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RESPONSIBILITIES OF QUALIFIED PLAN FIDUCIARIES, INCLUDING FEE DISCLOSURE

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Table of Contents

	<u>Page</u>
I. WHO IS A FIDUCIARY? ERISA §3(21)(A)	1
A. Broad Definition.	1
B. Categories of Fiduciaries.	1
C. Functional Test.....	1
D. Ministerial Functions May Not Be Fiduciary Functions.	2
II. FIDUCIARY DUTIES. ERISA §404.	2
A. General ERISA Fiduciary Duties.	2
III. PLANS COVERED BY ERISA FIDUCIARY RESPONSIBILITY RULES.	
ERISA §§4; 401	3
A. Covered Plans.	3
B. Exempt Plans.	3
IV. PROHIBITED TRANSACTIONS. ERISA §406; IRC §4975	3
A. Parties in Interest.....	3
B. Express Prohibitions for Parties in Interest. ERISA §406(a)	4
C. Fiduciary Prohibited Transactions. ERISA §406(b)	4
D. Prohibited Transactions Are Per Se Violations.	4
E. Excise Tax on Prohibited Transactions. IRC §4975.	5
F. Permitted Activities.....	6
G. Prohibited Transaction Statutory Exemptions.....	6
H. Prohibited Transaction Exemptions Under Pension Protection Act of 2006.	7
V. FEE DISCLOSURE	7
A. Overview.....	7
B. Revised Form 5500 Schedule C: Reporting of Direct and Indirect Compensation to Service Providers (2009 Plan Year).	8
C. Proposed Amendment to ERISA 408(b)(2) Regulation Implementing Statutory Exemption Permitting Parties in Interest to Provide Service to Plans.	11

VI.	PARTICIPANT DIRECTION OF RETIREMENT PLAN INVESTMENTS.	
	ERISA §404(c).	14
A.	§404(c) Relief From Some ERISA Standards.....	14
B.	Compliance Not Mandatory; Failure to Comply with Section 404(c).....	14
C.	No Standard for Other Fiduciary Decisions.....	14
D.	Section 404(c) Requirements. 29 CFR §2550.404c-1.....	14
E.	Retained Fiduciary Duties.....	15
F.	Default Investments.....	16
G.	Section 404(c) Coverage During Conversion Blackouts and Mapping.....	17
H.	Investment Advice to Plan Participants.....	17
I.	Sarbanes-Oxley Act of 2002 (SOA).....	18
VII.	DOL GUIDANCE FOR FIDUCIARIES.	19
A.	Meeting Your Fiduciary Responsibilities.....	19
B.	Essential Elements of a Plan.....	19
C.	Information to be Provided to Employees.....	20
D.	Tips for Employers with Retirement Plans.....	20
VIII.	ALLOCATION OF ADMINISTRATIVE EXPENSES BETWEEN PLAN AND EMPLOYER. DOL ADVISORY OPINION 2001-O1A; DOL FIELD ASSISTANCE BULLETIN 2003-3.	21
A.	Plan Assets May Be Used to Pay Reasonable Administrative Expenses. ERISA §404(a)(1)(A).....	21
B.	Early Department of Labor Rulings.....	21
C.	DOL List of Plan Expenses.....	21
D.	Department of Labor opinions.....	22
E.	Allocation of Expenses to Former Employees.....	24
F.	Employer Deduction of Plan Expenses.....	24

DOL Fact Sheet — Proposed Regulations Relating to Service Provider Disclosures
Under ERISA Section 408(b)(2)

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I. WHO IS A FIDUCIARY? ERISA §3(21)(A)

A. Broad Definition.

ERISA provides a broad definition of who is a fiduciary. The term includes any person or entity who:

1. exercises any discretionary authority or control with respect to a plan. ERISA §3(21)(A)(i);
2. exercises any authority or control with respect to the management or disposition of a plan's assets. ERISA §3(21)(A)(i);
3. renders investment advice with respect to a plan's assets for a fee or other compensation or has authority or responsibility to do so. ERISA §3(21)(A)(ii); or
4. has discretionary authority or responsibility with respect to the administration of the plan. ERISA §3(21)(A)(iii).

B. Categories of Fiduciaries.

The following persons will be considered to be fiduciaries:

1. Plan trustees;
2. Plan administrator;
3. Members of investment or administrative committee;
4. Investment manager; or
5. Any person who selects or appoints any of these people.

C. Functional Test.

There is generally no consent necessary for a person to be considered a fiduciary. If a person has or exercises authority or control over or oversees or engages in the

activities listed in ERISA §3(21)(A), he or she can be a fiduciary. *Mertens v. Hewitt Associates*, 508 U.S. 248 (1993).

D. Ministerial Functions May Not Be Fiduciary Functions.

1. Persons who perform purely ministerial functions within the framework of policies, interpretations, rules, practices, and procedures established by fiduciaries are generally not fiduciaries. DOL Reg. (29 CFR) §2509-75-8, Q&A D-2.
2. Ministerial functions may include:
 - a. application of rules determining plan eligibility for benefits;
 - b. calculation of benefits;
 - c. preparation of employee communication materials;
 - d. maintenance of employee service records;
 - e. preparation of required government reports or other reports concerning participants;
 - f. orientation of new employees to rights under plan;
 - g. collection of contributions and allocation of contributions as provided in plan;
 - h. processing of claims.
3. It may be difficult to distinguish between ministerial duties and management responsibilities.
4. Attorneys, accountants, actuaries, consultants, and advisers (other than investment advisers) will not normally be considered fiduciaries in the performance of their normal duties. It is possible, however, for consultants to be fiduciaries. DOL Reg. (29 CFR) §2509-75-5.

