

Notices

Federal Register

Vol. 73, No. 164

Friday, August 22, 2008

This section of the FEDERAL REGISTER contains documents other than rules or proposed rules that are applicable to the public. Notices of hearings and investigations, committee meetings, agency decisions and rulings, delegations of authority, filing of petitions and applications and agency statements of organization and functions are examples of documents appearing in this section.

DEPARTMENT OF LABOR

Employee Benefits Security Administration

RIN 1210-ZA14

Proposed Class Exemption for the Provision of Investment Advice to Participants and Beneficiaries of Self-Directed Individual Account Plans and IRAs

AGENCY: Employee Benefits Security Administration, DOL.

ACTION: Notice of proposed class exemption.

SUMMARY: This document contains a notice of pendency before the Department of Labor (Department) of a proposed class exemption from certain prohibited transaction restrictions of the Employee Retirement Income Security Act of 1974, as amended (ERISA, or the Act), and from certain taxes imposed by the Internal Revenue Code of 1986, as amended (Code). If granted, the proposed exemption would permit the provision of investment advice described in section 3(21)(A)(ii) of the Act by a fiduciary adviser to a participant or beneficiary in an individual account plan or individual retirement accounts (and certain similar plans), the acquisition, holding or sale of a security or other property pursuant to the investment advice, and 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 such transactions. The proposed exemption, if granted, would affect sponsors, fiduciaries, participants and beneficiaries of participant-directed individual account plans, as well as providers of investments and investment advice-related services to such plans.

DATES: Written comments on the proposed exemption should be

submitted to the Department of Labor on or before October 6, 2008.

ADDRESSES: To facilitate the receipt and processing of comment letters, the Employee Benefits Security Administration (EBSA) encourages interested persons to submit their comments electronically by e-mail to [e-ORI@dol.gov](mailto:ORI@dol.gov) (Subject: Investment Advice Class Exemption), or by using the Federal eRulemaking portal at <http://www.regulations.gov> (follow instructions for submission of comments). Persons submitting comments electronically are encouraged not to submit paper copies. Persons interested in submitting paper copies should send or deliver their comments to the Office of Regulations and Interpretations, Employee Benefits Security Administration, Attn: Investment Advice Class Exemption, Room N-5655, U.S. Department of Labor, 200 Constitution Avenue, NW., Washington, DC 20210. All comments will be available to the public, without charge, online at <http://www.regulations.gov> and <http://www.dol.gov/ebsa> and at the Public Disclosure Room, N-1513, Employee Benefits Security Administration, U.S. Department of Labor, 200 Constitution Avenue, NW., Washington, DC 20210.

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: This document contains a notice of pendency before the Department of a proposed class exemption from the restrictions of section 406(a) and 406(b) of the Act and from the taxes imposed by section 4975(a) and (b) of the Code, by reason of section 4975(c)(1) of the Code. The Department is proposing this class exemption pursuant to section 408(a) of the Act and section 4975(c)(2) of the Code, and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (55 FR 32836, August 10, 1990).¹ All section references herein

are to sections of ERISA unless otherwise indicated.

A. Background

Section 3(21)(A)(ii) of the Act includes 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 of other property of a plan, or has any authority or responsibility to do so.² 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.

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. 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(a) 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 section 4975(d)(17) and 4975(f)(8).⁴

² See also 29 CFR 2510.3-21(c).

³ Public Law 109-280, 120 Stat. 780 (Aug. 17, 2006).

⁴ See PPA section 601(b). Under Reorganization Plan No. 4 of 1978 (43 FR 47713, October 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

¹ Section 102 of Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 1 (1996), generally transferred the authority of the Secretary of the Treasury to issue exemptions under section 4975(c)(2) of the Code to the Secretary of Labor. For purposes of this proposed exemption, references to specific provisions of Title I of the Act, unless otherwise specified, refer also to the corresponding provisions of the Code.

