Joint Committee on Taxation
November 6, 2001
JCX-73-01

DESCRIPTION OF CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 2269, THE "RETIREMENT SECURITY ADVICE ACT OF 2001"

Scheduled for a Markup by the House Committee on Ways and Means on November 7, 2001

Present Law

Present law prohibits certain transactions between an employee benefit plan and a disqualified person.[1] Disqualified persons include a fiduciary of the plan, a person providing services to the plan, and an employer with employees covered by the plan. For this purpose, a fiduciary 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.

Prohibited transactions 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. However, certain transactions are exempt from prohibited transaction treatment, for example, certain loans to plan participants.

If a prohibited transaction occurs, the disqualified person who participates in the transaction is subject to a two-tier excise tax. The first level tax is 15 percent of the amount involved in the transaction. The second level tax is imposed if the prohibited transaction is not corrected within a certain period and is 100 percent of the amount involved. The prohibited transaction rules apply to a qualified retirement plan, a qualified retirement annuity, an individual retirement account or annuity, an Archer MSA, or a Coverdell education savings account.

[1] Similar rules apply under the Employee Retirement Income Security Act of 1974 ("ERISA").

Description of Proposal

The proposal would add a new category of prohibited transaction exemption in connection with the provision of investment advice with respect to plan assets for a fee if (1) the investment of plan assets is subject to the direction of plan participants or beneficiaries, (2) the advice is provided to the plan or a participant or beneficiary by a fiduciary advisor in connection with a sale, acquisition or holding of a security or other property (an "investment transaction") for purposes of investment of plan assets, and (3) certain other requirements are met. Under the proposal, the following would be exempt from prohibited transaction treatment: (1) the provision of investment advice to the plan, participant or beneficiary, (2) an investment transaction (including any lending of money or other extension of credit associated with the investment transaction) pursuant to the advice, and (3) the direct or indirect receipt of fees or other compensation by a fiduciary advisor or affiliate (or any employee, agent or registered representative of the fiduciary advisor or affiliate) in connection with the provision of the advice or an investment transaction pursuant to the advice.

Under the proposal, certain requirements would have to be met in order for the exemption to apply. When initially providing advice about a security or other property, the fiduciary advisor would have to provide to the recipient of the advice, on a reasonably contemporaneous basis, written notification of specified information (discussed below) as well as any disclosure required in connection with the investment transaction under any applicable securities laws. In addition, the investment transaction would have to occur solely at the direction of the recipient of the advice; the compensation received by the advisor and affiliates in connection with the investment transaction would have to be reasonable; and the terms of the investment transaction would have to be at least as favorable as an arm's length transaction would be.

The written notification required to be provided by the fiduciary advisor would have to include information about the following: (1) all fees or compensation to be received by the advisor or an affiliate (including from a third party) in connection with the advice or the investment transaction, (2) any material affiliation or contractual relationship of the advisor or affiliates in the security or other property involved in the investment transaction, (3) any limitation to be placed on the scope of the investment advice, (4) the types of services provided by the advisor in connection with the provision of investment advice, and (5) the advisor's status as a fiduciary of the plan in connection with the provision of the advice. The written notification could be provided electronically. In addition, in connection with the initial advice or subsequent advice, the required information would have to be provided in currently accurate form at least annually and also when requested by the recipient of the advice and when there is a material change in the information. Any notification (or currently accurate information) would have to be written in a clear and conspicuous manner, calculated to be understood by the average plan participant, and be sufficiently accurate and comprehensive reasonably to apprise participants and beneficiaries of the required information.

The fiduciary advisor would have to maintain for at least six years any records necessary for determining whether the requirements for the prohibited transaction exemption were met. A prohibited transaction would not be considered to have occurred merely because records were lost or destroyed before the end of six years due to circumstances beyond the advisor's control.

For purposes of the proposal, “fiduciary advisor” would be defined as a person who is a fiduciary of the plan by reason of the provision of investment advice to the plan, a participant or beneficiary and who is also (1) registered as an investment advisor under the Investment Advisors Act of 1940 or under State laws, (2) a bank or similar financial institution supervised by the United States or a State, (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 representative of any of the preceding who satisfies the requirements of applicable insurance, banking and securities laws relating to the provision of advice. “Affiliate” would mean an affiliated person as defined under section 2(a)(3) of the Investment Company Act of 1940. “Registered representative” would mean a person described in section 3(a)(18) of the Securities Exchange Act of 1934 or a person described in section 202(a)(17) of the Investment Advisors Act of 1940.

Effective Date

The provision would be effective with respect to investment advice provided on or after January 1, 2002.