



AMERICAN BENEFITS COUNCIL

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COMMENTS ON H.R. 1988: THE CONFLICTED INVESTMENT ADVICE PROHIBITION ACT OF 2009

The Conflicted Investment Advice Prohibition Act of 2009 (H.R. 1988) repeals the investment advice provision enacted in the Pension Protection Act of 2006 (“PPA”). The bill also prohibits several investment advice practices that existed prior to PPA and that do not involve conflicted advice. This document examines the non-PPA effect of H.R. 1988.

Effect on SunAmerica Arrangements.

Concern. In Advisory Opinion 2001-09A, the Department of Labor held that a financial institution is, under certain circumstances, permitted to provide investment advice through a computer model developed and administered by an independent third party that cannot benefit by reason of the advice given. This Advisory Opinion, and the arrangement structure based on it, are often referred to by the name of the financial institution involved—SunAmerica.

Except in two situations, H.R. 1988 would prohibit SunAmerica arrangements. Under one exception, SunAmerica arrangements would be permitted if the independent third party that develops the computer model accepts fiduciary responsibility for the advice provided to the participants (and meets certain other conditions, such as receiving level fees and not providing or managing any defined contribution plan assets). This occurs under some SunAmerica arrangements but not in many others where the third party does not have a contractual relationship with the plan. Third-party developers of computer models have informally indicated that, as expected, their price would increase materially if they became fiduciaries. Of course, where the third-party developer is not a fiduciary, other parties, such as the financial institutions that contract with the third party, are fiduciaries.

Under the second exception, SunAmerica arrangements would be permitted under H.R. 1988 if the arrangement is modified to comply with all of the PPA computer model requirements, including: (1) taking into account all investment options under the plan, (2) in some cases, taking into account non-retirement plan assets, (3) certification by an independent expert and annual audits, and (4) eliminating any managed account feature. Adding annual audits will add substantial cost. Requiring all plan investment options to be taken into account will require costly modifications of computer models that were developed based on specific investment options. Eliminating managed account features will, in some cases, make advice arrangements less effective.

In short, H.R. 1988 prohibits a very large number of existing investment advice arrangements that were developed based on pre-PPA law and that do not involve conflicted advice. If H.R. 1988 were enacted as it is, many of these arrangements would likely be terminated and the others would become more expensive and/or less effective.

Solution. The simplest solution is to exempt all investment advice arrangements that were permitted under pre-PPA law. This can be done very simply by repealing the PPA provision. While we would not recommend this, if the objective is to eliminate “PPA conflicted advice”, there is certainly no reason to do more than that.

As discussed below, this simple solution solves all of the concerns discussed in this paper.

Effect on Advice Provided by Financial Institutions.

Concern. Many financial institutions provide investment advice in a manner that does not involve any possible conflicts. Yet H.R. 1988 prohibits such advice solely by reason of the fact that the financial institution (or any affiliate) provides financial products to any defined contribution plan. So, for example, if a small affiliate of a financial institution provides investment management services with respect to certain small plans in one region of the country, the financial institution cannot provide investment advice to any plan in the country.

Solution. The simplest solution is the same one discussed above—preserving arrangements permitted under pre-PPA law. Pre-PPA law prohibited financial institutions from providing advice that could benefit the financial institution. That is an appropriate rule. It is not appropriate to ban a whole segment of the financial services industry from providing non-conflicted advice. This would eliminate a very knowledgeable source of investment advice and reduce competition, thus leading to a less efficient and less effective investment advice market.

Effect on Advice to Plans.

Concern. PPA did not affect advice provided to plans; PPA only addressed advice provided to participants. Yet H.R. 1988 applies its new rules to advice provided to plans. So, for example, financial institutions with no conflict of interest would be prohibited from providing advice to a plan by reason of an affiliate providing investment products to another plan.

Solution. The same simple solution discussed above would address this issue.

Extensive Disruption, Including Class Exemptions.

Concern. As discussed above, H.R. 1988 would (1) disrupt many SunAmerica arrangements, (2) ban an entire part of the financial services industry from giving non-conflicted advice to participants, and (3) ban the same entities from giving non-conflicted advice to plans. The disruption and cost associated with such a change in the law would be very significant, and would result in far less non-conflicted advice for participants and plans, as well as higher costs for the remaining advice.

Moreover, H.R. 1988 would invalidate all (or substantially all) existing Department of Labor prohibited transaction class exemptions involving investment advice provided to plans and/or participants. In other words, all (or substantially all) arrangements approved under pre-PPA law by the Department of Labor as protective of participant interests would be invalidated, causing widespread disruption of arrangements across the country. Without extensive changes in practices, there would be very significant and very broad exposure to liability.

Solution. The same simple solution discussed above would address this issue, as well as any other concerns that may be identified as H.R. 1988 is analyzed further.