Section 408(b)(14) of ERISA provides that certain investment advice-related transactions will be exempt from the prohibitions of section 406 if the requirements of section 408(g) are met. Section 408(g) of ERISA requires that investment advice must be provided by a fiduciary adviser under an “eligible investment advice arrangement” that meets a “level fee” requirement (ERISA section 408(g)(2)(A)(i)) or a “computer model” requirement (ERISA section 408(g)(2)(A)(ii)). However, PPA section 601(b)(3)(C) restricts the general availability of an eligible investment advice arrangement based on utilization of a computer model for certain plans described in Code section 4975(e)(1) (collectively referred to herein as Individual Retirement Accounts or IRAs), unless the Secretary of Labor, in consultation with the Secretary of the Treasury, determines that there is a computer model investment advice program that may be utilized by an IRA to provide investment advice to the account beneficiary which meets the requirements described in PPA section 601(b)(3)(B).⁵

On December 4, 2006, the Department published two Requests for Information in the **Federal Register** soliciting information to assist the Department in the development of regulations under ERISA section 408(b)(14) and 408(g), and in making its determination with respect to the utilization of computer models for IRAs. 71 FR 70429; 71 FR 70427. Concurrent with the publication of this document, the Department reported to Congress its determination that there exist computer models that meet the requirements described in PPA section 601(b)(3)(B). In addition, appearing elsewhere in today’s **Federal Register**, the Department is publishing proposed regulations that would 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), and parallel provisions in Code section 4975.

This class exemption is intended to complement the adoption of those implementing regulations 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 encompassed in the statutory exemption or implementing regulations, as described below.

B. Overview of Proposed Class Exemption

1. General

In general, the proposed class exemption, like the statutory exemption and proposed regulations published thereunder (proposed 29 CFR 2550.408g–1), provides relief from otherwise prohibited transactions relating to the provision of investment advice to the participant or beneficiary with respect to a security or other property available as an investment under a plan or IRA; the acquisition, holding or sale of a security or other property available as an investment under a plan or IRA 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 or IRA pursuant to the investment advice.

Unlike the statutory exemption and proposed regulations, however, the class exemption would provide relief for individualized investment advice to individuals following the furnishing of recommendations generated by a computer model or, in the case of IRAs with respect to which modeling is not feasible, the furnishing of certain investment education material. 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 exemption. Also unlike the statutory exemption and proposed regulations, the class exemption, as discussed below, 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.

2. Scope of Exemption—Sections I and II

Sections I and II of the proposal define the scope of the class exemption. Section 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. Section II 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.

3. Conditions—Section III

General—Paragraphs (a)–(d)

Paragraphs (a) through (c) set forth general requirements relating to the arrangements and investment advice covered by the exemption, without regard to whether a fiduciary adviser uses a computer model or levels fees in connection with the providing of individualized investment advice. Paragraph (a) provides that the investment advice arrangement must be authorized 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. The terms designated investment options and affiliate are defined in Section IV, described below. Paragraph (a) 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 the investment advice arrangements offered by their employer under the exemption. Paragraph (b) requires that the provided investment advice be based on certain generally accepted investment theories. Paragraph (c) requires that the investment advice must take into account information furnished by a participant or beneficiary.

notice to specific sections of ERISA should be taken as referring also to the corresponding sections of the Code.

⁵ PPA section 601(b)(3)(C)(i).

Paragraph (d) of Section III requires that the fiduciary adviser must provide advice in accordance with paragraph (e) or paragraph (f) or both. As discussed below, paragraph (e) generally requires the provision of investment advice generated by a computer model in advance of providing individualized, non-computer modeled advice. Paragraph (f) requires that investment advice be provided in a manner with respect to which fees or other compensation received by an employee, agent or registered representative providing investment advice on behalf of a fiduciary adviser do not vary based on the investment option selected by the participant or beneficiary. Paragraph (d) also permit the provision of investment advice using a combination of computer generated advice and fee-leveling.

Use of Computer Models—Paragraph (e)

Paragraph (e)(1) requires that, prior to the provision of other investment advice covered by the class exemption, participants and beneficiaries must be furnished with investment recommendations generated by a computer model. The computer model must either meet the requirements of ERISA section 408(g)(3)(B) and (C)⁶ or meet the requirements of section 408(g)(3)(B) and be designed and maintained by a person independent of the fiduciary adviser (and any of the adviser's affiliates) and utilize methodologies and parameters determined appropriate solely by the independent person. If the conditions of section III are satisfied, then the class exemption provides relief, as described in sections I and II, in connection with both the investment advice generated by the computer model and the non-computer model generated investment advice subsequently provided.

