rule occurring on or after that date.

8. General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under section 408(a) of the Act and section 4975(c)(2) of the Code does not relieve a fiduciary or other party in interest or disqualified person from other provisions of the Act and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of section 404 of the Act. Section 404 requires, among other things, that a fiduciary discharge its duties with respect to the plan prudently and solely in the interests of the plan's participants and beneficiaries. A transaction's qualification for an exemption also does not affect the requirement of section 401(a) of the Code that the plan must operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries;

(2) The exemptions contained herein are supplemental to, and not in derogation of, any other provisions of the Act and the Code, including statutory or administrative exemptions and transitional rules; and

(3) In accordance with section 408(a) of ERISA and section 4975(c)(2) of the Code, and based on the entire record, the Department finds that, as discussed above, the class exemption contained in this document is administratively feasible, in the interests of the plan(s) and IRAs and of its participants and beneficiaries, and protective of the rights of the participants and beneficiaries of the plan and IRAs.

C. Overview of Final § 2550.408g–2

Section 408(g)(11)(A) of ERISA provides that, with respect to an arrangement that relies on use of a computer model to qualify as an ''eligible investment advice arrangement'' under the statutory exemption, a person who develops the computer model, or markets the investment advice program or computer model, shall be treated as a fiduciary of a plan by reason of the provision of investment advice referred to in ERISA section 3(21)(A)(ii) to the plan participant or beneficiary, and shall be treated as a ''fiduciary adviser'' for purposes of ERISA sections 408(b)(14) and 408(g), except that the Secretary of Labor may prescribe rules under which only one fiduciary adviser may elect to be treated as a fiduciary with respect to the plan. Section 4975(f)(8)(J)(i) of the Code contains a parallel provision to ERISA section 408(g)(11)(A) that applies for purposes of Code sections 4975(d)(17) and 4975(f)(8).

In conjunction with the proposed regulation implementing the statutory exemption for investment advice, the Department also proposed a rule, § 2550.408g–2, governing the requirements for electing to be treated as a fiduciary and fiduciary adviser by reason of developing or marketing a computer model or an investment advice program used in an eligible investment advice arrangement. Section 2550.408g–2 sets forth requirements that must be satisfied in order for one such fiduciary adviser to elect to be treated as a fiduciary under such an eligible investment advice arrangement. See paragraph (a) of § 2550.408g–2.

Paragraph (b)(1) of § 2550.408g–2 provides that, if an election meets the requirements of paragraph (b)(2) of the proposal, then the person identified in the election shall be the sole fiduciary adviser treated as a fiduciary by reason of developing or marketing a computer model, or marketing an investment advice program, used in an eligible investment advice arrangement. Paragraph (b)(2) requires that the election be in writing and that the writing: identify the arrangement, and person offering the arrangement, with respect to which the election is to be effective; and identify the person who is the fiduciary adviser, the person who develops the computer model or markets the computer model or investment advice program with respect to the arrangement, and the person who elects to be treated as the only fiduciary, and fiduciary adviser, by reason of developing such computer model or marketing such computer model or investment advice program. Paragraph (b)(2) of § 2550.408g–2 also requires that the election be signed by the person acknowledging that it elects to be treated as the only fiduciary and fiduciary adviser; that a copy of the election be furnished to the plan fiduciary who authorized use of the arrangement; and that the writing be retained in accordance with the record retention requirements of § 2550.408g–1(e).

The Department received no substantive comments on this regulation and, therefore, is adopting the regulation substantially as proposed. This regulation, like § 2550.408g–1, will be effective 60 days after the date of publication of the final rule in the **Federal Register**.

D. Regulatory Impact Analysis

1. Summary

In the regulatory impact analysis (RIA) for the proposed regulation and class exemption (hereafter, ''the proposals''), the Department noted that, historically, many participants and beneficiaries in participant-directed defined contribution plans and beneficiaries of individual retirement accounts (IRAs) (collectively hereafter, ''participants'') have made investment mistakes. The Department anticipates that full implementation of the PPA under this final regulation, together with this class exemption (hereafter, the ''final rule''), by extending quality, expert investment advice to a greater number of participants will improve investment decisions and results. This improvement in investment results reflects reductions in investment errors, including poor trading strategies and inadequate diversification. The Department further anticipates that the increased investment advice resulting from the final rule also will reduce participants' investment related expenses, further improving their overall investment results, and will improve the welfare of participants by better aligning participant investments and their risk tolerances.

The provisions of the final rule are designed to promote the availability of affordable, quality investment advice.

2. Public Comments

The Department received several comments on the regulatory impact analysis of the proposals. The following is a summary of the major comments and the Department's response thereto.

a. Trading Strategies

A number of commenters objected to the Department's contention that participants' active attempts to ''time the market'' constitute inferior trading strategies that result in losses. According to these commenters, the term ''market timing'' ''no longer defines investment strategies providing investors with enhanced risk-adjusted returns'' and professionals are proficient in actively managing clients' portfolios. The commenters further asserted that the Department should not favor one investment strategy over another.

The Department continues to believe that automatic rebalancing is likely to be superior on average to participants' own efforts (without benefit of expert advice) to time the market (meaning to reallocate assets in anticipation of future market movements). However, this says nothing about the relative merits of active professional account management. The Department is unaware of any studies that measure the performance of managed accounts relative to that of target date funds or other automatic rebalancing arrangements, and proffers no view as to whether one strategy is superior to another.

b. Permissible Arrangements

The Department included in its analysis of the proposals a table summarizing how compensation of fiduciary advisers can vary in advice arrangements operating under the following three scenarios: Absent any exemptive relief, pursuant to the PPA statutory exemption, and pursuant to the proposed class exemption. As requested in comments, the Department advises that the table was not intended to exhaustively list all permissible advice arrangements. Some arrangements might operate pursuant to other exemptive relief. Participants and plans continue to have the option of obtaining advice under arrangements that were permitted prior to enactment of the PPA and promulgation of this final rule. Furthermore, the Department does not favor any particular permissible arrangement over any other.

c. Preferences for Computer Models v. Contact With Advisers

In response to commenters, the Department is modifying its assertion that some participants are dissatisfied with advice from computer models. Rather, the cited authorities indicate that plan sponsors rate arrangements that include contact with advisers as more effective than those that rely exclusively on computer models, and provide some evidence that more participants make use of the former than the latter.

d. Revenue Sources and Active Marketing

In its analysis of the proposals the Department suggested that advisers with revenue sources other than level [20] fees paid directly by participants, plans or sponsors might market their advisory services more actively to certain participant market segments than independent advisers do. Some commenters disputed this suggestion. These commenters pointed out that independent advisers may receive alternative revenue sources such as revenue sharing and may not rely exclusively on level fees, and emphasized that plan sponsors mediate adviser efforts to market to participants.

First, the Department clarifies that in this context ''independence'' was meant to reference exclusive reliance on level fees rather than a lack of affiliation. Second, the Department notes that other commenters strongly suggested that alternative sources of compensation for investment advisory services may facilitate sales of such services where exclusive reliance on level fees would not—particularly sales of adviser consultations (as distinct from computer models alone) to small account holders. Therefore, the Department continues to believe that some advisers with such alternative sources of compensation for investment advice services will be more inclined than independent advisers to market such services to some participant market segments. Finally, the Department notes that active marketing could target plan sponsors as well as plan participants and IRA beneficiaries.

e. Audit Requirement

In response to comments, the Department notes that its assumption that audits would be outsourced to an independent legal professional was intended only as a proxy to estimate the cost of compliance with the audit requirement. In fact, as discussed earlier in the preamble, the Department is not persuaded that there is necessarily one set of credentials, such as experience as certified public account or auditor or lawyer, that, in and of itself, qualifies an individual or organization to conduct the audits required by the statutory and class exemptions. Likewise, the Department's assumptions regarding the sample of transactions to be audited were adopted for purposes of cost estimation and should not be construed as guidance as to how sampling should be conducted. Having said that, the assumptions are consistent with compliant sampling at the level of the financial institution acting as the fiduciary adviser.

f. Advice Quality

The Department's RIA of the proposals devoted considerable attention to the question of whether adviser conflicts might taint advice. As detailed there, there is evidence to suggest that conflicted advisers sometimes reap profit at investors' expense. The proposals' conditions were intended to prevent conflicts from tainting advice. Accordingly, the RIA assumed that advice arrangements operating pursuant to the proposals would be as effective as arrangements operating without need for exemptive relief, notwithstanding the conflicts that are attendant to the former.

As noted earlier in this preamble, some commenters maintained that the proposals' conditions, together with the threat of substantial excise tax penalties for noncompliance, are sufficiently protective and that consequently advice provided pursuant to the proposals will be of high quality and reflect the participants' best interests. The Department can be confident that advice arrangements operating pursuant to the proposals will satisfy the applicable conditions because advisers are scrupulous about compliance, the commenters said. Some of these commenters suggested that some of the conditions were more stringent than necessary and should be relaxed. For example, some commenters objected to the proposed condition denying exemptive relief to all transactions under an arrangement where there is a pattern or practice of failures to satisfy applicable conditions. Relief should be denied only to particular transactions for which conditions were not satisfied, the commenters said. Some commenters argued that the proposals' limits on compensation that can be paid under level fee arrangements should be relaxed to permit certain types of performance based rewards, bonuses and promotions.

Also as noted earlier in this preamble, other commenters questioned the Department's assumption that advice arrangements operating pursuant to the proposals would be as effective as arrangements operating without need for exemptive relief, predicting that the former will too often be tainted by attendant conflicts. Most of these commenters expressed deepest concern with the proposed class exemption, arguing that the fiduciary adviser and the person providing the advice may be conflicted. Some commenters also expressed concern with the proposed regulation's interpretation of the statutory exemption, arguing that the fiduciary advisers' affiliates may be conflicted. These commenters maintained that the proposals' conditions are not sufficiently protective. Persons providing advice on behalf of fiduciary adviser entities cannot be fully insulated from conflicts affecting the entities or their affiliates, the commenters said, and the proposals' procedural safeguards, including disclosure and independent audits, together with available enforcement mechanisms, are not sufficient to ensure compliance with the proposals' substantive conditions, such as unbiasedness and adherence to investment theories. Some commenters cautioned that investors are vulnerable to manipulation.

The Department continues to believe, as it did in connection with the proposals, that, in the absence of adequate protections, an adviser's conflicts may result in biased advice.[21]

[20] ''Level'' in this context means invariant with respect to associated investment decisions.

[21] Since promulgating the proposals the Department has considered additional evidence

Continued

However, the Department also believes that the safeguards included in this final rule, together with associated enforcement mechanisms including the potentially significant excise taxes[22] for noncompliance and for patterns and practice of noncompliance, effectively minimize the possibility that fiduciary advisers will act on their conflicts. Provisions expected to deter noncompliance include the annual audit requirement, disclosure of noncompliant activities identified in the course of an audit to authorizing plan fiduciaries and, in the case of IRAs, to the Department, and the pattern or practice provision.