II. FIDUCIARY DUTIES. ERISA §404.

A. General ERISA Fiduciary Duties.

1. To act solely in the interest of plan participants and beneficiaries. ERISA §404(a)(i);
2. To act for the exclusive purpose of providing benefits to plan participants and their beneficiaries and defraying reasonable expenses in administering the plan. ERISA §404(a)(1)(A);
3. To exercise the same care, skill, prudence and diligence that a prudent person acting in a like capacity and familiar with such matters would exercise in the conduct of an enterprise of a like character and with like aims. ERISA §404(a)(1)(B);

4. to diversify plan investments so as to minimize the risk of large losses (unless it is clearly not prudent to do so under the circumstances). ERISA §404(a)(1)(C);
5. To act in accordance with the documents and instruments governing the plan (unless the documents are inconsistent with ERISA). ERISA §404(a)(1)(D); and
6. No fiduciary may maintain indicia of ownership of any assets outside jurisdiction of U.S. district courts. Exceptions in DOL Reg. §2550.404b-1.

III. PLANS COVERED BY ERISA FIDUCIARY RESPONSIBILITY RULES. ERISA §§4; 401

A. Covered Plans.

Employee benefit plans (welfare plans and retirement plans) maintained by an employer or an employee organization.

B. Exempt Plans.

Plans exempt from rules:

1. Government plans.
2. Church plans for which no election has been made to have provisions of ERISA apply.
3. Plan maintained solely for complying with workers compensation, unemployment or disability insurance laws.
4. Plan maintained outside U.S. primarily for benefit of persons substantially all of whom are nonresident aliens.
5. Excess benefit plan which is unfunded.
6. Unfunded plans maintained by employers primarily to provide deferred compensation to select group of managers or highly compensated employees ("top-hat plans").
7. Agreement described in IRC §736 which provides payments to retired or deceased partner or deceased partner's successor in interest.
8. Keogh plan covering only owner-employees.

IV. PROHIBITED TRANSACTIONS. ERISA §406; IRC §4975

A. Parties in Interest

ERISA §406 lists certain persons or entities defined as "parties in interest". IRC §4975 defines a similar group as "disqualified persons". This group includes:

1. The employer.
2. Any person providing services to a plan (e.g., if attorney, accountant, actuary, or TPA is paid by the plan, that person is a party in interest).
3. Fiduciaries of the plan.
4. Certain employees covered by the plan.

B. Express Prohibitions for Parties in Interest. ERISA §406(a)

The Plan and the Parties in Interest are expressly prohibited from engaging in any of the following transactions:

1. sale, exchange or leasing of any property between the plan and a party-in-interest. ERISA §406(a)(1)(A);
2. lending of money or other extension of credit between a plan and a party-in-interest. ERISA §406(a)(1)(B);
3. furnishing of goods, services or facilities between the plan and a party-in-interest. ERISA §406(a)(1)(C);
4. transfer to, or use by or for the benefit of a party-in-interest of any asset of the plan. ERISA §406(a)(1)(E).

C. Fiduciary Prohibited Transactions. ERISA §406(b)

In addition to the prohibited transactions listed in ERISA §406(a), ERISA §406(b) prohibits fiduciaries from:

1. Dealing with plan assets in the fiduciary's own interest or for the fiduciary's own account;
2. Acting in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan or its participants or beneficiaries; or
3. Receiving any consideration for the fiduciary's own personal account from any person dealing with the plan in connection with any transaction involving plan assets.

D. Prohibited Transactions Are Per Se Violations.

A Party in Interest cannot enter into a prohibited transaction or cause or allow a plan to do so regardless of motives.

1. Even if transactions would be considered fair and reasonable and show no evidence of scandal or bad faith.
2. Penalty is personal liability for any losses or repayment of any benefit or profit received by the Party in Interest.

- E. Excise Tax on Prohibited Transactions. IRC §4975.
1. IRC §4975 provides for an excise tax in the amount of 15% of the amount involved in the prohibited transaction for the period beginning on the date on which the prohibited transaction occurs and ending on the earliest of:
 - a. when the transaction is corrected;
 - b. when a deficiency notice is issued; or
 - c. the date the tax is assessed. IRC §4975(f)(2).
 2. The excise tax is assessed annually for each year that the prohibited transaction is outstanding.
 3. The excise tax for prohibited transactions occurring prior to August 20, 1996 was 5% of the amount involved in the transaction. It was 10% for prohibited transactions occurring from August 20, 1996 to August 5, 1997, and was increased to 15% for prohibited transactions occurring after August 5, 1997.
 - a. In Revenue Ruling 2002-43, the IRS stated that the applicable excise tax rate for each prohibited transaction is the rate in effect in the first year that the transaction occurred. The rate is then applicable to all years of the prohibited transaction.
 4. Although an additional second tier 100% tax may be assessed if the transaction is not corrected within the applicable period, the party in interest/disqualified person has an additional ninety (90) days to correct the transaction and avoid the additional tax. IRC §4975(b).
 5. The excise taxes on prohibited transactions are assessed against the party in interest/disqualified person involved in the transaction, not against the plan. IRC §4975(a) and (b).
 6. The amount involved in a loan for purposes of the excise tax is the interest on the loan amount, not the entire amount of the loan.
 7. Prohibited transaction excise taxes are paid with the filing of IRS Form 5330.
 8. Prohibited Transaction Example.
 - a. Party in Interest sells real estate to plan for \$200,000 on 12/15/2001 and corrects transaction on 1/15/2004.

b. Excise tax calculation:

1)	2001:	\$200,000	x	.15	\$ 30,000
2)	2002:	\$200,000	x	.15	\$ 30,000
3)	2003:	\$200,000	x	.15	\$ 30,000
4)	2004:	\$200,000	x	.15	\$ 30,000
5)	Total Excise Tax:				\$120,000

F. Permitted Activities.

ERISA does not prohibit fiduciaries from:

1. Receiving any benefit from a plan for which the fiduciary is entitled as a participant or beneficiary, calculated and paid on a basis consistent with all other participants and beneficiaries.
2. Receiving reasonable compensation for services rendered, or reimbursement of expenses incurred, while performing services for the plan.
 - a. If fiduciary receives full-time pay from employer or union sponsoring the plan, payment is limited to reimbursement for expenses properly incurred.
3. Serving as a fiduciary in addition to being an officer, employee, agent or other representation of a party in interest.

