January 22 (updated February 5) 2009

May an adviser give retirement plan participants conflicted investment advice?

As former President Bush's Administration has ended and President Obama's Administration is beginning, the U.S. Labor department published on January 21 a final rule that's fraught with political controversy. The rule includes interpretations that some members of Congress say are contrary to the statute that the rule ostensibly interprets. These interpretations are favored by leading Republicans, and opposed by leading Democrats.

What happens next? In a joint statement on January 16, Congressmen George Miller (chairman of the House committee with jurisdiction for ERISA legislation) and Rob Andrews said they intend to "use every tool at our disposal to block implementation of this harmful regulation." And following an Inauguration Day memo from White House Chief of Staff Rahm Emanuel, the Labor department extended the rule's effective date from March 23 to May 22, and reopened the rule for further comments. This extension, published in the FEDERAL REGISTER on February 4, was signed by Deputy Assistant Secretary Alan D. Lebowitz (who has served in the Government since 1970). President Obama's nominee for Secretary of Labor, Hilda Solis, has not been confirmed, and a Senate HELP Committee executive session scheduled for February 5 was postponed.)

The delayed effective date allows the Labor department some time to revise the rule to undo its controversial interpretations. Moreover, there's a real likelihood that Congress could enact legislation that clarifies or adds to the conditions that an adviser must meet in providing investment advice. With Democrats holding more power in both the legislative and executive branches, one might expect that a change would at least restore, and could further strengthen, Democrats' views about what an adviser must do to avoid or manage a conflict of interest.

What's the fight about? The *Pension Protection Act of 2006* permits – with some conditions – a person licensed or registered under banking, insurance, or securities law to render advice about investments for which he, she, or it receives compensation from persons other than the retirement plan or the person advised. The 2006 Act attempts to protect an advised person from recommendations that could be biased or influenced by an adviser's interest in its own compensation or other business interests.

On August 22, 2008, the Labor department published its proposed rule to interpret Congress's statutory exemption. In the same issue of the FEDERAL REGISTER, the Department also proposed a class exemption to allow participant investment advice under conditions more flexible than those of the statutory exemption. On January 9, 2009, the Assistant Secretary for employee benefits signed the rule, which in its final version included both the interpretation of the statutory exemption and the additional class exemption. The final rule was published in the FEDERAL REGISTER on January 21, 2009. (There was no issue of the FEDERAL REGISTER on Monday or Tuesday, January 19 and 20 because those days generally are holidays for most U.S. Government employees.) If not withdrawn, delayed, or found invalid, the rule would apply to "transactions … occurring on or after May 22, 2009."

The published rule remains controversial. Some commenters stated views that at least one of the rule's interpretations is contrary to the statute, or at least its intent. These commenters include five powerful members of Congress: Representatives Miller and Andrews and Senators Bingaman, Grassley, and Kennedy.

Other commenters opposed to the Bush Labor department's interpretation include:

- AARP (American Association of Retired Persons),
- AFL-CIO (American Federation of Labor-Congress of Industrial Organizations),
- Consumer Federation of America,
- Financial Planning Association,
- Fund Democracy,
- NAPFA (National Association of Personal Financial Advisors),
- National Retiree Legislative Network,
- Pension Rights Center.

The Financial Planning Association reminded the Labor department that it obtained a court order declaring another agency's rule void because it was contrary to the statute it ostensibly would have interpreted.

Representative John Boehner (the House Minority Leader) and some financial-services trade associations support the "Republican" interpretation. They suggest that some imperfection in avoiding conflicts should be tolerated (and managed with disclosures and other information) to help make investment advice more widely available to retirement plan participants.

What's the argument about? There's a choice of two different ways for an investment adviser to manage its conflicts of interests.

***Advice with level fees*:** An adviser may cure self-dealing conflicts by "levelizing" fees so that total fees and compensation can't vary based on a participant's investment choices. Under the published rule's interpretation of the statutory exemption, this leveling need not relate to the fees or other compensation of those of an adviser's affiliates that are not involved in rendering the adviser's advice. Some members of Congress, including especially some who were closely involved in the legislative compromise of the statute, state that the rule's interpretation is contrary to the statute. Moreover, under the rule's class exemption, fee-leveling is required only for the human being who presents advice and not the adviser company that provides the advice, even if the adviser is the human being's employer. Because this is at least contrary to Congress's intent, this part of the rule might be void as an improper delegation of Congress's legislative power that's precluded by the United States Constitution.

***Advice "cleansed" by an independent expert*:** An adviser may avoid conflicts by rendering advice from a computer model that's approved by an independent expert. Under the statutory exemption, that independent advice must be the *only* advice. But the class exemption would permit an adviser, after first delivering the computer model's advice, to render "off-model" advice. Several commenters observed that allowing off-model advice, even when restrained by the class exemption's conditions, presents obvious opportunities for recommending investments based on the adviser's, rather than the participant's, interests. Nevertheless, the Bush Labor department found that the information that the class exemption requires along with other conditions are sufficient to enable a participant to evaluate whether an adviser's business interests compromise its recommendations.

The passing tides of time and politics will reveal the next set of answers to these questions.

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