Because the conditions and enforcement mechanisms constitute adequate safeguards, the Department believes that any impact of conflicts on advice provided pursuant to the statutory and class exemptions will be minimal. The Department stands by its assumption that advice arrangements operating pursuant to the final rule will be as effective as arrangements operating without need for exemptive relief.

g. Effect on Expenses

Two distinct types of inefficiency can result in higher than optimal consumer expenditures for a particular type of good. The first is prices that are higher than would be efficient. Efficient markets require vigorous competition. Sellers with market power can command inefficiently high prices, thereby capturing consumer surplus and imposing a ''dead weight loss'' of welfare on society. Efficient markets also require perfect information and rational, utility maximizing consumers. Imperfect information, search costs and consumers' behavioral biases likewise can allow some sellers to command inefficiently high prices. The Department accordingly has considered whether such conditions might exist in the market for investment products and services bought by or on behalf of participants.

The second type of inefficiency is suboptimal consumer choices among available products. Even if goods are priced competitively, welfare will be lost if consumers make poor purchasing decisions. Imperfect information, search costs and behavioral biases can compromise purchasing decisions, and the Department has considered whether participants' purchases of investment products and services might be so compromised.

In its RIA of the proposals, the Department estimated that fees and expenses paid by unadvised participants are higher than necessary by 11.3 basis points on average. Some commenters on the proposals, as well as some commenters on the Department's proposed regulation governing disclosure to participant-directed defined contribution (DC) plan participants,[23] disputed this estimate. The commenters pointed to evidence that the pricing of investment products and related services is competitive and efficient, and contended that there is no credible evidence to the contrary.

The commenters raised several specific challenges to the Department's analysis. First, they contended that the Department's estimate relies inappropriately on dispersion in mutual fund expenses as evidence that such expenses are sometimes higher than necessary and as a basis for estimating the degree to which this is so. Dispersion in expenses reflects differences among the investment products or the services bundled with them, the commenters said, and therefore such dispersion is consistent with competitive, efficient pricing. Second, the commenters argued that the analysis draws incorrect inferences about fees and expenses in DC plans. The analysis overlooks the role of DC plan fiduciaries in choosing reasonably priced investments and relies too much on research that examined retail rather than DC plan experience, they said. Third, the commenters highlighted what they say are technical flaws in some of the research that the Department had cited as supporting the conclusion that fees and expenses are sometimes higher than necessary, and they took issue with the Department's interpretation of some of the research.

In response to these commenters, the Department undertook to refine and strengthen its analysis. First, the Department agrees that the RIA of the proposals relied too heavily on mere dispersion of fees and expenses as a basis for estimating whether and to what degree they might be higher than necessary. The estimate that they are on average 11.3 basis points higher than necessary lacks adequate basis and should be disregarded. Second, the Department agrees that fees and expenses paid by DC plan participants can differ from those paid by retail investors. Any evidence of higher than necessary expenses in the retail sector might suggest similar circumstances in DC plans, but would not demonstrate it. Third, the Department reviewed available research literature in light of the commenters, and refined its analysis and conclusions accordingly, as summarized immediately below.

(i) *Expense sensitivity*—Surveys and studies strongly suggest gaps in awareness of and sensitivity to expenses.[24] Other studies consider whether investors with different levels of sophistication make different decisions about fees. If more sophisticated investors are more sensitive to fees, less sophisticated ones might be paying more than would be optimal. Alternatively, they might be paying more in order to obtain sophisticated help. Much literature suggests a negative relationship between sophistication and expenses paid,[25] but some does not.[26] Overall this literature leaves open the question of whether investment prices are sometimes inefficiently high, but suggests that even if prices are efficient investors may make poor purchasing decisions. The Department believes that many individual investors, including both DC plan participants and IRA beneficiaries,

suggesting that adviser conflicts can taint advice. *See, e.g.*, U.S. SEC, *Protecting Senior Investors: Report of Examinations of Securities Firms Providing ''Free Lunch'' Sales Seminar* (Sept. 2007).

[22] Under Code section 4975, fiduciaries participating in prohibited transactions may be subject to an excise tax of 15 percent of the amount involved for each year in the taxable period, in addition to which an excise tax of 100 percent of the amount involved may be added depending on whether the prohibited transactions are timely corrected.

[23] *See* 73 FR 43013 (July 23, 2008).

[24] *See e.g.*, James J. Choi *et al., Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds,* National Bureau of Economic Research Working Paper W12261 (May 2006); Jeff Dominitz *et al., How Do Mutual Funds Fees Affect Investor Choices? Evidence from Survey Experiments* (May 2008) (unpublished, on file with the Department) (Dominitz); and John Turner & Sophie Korczyk, *Pension Participant Knowledge About Plan Fees,* AARP Pub ID: DD–105 (Nov. 2004). Commenters pointed out that net flows are concentrated in mutual funds with low expenses. However it is unclear whether this reflects investor fee sensitivity or brand name recognition and successful marketing by large, established funds whose low fees are attributable to economies of scale.

[25] Sebastian Müller & Martin Weber, *Financial Literacy and Mutual Fund Investments: Who Buys Actively Managed Funds?,* Social Science Research Network Abstract 1093305 (Feb. 14, 2008) found that more financially literate investors pay lower front-end loads but similar management fees, and suggest that investors who know about management fees appear not to care about them. Dominitz finds that financially literate individuals are better able to estimate fees, and better estimates are associated with more optimal investment choices. Brad M. Barber *et al., Out of Sight, Out of Mind, The Effects of Expenses on Mutual Fund Flows,* Journal of Business, Volume 79, Number 6, 2095–2119 (2005) found that repeat investors are more sensitive to load fees than expense ratios, but commenters point out that this finding may be an artifact of industry load setting practices.

[26] Mark Grinblatt *et al., Are Mutual Fund Fees Competitive? What IQ-Related Behavior Tells Us,* Social Science Research Network Abstract 1087120 (Nov. 2007) found that investors with different IQs pay similar fees, which ''suggests that fees are set competitively.''

historically have not factored expenses optimally into their investment choices.

(ii) *Sector differences*—Some studies lend insight to the question of whether investment prices are efficient by comparing prices paid or performance in different market segments.[27] The Department believes that taken together, this literature suggests that there are unexplained differences in prices and performance across sectors but fails to demonstrate conclusively whether such differences are systematically attributable to inefficiently high investment prices.

(iii) *Market power*—At least one study suggests that mutual funds may wield market power to mark up prices to inefficient levels.[28]

(iv) *What expenses buy*—A number of studies considered the degree to which expense dispersion is a function of product features and bundled services, and if it is, whether that dispersion is justified by differences in observable attendant financial benefits such as performance. Some of this literature also considered the degree to which investors choose investments where expenses are so justified. In the Department's view this literature taken together suggests that a substantial portion of expense dispersion is attributable to distribution expenses, including compensation of intermediaries and advertising.[29] It casts doubt on whether such expenses are duly offset by observable financial benefits. Most studies are consistent with the possibility that such expenses are at least partly offset by unobserved benefits such as reduced search costs and other support for novice and unsophisticated investors, but most are also consistent with the possibility that some expenses are not so offset and that investors, especially unsophisticated ones, sometimes pay inefficiently high prices.[30] The authors of some studies expressly interpreted their failure to identify offsetting financial benefits as evidence that prices are inefficiently high. Some suggested that conflicted intermediaries may serve their own and fund managers' interests, thereby generating inefficiently high profits for either or both. Others disagreed, believing that investors efficiently derive a combination of financial and intangible benefits for their expense dollars.[31]

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[27] John P. Freeman & Stewart L. Brown, *Mutual Fund Advisory Fees: The Cost of Conflicts of Interest,* The Journal of Corporate Law, Volume 26, 609–673 (Spring 2001), found that the price paid by mutual funds for equity fund management is higher than that paid by pension funds. Based on this and other evidence they argue that mutual fund fees are often excessive. John C. Coates & R. Glenn Hubbard, *Competition in the Mutual Fund Industry: Evidence and Implications for Policy,* Social Science Research Network Abstract 1005426 (Aug. 2007), challenged Freeman and Brown's methods and conclusions, arguing that these differences in prices are attributable to differences in services for which Freeman and Brown did not account. They offer evidence that fees are competitive. Alicia H. Munnell *et al., Investment Returns: Defined Benefits vs. 401(k) Plans,* Center for Retirement Research Issue Brief Number 52 (Sept. 2006), found higher returns in defined benefit (DB) plans than in DC plans and offered that ''part of the explanation may rest with higher fees'' that are paid by DC plan participants. Rob Bauer & Rik G.P. Frehen, *The Performance of U.S. Pension Funds,* Social Science Research Network Abstract 965388 (Jan. 2008), found that DC and DB plans both perform close to benchmarks while mutual funds underperform, and point to hidden costs in mutual funds as the most likely reason. Diane Del Guercio & Paula A. Tkac, *The Determinants of the Flow of Funds of Managed Portfolios: Mutual Funds* vs. *Pension Funds,* The Journal of Financial and Quantitative Analysis, Volume 37, Number 4, 523–557 (Dec. 2002), found that ''in contrast to mutual fund investors, pension clients punish poorly performing managers by withdrawing assets under management and do not flock disproportionately to recent winners.''

[28] Guo Ying Luo, *Mutual Fund Fee-Setting, Market Structure and Mark-Ups,* Economica, Volume 69, Number 274, 245–271 (May 2002), exploited differences in market concentration across different narrow mutual funds categories, and found that mark-ups average 30 percent of fees across all categories of no load funds and more than 70 percent across load funds (assuming a 5-year holding period).

[29] The literature also attributed much expense dispersion to differences in the cost of managing different types of funds. For example, active equity management is more expensive than passive and management of foreign or small cap equity funds is more expensive than management of large cap domestic equity funds. Investors therefore might optimally diversify across funds with different levels of investment management expense. Some studies questioned whether active management delivers observable financial benefits commensurate to the associate expense. For example, Kenneth R. French, *The Cost of Active Investing,* Social Science Research Network Abstract 1105775 (Apr. 2008), found that investors spend 0.67 percent of aggregate U.S. stock market value each year searching for superior return, and characterized this as society's cost of price discovery.

[30] Both of these hypotheses are also consistent with literature finding a negative link between sophistication and expenses.

[31] The following is a sampling of findings and interpretations reported in various studies that the Department reviewed. The Department observes that some of these studies have been published in peer-reviewed journals, while others have not. Some are working papers subject to later revision. Some research is visibly supported by industry or other interests, and some may be independent. Very little of this research separately examines DC plan investing. Nearly all of it examines mutual fund markets to the exclusion of certain competing insurance company or bank products. Some of it examines foreign experience. The Department believes it must be cautious in drawing inferences from this research as to whether investment prices paid by participants are efficient.

Daniel B. Bergstresser *et al., Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry,* Social Science Research Network Abstract 616981 (Sept. 2007), found that investors who pay to purchase funds via intermediaries realize inferior returns, and said this result is consistent with either intangible benefits for investors or inefficiently high prices due to conflicts.

Ralph Bluethgen *et al., Financial Advice and Individual Investors' Portfolios,* Social Science Research Network Abstract 968197 (Mar. 2008), found that advisers (who are mostly compensated by commission) improve diversification and allocation across classes while increasing fees and turnover. They said these findings are consistent with ''honest advice.''