In order to satisfy paragraph (e)(1), a computer model must, at least, meet the requirements of section 408(g)(3)(B) and the regulations issued thereunder

applicable to a computer model that serves as the basis of an eligible investment advice arrangement under the statutory exemption and related regulations (proposed 29 CFR 2550.408g–1(d)(1)). Additionally, unless the computer model is developed and maintained by a person independent of the fiduciary adviser (and its affiliates), the computer model must be certified, in accordance with ERISA section 408(g)(3)(C) and related regulations (proposed 29 CFR 2550.408g–1(d)(2)), as satisfying those requirements. Thus, unless the computer model is developed and maintained by an independent person, the model must meet the same requirements, including certification, as under the statutory exemption and related regulations. With respect to the inclusion of independently developed and maintained computer models under paragraph (e)(1), the Department opined in Advisory Opinion 2001–09A (Dec. 14, 2001) (AO 2001–09A) that an investment adviser providing investment advice regarding investments that pay additional fees to the adviser could avoid prohibited transaction issues under ERISA section 406(b)(1) and (3) by utilizing computer methodologies developed, maintained and overseen by an independent person to generate the advice provided. This continues to be the view of the Department.⁷ However, as with investment advice provided under the statutory exemption, the Department believes that plan participants and beneficiaries may want the flexibility to obtain other investment advice after receiving computer-generated advice, and advisers may be willing to offer such services. Accordingly, paragraph (e)(1) similarly encompasses transactions in connection with investment advice received after investment advice generated by a computer model developed and maintained by a person independent of the fiduciary adviser and its affiliates. For purposes of this paragraph, the term “independent” is defined in paragraph (h) of Section IV. The Department notes, however, that it continues to believe that what constitutes “independent” for purposes of the analysis in AO 2001–09A is an inherently factual question,⁸ and that no inferences should be drawn

with regard to the effect of the definition contained in paragraph (h) of section IV on the analysis in AO 2001–09A.

The general requirement for computer model investment advice set forth in paragraph (e)(1) also applies to IRAs, unless the fiduciary adviser determines that the types or number of investment choices available to an IRA beneficiary reasonably precludes the use of a computer model meeting of the requirements of section ERISA 408(g)(3)(B). See paragraph (e)(2) of Section III. If the fiduciary adviser so concludes, paragraph (e)(2) of Section III requires that the beneficiary be provided certain investment education-type materials, 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. Paragraph (e)(2) also sets forth some general standards intended to ensure the reasonableness and objectivity of the materials furnished. These materials, like the investment advice generated by a computer model required under paragraph (e)(1), are intended to provide a means by which a participant or beneficiary may assess the individualized advice provided by the fiduciary adviser, taking into account whether and to what extent the individualized advice deviates from the computer generated advice or education-type materials furnished in advance by the fiduciary adviser.

Paragraph (e)(3) of Section III requires that the investment advice provided does 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. Section III(e)(4), described below, imposes a specific documentation requirement with respect to any such advice. Section III(e)(3) does not apply to investment advice generated solely by use of a computer model described in paragraph (e)(1)(A) or (B) of section III.

Paragraph (e)(4) of Section III generally requires that not later than 30 days following the provision of investment advice under paragraph (e), the individual providing the advice on behalf of the fiduciary adviser must document the basis of any investment option(s) recommended to a participant or beneficiary, including an explanation

⁶In general, paragraph (3)(B) of section 408(g) provides that a computer model under an investment advice program must apply certain generally accepted investment theories, utilize relevant information about the participant, utilize prescribed objective criteria to provide asset allocation portfolios comprised of investment options available under the plan, operate in a manner that is not biased in favor of certain investments, and take into account all investment options under the plan in specifying how a participant's account balance should be invested. Paragraph (3)(C) of section 408(g) requires that a computer model utilized under an investment advice program be certified as meeting the requirements of paragraph (3)(B) by an eligible investment expert. Proposed regulations being published in today's **Federal Register** provide further guidance with respect to the computer model requirements contained in ERISA section 408(g)(3).