G. Prohibited Transaction Statutory Exemptions.

1. Certain loans to participants and beneficiaries.
2. Reasonable arrangements with parties in interest for office space and for legal, accounting, or other services needed for the plan.
3. Certain loans to ESOPs.
4. Certain investments by plans in deposits in banks or similar financial institutions whose employees are covered by the plans.
5. Certain contracts for insurance between a plan and an employer maintaining the plan or party in interest.
6. Provision of ancillary bank services to a plan by a bank or similar financial institution that is a fiduciary of the plan.
7. Exercise by a plan of a privilege to convert securities.
8. Various transactions between a bank and certain common or collective trust funds or pooled investment funds.
9. Distribution by a fiduciary of plan assets in accordance with the plan and ERISA.

10. Transactions required or permitted in accordance with withdrawal provisions in multi-employer plans.
11. Mergers of multi-employer plans, or transfers of assets between multi-employer plans where the PBGC determines they meet ERISA requirements.
12. Qualified transfers of assets from single-employer defined benefit plans to qualified retiree health accounts.

H. Prohibited Transaction Exemptions Under Pension Protection Act of 2006.

1. An exemption permits service providers that are not fiduciaries and have no other relationship to a plan to engage in sales, exchanges, leases, and loans with plans, as long as the plan receives adequate consideration.
2. Parties that engage in prohibited transactions involving securities or commodities are given 14 days from the discovery of the prohibited transaction to take corrective action without incurring a penalty. This relief is not available to parties that know or should have known that the transaction was prohibited or for transactions involving employer securities.
3. Investment funds and limited partnerships will not be treated as ERISA fiduciaries if investments by ERISA-covered plans account for less than 25 percent of assets of the investment fund or limited partnership. Under prior law, the investments of non-ERISA governmental and foreign plans were also taken into account.
4. An exemption for providing investment advice to plan participants is effective for advice provided after December 31, 2006. The exemption is discussed in greater detail at section VI.H. of this chapter.

V. FEE DISCLOSURE

A. Overview.

1. The impetus for greater fee disclosure for tax-qualified retirement plans (particularly 401(k) plans) has come from four separate sources:
 - a. Revised Form 5500 Schedule C - Reporting of direct and indirect compensation to service providers to tax-qualified plans.
 - b. Department of Labor Proposed Amendments to ERISA Section 408(b)(2) Regulation relating to source provider disclosures.
 - c. Participant litigation relating to 401(k) fees.
 - d. Pending Federal fee disclosure legislation.

B. Revised Form 5500 Schedule C: Reporting of Direct and Indirect Compensation to Service Providers (2009 Plan Year).

1. Plan sponsors of ERISA-covered employee benefit plans generally must file an annual report for the plan on Form 5500. For plans covering more than 100 employees, the Form 5500 must include a complete Schedule C, setting forth information about fees of \$5,000 or more paid by the plan for the provision of services.
2. The revised Schedule C:
 - a. Broadens the definition of "service provider" whose compensation must be reported,
 - b. Provides for reporting of "direct compensation" paid to service providers, and
 - c. For the first time, requires reporting on indirect compensation received by service providers.

3. Service Provider Redefined.

Under revised Schedule C, the term "service provider" is defined to include any person who provides services directly to a plan or to another service provider to a plan, as well as any person who provides services in connection with a transaction involving a plan.

4. Direct Compensation.

Revised Schedule C distinguishes between "direct" and "indirect" compensation paid to service providers. The instructions define "direct compensation" as compensation paid directly by a plan or a plan sponsor to a service provider, as well as compensation paid or debited directly from a plan account. Direct compensation does not include payments made by the plan sponsor that are not reimbursed by the plan. The revised Schedule C requires the plan sponsor to: (a) identify each service provider (subject to the \$5,000 threshold), (b) describe the relationship of the service provider to the plan sponsor (or to any person known to be a party in interest to the plan), (c) provide the total direct compensation paid to the service provider, and (d) provide a statement of whether the service provider received any "indirect compensation". If a service provider received direct compensation from several plans, the service provider may use any reasonable method of allocating the compensation among the plans.

5. Reporting Indirect Compensation — General Rule.

"Indirect Compensation" is defined in the instructions as all compensation other than direct compensation, received by a service provider in connection with services provided to the plan or in connection with a person's position with a plan. The instructions indicate that compensation is received "in connection with" services provided to the plan or a person's

position with a plan if the payment is based, in whole or in part, on services provided to the plan or on one or more transactions involving the plan. Indirect compensation does not include compensation that a person would have received if the service for, or transaction involving, a plan had not occurred.

- a. Indirect compensation includes fees and expense reimbursement payments received from mutual funds, bank commingled trusts, insurance company pooled investment funds in which a plan invests, if the payments are charged against the fund or account and are reflected in the value of the plan's investment. The DOL explanation accompanying revised Schedule C indicates that these fees include "management fees paid by a mutual fund to its investment adviser, sub-transfer agency fees, shareholder servicing fees, account maintenance fees, and 12b-1 distribution fees..." (even if the recipients of these funds provide their services only to the fund). The explanation also indicates that other examples of indirect compensation are finder's fees, float revenue, brokerage commissions, research, other products or services received from a broker-dealer or other third party in connection with securities transactions, and other transaction-based fees received in connection with transactions or services involving a plan.
- b. If a service provider receives total compensation of \$5,000 or more that includes any indirect compensation, the revised Schedule C must (unless the special rule for "eligible indirect compensation" is applicable) include: (i) the service provider's name and tax identification number, (ii) a statement that the service provider received indirect compensation, and (iii) the total amount of the indirect compensation received by the service provider (actual or estimated). If a service provider receives indirect compensation but is unable to determine the specific amount of the compensation, the revised Schedule C must include a description of the method or formula used by the service provider to determine the amount of the indirect compensation.
- c. If a service provider is a plan fiduciary or provides contract administration, consulting, investment advisory, investment management, brokerage or recordkeeping services and received \$1,000 or more in indirect compensation from any source, then the revised Schedule C must include, for each person paying such indirect compensation: (i) the payor's name and tax identification number, (ii) a statement of the total indirect compensation received by the service provider from the payor, and (iii) a description of the indirect compensation and any formula used to determine the amount of the indirect compensation.