Mercer Bullard *et al., Investor Timing and Fund Distribution Channels,* Social Science Research Network Abstract 1070545 (Dec. 2007), found that investors who transact through conflicted advisers incur timing underperformance.

Susan Christoffersen *et al., The Economics of Mutual-Fund Brokerage: Evidence from the Cross Section of Investment Channels,* Science Research Network Abstract 687522 (Dec. 2005), identified some financial benefits reaped by investors who pay to invest through intermediaries.

Sean Collins, *Fees and Expenses of Mutual Funds, 2006,* Investment Company Institute Research Fundamentals, Volume 16, Number 2 (June 2007), reported that mutual fund fees and expenses are declining.

Sean Collins, *Are S&P 500 Index Mutual Funds Commodities?,* Investment Company Institute Perspective, Volume 11, Number 3 (Aug. 2005), argued that S&P 500 index funds are not uniform commodities. For example, they are distributed in different ways. He found that 91 percent of the variation in these funds' expense ratios can be explained by a combination of fund asset size, investor account size, fee waivers and separate fees, and investor advice that is bundled into expense ratios. He argued that these funds competitively pass economies of scale along to investors, and reported that assets and flows are concentrated in low-cost funds.

Henrik Cronqvist, *Advertising and Portfolio Choice,* Social Science Research Network Abstract 920693 (July 26, 2006), found that fund advertising steered investors toward ''portfolios with higher fees, more risk, more active management, more 'hot' sectors, and more home bias.'' He suggested that ''with the use of advertising, funds can differentiate themselves and therefore charge investors higher fees than the lowest-cost supplier in the industry.''

Daniel N. Deli, *Mutual Fund Advisory Contracts: An Empirical Investigation,* The Journal of Finance, Volume 57, Number 1, 109–133 (Feb. 2002), found that differences in investment advisers' marginal compensation reflected differences in their marginal product, difficulty in measuring adviser performance, control environments, and scale economies. Based on this finding, he suggested that investment prices are efficient and recommended caution in any regulatory effort to influence such prices.

Edwin J. Elton *et al., Are Investors Rational? Choices Among Index Funds,* The Journal of Finance, Volume 59, Number 1, 261–288 (Feb. 2004), found that flows into high-expense (and therefore predictably low performance) S&P 500 index mutual funds were higher than would be expected in an efficient market. They concluded that, because investors are not perfectly informed and rational, inferior products can prosper. Commenters, however, contended that, because the authors scaled flows by fund size and smaller funds have higher expenses, these findings exaggerated the degree to which flows are directed to high-expense funds.

Javier Gil-Bazo & Pablo Ruiz-Verdú, *Yet Another Puzzle? Relation Between Price and Performance in the Mutual Fund Industry,* Social Science Research Network Abstract 947448 (March 2007), found that ''funds with worse before-fee performance charge higher fees.'' They hypothesized that lower-performing funds lose sophisticated investors to higher performing funds, then are left with relatively unsophisticated investors who are not as responsive to price.

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In light of this literature and public commenters, the Department believes that the available research provides an insufficient basis to confidently determine whether or to what degree participants pay inefficiently high investment prices. Market conditions that may lead to inefficiently high prices—namely imperfect information, search costs and investor behavioral biases—certainly exist in the retail IRA market and likely exist to some degree in particular segments of the DC plan market. The Department believes there is a strong possibility that at least some participants, especially IRA beneficiaries, pay inefficiently high investment prices. If so, the Department would expect these actions to reduce that inefficiency. This would increase participants' welfare by transferring surplus from producers of investment products and services to them and by reducing dead weight loss. The Department additionally believes that even where investment prices are efficient, participants often make bad investment decisions with respect to expenses—that is, they buy investment products and services whose marginal cost exceed the associated marginal benefit to them.[32]

The Department expects these actions to reduce such investment errors, improving participant and societal welfare. However, the Department has no basis on which to quantify such errors or improvements.

3. Impact Assessment

Although the Department anticipates that these actions will increase the availability of investment advice to DC plan participants and the use of advice by IRA beneficiaries, the Department is uncertain how changing market conditions might affect the incidence and magnitude of investment errors, as well as the availability, use, and effect of investment advice. Recent developments in financial markets and in the market for financial products and services underscore this uncertainty. However, given that the costs of this regulation are due to the cost of providing (or paying for) investment advice, it will be incurred only to the extent that participants seek advice and anticipate improved returns on their investments. Thus, the Department remains confident that these actions will yield positive net benefits though we are uncertain of the magnitude. The Department believes that the approach used in the analysis for the proposed rule could reflect the long-term effects of these actions and can be viewed as a reasonable upper bound. The Department's assumptions are summarized in Tables 1, 2, and 3.

TABLE 1—AVAILABILITY OF ADVICE TO DC PLAN PARTICIPANTS

Policy context	Any advice (computer or live)	Live adviser
Pre-PPA	40%	20%
PPA	50	25
Class exemption	60	35

Note: There are approximately 66 million DC participants.

TABLE 2—NUMBER OF ENTITIES

	Pre PPA	PPA	CE
DC:			
Plans offering (000s)	209.46	261.82	314.19
Participants offered (MM)	26.44	33.05	39.66
Participants using (MM)	6.61	8.26	10.25
IRA:			
IRAs using (MM)	16.81	25.47	33.97

John A. Haslem *et al., Performance and Characteristics of Actively Managed Retail Equity Mutual Funds with Diverse Expense Ratios,* Financial Services Review, Volume 17, Number 1, 49–68 (2008), found that funds with lower expenses have superior returns. John A. Haslem *et al., Identification and Performance of Equity Mutual Funds with High Management Fees and Expense Ratios,* Journal of Investing, Volume 16, Number 2 (2007), found that certain performance measures vary negatively with fees and, on that basis, suggested that mutual funds do not compete strongly on price and that expenses are too high.

Sarah Holden & Michael Hadley, *The Economics of Providing 401(k) Plans: Services, Fees and Expenses 2006,* Investment Company Institute Research Fundamentals, Volume 16, Number 4 (Sept. 2007), reported that 401(k) mutual fund investors tended to pay lower than average expenses and that 401(k) assets were concentrated in low-cost funds.

Ali Hortacsu & Chad Syverson, *Product Differentiation, Search Costs, and Competition in the Mutual Fund Industry: A Case Study of S&P 500 Index Funds,* Quarterly Journal of Economics, 403 (May 2004), documented dispersion in S&P 500 Index Fund expense ratios, and reported that low-cost funds had a dominant, but falling, market share. They concluded that an influx of novice investors who must defray search costs explained dispersion in expenses and flows to high-expense funds.

Todd Houge & Jay W. Wellman, *The Use and Abuse of Mutual Fund Expenses,* Social Science Research Network Abstract 880463 (Jan. 2006), found that load funds charge higher 12b-1 and management fees. They attributed this to abusive market segmentation that extracted excessive fees from unsophisticated investors.

Giuliano Iannotta & Marco Navone, *Search Costs and Mutual Fund Fee Dispersion,* Social Science Research Network Abstract 1231843 (Aug. 2008), analyzed the effect of search costs on mutual fund fees with data on broad U.S. domestic equity funds. They estimated the portion of the expense ratio that was not justified by the quality of service provided, by the cost structure of the investment company, or by the specificities of the clientele served by the fund and found that its dispersion was lower for highly visible funds and for funds that invested heavily in marketing. In the case of the U.S. mutual fund market, they argued, the dispersion of this residual demonstrated the extent to which some firms can charge a ''non-marginal'' (that is higher than competitive) price.

Marc M. Kramer, *The Influence of Financial Advice on Individual Investor Portfolio Performance,* Social Science Research Network Abstract 1144702 (Mar. 2008), found that advised investors took less risk and thereby reaped lower returns. Risk-adjusted performance was similar. Adjusting further for investor characteristics, advised investors performed slightly worse.

Erik R. Sirri & Peter Tufano, *Costly Search and Mutual Fund Flows,* The Journal of Finance, Volume 53, Number 5, 1589–1622 (Oct. 1998), found that investors were ''fee sensitive in that lower-fee funds and funds that reduce fees grow faster.'' Investors' fee sensitivity was not symmetric, however.

Edward Tower & Wei Zheng, *Ranking Mutual Fund Families: Minimum Expenses and Maximum Loads as Markers for Moral Turpitude,* Social Science Research Network Abstract 1265103 (Sept. 2008), found a negative relationship between expense ratios and gross performance. The *Division of Investment Management: Report on Mutual Fund Fees and Expenses,* U.S. Securities and Exchange Commission (Dec. 2000), *at http://www.sec.gov/news/studies/feestudy.htm,* described mutual fund fees and expenses and identified major factors that influenced fee levels but did not assess whether prices were efficient.

Xinge Zhao, *The Role of Brokers and Financial Advisors Behind Investment Into Load Funds,* China Europe International Business School Working Paper (Dec. 2005), *at http://www.ceibs.edu/faculty/zxinge/brokerrole-zhao.pdf,* found that funds with higher loads received higher flows, and suggested that conflicted intermediaries enriched themselves at investors' expense.

[32] It is possible that the converse could sometimes occur: participants might fail to buy efficiently priced products and services whose marginal cost lags the associated marginal benefit to them. In that case advice, by correcting this error, might lead to higher expenses, but would still improve welfare. Because research suggests that participants are insensitive to fees rather than excessively sensitive to them, the Department believes that this converse situation is likely to be rare.

TABLE 3—USE OF ADVICE BY DC PLAN AND IRA PARTICIPANTS

Policy context	Share of participants advised			Dollars advised ($ trillions)		
	DC plans		IRA	DC plans	IRAs	Combined
	Where offered	Overall				
Pre-PPA	25%	10%	33%	$0.30	$1.40	$1.70
PPA	25	13	50	0.30	2.10	2.50
Class exemption	26	16	67	0.40	2.80	3.20

Note: There are approximately 66 million DC participants and approximately 51 million IRA beneficiaries.

As in its RIA of the proposals, the Department assumes here that advised participants make investment errors at one-half the rate of unadvised participants. The remaining errors reflect participant failures to follow advice, together with possible flaws in some advice. Advice arrangements operating without need for exemptive relief, pursuant to the PPA statutory exemption, and pursuant to the class exemption are equally effective on average, the Department assumes.

The Department expects the PPA as implemented by this regulation, together with this class exemption, to reduce investment errors to the benefit of participants. The Department's estimates of investment errors and reductions from investment advice are summarized in Table 4.

TABLE 4—LONG TERM INVESTMENT ERRORS AND IMPACT OF ADVICE

[$ billions, annual]

Policy context	Remaining errors	Errors eliminated by advice	
		Incremental	Cumulative
No advice	$115	$0	$0
Pre-PPA advice only	101	14	14
PPA	95	7	20
Class exemption	88	7	27

In the RIA of the proposals, the Department estimated costs of $1.8 billion for advice arrangements operating under the PPA statutory exemption and $2.3 billion for advice arrangements under the class exemption. As the requirement to document and keep records on the basis of advice provided under the class exemption was broadened, costs of about $610 million were added to the costs of the class exemption, leading to a new estimate of $2.9 billion. The current cost estimates are summarized in Table 5.