⁷ See Field Assistance Bulletin 2007–01 (February 2, 2007).

⁸ See AO 2001–09A, footnote 11 (“whether a party is ‘independent’ for purposes of the subject analysis will generally involve a determination as to whether there exists a financial interest (e.g., compensation, fees, etc.), ownership interest, or other relationship, agreement or understanding that would limit the ability of the party to carry out its responsibility beyond the control, direction or influence of the fiduciary”).

as to how such recommendation relates to the recommendations or information provided or generated pursuant to paragraph (e)(1) or, if applicable, paragraph (e)(2). As an example, in the case of an IRA described in paragraph (e)(2) with respect to which a fiduciary adviser provides several generic asset allocation portfolios prior to rendering investment advice, the documentation required by paragraph (e)(4) must include explanations as to the asset allocation portfolio on which the investment advice is based, including reasons for its selection or deviation from those provided, and how the recommended investments provide the appropriate asset class exposures consistent with the portfolio.

Paragraph (e)(4) further requires that with respect to any investment advice that recommends investment options that may generate for the fiduciary adviser, or certain persons, greater income than other options of the same asset class, the individual providing the investment advice on behalf of the fiduciary adviser must, not later than 30 days following its provision, document the basis for concluding that the recommendation is in the best interest of the participant or beneficiary. As with the requirements of paragraph (e)(3), this requirement does not apply to investment advice generated solely by use of a computer model described in paragraph (e)(1)(A) or (B) of Section III.

Paragraph (e)(5) provides that the documentation required by paragraph (e)(4) must be retained in accordance with the exemption's record-retention provision, section paragraph (n) of Section III, described below.

Use of Fee-Leveling—Paragraph (f)

Paragraph (f) of Section III requires that 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 the class exemption do not vary depending on the basis of any investment option selected by a participant or beneficiary. The Department notes that, in contrast to the fee-leveling requirement under the statutory exemption as described above and interpreted in proposed regulations being published in today's **Federal Register**, the fee-leveling requirement under paragraph (f) applies *only* to the individual who provides investment advice. In this regard, the Department is persuaded that the safeguards provided for in the class exemption are 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.

Disclosure—Paragraphs (g)–(h)

The disclosure provisions set forth in paragraph (g) of Section III generally track the disclosure provisions of the proposed regulations. See proposed 29 CFR 2550.408g–1(g). In this regard, paragraph (g) of Section III requires that a fiduciary adviser furnish certain information, without charge, to a participant or beneficiary in advance of the initial provision of investment advice under the class exemption, and at least once each year thereafter during which the adviser provides investment advice to the participant or beneficiary under the class exemption.

Pursuant to paragraph (g)(1), a fiduciary adviser is required to provide to participants and beneficiaries 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 the computer model described in paragraph (e)(1) or materials described in section paragraph (e)(2) of Section III 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 or IRA to the extent 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; and of any material affiliation or material contractual relationship of the fiduciary adviser or affiliates thereof in the security or other property.

The notification also is required to explain the manner, and under what circumstances, any participant or beneficiary information provided under the investment advice arrangement will be used or disclosed, and 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 that utilizes a computer model pursuant to paragraph (e)(1), any limitations on the ability of the computer model to take into account an investment option that constitutes an investment primarily in qualifying employer securities, as provided for in

proposed 29 CFR 2550.408g–1(d)(1)(v). This disclosure of limitations on a computer model's ability to take into account investments in qualifying employer securities parallels a similar requirement contained in the proposed regulations under section 408(g)(3) being published today.⁹

In addition to the foregoing, the notification must inform participants and beneficiaries that the fiduciary adviser is acting as a fiduciary of the plan in connection with the provision of the advice, and that the participants or beneficiaries may separately arrange for the provision of advice by another adviser, that could have no material affiliation with, and receives no fees or other compensation in connection with, the security or other property recommended to the participant or beneficiary.

Paragraph (g)(2)(i) provides that the information furnished pursuant to paragraph (g)(1) must be written in a clear and concise manner and in a manner calculated to be understood by the average plan participant and is sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of the information required to be disclosed. Paragraph (g)(2)(ii) notes that the appendix to proposed 29 CFR 2550.408g–1 contains a model disclosure form that may be used to provide the required notification of information described in paragraph (g)(1)(iii). Paragraph (g)(2)(ii) makes clear that use of the model is voluntary. However, use of an appropriately completed model disclosure form will be deemed to satisfy the requirements of paragraphs (g)(1) and (2)(i) with respect to such information.

