

## **What are Eligible Investment Advice Arrangements for Plan Sponsors?**

(*Italicized* words are defined on the “Terms Defined” page)

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### **Introduction:**

Prior to the Pension Protection Act of 2006 (PPA), *plan sponsors* (employers and investment committees) of retirement plans typically provided “basic” *investment education*, which was risk-free. Fiduciaries (typically the Trustees, the named Plan Administrator, and Investment Advisors to the Plan) were cautious about providing “*investment advice*” to participants, because violations of *prohibited transactions by fiduciaries* could make them personally liable and subject to fees and penalties.

A participant-directed retirement account plan, such as a 403(b) (TSA) or 401(k) plan, may qualify under ERISA Sec. 404(c), whereby the participant exercises control by self-directing their own account balance. In addition, no person who is otherwise a fiduciary, is liable under the fiduciary responsibility rules for any loss or for any breach that results from the participant’s exercise of control. However, many times the plan sponsor was not properly following the complex rules of ERISA Sec. 404(c) and/or participants weren’t receiving sufficient information to make informed investment decisions on their individual account balance.

The *Pension Protection Act of 2006(PPA)* adds a new category of a prohibited transaction *exemption* under the Code and ERISA, in connection with providing investment advice through an “*eligible investment advice arrangement*” to participants/beneficiaries who self-direct their 403(b) and 401(k) plans.

### **What is an Eligible Investment Advice Arrangement?**

An eligible investment advice arrangement is an “arrangement” whereby investment advice is provided (1) through an unbiased computer model that has been certified and audited by an independent third party, or (2) by fiduciary advisers whose investment advice service fees and commissions do not vary depending on the investment option chosen by the participant. To qualify as an eligible investment advice arrangement, certain audit, disclosure, record retention and other rules must also be met (see below under “Requirements to Qualify as an Eligible Investment Advice Arrangement”).

### **What is a Fiduciary Adviser?**

Under the new prohibited transaction exemption, qualified “*fiduciary advisers*” can offer personally tailored professional investment advice to help employees manage their individual account plans. The fiduciary adviser may be affiliated with the investment funds offered in a plan, but the advisor must meet disclosure, qualification, and other self-dealing safeguards. Fiduciary advisers are personally liable for the investment advice that they provide.

Investment advice providers, such as an Investment Advisor, a Registered Representative of a brokerage firm, and a Fiduciary Adviser, may be analyzed and “certified” through CEFEX, an international certifying body for investment fiduciaries. An annual certification of these investment advice providers provides a means to demonstrate their conformity to all fiduciary practices and their ability to manage investment decisions. In addition, the Plan Sponsor’s duties to prudently select and periodically review their advisors is greatly reduced if the investment advice provider is CEFEX-certified. Certified advisors and Fiduciary Advisers can be found on the website [www.cefex.org](http://www.cefex.org).

An Accredited Investment Fiduciary™ (AIF®) can provide consulting to the Advisor seeking certification and an Accredited Investment Fiduciary Analyst™(AIFA®) can perform the annual

fiduciary audit. To find an AIF® or AIFA®, go to [www.fi360.com](http://www.fi360.com) and look for the AIF®/AIFA® designee search icon.

### **What Fiduciary Responsibility does the Plan Sponsor have in Selecting a Fiduciary Adviser?**

The Pension Act does not exempt the Plan Sponsor from fiduciary responsibility under ERISA for the prudent selection and periodic review of the Fiduciary Adviser chosen to provide investment advice, but the Plan Sponsor doesn't have a duty to monitor the specific investment advice given by the fiduciary adviser to a participant or beneficiary. As stated in the question above, CEFEX certification greatly reduces the Plan Sponsor's duties to prudently select and periodically review their advisors. To find a certified investment advisor or Fiduciary Adviser in your area, go to the [www.cefex.org](http://www.cefex.org) website.

### **Why Would an Employer Want an Eligible Investment Advice Arrangement?**

Plan Sponsors have become reluctant to offer individual investment advice to participants that manage their own retirement accounts because of the fiduciary liability that could ensue. However, Congress is aware that most employees either (a) don't know how to properly invest their money, (b) are uncomfortable doing so, (c) are doing a poor job on self-investing, or (d) are disillusioned by the many retirement fee lawsuits eroding their investments.