TABLE 5—COST OF ADVICE

	Pre-PPA	PPA	Class exemption
Incremental			
Advice cost ($ billions)	$3.80	$1.80	$2.90
Advice cost rate (bps, average)	23	23	37
Cumulative (combined with policies to the left)			
Advice cost ($ billions)	$3.80	$5.60	$8.50
Advice cost rate (bps, average)	23	23	26

4. Alternatives

In formulating this final rule, the Department considered several alternative approaches, which it detailed in its RIA of the proposals. The Department in these final actions did not adopt any of the alternatives discussed in its RIA of the proposals, having received no sufficiently persuasive comments suggesting that it should. Some public commenters on the proposals suggested alternatives the Department had not yet considered. The furthest reaching commenters, expressing concern that conflicts permitted under the proposals would taint advice, suggested that the Department should either withdraw the proposals or modify them to require stricter and/or broader fee leveling. As detailed above, the Department believes these actions' conditions are sufficiently protective to safeguard the quality of advice. Accordingly, the Department did not pursue these alternatives. Other commenters suggested more incremental revisions to the proposals. The Department's decisions whether to adopt these suggestions are discussed earlier in this preamble.

5. Uncertainty

As previously stated, the Department is uncertain how changing market conditions might affect the incidence and magnitude of investment errors, as well as the availability, use, and effect of investment advice. Recent developments in financial markets and in the market for financial products and services underscore this uncertainty. On one hand, falling account balances might reduce the magnitude of both investment errors and potential gains from corrective advice. On the other hand, volatility and losses in financial markets might amplify these, and might increase plan sponsors' propensity to make advice available and participants' propensity to seek and follow advice. At the same time, restructuring and consolidation among suppliers of financial products and services might alter the cost and availability of advice. The Department intends its quantitative estimates to reflect the long-term effects that will encompass a variety of market circumstances. The literature and experience underlying the Department's estimates reflect a variety of historical market contexts and conditions. However, given the uncertainty, we now present the estimate as a plausible upper bound for the possible effects.

Regardless, the Department remains highly confident in its conclusion expressed in its RIA of the proposals that investment errors are common and often large, producing large avoidable losses (including foregone earnings) in the long run for participants. It likewise remains confident that participants can reduce errors substantially by obtaining and following good advice. Public comments on the proposals reinforce these conclusions.

The Department also remains confident that these actions, by relaxing rules governing arrangements under which advice can be delivered, will promote wider use of advice. However, the Department is uncertain to what extent advice will reach participants and to what extent advice that does reach them will reduce errors. To illustrate that uncertainty, the Department conducted sensitivity tests of how its estimates of the reduction in investment errors attributable to the PPA and this class exemption would change in response to alternative assumptions regarding the availability, use, and quality of advice. Table 6 summarizes the results of these tests.

TABLE 6—UNCERTAINTY IN ESTIMATE OF INVESTMENT ERROR REDUCTION

[$ billions annually]

Scenarios	Impact of PPA	Impact of class exemption	Impact of all advice	Remaining errors
Advice eliminates:				
75% of errors	$10	$10	$43	$80
50% of errors	7	7	27	88
25% of errors	3	3	13	96
After PPA/class exemption, advice reaches:				
15%/21% of DC and 60%/80% of IRA	11	8	33	82
13%/16% of DC and 50%/67% of IRA	7	7	27	88
11%/13% of DC and 40%/50% of IRA	3	4	20	95

The Department remains uncertain whether the magnitude and incidence of investment errors and the potential for correction of such errors in the context of IRAs might differ from that in the context of ERISA-covered DC plans. If a DC plan's menu of investment options is efficient then the incidence and/or magnitude of errors might be smaller than in the IRA context. If it is inefficient then errors might be more numerous and/or larger, but the potential for correcting them might be constrained. Commenters that address this issue mostly suggest that menus are efficient.

The Department remains uncertain about the mix of advice and other support arrangements that will compose the market, and about the relative effectiveness of alternative investment advice arrangements or other means of supporting participants' investment decisions. As discussed above, comments on these questions are mixed and provide no basis for the Department to revise its baseline assumption that all arrangements will be equally effective.

The Department is uncertain about the potential magnitude of any transitional costs associated with this final rule. These might include costs associated with efforts of prospective fiduciary advisers to adapt their business practices to the applicable conditions. They might also include transaction costs associated with initial implementation of investment recommendations by newly advised participants. The Department's concern over this uncertainty is modest because commenters on the proposals emphasize the industry's willingness to comply with these actions' conditions and the benefits to investors of implementing sound recommendations.

Another source of uncertainty involves potential indirect downstream effects of this final rule. Investment advice may sometimes come packaged with broader financial advice, which may include advice on how much to contribute to a DC plan. The Department has no basis to estimate the incidence of such broad advice or its effects, but notes that those effects could be large. The opening of large new markets to a variety of investment advice arrangements to which they were heretofore closed may affect the evolution of investment advice products and services and related technologies and their distribution channels and respective market shares. Other possible indirect effects that the Department lacks bases to estimate include financial market impacts of changes in investor behavior and related macroeconomic effects.

However, given that the costs of this regulation are due to the cost of providing (or paying for) investment advice, it will be incurred only to the extent that participants seek advice and anticipate improved returns on their investments. Thus, the Department remains confident that these actions will yield positive net benefits though we are uncertain of the magnitude.

E. Executive Order 12866

Under Executive Order 12866, the Department must determine whether a regulatory action is significant and therefore subject to the requirements of the Executive Order and review by the Office of Management and Budget (OMB). This action, comprising this final rule, is economically significant under section 3(f)(1) of the Executive Order because it is likely to have an effect on the economy of $100 million or more in any one year. Accordingly, the Department undertook the foregoing analysis of the action's impact. On that basis the Department believes that the action's benefits justify its costs.

F. Regulatory Flexibility Act

In the notice of proposed rulemaking, the Department certified that the proposed regulation, if adopted, would not have a significant economic impact on a substantial number of small entities. For purposes of the analysis, the Department proposed to continue its usual practice of considering a small entity to be an employee benefit plan with fewer than 100 participants. The Department consulted with the Small Business Administration Office of Advocacy concerning use of this participant count standard for Regulatory Flexibility Act purposes and requested public commenters on this issue. The Department did not receive any comments that address its use of the participant count standard and continues to consider a small entity to be an employee benefit plan with fewer than 100 participants.

The Department received a comment from a small investment advisory firm that provides investment management services to IRA beneficiaries. The commenter expressed concern that it will incur substantial cost to comply with the PPA's statutory exemption in order to continue providing investment advisory services for its IRA clients. The Department observes, however, that investment advice arrangements that were permissible before enactment of the PPA remain permissible without respect to whether they satisfy the conditions of the PPA's statutory exemption. Therefore the Department does not detect in this comment evidence of a substantial impact on a small entity.

Another commenter stated that small plan sponsors will bear an additional fiduciary burden under the statutory exemption, because it allows them to enter into investment advice arrangements with conflicted fiduciary advisers. Therefore, the commenter opined, the Department should have completed an Initial Regulatory Flexibility Analysis when proposing the regulation. The Department notes, however, that the permissibility of such arrangements is established by statute and not by this implementing regulation. The Department also notes that small plan sponsors remain free to enter into advice arrangements that are free from conflicts. Therefore the Department does not detect in this comment evidence of a substantial impact on a significant number of small entities.

In light of the foregoing, the Department hereby certifies that the final rule will not have a significant impact on a substantial number of small entities.

G. Congressional Review Act

This final rule is subject to the Congressional Review Act provisions of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801 *et seq.*) and will be transmitted to the Congress and the Comptroller General for review.

H. Unfunded Mandates Reform Act

For purposes of the Unfunded Mandates Reform Act of 1995 (Pub. L. 104–4), as well as Executive Order 12875, the final rule does not include any federal mandate that will result in expenditures by state, local, or tribal governments in the aggregate of more than $100 million, adjusted for inflation, or increase expenditures by the private sector of more than $100 million, adjusted for inflation.

I. Federalism Statement

Executive Order 13132 (August 4, 1999) outlines fundamental principles of federalism and requires the adherence to specific criteria by federal agencies in the process of their formulation and implementation of policies that have substantial direct effects on the States, the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. This final rule does not have federalism implications because it has no substantial direct effect on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Section 514 of ERISA provides, with certain exceptions specifically enumerated, that the provisions of Titles I and IV of ERISA supersede any and all laws of the States as they relate to any employee benefit plan covered under ERISA. The requirements implemented in the rule do not alter the fundamental provisions of the statute with respect to employee benefit plans, and as such would have no implications for the States or the relationship or distribution of power between the national government and the States.

J. Paperwork Reduction Act

In accordance with the requirements of the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3506(c)(2)), the notice of proposed rulemaking (NPRM) solicited commenters on the information collections included therein. The Department also submitted an information collection request (ICR) to OMB in accordance with 44 U.S.C. 3507(d), contemporaneously with the publication of the NPRM, for OMB's review. No public comments were received that specifically addressed the paperwork burden analysis of the information collections.

The Department submitted an ICR to OMB for its request of a new information collection. OMB approved the ICR on January 9, 2009, under OMB Control Number 1210–0134, which will expire on January 31, 2012.

In order to use the statutory exemption and/or the class exemption to provide investment advice to participants and beneficiaries in participant-directed DC plans and beneficiaries of IRAs (collectively hereafter, "participants"), investment advisory firms are required to make disclosures to participants and hire an independent auditor to conduct a compliance audit and issue an audit report every year. Investment advice firms following the conditions of the exemption based on disclosure of computer model-generated investment advice are required to obtain certification of the model from an eligible investment expert. The class exemption conditions its relief on establishing written policies and procedures, and both exemptions impose recordkeeping requirements. These paperwork requirements are designed to safeguard the interests of participants in connection with investment advice covered by the exemptions.

The calculation of the estimated hour and cost burden of the ICRs under the statutory and class exemption were discussed in detail in the NPRM and are summarized below.[33]

1. Final Statutory Exemption Hour and Cost Burden

The Department estimates that the third-party disclosures, computer model certification, and audit requirements for

[33] Changes made to the disclosure requirements in the final rule are specifically identified below. In addition to the disclosure requirements contained in the NPRM, the final statutory and class exemption provide that, if a computer model does not make recommendations with respect to investment options that constitute certain investment funds, products, or services, the fiduciary adviser must provide the participant or beneficiary with information explaining such funds, products, or services when the investment advice generated by the computer model is presented. For purposes of this analysis, the Department assumes that this information is readily available to the fiduciary advisor and will not necessarily have to be given to the participant in paper form. Therefore, no additional paperwork burden was added. The numbers presented also reflect a very minor update of the number of DC plan participants utilizing advice.

the final statutory exemption will require approximately 4.0 million burden hours with an equivalent cost of approximately $416.8 million and a cost burden of approximately $579.4 million in the first year. In each subsequent year the total labor burden hours are estimated to be approximately 2.1 million hours with an equivalent cost of approximately $215.6 million and the cost burden is estimated at approximately $430.1 million per year.