Paragraph (g)(3) indicates that required notification may be provided in written or electronic form.

Paragraph (g)(4) requires that the fiduciary adviser provide, without charge, updated information to the advice recipient concerning any material change to the information required to be provided to the advice recipient under section III(g) at a time reasonably contemporaneous to the change in information.

Paragraph (h) requires that the fiduciary adviser provide appropriate disclosure, in connection with the sale, acquisition, or holding of the security or other property, in accordance with all applicable securities laws.

⁹For a description of computer model limitations, see proposed regulations published in today's **Federal Register**.

Policies and Procedures—Paragraph (i)

Paragraph (j) of Section III requires that the fiduciary adviser adopt and follow written policies and procedures that are designed to assure compliance with the conditions of the exemption. 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. In this regard, the Department notes that, as discussed below, the auditor engaged pursuant to paragraph (j) is required to review a fiduciary adviser's compliance with its policies and procedures.

Annual Audit—Paragraph (j)

The annual audit requirements of this proposed class exemption generally track the audit requirements applicable to investment advice arrangements offered under the statutory exemption and regulations issued thereunder, appearing elsewhere in today's **Federal Register**. See proposed 29 CFR 2550.408g–1(f).

Paragraph (j)(1)(i) of Section III of the proposed class exemption requires that, at least annually, the fiduciary adviser engage an independent auditor to conduct an audit, and prepare a report with respect thereto and setting forth its specific findings, to determine compliance with the policies and procedures required under paragraph (i) of Section III and the requirements of the class exemption. The auditor, within 60 days following the completion of the audit, must furnish its report to the fiduciary adviser and, except with respect to an arrangement with an IRA, to the fiduciary that authorized the investment advice arrangement, as required under paragraph (a) of Section III. The audit must be conducted by an auditor who has appropriate technical training or experience and proficiency and so represents in writing to the fiduciary adviser. Paragraph (j)(2) provides that for purposes of paragraph (j)(1), 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 person providing designated investment options under the plan or IRA.

Paragraph (j)(1)(ii) contains additional requirements that apply with respect to an arrangement with an IRA. Under this provision, the fiduciary adviser, within 30 days following receipt of the report from the auditor, as described in paragraph (j)(1)(i), must furnish a copy

of the report to the IRA beneficiary or make such report available on its *Web site*, provided, however, that with respect to availability on a *Web site*, such IRA beneficiaries must be provided information, with the information required to be furnished pursuant to section III(g)(1), 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)¹⁰ 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 solicits comments on this finding. Further, in the event that the report of the auditor identifies noncompliance with the policies and procedures required by section III(i) or the conditions of the class exemption, the fiduciary adviser, within 30 days following receipt of the report from the auditor, must send a copy of the report to the Department at the address provided in the class exemption.

Paragraph (j)(3) provides that, in conducting the audit required in (j)(1), the auditor must 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 required under paragraph (i) of Section III and the requirements of the class exemption. Paragraph (j)(3) also makes clear, however, that it does not 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.

Miscellaneous Conditions—Paragraphs (k)–(m)

Paragraphs (k)–(m) track provisions of the statutory exemption and proposed regulations, appearing elsewhere in today's **Federal Register**. See proposed 29 CFR 2550.408g–1(h). Paragraph (k) of Section III requires that the sale, acquisition or holding of a security or other property on behalf of a plan or IRA under the exemption must occur

solely at the direction of the recipient of the investment advice. Paragraph (l) requires that the compensation received by the fiduciary adviser and affiliates thereof in connection with the sale, acquisition or holding of the security or other property must be reasonable. Paragraph (m) requires that the terms of the sale, acquisition or holding of the security or other property must be at least as favorable to the plan or IRA as an arm's length transaction with an unrelated party would be.

Record Retention—Paragraph (n)

Paragraph (n) of Section III provides that the fiduciary adviser must maintain, in a manner accessible for audit or examination, for a period not less than six years after the provision of investment advice any records necessary to determine, explain or verify compliance with the conditions of the class exemption.