With this recognition, Congress has devised a way for Plan Sponsors to offer individual investment advice without running afoul of their fiduciary responsibilities, and a means to require full disclosure of Plan fees and expenses from their Advisers. While such an arrangement is not required, it may (1) solve employee dissatisfaction in their retirement plans, (2) prevent fiduciary lawsuits for breach of plan assets, and (3) provide a method for the Plan Sponsors to **finally** receive full disclosure of plan fees and expenses of the investments. With full disclosure, the Plan Sponsor can make informed decisions regarding plan fees in choosing one Fiduciary Adviser over another, and by comparing the expenses associated with their investment products.

### **What are the Requirements to Qualify as an Eligible Investment Advice Arrangement?**

With the help of trained consultants, Fiduciary Advisers and Plan Sponsors will need to prove annually that their Plan complies with the "arrangement":

- CEFEX, an international certifying body for investment fiduciaries, uses ISO-19011, a globally recognized auditing standard, to develop an audit procedure for such "arrangements". An Accredited Investment Fiduciary™ (AIF®) can provide consulting on the "arrangement" and an Accredited Investment Fiduciary Analyst™ (AIFA®) can perform the annual "arrangement" audit for the Plan Sponsor. To find an AIF® or AIFA®, go to [www.fi360.com](http://www.fi360.com) and look for the AIF®/AIFA® designee search icon.
- The Fiduciary Adviser must provide a participant/beneficiary written notification of certain information about the plan, such as; disclosure of any related party information in the development of the "arrangement" and the investment product(s) involved, other services he or she provides in connection with investment advice, the ability of the employee to use another Adviser not affiliated with the investment products, past performance and historical rates of return for each investment option offered, and any fees or compensation the Adviser or its affiliates will receive in connection with the advice or the investment transaction. (The Secretary of Labor is directed to issue a model form for the disclosure of fees and other compensation).
- The Fiduciary Adviser is required to provide the necessary disclosures in accordance with all relevant securities laws. Any compensation received by the Adviser or its affiliates in connection with the investment transactions must be reasonable and the terms of the transaction must be no less favorable to the plan than an arm's length transaction would be.
- Fiduciary advisers must retain proof of meeting their prohibited transaction exemption requirements for a minimum of six years after providing the investment advice.

- The Plan Sponsor is not treated as failing to meet the fiduciary requirements of ERISA solely by providing investment advice as permitted under the Pension Act. This rule applies if: (1) the advice is provided under the “eligible investment advice arrangement”; (2) the terms of the arrangement require the Fiduciary Adviser to be in compliance with the requirements; and (3) the terms of the arrangement include a written acknowledgement by the Fiduciary Adviser that the Fiduciary Adviser is a plan fiduciary with regard to providing the advice.

**Can the Plan Assets Pay for the Investment Advice?**

Yes, Plan assets may be used to pay for reasonable expenses in providing investment advice.

**Does the Pension Protection Act change any current exemptions?**

No, the Pension Protection Act’s prohibited transaction exemption does not in any way change any current individual or class exemption provided by statute or administrative action.

**Conclusion:**

The Pension Protection Act of 2006 provides a Plan Sponsor with the opportunity to offer investment advice to participants and beneficiaries of its retirement plan without running afoul of the prohibited transaction rules under the Internal Revenue Code and ERISA. The key is to create an “eligible investment advice arrangement” with the help of qualified consultants and analysts that provide accurate, efficient, and cost-effective services. Fi360 (Fiduciary360) trains consultants and analysts on fiduciary practices. Their program encompasses all the legal and regulatory environment that shapes a prudent investment process and defines professional standards of care for investment fiduciaries. CEFEX (Centre for Fiduciary Excellence, LLC) is an independent certification organization that works closely with investment fiduciaries and industry experts to provide comprehensive assessment programs to improve risk management for institutional and retail investors. CEFEX certifications help determine trustworthiness of investment fiduciaries. Through their websites ([www.fi360.com](http://www.fi360.com) and [www.cefex.org](http://www.cefex.org), respectively), you can obtain names of professionals already trained and certified to meet your fiduciary needs.

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**Terms Defined**

**Eligible Investment Advice Arrangement:** an arrangement whereby investment advice is provided (1) through an unbiased computer model that has been certified and audited by an independent third party, or (2) by fiduciary advisers whose investment advice service fees and commissions do not vary depending on the investment option chosen by the participant.