2. Final Class Exemption Hour and Cost Burden

The Department estimates that the third-party disclosures, the written policies and procedures, and the recordkeeping and audit requirements for the final class exemption will require a total of approximately 12.1 million burden hours with an equivalent cost of approximately $991.3 million and a total cost burden of approximately $63.2 million in the first year. In each subsequent year, the total burden hours are estimated at approximately 11.4 million hours with an equivalent cost of approximately $905.6 million and a total cost burden of approximately $63.2 million per year.

These numbers include an additional 7.7 million burden hours ($610 million in equivalent costs) in all years due to the extension in the final class exemption of the requirement that fiduciary advisers in arrangements using fee-leveling conclude that the provided advice is in the best interest of the participant or beneficiary, explain the basis of this conclusion, document the explanation within 30 days, and retain the documentation. Under the proposed class exemption, this requirement only applied to arrangements involving post-computer model or post-investment education investment advice.

3. Overall Exemption Hour and Cost Burden

The Department estimates that the third-party disclosures, the computer model certification, the written policies and procedures, and the recordkeeping and audit requirements for the statutory and class exemptions require approximately 16.1 million burden hours with an equivalent cost of approximately $1.41 billion and a cost burden of approximately $642.6 million in the first year. The labor burden hours in each subsequent year are approximately 13.5 million hours with an equivalent cost of approximately $1.12 billion and the cost burden in each subsequent year is approximately $493.3 million per year. These paperwork burden estimates are summarized as follows:

Type of Review: New collection (Request for new OMB Control Number).

Agency: Employee Benefits Security Administration, Department of Labor.

Titles: (1) Proposed Class Exemption for the Provision of Investment Advice to Participants and Beneficiaries of Self-Directed Individual Account Plans and IRAs, and (2) Proposed Investment Advice Regulation.

OMB Control Number: 1210–NEW.

Affected Public: Business or other for-profit.

Estimated Number of Respondents: 16,000.

Estimated Number of Annual Responses: 20,789,000.

Frequency of Response: Initially, Annually, Upon Request, when a material change.

Estimated Total Annual Burden Hours: 16,126,000 hours in the first year; 13,504,000 hours in each subsequent year.

Estimated Total Annual Burden Cost: $642,552,000 for the first year; $493,253,000 for each subsequent year.

List of Subjects in 29 CFR Part 2550

Employee benefit plans, Exemptions, Fiduciaries, Investments, Pensions, Prohibited transactions, Reporting and recordkeeping requirements, and Securities.

■ For the reasons set forth in the preamble, the Department amends Chapter XXV, subchapter F, part 2550 of Title 29 of the Code of Federal Regulations as follows:

SUBCHAPTER F—FIDUCIARY RESPONSIBILITY UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

PART 2550—RULES AND REGULATIONS FOR FIDUCIARY RESPONSIBILITY

■ 1. The authority citation for part 2550 is revised to read as follows:

Authority: 29 U.S.C. 1135; and Secretary of Labor's Order No. 1–2003, 68 FR 5374 (Feb. 3, 2003). Sec. 2550.401b–1 also issued under sec. 102, Reorganization Plan No. 4 of 1978, 43 FR 47713 (Oct. 17, 1978), 3 CFR, 1978 Comp. 332, effective Dec. 31, 1978, 44 FR 1065 (Jan. 3, 1978), 3 CFR, 1978 Comp. 332. Sec. 2550.401c–1 also issued under 29 U.S.C. 1101. Sections 2550.404c–1 and 2550.404c–5 also issued under 29 U.S.C. 1104. Sec. 2550.407c–3 also issued under 29 U.S.C. 1107. Sec. 2550.404a–2 also issued under 26 U.S.C. 401 note (sec. 657, Pub. L. 107–16, 115 Stat. 38). Sec. 2550.408b–1 also issued under 29 U.S.C. 1108(b)(1) and sec. 102, Reorganization Plan No. 4 of 1978, 3 CFR, 1978 Comp. p. 332, effective Dec. 31, 1978, 44 FR 1065 (Jan. 3, 1978), and 3 CFR, 1978 Comp. 332. Sec. 2550.408b–19 also issued under sec. 611, Public Law 109–280, 120 Stat. 780, 972, and sec. 102, Reorganization Plan No. 4 of 1978, 3 CFR, 1978 Comp. p. 332, effective Dec. 31, 1978, 44 FR 1065 (Jan. 3, 1978), and 3 CFR, 1978 Comp. 332. Sec. 2550.408g–1 also issued under sec. 102, Reorganization Plan No. 4 of 1978, 3 CFR, 1978 Comp. p. 332, effective Dec. 31, 1978, 44 FR 1065 (Jan. 3, 1978), and 3 CFR, 1978 Comp. 332. Sec. 2550.408g–2 also issued under 29 U.S.C. 1108(g) and sec. 102, Reorganization Plan No. 4 of 1978, 3 CFR, 1978 Comp. p. 332, effective Dec. 31, 1978, 44 FR 1065 (Jan. 3, 1978), and 3 CFR, 1978 Comp. 332. Sec. 2550.412–1 also issued under 29 U.S.C. 1112.

■ 2. Add § 2550.408g–1 to read as follows:

§ 2550.408g–1 Investment advice—participants and beneficiaries.

(a) *In general.* (1) This section provides relief from the prohibitions of section 406 of the Employee Retirement Income Security Act of 1974, as amended (ERISA or the Act), and section 4975 of the Internal Revenue Code of 1986, as amended (the Code), for certain transactions in connection with the provision of investment advice to participants and beneficiaries. This section, at paragraph (b), implements the statutory exemption set forth at sections 408(b)(14) and 408(g)(1) of ERISA and sections 4975(d)(17) and 4975(f)(8) of the Code. This section, at paragraph (d), prescribes, pursuant to section 408(a) of ERISA and section 4975(c)(2) of the Code, a class exemption for certain transactions not otherwise covered by the statutory exemption. The requirements and conditions set forth in this section apply solely for the relief described in paragraphs (b) and (d) of this section and, accordingly, no inferences should be drawn with respect to requirements applicable to the provision of investment advice not addressed by this section.

(2) Nothing contained in ERISA section 408(g)(1), Code section 4975(f)(8), this regulation or the class exemption contained herein imposes an obligation on a plan fiduciary or any other party to offer, provide or otherwise make available any investment advice to a participant or beneficiary.

(3) Nothing contained in ERISA section 408(g)(1), Code section 4975(f)(8), this regulation or the class exemption contained herein invalidates or otherwise affects prior regulations, exemptions, interpretive or other guidance issued by the Department of Labor pertaining to the provision of investment advice and the circumstances under which such advice may or may not constitute a prohibited

transaction under section 406 of ERISA or section 4975 of the Code.

(b) *Statutory exemption.* (1) General. Sections 408(b)(14) and 408(g)(1) of ERISA provide an exemption from the prohibitions of section 406 of ERISA for transactions described in section 408(b)(14) of ERISA in connection with the provision of investment advice to a participant or a beneficiary if the investment advice is provided by a fiduciary adviser under an ''eligible investment advice arrangement.'' Sections 4975(d)(17) and (f)(8) of the Code contain parallel provisions to ERISA sections 408(b)(14) and (g)(1).

(2) Eligible investment advice. For purposes of section 408(g)(1) of ERISA and section 4975(f)(8) of the Code, an ''eligible investment advice arrangement'' means an arrangement that meets either the requirements of paragraph (b)(3) of this section or paragraph (b)(4) of this section, or both.

(3) Arrangements that use fee-leveling. For purposes of this section, an arrangement is an eligible investment advice arrangement if—

(i)(A) Any investment advice is based on generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time, although nothing herein shall preclude any investment advice from being based on generally accepted investment theories that take into account additional considerations;

(B) Any investment advice takes into account investment management and other fees and expenses attendant to the recommended investments;

(C) Any investment advice takes into account, to the extent furnished by a plan, participant or beneficiary, information relating to age, time horizons (e.g., life expectancy, retirement age), risk tolerance, current investments in designated investment options, other assets or sources of income, and investment preferences of the participant or beneficiary. A fiduciary adviser shall request such information, but nothing in this paragraph (b)(3)(i)(C) shall require that any investment advice take into account information requested, but not furnished by a participant or beneficiary, nor preclude requesting and taking into account additional information that a plan or participant or beneficiary may provide;

(D) Any fees or other compensation (including salary, bonuses, awards, promotions, commissions or other things of value) received, directly or indirectly, by any employee, agent or registered representative that provides investment advice on behalf of a fiduciary adviser does not vary depending on the basis of any investment option selected by a participant or beneficiary;

(E) Any fees (including any commission or other compensation) received by the fiduciary adviser for investment advice or with respect to the sale, holding, or acquisition of any security or other property for purposes of investment of plan assets do not vary depending on the basis of any investment option selected by a participant or beneficiary; and

(ii) The requirements of paragraphs (b)(5), (6), (7), and (8) and paragraph (e) of this section are met.

(4) Arrangements that use computer models. For purposes of this section, an arrangement is an eligible investment advice arrangement if the only investment advice provided under the arrangement is advice that is generated by a computer model described in paragraphs (b)(4)(i) and (ii) of this section under an investment advice program and with respect to which the requirements of paragraphs (b)(5), (6), (7), and (8) and paragraph (e) are met.

(i) A computer model shall be designed and operated to—

(A) Apply generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time, although nothing herein shall preclude a computer model from applying generally accepted investment theories that take into account additional considerations;

(B) Take into account investment management and other fees and expenses attendant to the recommended investments;

(C) Request from a participant or beneficiary and, to the extent furnished, utilize information relating to age, time horizons (e.g., life expectancy, retirement age), risk tolerance, current investments in designated investment options, other assets or sources of income, and investment preferences; provided, however, that nothing herein shall preclude a computer model from requesting and taking into account additional information that a plan or a participant or beneficiary may provide;

(D) Utilize appropriate objective criteria to provide asset allocation portfolios comprised of investment options available under the plan;

(E) Avoid investment recommendations that:

(*1*) Inappropriately favor investment options offered by the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser over other investment options, if any, available under the plan; or

(*2*) Inappropriately favor investment options that may generate greater income for the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser; and

(F)(*1*) Except as provided in clause (*2*) of this paragraph (F), take into account all designated investment options, within the meaning of paragraph (c)(1) of this section, available under the plan without giving inappropriate weight to any investment option.

(*2*) A computer model shall not be treated as failing to meet the requirements of this paragraph merely because it does not make recommendations relating to the acquisition, holding or sale of an investment option that:

(*i*) Constitutes an investment primarily in qualifying employer securities;

(*ii*) Constitutes an investment fund, product or service that allocates the invested assets of a participant or beneficiary to achieve varying degrees of long-term appreciation and capital preservation through equity and fixed income exposures, based on a defined time horizon (such as retirement age or life expectancy) or level of risk of the participant or beneficiary, provided that, contemporaneous with the provision of investment advice generated by the computer model, the participant or beneficiary is also furnished a general description of such funds, products or services and how they operate; or

(*iii*) Constitutes an annuity option with respect to which a participant or beneficiary may allocate assets toward the purchase of a stream of retirement income payments guaranteed by an insurance company, provided that, contemporaneous with the provision of investment advice generated by the computer model, the participant or beneficiary is also furnished a general description of such options and how they operate.