6. Special Rule for "Eligible Indirect Compensation".

Under revised Schedule C, a plan sponsor is not required to separately report "eligible indirect compensation" received by a plan service provider. Moreover, if a service provider receives only eligible indirect

compensation and certain disclosures are made to the plan, the plan sponsor is only required to report the name and tax identification number of any service provider (or the name and taxpayer identification number of any other person who provided the plan sponsor with the required information about eligible indirect compensation received by the service provider).

- a. "Eligible indirect compensation" is defined as indirect compensation that is received by a service provider as fees charged to investment funds in which a plan invests that are reflected in the value of the investment or in the return on investment and that constitute compensation for distribution, investment management, recordkeeping or shareholder services or that constitute commissions, finder's fees, float revenue, other transaction-based fees or "soft dollar" revenue.
- b. To take advantage of the alternative reporting method for eligible indirect compensation, a plan sponsor must certify on revised Schedule C that it has been provided with written or electronic materials that disclose the following:
 - i. The existence of eligible indirect compensation;
 - ii. The services provided for the indirect compensation or the purpose for the payment of the indirect compensation;
 - iii. The amount, or an estimate, of the compensation "or a description of the formula used to calculate or determine the compensation"; and
 - iv. The identity or the party or parties paying and receiving the compensation.

7. Excludable Non-Monetary Compensation.

Revised Schedule C provides that non-monetary compensation, such as business meals, gifts, promotional items and the like, need not be reported if it is both insubstantial and tax deductible to the person paying the compensation. The revised Schedule C defines "insubstantial" as gifts or gratuities valued at less than \$50 that do not in the aggregate exceed \$100 annually from any single source. Gifts of \$10 or less need not be counted for purposes of the \$100 threshold, but all such compensation must be reported if the \$100 threshold is reached or exceeded. Multiple employees of one service provider entity should probably be treated as from a single source for purposes of the \$100 threshold.

8. Insurance Commissions.

Service provider compensation that consists only of insurance fees and commissions (which are reported currently on Schedule A of Form 5500) need not be reported on revised Schedule C.

9. Bundled Service Arrangements.

Revised Schedule C provides that the "lead service provider" in a bundled service arrangement generally may report all direct compensation received in connection with the arrangement. If, however, another service provider in the bundled arrangement receives compensation that is (i) a separate charge directly against a plan's investment reflected in the net value of the investment or (ii) paid on a transactional basis, that service provider's direct compensation must be reported separately.

- a. For service providers in a bundled arrangement that are fiduciaries or that provide contract administration, consulting, investment advisory, investment management, brokerage, or recordkeeping services, the plan sponsor must report indirect compensation separately (as discussed above) regardless of whether direct compensation received by the service provider is included in a report by a lead service provider.

10. Service Providers That Fail or Refuse to Provide Information.

If a service provider fails to provide a plan sponsor with the information needed to complete revised Schedule C, the plan sponsor must report the name and tax identification number of the service provider and a description of the information that was not provided. The instructions to revised Schedule C make clear that it is the plan sponsor's responsibility to request the necessary information.

C. Proposed Amendment to ERISA 408(b)(2) Regulation Implementing Statutory Exemption Permitting Parties in Interest to Provide Service to Plans.

1. Overview.

- a. Persons providing services to an ERISA-covered plan are "parties in interest" of the plan, and ERISA section 406(a) prohibits parties in interest from providing services to a plan. ERISA section 408(b)(2) provides an exemption for "reasonable arrangements" under which parties in interest may provide services to a plan. The current regulations under section 408(b)(2) require: (i) the services must be appropriate and helpful to the plan, (ii) the arrangement must be terminable by the plan without penalty on reasonably short notice, and (iii) the compensation received by the service providers must be reasonable.

- b. The proposed amendments to the regulations under section 408(b)(2) provide that, in order to rely on the section 408(b)(2) exemption, service providers will need to assemble and report information relating to their direct or indirect compensation. Under the proposed regulations, the exemption would be considered in part on a requirement that the service provider disclose compensation information to enable the plan to fulfill Form 5500 reporting requirements.

2. Requirements Under the Proposed Amendments.

Under the proposed 408(b)(2) amendments, any service arrangement with a plan must:

- a. Be in writing;
- b. Specifically require the service provider to disclose, to the best of its knowledge: (i) all services to be provided to the plan, (ii) all of the service provider's "compensation or fees" for the services, and (iii) how the service provider will receive such compensation or fees;
- c. Include a representation by the service provider that, before the contract or arrangement was entered into, all required information was provided to a responsible plan fiduciary;
- d. Require the service provider to disclose information to help the plan fiduciary assess conflicts of interest, including: (i) whether the service provider will be a fiduciary to the plan, either under ERISA or the Investment Advisers Act of 1940; (ii) any financial or other interest in transactions to be entered into by the plan in connection with the service arrangement, (iii) any material financial, referral, or other relationship with various parties, such as investment professionals, other service providers, or clients, that may give rise to conflicts of interest, (iv) whether the service provider can affect its own compensation without the prior approval of an independent plan fiduciary, and the nature of this compensation, and (v) whether the service provider has policies or procedures to manage conflicts of interest and, if so, an explanation of those policies or procedures;
- e. Require the service provider to disclose any material change in the information required to be disclosed within 30 days of its knowledge of such change;
- f. Require the service provider to comply with requests for fee and compensation information from a responsible plan fiduciary in order to fulfill the reporting and disclosure requirements of ERISA and the regulations, forms, and schedules thereunder (including Form 5500); and
- g. Permit termination of the arrangement by the plan without penalty and on reasonably short notice.

Even if the service contract contains all the required provisions, the service provider must actually make the necessary disclosures for the contract or arrangement to be considered "reasonable" — and thus exempt — under the proposed amendments.

3. Compensation of Fees.

The proposed amendments define "compensation or fees" very broadly to include, in addition to money, any other thing of monetary value received by the service provider or its affiliates "in connection with" the services provided to the plan. Examples DOL gives of covered compensation include, among other things, gifts, awards, trips, research, float, 12b-1 fees, commissions and various other fees.