4. Definitions—Section IV

Section IV defines certain terms that apply for purposes of the class exemption. In general, the definitions applied for purposes of the class exemption comport with the definitions applied to terms under the statutory exemption and the proposed regulations, appearing elsewhere in today's **Federal Register**. See proposed 29 CFR 2550.408g–1(j).

As a threshold matter, this proposed class exemption would be available only in connection with investment advice provided by a fiduciary adviser. Paragraph (a) defines the term “fiduciary adviser.” This definition tracks the statutory definition of that term.

Paragraph (b) defines the term “registered representative” of another entity to mean a person described in section 3(a)(18) of the Securities Exchange Act of 1934 (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 (substituting the entity for the investment adviser referred to in such section). Paragraph (c) defines the term “individual retirement account” and paragraph (d) defines the term “affiliate” for purposes of the class exemption.

As with the proposed regulations, the proposed class exemption, at paragraphs (e) and (f), respectively, also defines the terms “material affiliation” and “material contractual relationship.” Paragraph (e)(1) defines a person with a “material affiliation” with another person as: any affiliate of the other person; any person directly or indirectly owning, controlling, or holding, 5

¹⁰ 15 U.S.C. 7004(d)(1) (2000).

percent or more of the interests of such other person; and any person 5 percent or more of whose interests are directly or indirectly owned, controlled, or held, by such other person. The Department notes that the definition of material affiliation includes an affiliate, as defined in paragraph (d) of section IV, and that, whereas the definition of affiliate focuses on voting securities owned, controlled or held, the definition of material affiliate focuses not only on the voting interests, but also on any interest. In this regard, paragraph (e)(2) defines the term "interest" for purposes of paragraph (e)(1).

Paragraph (f) provides that persons have a "material contractual relationship" if payments made by one person to the other person pursuant to written contracts or agreements between the persons exceed 10 percent of the gross revenue, on an annual basis, of such other person. The Department believes that one person's receipt of more than 10 percent of gross revenue from another person is sufficiently significant to be considered material. However, the Department specifically invites comments on whether the percentage test should be higher or lower and, if so, why.

Paragraph (g) defines "control" to mean the power to exercise a controlling influence over the management or policies of a person other than an individual.

Paragraph (h) of Section IV defines, for purposes of paragraph (e)(1) of Section III, the term "independent" to mean a person that is not an affiliate of the other person and does not have a material affiliation or material contractual relationship with the other person.

For purposes of paragraphs (a), (g)(1) and (j)(2) of Section III of the proposal, paragraph (i) of Section IV defines the term "designated investment option" 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. However, 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.

5. Effect of Noncompliance—Section V

Section V clarifies that the class exemption will not apply to any transaction (described in section I or II) 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. In addition, in the case of a pattern or practice of noncompliance with any of the conditions, the exemption will 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.

C. Effective Date

The Department is proposing an effective date for the proposed class exemption which is 90 days after the publication of the final exemption in the **Federal Register**.

D. 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) If granted, the proposed exemption will apply to a transaction only if the conditions specified in the exemption are met; and

(3) The proposed exemption, if granted, will be supplemental to, and not in derogation of, any other provisions of the Act and the Code, including statutory or administrative exemptions and transitional rules.

E. Written Comments

Interested persons are encouraged to submit written comments on the proposed exemption. Comments are due not later than 45 days after the date of publication of the proposal in the **Federal Register**. The Employee Benefits Security Administration encourages interested persons to submit their comments electronically by e-mail to e-ORI@dol.gov (Subject: Investment Advice Class Exemption). Persons submitting comments electronically are encouraged not to submit paper copies.

Persons interested in submitting paper copies should refer to the information set forth above under **ADDRESSES** for the specific information relating to the delivery comments. All comments will be available to the public, without charge, online at <http://www.dol.gov/ebsa> and at the Public Disclosure Room, N-1513, Employee Benefits Security Administration, U.S. Department of Labor, 200 Constitution Avenue, NW., Washington, DC 20210.