(ii) Prior to utilization of the computer model, the fiduciary adviser shall obtain a written certification, meeting the requirements of paragraph (b)(4)(iv) of this section, from an eligible investment expert, within the meaning of paragraph (b)(4)(iii) of this section, that the computer model meets the requirements of paragraph (b)(4)(i) of this section. If, following certification, a computer model is modified in a manner that may affect its ability to meet the requirements of paragraph (b)(4)(i), the fiduciary adviser shall, prior to utilization of the modified model, obtain a new certification from an eligible investment expert that the computer model, as modified, meets the requirements of paragraph (b)(4)(i).

(iii) The term ''eligible investment expert'' means a person that, through employees or otherwise, has the appropriate technical training or experience and proficiency to analyze, determine and certify, in a manner consistent with paragraph (b)(4)(iv) of this section, whether a computer model meets the requirements of paragraph (b)(4)(i) of this section; except that the term ''eligible investment expert'' does not include any person that has any material affiliation or material contractual relationship with the fiduciary adviser, with a person with a material affiliation or material contractual relationship with the fiduciary adviser, or with any employee, agent, or registered representative of the foregoing.

(iv) A certification by an eligible investment expert shall—

(A) Be in writing;

(B) Contain—

(*1*) An identification of the methodology or methodologies applied in determining whether the computer model meets the requirements of paragraph (b)(4)(i) of this section;

(*2*) An explanation of how the applied methodology or methodologies demonstrated that the computer model met the requirements of paragraph (b)(4)(i) of this section;

(*3*) A description of any limitations that were imposed by any person on the eligible investment expert's selection or application of methodologies for determining whether the computer model meets the requirements of paragraph (b)(4)(i) of this section;

(*4*) A representation that the methodology or methodologies were applied by a person or persons with the educational background, technical training or experience necessary to analyze and determine whether the computer model meets the requirements of paragraph (b)(4)(i); and

(*5*) A statement certifying that the eligible investment expert has determined that the computer model meets the requirements of paragraph (b)(4)(i) of this section; and

(C) Be signed by the eligible investment expert.

(v) The selection of an eligible investment expert as required by this section is a fiduciary act governed by section 404(a)(1) of ERISA.

(5) Arrangement must be authorized by a plan fiduciary. (i) Except as provided in paragraph (b)(5)(ii), the arrangement pursuant to which investment advice is provided to participants and beneficiaries pursuant to this section must be expressly authorized by a plan fiduciary (or, in the case of an Individual Retirement Account (IRA), the IRA beneficiary) other than: The person offering the arrangement; any person providing designated investment options under the plan; or any affiliate of either. Provided, however, that for purposes of the preceding, in the case of an IRA, an IRA beneficiary will not be treated as an affiliate of a person solely by reason of being an employee of such person.

(ii) In the case of an arrangement pursuant to which investment advice is provided to participants and beneficiaries of a plan sponsored by the person offering the arrangement or a plan sponsored by an affiliate of such person, the authorization described in paragraph (b)(5)(i) may be provided by the plan sponsor of such plan, provided that the person or affiliate offers the same arrangement to participants and beneficiaries of unaffiliated plans in the ordinary course of its business.

(iii) For purposes of the authorization described in paragraph (b)(5)(i), a plan sponsor shall not be treated as a person providing a designated investment option under the plan merely because one of the designated investment options of the plan is an option that permits investment in securities of the plan sponsor or an affiliate.

(6) Annual audit. (i) The fiduciary adviser shall, at least annually, engage an independent auditor, who has appropriate technical training or experience and proficiency, and so represents in writing to the fiduciary adviser, to:

(A) Conduct an audit of the investment advice arrangements for compliance with the requirements of this section; and

(B) Within 60 days following completion of the audit, issue a written report to the fiduciary adviser and, except with respect to an arrangement with an IRA, to each fiduciary who authorized the use of the investment advice arrangement, in accordance with paragraph (b)(5) of this section, setting forth the specific findings of the auditor regarding compliance of the arrangement with the requirements of this section.

(ii) With respect to an arrangement with an IRA, the fiduciary adviser:

(A) Within 30 days following receipt of the report from the auditor, as described in paragraph (b)(6)(i)(B) of this section, shall furnish a copy of the report to the IRA beneficiary or make such report available on its Web site, provided that such beneficiaries are provided information, with the information required to be disclosed pursuant to paragraph (b)(7) of this section, concerning the purpose of the report, and how and where to locate the report applicable to their account; and

(B) In the event that the report of the auditor identifies noncompliance with the requirements of this section, within 30 days following receipt of the report from the auditor, shall send a copy of the report to the Department of Labor at the following address: Investment Advice Exemption Notification—Statutory, U.S. Department of Labor, Employee Benefits Security Administration, Room N–1513, 200 Constitution Ave., NW., Washington, DC 20210.

(iii) For purposes of this paragraph (b)(6), an auditor is considered independent if it does not have a material affiliation or material contractual relationship with the person offering the investment advice arrangement to the plan or with any designated investment options under the plan.

(iv) For purposes of this paragraph (b)(6), the auditor shall review sufficient relevant information to formulate an opinion as to whether the investment advice arrangements, and the advice provided pursuant thereto, offered by the fiduciary adviser during the audit period were in compliance with this section. Nothing in this paragraph shall preclude an auditor from using information obtained by sampling, as reasonably determined appropriate by the auditor, investment advice arrangements, and the advice pursuant thereto, during the audit period.

(v) The selection of an auditor for purposes of this paragraph (b)(6) is a fiduciary act governed by section 404(a)(1) of ERISA.

(7) Disclosure. (i) The fiduciary adviser must provide, without charge, to a participant or a beneficiary before the initial provision of investment advice with regard to any security or other property offered as an investment option, a written notification of:

(A) The role of any party that has a material affiliation or material contractual relationship with the fiduciary adviser in the development of the investment advice program, and in the selection of investment options available under the plan;

(B) The past performance and historical rates of return of the designated investment options available under the plan, to the extent that such information is not otherwise provided;

(C) All fees or other compensation that the fiduciary adviser or any affiliate thereof is to receive (including compensation provided by any third party) in connection with—

(*1*) The provision of the advice;

(*2*) The sale, acquisition, or holding of any security or other property pursuant to such advice; or

(*3*) Any rollover or other distribution of plan assets or the investment of distributed assets in any security or other property pursuant to such advice;

(D) Any material affiliation or material contractual relationship of the fiduciary adviser or affiliates thereof in the security or other property;

(E) The manner, and under what circumstances, any participant or beneficiary information provided under the arrangement will be used or disclosed;

(F) The types of services provided by the fiduciary adviser in connection with the provision of investment advice by the fiduciary adviser, including, with respect to a computer model arrangement referred to in paragraph (b)(4) of this section, any limitations on the ability of a computer model to take into account an investment primarily in qualifying employer securities;

(G) The adviser is acting as a fiduciary of the plan in connection with the provision of the advice; and

(H) That a recipient of the advice may separately arrange for the provision of advice by another adviser that could have no material affiliation with and receive no fees or other compensation in connection with the security or other property.

(ii)(A) The notification required under paragraph (b)(7)(i) of this section must be written in a clear and conspicuous manner and in a manner calculated to be understood by the average plan participant and must be sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of the information required to be provided in the notification.

(B) The appendix to this section contains a model disclosure form that may be used to provide notification of the information described in paragraph (b)(7)(i)(C) of this section. Use of the model form is not mandatory. However, use of an appropriately completed model disclosure form will be deemed to satisfy the requirements of paragraphs (b)(7)(i) and (ii) of this section with respect to such information.

(iii) The notification required under paragraph (b)(7)(i) of this section may, in accordance with 29 CFR 2520.104b-1, be provided in written or electronic form.

(iv) With respect to the information required to be disclosed pursuant to paragraph (b)(7)(i) of this section, the fiduciary adviser shall, at all times during the provision of advisory services to the participant or beneficiary pursuant to the arrangement,—

(A) Maintain accurate, up-to-date information in a form that is consistent with paragraph (b)(7)(ii) of this section,

(B) Provide, without charge, accurate, up-to-date information to the recipient of the advice no less frequently than annually,

(C) Provide, without charge, accurate information to the recipient of the advice upon request of the recipient, and

(D) Provide, without charge, to the recipient of the advice any material change to the information described in paragraph (b)(7)(i) at a time reasonably contemporaneous to the change in information.

(8) Other Conditions. The requirements of this paragraph are met if-

(i) The fiduciary adviser provides appropriate disclosure, in connection with the sale, acquisition, or holding of the security or other property, in accordance with all applicable securities laws,

(ii) Any sale, acquisition, or holding of a security or other property occurs solely at the direction of the recipient of the advice,

(iii) The compensation received by the fiduciary adviser and affiliates thereof in connection with the sale, acquisition, or holding of the security or other property is reasonable, and

(iv) The terms of the sale, acquisition, or holding of the security or other property are at least as favorable to the plan as an arm's length transaction would be.

(c) *Definitions.* For purposes of this section:

(1) The term ''designated investment option'' means any investment option designated by the plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. The term ''designated investment option'' shall not include ''brokerage windows,'' ''self-directed brokerage accounts,'' or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.

(2)(i) The term ''fiduciary adviser'' means, with respect to a plan, a person who is a fiduciary of the plan by reason of the provision of investment advice referred to in section 3(21)(A)(ii) of ERISA by the person to the participant or beneficiary of the plan and who is—

(A) Registered as an investment adviser under the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 *et seq.*) or under the laws of the State in which the fiduciary maintains its principal office and place of business,

(B) A bank or similar financial institution referred to in section 408(b)(4) of ERISA or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1)), but only if the advice is provided through a trust department of the bank or similar financial institution or savings association which is subject to periodic examination and review by Federal or State banking authorities,

(C) An insurance company qualified to do business under the laws of a State,

(D) A person registered as a broker or dealer under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*),

(E) An affiliate of a person described in any of clauses (A) through (D), or

(F) An employee, agent, or registered representative of a person described in paragraphs (c)(2)(i)(A) through (E) of this section who satisfies the requirements of applicable insurance, banking, and securities laws relating to the provision of advice.

(ii) Except as provided under 29 CFR 2550.408g–2, a fiduciary adviser includes any person who develops the computer model, or markets the computer model or investment advice program, utilized in satisfaction of paragraph (b)(4) of this section.

(3) A ''registered representative'' of another entity means a person described in section 3(a)(18) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(18)) (substituting the entity for the broker or dealer referred to in such section) or a person described in section 202(a)(17) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(17)) (substituting the entity for the investment adviser referred to in such section).

(4) ''Individual Retirement Account'' or ''IRA'' means—

(i) An individual retirement account described in section 408(a) of the Code;

(ii) An individual retirement annuity described in section 408(b) of the Code;

(iii) An Archer MSA described in section 220(d) of the Code;

(iv) A health savings account described in section 223(d) of the Code;

(v) A Coverdell education savings account described in section 530 of the Code; or

(vi) A trust, plan, account, or annuity which, at any time, has been determined by the Secretary of the Treasury to be described in any of paragraphs (c)(4)(i) through (v) of this section.