DOL indicates in explaining the proposed regulations that, if a service provider does not know the exact amount of compensation when it signs a contract with a plan, compensation may be disclosed and expressed in terms of a formula, a percentage of the plan's assets, or a per capita charge for each participant or beneficiary.

4. Bundled Arrangements.

The proposed regulations would require a provider of a "bundled" plan services prices as a package, rather than on a service-by-service basis, to make all of the required disclosures, even if another provider actually performs one or more of the underlying services. Generally, a bundled service provider would not be required to break down how the compensation relates to each component service within the arrangement, or to disclose how revenue sharing or other indirect payments are allocated among service provider participants in the bundled arrangement. A bundled service provider would, however, be required to disclose any compensation separately paid to an underlying service provider that would be reflected in the net value of the plan's investment.

5. Proposed Class Exemption.

DOL issued a proposed prohibition transaction class exemption simultaneously with the issuance of the proposed amendments to the section 408(b)(2) regulations. The proposed class exemption would relieve plan fiduciaries, other than in their capacity as a service provider, from liability for engaging in a prohibited transaction in cases where an arrangement with a service provider fails to be "reasonable" due to the service provider's failure to comply with its contractual disclosure obligations.

In order for this relief to be available, a plan fiduciary:

- a. Must reasonably believe the contract or arrangement is reasonable as defined in the proposed section 408(b)(2) regulations, and must now know, or have any reason to know, that the service provider would fail to meet its obligations.
- b. Upon discovery of the service provider's failure to comply with its contractual obligations, must have requested in writing that the service provider furnish the required information.

- c. If the service provider does not comply with the request within 90 days after the written request for the required information, must notify DOL.
- d. After discovery of the service provider's failure to comply with its contractual obligations, must take the service provider's failure to provide the required information into account in determining whether to terminate or continue to service arrangement.

VI. PARTICIPANT DIRECTION OF RETIREMENT PLAN INVESTMENTS. ERISA §404(c).

A. §404(c) Relief From Some ERISA Standards.

In the case of individual account plans that permit participants to exercise control over the assets in their accounts, Section 404(c) provides *partial* relief from the standards that otherwise govern fiduciary conduct.

1. If participants actually exercise control over the assets in their accounts, plan fiduciaries will not be liable for any losses that are the direct result of the participants' control.
2. The protection of Section 404(c) is available only to defined contribution plans that allow participant-directed investments, such as 401(k) plans and profit sharing plans. Section 404(c) relief is not available for defined benefit pension plans.

B. Compliance Not Mandatory; Failure to Comply with Section 404(c).

Compliance with Section 404(c) is not mandatory and failure to comply with Section 404(c) does not of itself cause a plan to violate ERISA.

1. Failure to comply simply means that plan fiduciaries may continue to be responsible under ERISA for participant-directed investments.
2. Fiduciaries will need to continue to act prudently in selecting and retaining designated investment alternatives for the plan.

C. No Standard for Other Fiduciary Decisions.

The DOL clearly stated that the requirements of Section 404(c) only apply for purposes of determining whether a plan is a Section 404(c) Plan. The regulations are not intended to be applied to determine whether or to what extent a fiduciary with respect to a plan that is not a Section 404(c) Plan satisfied the fiduciary responsibility provisions of ERISA. A plan that does not satisfy the Section 404(c) requirements may have a prudent and well-diversified portfolio.

D. Section 404(c) Requirements. 29 CFR §2550.404c-1.

Department of Labor Regulations prescribe extensive requirements to qualify as an ERISA §404(c) plan. In order to satisfy ERISA §404(c), a plan must permit each participant to:

1. Choose from a broad range of investment alternatives with at least three (3) diversified investment choices (called "Core Alternatives") with materially different risk/return characteristics.
 - a. The regulations require affirmative investment elections from plan participants. Simply offering participants the opportunity to make investment decisions may not be sufficient for §404(c) protection.
2. Give investment instructions (e.g. make new investment elections and transfer current balances) at least once every three (3) months and possibly more often if appropriate in light of the market volatility of the investment alternatives;
 - a. The three (3) month change of investment rule applies to transfers among the Core Alternatives. Other fixed rate options could require a longer minimum time for the investment, but such options would not be considered Core Alternatives.
3. Diversify investments both generally and within investment categories; and
4. Receive current information from the plan that enables participants to make informed investment decisions.
 - a. DOL Advisory Opinion 2003-11A states that mutual fund "profiles" can be used to satisfy the requirements that a fiduciary provide a prospectus for each mutual fund either immediately before or immediately following a participant's investment in the fund.
 - b. Commencing in 2002, summary plan descriptions are required to inform plan participants if the plan is intended to comply with §404(c).

E. Retained Fiduciary Duties.

If a plan satisfies the Section 404(c) requirements, plan fiduciaries remain responsible for, among other things, the following:

1. the prudent selection and monitoring of plan investment alternatives (such as registered investment advisors, banks, trust companies, mutual funds, insurance companies, etc.);
2. the proper implementation of participant investment decisions;
3. the timely dissemination of required information relating to such investment alternatives; and
4. the avoidance of prohibited transactions (i.e., transactions between the plan and certain parties in interest or transactions involving a conflict of interest among, or self-dealing by, fiduciaries).

F. Default Investments.

1. The Pension Protection Act of 2006 (PPA) expands section 404(c) protection to include default investments if certain requirements are met.
2. Effective for plan years commencing after December 31, 2006.
3. The Department of Labor provided guidance on the appropriateness of default investments including guidance regarding mixes of default investment and asset classes consistent with long term capital appreciation or long-term capital preservation.
4. A notice must be given to each participant explaining the participant's right to exercise control over investment of his or her account. In addition, the notice must explain how contributions will be invested under the default arrangement. The participant must have a reasonable time after receipt of the notice and before investments are first invested to make such an election.
5. The section 404(c) default investment rules will also apply to automatic enrollment 401(k) plans.
6. Qualified Default Investment Alternatives (QDIA).

A QDIA must satisfy certain requirements under the DOL proposed regulations.