**Fiduciary:** a person involved in the confidence or trust for another. It includes any person who: (1) exercises any authority or control respecting management or disposition of the plan’s assets, (2) renders investment advice for a fee or other compensation with respect to any plan moneys or property, or has the authority or responsibility to do so, or (3) has any discretionary authority or responsibility in the administration of the plan (Code Sec. 4975(e)(2) and ERISA Sec. 3(14)). Retirement plan documents name fiduciaries such as the Plan Trustee(s) and a Plan Administrator (Third-Party Administrators are not typically considered fiduciaries). Fiduciaries are also called “disqualified persons”, a term defined by the Internal Revenue Code, and “parties in interest”, a term defined by ERISA.

**Fiduciary Adviser:** a person who is a fiduciary of the plan by reason of the provision of investment advice to a participant or beneficiary and who is also:

(1) registered as an investment adviser under the Investment Advisers Act of 1940 or under laws of the state in which the fiduciary maintains its principal office and place of business;

(2) a bank, a similar financial institution supervised by the United States or a state, or a savings association (as defined under the Federal Deposit Insurance Act), but only if the advice is provided

through a trust department that is subject to periodic examination and review by federal or state banking authorities;

(3) an insurance company qualified to do business under state law;

(4) registered as a broker or dealer under the Securities Exchange Act of 1934;

(5) an affiliate of any of the preceding; or

(6) an employee, agent or registered representative or any of the preceding who satisfies the requirements of applicable insurance, banking and securities laws relating to the provision of advice (Code Sec. 4975(f)(8)(J) and ERISA Sec. 408(g)(11), as added by the Pension Act).

**Investment Advice:** specific investment advice to participants, subject to fiduciary liability rules.

**Investment Education:** plan information, general financial and investment information, asset allocation models, and interactive investment materials considered relatively risk-free.

**Investment Fiduciary:** a person advising the plan sponsor or investment committee, as opposed to the participants. In many cases, the investment advisor could be both an “investment fiduciary” to the plan, and a fiduciary adviser to the participants.

**Investment Transaction:** a sale, acquisition, or holding of a security (i.e., mutual fund, annuity, stocks and/or bonds) or other property.

**Pension Protection Act of 2006 (PPA):** In the wake of Enron and numerous other corporate accounting scandals, Congress passed the more-than-900-page Pension Act. It is the most comprehensive pension reform package in more than 30 years. The Act contains a variety of provisions. For example, it creates a prohibited transaction exemption for investment advice provided to plan participants, it provides significant provisions related to investments, portability, distribution, contribution, plan diversification, plan participation, plan reporting, and spousal protection for qualified retirement plans, as well as fiduciary rules, it strengthens the funding rules for defined benefit pension plans, it provides relief for the airlines in the form of longer amortization periods and higher amortization interest rates, and provides a number of provisions impacting, charities and charitable donations, a handful of miscellaneous provisions, and technical corrections.

**Plan Sponsor:** the company (employer) or employee organization (i.e., investment committee) sponsoring a “qualified” retirement plan.

**Prohibited Transactions by Fiduciaries** include: (1) the sale, exchange, or leasing of property, (2) the lending of money or other extension of credit, (3) the furnishing of goods, services, or facilities, (4) the transfer to, or use by or for the benefit of, the income or assets of the plan, (5) in the case of a fiduciary, any act that deals with the plan’s income or assets for the fiduciary’s own interest or account, and (6) the receipt by a fiduciary of any consideration for the fiduciary’s own personal account from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

**Qualified Retirement Plan:** a retirement plan or program given special tax treatment for meeting a host of requirements of the Internal Revenue Code and is maintained by a plan sponsor to provide retirement income to employees or results in a deferral of income by employees for periods extending generally to the end of employment or beyond, regardless of how plan contributions or benefits are calculated or how benefits are distributed.

**Related Party:** any party having a material affiliation or contractual relationship to the financial adviser.

**Disclaimer:** The information provided in this article is based upon complex rules of the Internal Revenue Code and ERISA. It is provided with the understanding that (1) the Internal Revenue Service and/or Department of Labor may revise the above rules in the future (i.e., technical corrections) and (2) will issue final regulations regarding the Pension Protection Act of 2006. The provider is not engaged in rendering legal or accounting services. The preparer disclaims any implied or actual warranties as to the accuracy of any information herein and any liability with respect thereto, even though care has been taken to present the material accurately.