(5) An ''affiliate'' of another person means—

(i) Any person directly or indirectly owning, controlling, or holding with power to vote, 5 percent or more of the outstanding voting securities of such other person;

(ii) Any person 5 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person;

(iii) Any person directly or indirectly controlling, controlled by, or under common control with, such other person; and

(iv) Any officer, director, partner, copartner, or employee of such other person.

(6)(i) A person with a ''material affiliation'' with another person means—

(A) Any affiliate of the other person;

(B) Any person directly or indirectly owning, controlling, or holding, 5 percent or more of the interests of such other person; and

(C) Any person 5 percent or more of whose interests are directly or indirectly owned, controlled, or held, by such other person.

(ii) For purposes of paragraph (c)(6)(i) of this section, ''interest'' means with respect to an entity—

(A) The combined voting power of all classes of stock entitled to vote or the total value of the shares of all classes of stock of the entity if the entity is a corporation;

(B) The capital interest or the profits interest of the entity if the entity is a partnership; or

(C) The beneficial interest of the entity if the entity is a trust or unincorporated enterprise.

(7) Persons have a ''material contractual relationship'' if payments made by one person to the other person pursuant to contracts or agreements between the persons exceed 10 percent of the gross revenue, on an annual basis, of such other person.

(8) ''Control'' means the power to exercise a controlling influence over the management or policies of a person other than an individual.

(d) *Class exemption.* (1) General. Pursuant to section 408(a) of the Act and section 4975(c)(2) of the Code—

(i) The restrictions of sections 406(a) and 406(b) of the Act and the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A) through (F) of the Code, shall not apply to:

(A) The provision of investment advice described in section 3(21)(A)(ii) of the Act by a fiduciary adviser to a participant or beneficiary of an individual account plan that permits such participant or beneficiary to direct the investment of their individual accounts;

(B) The acquisition, holding, or sale of a security or other property pursuant to the investment advice; and

(C) except as otherwise provided in this exemption, the direct or indirect receipt of fees or other compensation by the fiduciary adviser (or any employee, agent, registered representative or affiliate thereof) in connection with the provision of the advice or in connection with an acquisition, holding, or sale of a security or other property pursuant to the investment advice, provided that the conditions set forth in paragraph (d)(2) are met;

(ii) The sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A) through (F) of the Code, shall not apply to:

(A) The provision of investment advice described in section 4975(e)(3)(B) of the Code by a fiduciary adviser to a beneficiary of an IRA that permits such beneficiary to direct the investment of the assets of his or her IRA;

(B) The acquisition, holding, or sale of a security or other property pursuant to the investment advice; and

(C) Except as otherwise provided in this exemption, the direct or indirect receipt of fees or other compensation by the fiduciary adviser (or any employee, agent, registered representative or affiliate thereof) in connection with the provision of the advice or in connection with an acquisition, holding, or sale of a security or other property pursuant to the investment advice, provided that the conditions set forth in paragraph (d)(2) of this section are met.

(2) Conditions. The relief described in paragraph (d)(1) shall be available if the fiduciary adviser—

(i) Provides investment advice in accordance with paragraphs (d)(3) or (4), or both; and

(ii) Satisfies the requirements of paragraphs (d)(5) through (10).

(3) Use of computer model or investment education. The requirements of this paragraph (d)(3) will be satisfied if:

(i) Except as provided in paragraph (d)(3)(ii), before providing other investment advice covered by this exemption, the participant or beneficiary shall be furnished with investment recommendations generated by a computer model that—

(A) Meets the requirements of paragraphs (b)(4)(i) and (ii); or

(B) Meets the requirements of paragraph (b)(4)(i) and was designed and is maintained by a person independent of the fiduciary adviser (and any of the adviser's affiliates) and utilizes methodologies and parameters determined appropriate solely by the independent person, without influence from the fiduciary adviser (or any of the adviser's affiliates); for purposes of this paragraph (d)(3)(i), a person is ''independent'' of another person if it is not an affiliate of the other person, and does not have a material affiliation or material contractual relationship with the other person.

(ii)(A) In the case of a plan that offers a ''brokerage window,'' ''self-directed brokerage account'' or similar arrangement that enables participants and beneficiaries to select investments beyond those designated by the plan, if any, before providing investment advice with respect to any investment utilizing such arrangement, the participant or beneficiary shall be furnished the material described in paragraph (d)(3)(ii)(B) and, if the plan offers designated investment options, the participant or beneficiary also shall be furnished the recommendations described in paragraph (d)(3)(i) with regard to such options.

(B) In the case of an IRA with respect to which the types or number of investment choices reasonably precludes the use of a computer model meeting the requirements of section 408(g)(3)(B) of ERISA to generate recommendations, before providing other investment advice covered by this exemption, the participant or beneficiary shall be furnished with material, such as graphs, pie charts, case studies, worksheets, or interactive software or similar programs, that reflect or produce asset allocation models taking into account the age (or time horizon) and risk profile of the beneficiary, to the extent known. Nothing shall preclude the furnishing of material, in addition to the foregoing, reflecting asset allocation portfolios of hypothetical individuals with different time horizons and risk profiles. For purposes of any materials provided pursuant to this paragraph (d)(3)(ii):

(*1*) Models must be based on generally accepted investment theories that take into account the historic returns of different asset classes (e.g., equities, bonds, or cash) over defined periods of time;

(*2*) Such models must operate in a manner that is not biased in favor of investments offered by the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser; and

(*3*) All material facts and assumptions on which such models are based (e.g., retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, and rates of return) accompany the models.

(iii) The fiduciary adviser shall retain the information furnished pursuant to paragraph (d)(3)(i) or (ii) in accordance with paragraph (e) of this section.

(4) Use of fee-leveling. Any fees or other compensation (including salary, bonuses, awards, promotions, commissions or any other thing of value) received, directly or indirectly, by an employee, agent or registered representative providing advice on behalf of the fiduciary adviser pursuant to this exemption (as distinguished from any compensation received by the fiduciary adviser on whose behalf the employee, agent or registered representative is providing such advice) do not vary depending on the basis of any investment option selected by a participant or beneficiary.

(5) Authorized by a plan fiduciary or IRA beneficiary. (i) Except as provided in paragraph (d)(5)(ii), the arrangement pursuant to which investment advice is provided to participants and beneficiaries is expressly authorized in advance by a plan fiduciary (or, in the case of an IRA, the IRA beneficiary) other than: The person offering the investment advice arrangement; any person providing designated investment options under the plan; or any affiliate of either. Provided, however, that for purposes of the preceding, in the case of an IRA, an IRA beneficiary will not be treated as an affiliate of a person solely by reason of being an employee of such person.

(ii) In the case of an arrangement pursuant to which investment advice is provided to participants and beneficiaries of a plan sponsored by the person offering the arrangement or a plan sponsored by an affiliate of such person, the authorization described in paragraph (d)(5)(i) may be provided by the plan sponsor of such plan, provided that the person or affiliate offers the same arrangement to participants and beneficiaries of unaffiliated plans in the ordinary course of its business.

(iii) For purposes of the authorization described in paragraph (d)(5)(i), a plan sponsor shall not be treated as a person providing a designated investment option under the plan merely because one of the designated investment options of the plan is an option that permits investment in securities of the plan sponsor or an affiliate.

(6) Basis for advice. (i) The investment advice—

(A) Is based on generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time; provided, however, that nothing herein shall preclude any investment advice from being based on generally accepted investment theories that take into account additional considerations;

(B) Takes into account investment management and other fees and expenses attendant to the recommended investments; and

(C) Takes into account, to the extent furnished by a plan, participant or beneficiary, information relating to age, time horizons (e.g., life expectancy, retirement age), risk tolerance, current investments in designated investment options, other assets or sources of income, and investment preferences of the participant or beneficiary. A fiduciary adviser shall request such information, but nothing in this paragraph (d)(6)(i)(C) shall require that any investment advice take into account information requested, but not furnished by a participant or beneficiary, nor preclude requesting and taking into account additional information that a plan or participant or beneficiary may provide.

(ii) In connection with the provision of the investment advice—

(A) The fiduciary adviser concludes that the advice to be provided is prudent and in the best interest of the participant or beneficiary, and explains to the participant or beneficiary—

(*1*) The basis for the conclusion,

(*2*) If applicable, why the advice includes an option(s) with higher fees than other options in the same asset class(es) available under the plan, and

(*3*) If applicable, in the case of investment advice provided pursuant to paragraph (d)(3)(i) or (ii), how the advice deviates from or relates to the information provided pursuant to such paragraphs;

(B) Not later than 30 days following the explanation described in paragraph (d)(6)(ii)(A), the employee, agent, or registered representative providing the advice on behalf of the fiduciary adviser shall document such explanation; and

(C) The fiduciary adviser retains the documentation developed pursuant to paragraph (d)(6)(ii)(B) in accordance with paragraph (e) of this section.

(7) Policies and procedures. The fiduciary adviser adopts and follows written policies and procedures that are designed to assure compliance with the conditions of this exemption.

(8) Disclosure. (i) The fiduciary adviser provides, without charge, to the participant or beneficiary before the initial provision of investment advice under the class exemption, written notification of:

(A) The role of any party that has a material affiliation or material contractual relationship with the fiduciary adviser in the development of the computer model described in paragraph (d)(3)(i) of this section or, if applicable, the materials described in paragraph (d)(3)(ii) of this section, and, to the extent applicable, in the selection of investment options available under the plan;

(B) The types of services provided by the fiduciary adviser in connection with the provision of investment advice by the fiduciary adviser, including, with respect to a computer model arrangement referred to in paragraph (d)(3)(i) of this section, any limitations on the ability of a computer model to take into account an investment primarily in qualifying employer securities; and

(C) The information described in paragraphs (b)(7)(i)(B) through (E), (G) and (H);

(ii)(A) Such notification must be written in a clear and conspicuous manner and in a manner calculated to be understood by the average plan participant and shall be sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of the information required to be disclosed;

(B) The appendix to this section contains a model disclosure form that may be used to provide the notification of information described in paragraph (b)(7)(i)(C). Use of the model disclosure form is not mandatory. However, use of an appropriately completed model disclosure form will be deemed to satisfy the requirements of paragraphs (d)(8)(i)(C) and (d)(8)(ii)(A) with respect to such information.

(iii) Such notification may, in accordance with 29 CFR 2520.104b–1, be provided in written or electronic form.

(iv) With respect to the information required to be disclosed pursuant to paragraph (d)(8)(i) of this section, the fiduciary adviser shall, at all times during the provision of advisory services to the participant or beneficiary pursuant to the arrangement—

(A) Maintain accurate, up-to-date information in a form that is consistent with paragraph (d)(8)(ii) of this section,

(B) Provide, without charge, accurate, up-to-date information to the recipient of the advice no less frequently than annually,

(C) Provide, without charge, accurate information to the recipient of the advice upon request of the recipient, and

(D) Provide, without charge, to the recipient of the advice any material change to the information described in paragraph (d)(8)(i) at a time reasonably contemporaneous to the change in information.

