Publications

DOL Advisory Opinion Clarifies Application of Prohibited Transaction Rules to Asset Allocation Programs

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SERVICES

The Department of Labor recently issued an advisory opinion regarding an asset allocation program offered by SunAmerica Retirement to participant-directed 401(k) plans. DOL Advisory Opinion 2001-09A (Dec. 14, 2001). This advisory opinion is an important step in clarifying application of the prohibited transaction rules to a common form of asset allocation program, where the service provider offers its own funds as a package in partnership with an independent investment adviser or through a computer model, which makes recommendations to plan participants as to how their plan assets should be invested. Importantly, this advice may include recommendations that the participant invest in affiliated mutual funds or other affiliated investments, from which the bundled service provider or its affiliates may earn fees.

The Asset Allocation Services — SunAmerica is marketing a bundled services arrangement that will include discretionary or nondiscretionary asset allocation services (as selected by the plan sponsor) to participants who direct the investment of their individual plan accounts. Under the program, SunAmerica will create for each participant a "model" asset allocation mapping to the plan's available investment options. SunAmerica will receive a typical "wrap" fee that remains the same regardless of the underlying investments. However, the underlying investment options — which will be selected by the plan sponsor — may include various investment funds advised by SunAmerica or its affiliates from which they may receive additional fees.

Although the product will be marketed by SunAmerica as a package, the non-discretionary investment advice or discretionary investment decisions will be provided by an unaffiliated investment professional retained by SunAmerica or proprietary software developed by parties unaffiliated with SunAmerica. (SunAmerica may provide non-advisory "support" to the independent expert in the form of financial information, models, and the like.) SunAmerica will have no discretion to deviate from the financial professional's determinations. Although it is not clear in all

circumstances, SunAmerica and the Department assumed that the services would be fiduciary services for purposes of the opinion.

Legal Background — Under normal circumstances, a fiduciary's selection or recommendation of an investment vehicle from which it or an affiliate may derive additional fees would constitute a prohibited transaction. A prohibited transaction would occur, for instance, if the advisory fees received by SunAmerica from the underlying investment options could vary from one asset allocation model to another. Even if the investment advice comes from an unaffiliated party, the fact that the fiduciary is selecting the third-party adviser and marketing its services as part of the "bundled" product has led to confusion as to whether those services may be attributed to the financial institution that sponsors the bundled program. Consequently, in the past the Department has issued individual exemptions covering similar arrangements, including notably PTE 97-60, 62 Fed. Reg. 59744 (Nov. 4, 1997) to the (former) Trust Company of the West (TCW); and PTE 2000-39, 65 Fed. Reg. 49018 (Aug. 10, 2000) to an affiliate of Standard and Poor's. Other financial institutions, however, have structured their programs to keep their asset allocation services within the non-fiduciary "employee education" safe-harbor of Interpretive Bulletin 96-1 (29 C.F.R. section 2509.96-1), to maintain "level" fees, or to rely on one or more prohibited transaction class exemptions.

SunAmerica originally applied for its own individual exemption. In issuing the advisory opinion, however, the Department concluded that the proposed structure would not involve a per se prohibited transaction, if in fact the investment services are performed by the unaffiliated financial expert hired by SunAmerica, by using computer software developed by persons unaffiliated with SunAmerica, or by a combination of the two. SunAmerica is not free to deviate from the decisions of the financial expert, and it must not be in a position improperly to "influence" those decisions. Under these circumstances, even though it will be marketing the investment services as its own and will accept fiduciary responsibility for them, the Department agreed that SunAmerica would not be "acting" as a fiduciary in a way that could generate higher fees for itself and its affiliates, and so would not be engaged in a prohibited transaction. The Department further noted, however, that this does not relieve SunAmerica of its fiduciary responsibility for the initial selection and ongoing monitoring of the financial expert's services.

Observations — In several respects, the opinion represents a major step for the Department and is a clear attempt to undo some of the confusion resulting from its earlier exemptions to TCW, Standard and Poor's, and others. The advisory opinion was followed on December 19 by a press release by Assistant Secretary Ann Combs. It states, among other things, that "the Department would like to remind the regulated community that exemptions will only be provided for conduct that is clearly prohibited under ERISA" — as much an admonition to the regulators as the regulated. It is widely believed that some exemption applications were made for "marketing" purposes as much as any concern over potential prohibited transactions. She also stated that "this opinion is an important precedent and will facilitate the provision of investment advice," though DOL continues to "look forward to" final passage of the Retirement Security Advice Act passed by the House of Representatives last month.

The effects of this opinion remain to be seen, but there are reasons to believe that it may have broad implications beyond the delivery of investment advice, perhaps signaling a reversal of what often appears to be a preference by Department staff for form over substance. Under normal contract and agency law (and prior DOL authority), any activities of the financial expert retained as a subcontractor by SunAmerica would be attributed to SunAmerica as if they were its own. However, while SunAmerica clearly remains liable as a fiduciary for the decisions of the financial expert, the Department now acknowledges that, for prohibited transaction purposes, taking responsibility for those decisions is not the same as making them.