- a. With limited exceptions, the QDIA must not hold employer securities. The first exception applies to securities held by an investment company registered under the Investment Company Act of 1940. The second exception is for employer securities acquired as a matching contribution from the plan sponsor.
- b. A QDIA must not impose financial penalties or otherwise restrict a participant's or beneficiary's ability to transfer his or her investments to any other investment alternative under the plan.
- c. A QDIA must be managed by an investment manager as defined in PPA Section 3(38) or by an investment company registered under the Investment Company Act of 1940.
- d. A QDIA must be diversified to minimize the risk of large losses.
- e. The QDIA must constitute one of three types of investment products:
 - i. A life cycle or targeted retirement date fund or account designed to provide varying degrees of long-term appreciation and capital preservation via a mix of equity and fixed income investments based on the participant's age, target retirement date or life expectancy.

- ii. A balanced fund that is designed to provide long-term appreciation and capital preservation through a mix of equity and fixed income investments with a risk appreciation for plan participants as a whole.
- iii. An investment fund management service allocating assets for a participant's account to achieve long-term appreciation and capital preservation through a mix of equity and fixed income investments.

G. Section 404(c) Coverage During Conversion Blackouts and Mapping.

- 1. PPA extends 404(c) protection through a conversion blackout period if certain requirements are met.
- 2. The DOL has been instructed to develop regulations with respect to mapping of investments where the participant's account is reallocated among funds with reasonably similar characteristics.
- 3. Applicable for plan years beginning after December 31, 2007, with a delayed effective date for collectively bargained plans, depending on the expiration of the bargaining agreement.

H. Investment Advice to Plan Participants.

- 1. PPA provides a prohibited transaction exemption permitting a fiduciary who is a registered investment company, bank, insurance company, or registered broker-dealer to give investment advice to participants in ERISA-covered, employer-approved retirement plans.
- 2. In order to meet the requirements for the prohibited transaction exemption the arrangement must (i) disclose fees or (ii) use a pre-approved computer model.
 - a. The investment advisor must disclose in easy-to-understand language all fees and potential conflicts of interest. An annual audit of the arrangement and notices about the advisory arrangement must be given to recipients of the advice. Fees may not vary based on the recommendation of the advisor or the investment choices selected.
 - b. Under the Computer Model exemption, the adviser may offer an investment model based on the SunAmerica Advisory Opinion and approved by a certified investment expert. The model may take into account individual circumstances of a participant. Fee disclosure and affiliation with the model development must be disclosed to participants.
 - c. The fiduciary approving the arrangement must be independent of the advisor or any person providing the investment options under the plan.

- d. Advice cannot be biased in favor of investments offered by the fiduciary advisor or a person of material affiliation or contractual relationship to the fiduciary.
 - e. The exemption for advice applies to advice given after December 31, 2006.
3. The plan sponsor is deemed to be in compliance with ERISA's fiduciary duties, except for the duty to monitor the advisor. The sponsor retains fiduciary responsibility for prudent selection and monitoring of the advisor's overall performance, but is not required to monitor individual recommendations by the advisor. Aside from the oversight responsibility, the sponsor is deemed to be in compliance with the ERISA fiduciary standards with respect to plan investments.
 4. A similar exception is provided for IRAs, except that advice based on computer models will only be exempt if the model complies with guidelines developed by the Department of Labor.
 5. *See* DOL Field Assistance Bulletin (FAB) 2007-01 for DOL guidance for the PT exemption for investment advice.

I. Sarbanes-Oxley Act of 2002 (SOA).

1. SOA Section 306(b) Blackout Period Notice Requirements for Participants and Beneficiaries under ERISA:
 - a. ERISA Section 101 (29 USC Section 1021) is amended to provide for notice requirements for Blackout periods.
2. SOA Section 306(b)(7): "blackout period" is defined as a period of more than three consecutive business days during which the participants or beneficiaries in an Individual Account Plan are limited to or restricted from their normal right to direct or diversify assets in their accounts or obtain plan loans or distributions. A change in the plan's investment manager will generally result in a blackout period.
3. SOA Section 306(b)(1)(i)(2)(A): The Plan Administrator must notify all affected participants and beneficiaries at 30 days in advance of the blackout period. The Notice shall include:
 - a. the reasons for the blackout period;
 - b. the identification of the investments and other rights affected;
 - c. the expected beginning date and length of the blackout period;
 - d. a statement that the participant or beneficiary shall evaluate the appropriateness of their current investment decisions in light of their inability to direct or diversify assets credited to their accounts during the blackout period.

4. The Pension Protection Act of 2006 provides an exception to the blackout notice requirements for one-participant plans; plans that cover only the owner and the owner's spouse, and plans that only cover partners (or partners and spouses). Such plans are exempt from the blackout notice requirements.

VII. DOL GUIDANCE FOR FIDUCIARIES.

A. Meeting Your Fiduciary Responsibilities.

The U.S. Department of Labor Employee Benefits Security Administration published on its website (www.DOL.GOV/EBSA) guidance for fiduciaries entitled "Meeting Your Fiduciary Responsibilities". Topics in the guidance include:

1. Who is a Fiduciary?
2. What is the Significance of Being a Fiduciary?
3. Limited Liability.
4. Other Plan Fiduciaries.
5. Bonding.
6. Employee Contributions.
7. Hiring a Service Provider.
8. Fees.
9. Monitoring a Service Provider.
10. Prohibited Transactions.
11. Information for Employees.
12. Reporting to the Government.

B. Essential Elements of a Plan.

The DOL notes that each Plan has certain key elements including:

1. A written plan that describes the benefit structure and guides day-to-day operations;
2. A trust fund to hold the plan's assets;
3. A recordkeeping system to track the flow of monies going to and from the retirement plan; and
4. Documents to provide plan information to employees participating in the plan and to the government.

C. Information to be Provided to Employees.

The DOL states that the following information must be provided to plan participants and beneficiaries:

1. Summary Plan Description (SPD);
2. Summary of Plan Modifications (SMM);
3. Individual Benefit Statement;
4. Summary Annual Report (SAR); and
5. Blackout Period Notice.