(9) Annual audit. (i) The fiduciary adviser shall, at least annually, engage an independent auditor, who has appropriate technical training or experience and proficiency and so represents in writing to the fiduciary adviser, to:

(A) Conduct an audit for compliance with the policies and procedures of paragraph (d)(7) of this section and the requirements of paragraph (d) of this section; and

(B) Within 60 days following the completion of the audit, issue a written report to the fiduciary adviser, and, except with respect to an arrangement with an IRA, to each fiduciary who authorized the arrangement, in accordance with paragraph (d)(5), setting forth the specific findings of the auditor regarding compliance of the arrangement with the policies and procedures of paragraph (d)(7) and the requirements of paragraph (d) of this section.

(ii) With respect to an arrangement with an IRA, the fiduciary adviser:

(A) Within 30 days following receipt of the report from the auditor, shall furnish a copy of the report to the IRA beneficiary or make such report available on its Web site, provided that such beneficiaries are provided information, with the information required to be disclosed pursuant to paragraph (d)(8) of this section, concerning the purpose of the report, and how and where to locate the report applicable to their account; and

(B) In the event that the report of the auditor identifies noncompliance with the policies and procedures required by paragraph (d)(7) or the conditions of paragraph (d) of this section, within 30 days following receipt of the report from the auditor, sends a copy of the report to the Department of Labor at the following address: Investment Advice Notification—Class Exemption, U.S. Department of Labor, Employee Benefits Security Administration, Room N–1513, 200 Constitution Ave., NW., Washington, DC 20210.

(iii) For purposes of paragraph (d)(9)(i), an auditor is considered independent if it does not have a material affiliation or material contractual relationship with the person offering the investment advice arrangement to the plan or IRA or any designated investment options under the plan or IRA.

(iv) For purposes of the audit described in paragraph (d)(9)(i), the auditor shall review sufficient relevant information to formulate an opinion as to whether the investment advice arrangements, and the advice provided pursuant thereto, offered by the fiduciary adviser during the audit period were in compliance with the policies and procedures of paragraph (d)(7) of this section and the requirements of this paragraph (d); provided, however, that nothing in this subparagraph shall preclude an auditor from using information obtained by sampling, as reasonably determined appropriate by the auditor, investment advice arrangements, and the advice pursuant thereto, during the audit period.

(v) The selection of an auditor for purposes of this paragraph (d)(9) is a fiduciary act governed by section 404(a)(1) of ERISA.

(10) Other. The requirements of paragraph (b)(8), relating to other conditions, and paragraph (e), relating to retention of records, of this section are met.

(e) *Retention of records*. The fiduciary adviser must maintain, for a period of not less than 6 years after the provision of investment advice under this section any records necessary for determining whether the applicable requirements of this section have been met. A transaction prohibited under section 406 of ERISA shall not be considered to have occurred solely because the records are lost or destroyed prior to the end of the 6-year period due to circumstances beyond the control of the fiduciary adviser.

(f) *Noncompliance*. (1) The relief from the prohibited transaction provisions of section 406 of ERISA and the sanctions resulting from the application of section 4975 of the Code described in paragraphs (b) and (d) of this section shall not apply to any transaction described in such paragraphs in connection with the provision of investment advice to an individual participant or beneficiary with respect to which the applicable conditions of this section have not been satisfied.

(2) In the case of a pattern or practice of noncompliance with any of the applicable conditions of this section, the relief described in paragraph (b) or (d) shall not apply to any transaction in connection with the provision of investment advice provided by the fiduciary adviser during the period over which the pattern or practice extended.

(g) *Applicability date*. This section shall apply to transactions described in paragraphs (b) and (d) of this section occurring on or after March 23, 2009.

Appendix to § 2550.408g–1

Fiduciary Adviser Disclosure

This document contains important information about [enter name of Fiduciary Adviser] and how it is compensated for the investment advice provided to you. You should carefully consider this information in your evaluation of that advice.

[enter name of Fiduciary Adviser] has been selected to provide investment advisory services for the [enter name of Plan]. [enter name of Fiduciary Adviser] will be providing these services as a fiduciary under the Employee Retirement Income Security Act (ERISA). [enter name of Fiduciary Adviser], therefore, must act prudently and with only your interest in mind when providing you recommendations on how to invest your retirement assets.

Compensation of the Fiduciary Adviser and Related Parties

[enter name of Fiduciary Adviser] (is/is not) compensated by the plan for the advice it provides. (if compensated by the plan, explain what and how compensation is charged (e.g., asset-based fee, flat fee, per advice)). (If applicable, [enter name of Fiduciary Adviser] is not compensated on the basis of the investment(s) selected by you.)

Affiliates of [enter name of Fiduciary Adviser] (if applicable enter, and other parties with whom [enter name of Fiduciary Adviser] is related or has a material financial relationship) also will be providing services for which they will be compensated. These services include: [enter description of services, e.g., investment management, transfer agent, custodial, and shareholder services for some/all the investment funds available under the plan.]

When [enter name of Fiduciary Adviser] recommends that you invest your assets in an investment fund of its own or one of its affiliates and you follow that advice, [enter name of Fiduciary Adviser] or that affiliate will receive compensation from the investment fund based on the amount you invest. The amounts that will be paid by you will vary depending on the particular fund in which you invest your assets and may range from __% to __%. Specific information concerning the fees and other charges of each investment fund is available from [enter source, such as: your plan administrator, investment fund provider (possibly with Internet Web site address)]. This information should be reviewed carefully before you make an investment decision.

(if applicable enter, [enter name of Fiduciary Adviser] or affiliates of [enter name of Fiduciary Adviser] also receive compensation from non-affiliated investment funds as a result investments you make as a result of recommendations of [enter name of Fiduciary Adviser]. The amount of this compensation also may vary depending on the particular fund in which you invest. This compensation may range from __% to __%. Specific information concerning the fees and other charges of each investment fund is available from [enter source, such as: your plan administrator, investment fund provider (possibly with Internet Web site address)]. This information should be reviewed carefully before you make an investment decision.

(if applicable enter, In addition to the above, [enter name of Fiduciary Adviser] or affiliates of [enter name of Fiduciary Adviser] also receive other fees or compensation, such as commissions, in connection with the sale, acquisition or holding of investments selected by you as a result of recommendations of [enter name of Fiduciary Adviser]. These amounts are: [enter description of all other fees or compensation to be received in connection with sale, acquisition or holding of investments]. This information should be reviewed carefully before you make an investment decision.

(if applicable enter, When [enter name of Fiduciary Adviser] recommends that you take a rollover or other distribution of assets from the plan, or recommends how those assets should subsequently be invested, [enter name of Fiduciary Adviser] or affiliates of [enter name of Fiduciary Adviser] will receive additional fees or compensation. These amounts are: [enter description of all other fees or compensation to be received in connection with any rollover or other distribution of plan assets or the investment of distributed assets]. This information should be reviewed carefully before you make a decision to take a distribution.

Consider Impact of Compensation on Advice

The fees and other compensation that [enter name of Fiduciary Adviser] and its affiliates receive on account of assets in [enter name of Fiduciary Adviser] (enter if applicable, and non-[enter name of Fiduciary Adviser]) investment funds are a significant source of revenue for the [enter name of Fiduciary Adviser] and its affiliates. You should carefully consider the impact of any such fees and compensation in your evaluation of the investment advice that [enter name of Fiduciary Adviser] provides to you. In this regard, you may arrange for the provision of advice by another adviser that may have not material affiliation with or receive compensation in connection with the investment funds or products offered under the plan. This type of advice is/is not available through your plan.

Investment Returns

While understanding investment-related fees and expenses is important in making informed investment decisions, it is also important to consider additional information about your investment options, such as performance, investment strategies and risks. Specific information related to the past performance and historical rates of return of the investment options available under the plan (has/has not) been provided to you by [enter source, such as: your plan administrator, investment fund provider]. (If applicable enter. If not provided to you, the information is attached to this document.)

For options with returns that vary over time, past performance does not guarantee how your investment in the option will perform in the future; your investment in these options could lose money.

Parties Participating in Development of Advice Program or Selection of Investment Options

Name, and describe role of, affiliates or other parties with whom the fiduciary adviser has a material affiliation or contractual relationship that participated in the development of the investment advice program (if this is an arrangement that uses computer models) or the selection of investment options available under the plan.

Use of Personal Information

Include a brief explanation of the following—

What personal information will be collected;

How the information will be used;

Parties with whom information will be shared;

How the information will be protected; and

When and how notice of the Fiduciary Adviser's privacy statement will be available to participants and beneficiaries.

Should you have any questions about [enter name of Fiduciary Adviser] or the information contained in this document, you may contact [enter name of contact person for fiduciary adviser, telephone number, address].

■ 3. Add § 2550.408g–2 to read as follows:

§ 2550.408g–2 Investment advice—fiduciary election.

(a) *General.* Section 408(g)(11)(A) of the Employee Retirement Income Security Act, as amended (ERISA), provides that a person who develops a computer model or who markets a computer model or investment advice program used in an ''eligible investment advice arrangement'' shall be treated as a fiduciary of a plan by reason of the provision of investment advice referred to in ERISA section 3(21)(A)(ii) to the plan participant or beneficiary, and shall be treated as a ''fiduciary adviser'' for purposes of ERISA sections 408(b)(14) and 408(g), except that the Secretary of Labor may prescribe rules under which only one fiduciary adviser may elect to be treated as a fiduciary with respect to the plan. Section 4975(f)(8)(J)(i) of the Internal Revenue Code, as amended (the Code), contains a parallel provision to ERISA section 408(g)(11)(A) that applies for purposes of Code sections 4975(d)(17) and 4975(f)(8). This section sets forth requirements that must be satisfied in order for one such fiduciary adviser to elect to be treated as a fiduciary with respect to a plan under an eligible investment advice arrangement.

(b)(1) If an election meets the requirements in paragraph (b)(2) of this section, then the person identified in the election shall be the sole fiduciary adviser treated as a fiduciary by reason of developing or marketing the computer model, or marketing the investment advice program, used in an eligible investment advice arrangement.

(2) An election satisfies the requirements of this subparagraph with respect to an eligible investment advice arrangement if the election is in writing and such writing—

(i) Identifies the investment advice arrangement, and the person offering the arrangement, with respect to which the election is to be effective;

(ii) Identifies a person who—

(A) Is described in any of 29 CFR 2550.408g–1(c)(2)(i)(A) through (E);

(B) Develops the computer model, or markets the computer model or investment advice program, utilized in satisfaction of 29 CFR 2550.408g–1(b)(4) with respect to the arrangement, and

(C) Acknowledges that it elects to be treated as the only fiduciary, and fiduciary adviser, by reason of developing such computer model, or marketing such computer model or investment advice program;

(iii) Is signed by the person identified in paragraph (b)(2)(ii) of this section;

(iv) Is furnished to the fiduciary who authorized the arrangement, in accordance with 29 CFR 2550.408g–1(b)(5); and

(v) Is maintained in accordance with 29 CFR 2550.408g–1(e).

Signed at Washington, DC, this 9th day of January, 2009.

Bradford P. Campbell,

Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

[FR Doc. E9–710 Filed 1–16–09; 8:45 am]

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