F. Executive Order 12866; Paperwork Reduction Act

The Department's full Regulatory Impact Analysis for the class exemption proposed herein and rules proposed under the statutory exemption for investment advice can be found in the preamble to those proposed rules appearing elsewhere in today's **Federal Register**.

G. Proposed Exemption

The Department has under consideration the grant of the following class exemption under the authority of section 408(a) of ERISA and section 4975(c)(2) of the Code, and in accordance with the procedures set forth in 29 CFR Part 2570, Subpart B (55 FR 32836, 32847, August 10, 1990).

Section I—Proposed Exemption for the Provision of Investment 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:

(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 section III below are met.

Section II—Proposed Exemption for the Provision of Investment Advice to Beneficiaries of Individual Retirement Accounts

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 Individual Retirement Account (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 section III below are met.

Section III. Conditions

(a) 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.

(b) The 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; provided, however, that nothing herein shall preclude any investment advice from being based on generally accepted investment theories that take into account additional considerations.

(c) The investment advice takes into account information furnished by a participant or beneficiary relating to age, life expectancy, retirement age, risk tolerance, other assets or sources of income and investment preferences, although nothing herein shall preclude any investment advice from taking into account additional information that a participant or beneficiary may provide.

(d) The fiduciary adviser provides advice in accordance with paragraph (e) or (f), or both.

(e)(1) Except as provided in subparagraph (2), before providing other investment advice covered by this exemption, participants and beneficiaries shall be furnished with investment recommendations generated by a computer model that—(A) meets the requirements of ERISA section 408(g)(3)(B) and (C); or (B) meets the requirements of section 408(g)(3)(B) 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);

(2) 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 investment recommendations, before providing other investment advice covered by this exemption, beneficiaries 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 subparagraph (2): (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;

(3) The investment advice provided does not recommend investment options that may generate for the fiduciary adviser or any employee, agent or registered representative, or any affiliate thereof, or any person with a

material affiliation or material contractual relationship with the foregoing, greater income than other options of the same asset class, unless the 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. This subparagraph (3) shall not apply to investment advice generated solely by use of a computer model described in clause (A) or (B) of subparagraph (1);

(4) Not later than 30 days following the provision of investment advice under this paragraph (e), the employee, agent or registered representative providing the advice on behalf of the fiduciary adviser shall document the basis of any investment option(s) recommended to a participant or beneficiary, including an explanation as to how such recommendation relates to the recommendations or information provided or generated pursuant to subparagraph (1) or (2) of this paragraph (e); and, with respect to any investment advice (other than generated solely by a computer model described in clause (A) or (B) of subparagraph (1)) that recommends investment options that may generate for the fiduciary adviser or any employee, agent or registered representative, or any affiliate thereof, or any person with a material affiliation or material contractual relationship with the foregoing, greater income than other options of the same asset class, the basis for concluding that the recommendation is in the best interest of the participant or beneficiary;

(5) Any documentation required by subparagraph (4) of this paragraph (e) shall be retained in accordance with paragraph (n) of this section.

(f) 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.

(g)(1) The fiduciary adviser provides, without charge, to the participant or beneficiary before the initial provision of investment advice under this exemption, and at least once each year thereafter during which the fiduciary adviser provides investment advice to the participant or beneficiary, written notification: (i) Of 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 (e)(1) of this section or, if applicable, the materials described in paragraph (e)(2) of this section, and, to the extent applicable, in the selection of investment options available under the plan, (ii) of the past performance and historical rates of return of the designated investment options available under the plan or IRA to the extent such information is not otherwise provided, (iii) of 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, (iv) of any material affiliation or material contractual relationship of the fiduciary adviser or affiliates thereof in the security or other property, (v) of the manner, and under what circumstances, any participant or beneficiary information provided under the arrangement will be used or disclosed, (vi) of 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 that utilizes a computer model pursuant to paragraph (e)(1), any limitations on the ability of the computer model to take into account an investment option that constitutes an investment primarily in qualifying employer securities, as provided for at 29 CFR 2550.408g-1(d)(1)(v), (vii) that the fiduciary adviser is acting as a fiduciary of the plan in connection with the provision of the investment advice, and (viii) 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 receives no fees or other compensation in connection with, the security or other property;

(2)(i) 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; (ii) the appendix to 29 CFR 2550.408g-1 contains a model disclosure form that may be used to provide the notification of information described in paragraph (g)(1)(iii). 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 (g)(1) and (2)(i) with respect to such information.

