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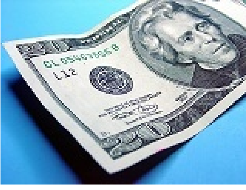
EMPLOYEES CAN NOW RECEIVE QUALITY INVESTMENT ADVICE



For persons of 401(k)-type plans and individual retirement accounts (IRAs), investment advice is an often necessary but not readily available component. This is in part due to the Employee Retirement Income Security Act of 1974 (ERISA), which was passed to protect such participants but also implemented safeguards when receiving investment advice. Investment advisors are typically prohibited from retaining any compensation from investment vehicles recommended to people with plans or IRAs, as per the ERISA and the Internal Revenue Code's regulations. As a result, valuable advice from a professional is narrow in its accessibility. The U.S. Department of Labor's Employee Benefits Security Administration (EBSA), which administers and imposes the ERISA's provisions, recently finalized its rule to executive provisions initially amended by the Pension Protection Act of 2006. The "statutory exemption" allows two ways in which professionals can receive compensation from investment advice that they have provided to participants. The first such way is investment advice based on a computer model that has been certified as unbiased and applies investment theories that are "generally accepted." The second way is that the advisor's compensation is based on a "level fee." In other words, the fees remain the same, regardless of what the participant has chosen for investments. There are further stipulations for both putative methods of providing investment advice. With regard to the application of a computer model, it must be certified before use as unbiased and meeting the requirements by an independent expert. The rule additionally suggests determining qualifications and a process of selection for the aforementioned expert who certifies the computer models. The level-fee requirement was clarified by stating that investment advisors are not permitted compensation from any party that varies based on what the participant has chosen. The updated regulations also require that the "advice arrangement" is authorized independently of the investment advisor or any of its associates. Investment advisors maintaining records is likewise required for those relying on the exemption. An annual audit should be established for both the computer models and the level-fee arrangements, managed by an auditor who is not associated with the person providing the investment advice. Advisors would also be required to supply disclosures to plan participants. The DOL hopes that the new exemption will help participants receive higher quality investment advice. Participants should benefit from lower fees and expenses, avoid excessive and poorly timed trading, be able to diversify their portfolios with less uncompensated risk, improve their level of compensated risk, or pay less excess tax. The Department predicts a reduction in "investment mistakes," from an annual cost of anywhere between seven to 18 billion dollars to a cost between two to five billion. Finally, the DOL has estimated the costs for disclosures to participants, authorization of plans, auditing of plan arrangements, and certification of computer models, costs which would likely drop in the subsequent years of implementation. The final rule will go into effect Tuesday, Dec. 27, 2011.