D. Tips for Employers with Retirement Plans.

The DOL guidance provides the following tips for employers with retirement plans:

1. Have you identified your plan fiduciaries, and are they clear about the extent of their fiduciary responsibilities?
2. If participants make their own investment decisions, have you provided sufficient information for them to exercise control in making those decisions?
3. Are you aware of the schedule to deposit participants' contributions in the plan, and have you made sure it complies with the law?
4. If you are hiring third-party service providers, have you looked at a number of providers, given each potential provider the same information, and considered whether the fees are reasonable for the services provided?
5. Have you documented the hiring process?
6. Are you prepared to monitor your plan's service providers?
7. Have you identified parties-in-interest to the plan and taken steps to monitor transactions with them?
8. Are you aware of the major exemptions under ERISA that permit transactions with parties-in-interest, especially those key for plan operations (such as hiring service providers and making plan loans to participants)?
9. Have you reviewed your plan document in light of current plan operations and made necessary updates? After amending the plan, have you provided participants with an updated SPD or SMM?
10. Do those individuals handling plan funds or other plan property have a fidelity bond? Bond must be at least 10% of plan assets but bond need not exceed \$500,000.

PPA increases the maximum bond amount to \$1,000,000 for plan years beginning after December 31, 2007.

VIII. ALLOCATION OF ADMINISTRATIVE EXPENSES BETWEEN PLAN AND EMPLOYER. DOL ADVISORY OPINION 2001-01A; DOL FIELD ASSISTANCE BULLETIN 2003-3.

A. Plan Assets May Be Used to Pay Reasonable Administrative Expenses. ERISA §404(a)(1)(A)

1. Although ERISA states that the plan assets of a plan must be used exclusively to pay benefits to participants and beneficiaries, ERISA also provides that the plan assets may be used to pay reasonable administrative expenses. There has been much discussion on what are "reasonable administrative expenses".

B. Early Department of Labor Rulings.

1. Kirk Maldonado Letter dated March 2, 1987. The Department of Labor stated that it would not be appropriate for a plan to pay expenses incurred in connection with the provision of services to the plan if the payments are made for the employer's benefit in the normal course of such employer's business or operations. This letter further stated that services provided to establish, terminate or design a plan are "settlor functions" which relate to the employer's business activities, and, therefore, may not be properly paid from the plan.
2. John Erlenborn Letter March 3, 1986. The Department of Labor stated that "settlor functions" refer to a class of discretionary activities which relate to the formation, rather than the management of plans. According to the Department of Labor, these settlor functions are not fiduciary activities subject to Title I of ERISA.

C. DOL List of Plan Expenses.

DOL Kansas City Office lists items to be paid by the plan sponsor or allocated between the sponsor and the plan (Nov. 2000).

1. Plan design for new plan or amendment not required to comply with ERISA (e.g. cash balance redesign).
2. Expenses related to maintenance of tax qualified status (allocated between plan and sponsor based on benefit to plan and sponsor). Note: DOL Advisory Opinion 2001-01A states that the plan can pay the costs of legally mandated amendments, such as amendments necessary to comply with tax law changes.
3. Determination of FASB 87, 88, 106 and 112 liabilities and expenses for financial accounting purposes.
 - a. FASB 87 — Employers' Accounting for Pensions

- b. FASB 88 — Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits.
 - c. FASB 106 — Employers' Accounting for Post-Retirement Benefits Other Than Pensions.
 - d. FASB 112 — Employers' Accounting for Post-Employment Benefits.
4. Determination of maximum deductible employer contribution.
 5. Study to decide plan termination.
 6. Analysis of assets recoverable on plan termination.
 7. Consultation on establishment and design of successor to terminated plan.
 8. Asset/liability forecasting relating to plan design or financial accounting issue.
 9. Financial forecasting — financial liability — tax implications.
 10. EPCRS, CAP, DOL and IRS sanctions or penalties.
 11. DOL delinquent filer program fee (DFVC)
 12. Nondiscrimination testing (allocate between plan and sponsor).
 13. Developing and defining employer's benefits/health care strategies (e.g. benefit design, employer contribution policy).
 14. Modeling the impact of proposed legal/regulatory changes on benefit plans and their administration.
 15. Preparing for and conducting union negotiations.
 16. Any expense for which an employer could reasonably be expected to bear the cost in the normal course of the employer's business or operations.
 17. Expenses for which there is more than an incidental benefit to the employer (allocate expense to employer to the extent of the employer's benefit).

D. Department of Labor opinions.

1. QDRO charges — The DOL does not oppose fees charged to the trust as whole. Prior to 2003, the DOL disapproved of fees charged to individual accounts. DOL Advisory Opinion 94-32 A (8/4/94). In FAB 2003-3, the DOL reversed its position and stated that QDRO charges may be assessed against the benefits of the individual's account to which such QDRO applies. Any offset policy would be required to be explained to the participant in advance (e.g., in the SPD) before any such offset could occur.

2. Plan Loans — The overriding criteria as to whether administrative loan charges are considered reasonable is whether the charges affect the ability of the plan to offer loans to all employees on a reasonably equivalent basis.
3. Settlor Costs — A settlor cost will occur when the employer receives more than an incidental benefit. When an expense may be chargeable both to the plan and to the employer (e.g. bringing a plan into compliance with §401(a)(4)), the sharing of costs would be the most reasonable solution.
4. Plan Terminations — The employer should be charged with the costs associated with the decision of whether to terminate the plan. The plan may be charged with the legal and actuarial costs associated with wrapping up a previously made decision to terminate the plan.
5. Distribution Expenses — Reasonable distribution expenses may be charged directly to the participant.
6. Based upon the Department of Labor's formal and informal opinions, the following expenses are generally employer expenses:
 - a. Actuarial reports which provide information to employers with respect to financial impact of plans on employers;
 - b. Consulting fees incurred by employers in determining plan design;
 - c. Decisions to terminate plans;
 - d. Preparation of plan documents;
 - e. Amendments to plans if the amendment is a settlor function; and
 - f. Closing agreement and EPCRS expenses.
7. Based upon the Department of Labor formal and informal opinions, the following expenses are generally plan expenses:
 - a. Actuarial reports that relate to determination of minimum contributions required;
 - b. Preparation of summary plan descriptions;
 - c. Liquidation of plans upon termination;
 - d. QDRO charges; and
 - e. Plan amendments if the amendment involves a fiduciary function or is required due to changes in law (e.g., GUST or EGTRRA2).
8. Based upon the Department of Labor's formal and informal opinions, the following expenses may be split between the employer and the plan:

- a. Actuarial reports used for the purpose of meeting minimum funding requirements; and
- b. Amendments; depending upon the nature of the amendment.