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

(4) At all times during the provision of advisory services to the participant or beneficiary pursuant to this exemption, the fiduciary adviser provides, without charge, accurate information to the recipient of the advice concerning any material change to the information required to be provided to the recipient of the advice at a time reasonably contemporaneous to the change in information.

(h) 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.

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

(j)(1) The fiduciary adviser—

(i) at least annually, engages 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, and prepare a report with respect thereto and setting forth its specific findings, to determine compliance with the policies and procedures of paragraph (i) of this section and the requirements of this exemption, and (B) within 60 days following the completion of the audit, furnish its report to the fiduciary adviser, and, except with respect to an arrangement with an IRA, to the fiduciary who authorized the arrangement pursuant to which investment advice under this exemption is provided; and

(ii) with respect to an arrangement with an IRA—(A) within 30 days following receipt of the report from the auditor, furnishes a copy of the report to the IRA beneficiary or makes such report available on its *Web site*, provided that such beneficiaries are provided information, with the information required to be disclosed pursuant to paragraph (g)(1) 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 (i) or the conditions of this exemption, 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 Class Exemption Notification, U.S. Department of Labor, Employee Benefits Security Administration, Room N-1513, 200 Constitution Ave., NW., Washington, DC 20210;

(2) for purposes of subparagraph (1), 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;

(3) for purposes of the audit described in subparagraph (1), 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 (i) of this section and the requirements of this exemption; 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.

(k) The sale, acquisition or holding of a security or other property on behalf of a plan or IRA occurs solely at the direction of the recipient of the investment advice.

(l) 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.

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

(n) The fiduciary adviser maintains, in a manner accessible for audit or examination, for a period not less than six years after the provision of investment advice under this exemption, any records necessary to determine, explain or verify compliance with the conditions of this exemption.

Section IV. Definitions

(a) **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 described in section 3(21)(A)(ii) of the Act by the person to the participant or beneficiary of the plan and who is—

(1) 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,

(2) A bank or similar financial institution referred to in section 408(b)(4) of the Act 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 which is subject to periodic examination and review by Federal or State banking authorities, or

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

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

(5) An affiliate of a person described in any of clauses (1) through (4) above, or

(6) An employee, agent, or registered representative of a person described in clauses (1) through (5) above who satisfies the requirements of applicable insurance, banking, and securities laws relating to the provision of the advice.

(b) Registered Representative—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).

(c) Individual Retirement Account or IRA means—(1) an individual retirement account described in section 408(a) of the Code; (2) an individual retirement annuity described in section 408(b) of the Code; (3) an Archer MSA described in section 220(d) of the Code; (4) a health savings account described in section 223(d) of the Code; (5) a Coverdell education savings account described in section 530 of the Code; or

(6) a trust, plan, account, or annuity which, at any time, has been determined by the Secretary of the Treasury to be described in any preceding subparagraph of this paragraph [*i.e.*, (1) through (5) above].

(d) Affiliate—unless specifically provided otherwise, an affiliate of another person means—

(1) 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;

(2) 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;

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

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

(e) Material Affiliation—(1) 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;

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

(2) For purposes of subparagraph (e)(1) of this section, the term “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.

(f) Material Contractual Relationship—persons have a “material contractual relationship” if payments made by one person to the other person

pursuant to written contracts or agreements between the persons exceed 10 percent of the gross revenue, on an annual basis, of such other person.

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

(h) Independent—for purposes of section III(e)(1), 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.

(i) 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.

Section V. Noncompliance With Terms of the Exemption

This exemption shall not apply to any transaction (described in Section I or II of this exemption) in connection with the provision of investment advice to an individual participant or beneficiary with respect to which the conditions of this exemption have not been satisfied. In addition, in the case of a pattern or practice of noncompliance with any of the conditions of this exemption, the exemption 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.

Signed at Washington, DC, this 15th day of August, 2008.

Bradford P. Campbell,

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

[FR Doc. E8-19273 Filed 8-21-08; 8:45 am]

BILLING CODE 4510-29-P