E. Allocation of Expenses to Former Employees

In Rev. Rul. 2004-10, the IRS concluded that a defined contribution plan may charge the accounts of former employees for a pro-rata share of the plan's reasonable administrative expenses while not charging the accounts of current employees.

F. Employer Deduction of Plan Expenses.

The IRS stated in PLR 9252029 that an employer's payment of certain investment management fees may be deductible under IRC §§162 or 212 and will not be treated as a contribution to the plan. The issue is whether fees paid by the employer are counted as plan contributions under the IRC §404 deduction limitations. In this ruling, an investment manager separately and directly billed the employer for 100% of the charges for investment management as well as for custodial, accounting and legal services received by the plan and the employer paid these bills directly. See also: PLR 8941009, PLR 8941010 and PLR 8940014. However, payments by an employer to the plan trustee to reimburse the trust for investment management expenses are deemed to be contributions. PLR 9124036.

The IRS also stated that payments to:

1. The trustees as compensation for their attendance at the meetings and the performance of their trustee services for the plan;
2. Accountants for the preparation of the annual accounting and ERISA reporting requirements; and
3. Legal counsel for services required to maintain the plan's qualification (including plan document preparation and filings, correspondence regarding the qualification of the plans, advice to the plan's fiduciaries regarding their duties under ERISA, interpretation of plan provisions and of the law with respect to plan issues) were all deductible under IRC §162.

Fact Sheet

U.S. Department of Labor
Employee Benefits Security Administration
December 2007

Proposed Regulation Relating to Service Provider Disclosures Under ERISA Section 408(b)(2)

Background

- In recent years, changes in the way services are provided to plans have resulted in complexities that make it difficult for plan fiduciaries to understand how service providers are compensated and whether they have possible conflicts of interest that may affect their performance.
- Under ERISA, plan fiduciaries are obligated to act prudently in selecting service providers and ensure that no more than reasonable compensation is paid for services provided to plans, taking into account the direct and indirect compensation received by the service provider.
- Thus, a plan fiduciary must have sufficient information regarding fees and compensation that the service provider receives and whether there are relationships or interests on the part of the service provider that may call into question the objectivity of the service provider in providing services to the plan.
- The Labor Department's Employee Benefits Security Administration (EBSA) has proposed amending the regulation under section 408(b)(2) of the Employee Retirement Income Security (ERISA), which provides an exemption from the prohibited transaction rules, to clarify what constitutes a reasonable contract or arrangement and to require more comprehensive written disclosure concerning plan contracts with service providers.

Overview of Proposed Regulation

- The proposed regulation focuses on disclosure of the direct and indirect compensation received by service providers and potential conflicts that may affect their objectivity.
 - The proposed regulation affects only certain service providers whose contracts or arrangements are most likely to raise concerns about the receipt of indirect compensation, the fiduciary nature of the services to be provided, or conflicts of interest that might affect the provision of services.
 - In addition, the Department is proposing a class exemption that would provide relief to a plan fiduciary who enters into a contract that is not "reasonable" because, unknown to the plan fiduciary, the service provider failed to comply with its disclosure obligations under the proposed regulation.
 - The Department believes the benefits will outweigh the costs of compliance with the proposal, which generally fall on service providers that must create and provide additional disclosures. The cost of the proposed regulation is estimated to be \$52 million in the year of implementation, falls to approximately \$36 million in the second year, and varies slightly with changes in market size thereafter. Benefits accrue due to possible lower fees paid by plans, possible increased efficiency in plan-service provider relationships and reduced costs incurred by plans to evaluate potential service providers.
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- The proposal applies to:

- fiduciary service providers;
- providers of banking, consulting, custodial, insurance, investment advisory or management, recordkeeping, securities brokerage, or third party administration services; or
- providers who receive indirect compensation for accounting, actuarial, appraisal, auditing, legal, or valuation services.

Disclosure Requirements

- ***Disclosure of Services and Compensation***

The terms of the contract must require that the service provider disclose information regarding all services to be performed and all compensation that will be received either directly from the plan or indirectly from parties other than the plan or plan sponsor. The proposal includes a definition of “compensation or fees” and rules for bundled service providers and for estimating the amount of prospective compensation.

- ***Disclosure of Conflicts of Interest***

Service providers also must disclose information about relationships or interests that may raise conflicts of interest for the service provider in performing plan services. Specifically, service providers must describe:

- any participation or interest of the service provider in transactions to be entered into by the plan pursuant to the contract;
- any material relationships with other parties that may create conflicts of interest;
- any compensation the service provider may receive that it can affect without prior approval by an independent fiduciary; and
- any policies or procedures in place to address potential conflicts of interest.

- ***Ongoing Disclosure Obligations***

The proposal includes ongoing disclosure obligations relating to:

- **Material Changes:** During the term of the contract, a service provider must disclose material changes to information previously furnished within 30 days of such changes.
- **Reporting and Disclosure Requirements:** Service providers must disclose compensation or other information related to the contract or arrangements that is requested by the responsible plan fiduciary or plan administrator in order to comply with ERISA’s reporting and disclosure requirements.
- **Actual Performance:** The proposal also includes an explicit requirement that service providers actually make the required disclosures.

Contact Information

For questions about the proposed regulation, contact EBSA’s Office of Regulations and Interpretations at (202) 693-8500. Comments on the proposed regulation should be directed to the U.S. Department of Labor, Employee Benefits Security Administration, Room N-5655, 200 Constitution Ave., N.W., Washington, D.C. 20210, Attention: 408(b)(2) Amendment; or electronically to e-ORI@dol.gov or www.regulations.gov.

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