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Inside This Issue

Candid Commentary and Call to Action
July 1, 2012 New ERISA Deadline

As you all probably know, plan sponsors and fiduciaries must receive a new type of disclosure regarding a plan's fees, expenses and compensation arrangements. That deadline for receipt and compliance therewith generally is July 1, 2012.

<u>What you may not know, and which is of utmost importance, is what needs to be done with these disclosures.</u> An employer or fiduciary cannot simply take the disclosures it receives from the plan service providers and file them. <u>The fiduciary must act upon those disclosures</u> in a collaborative process with its providers. With respect to those service providers who would rather not share intimate details of fees, expenses and internal compensation arrangements with their customers, the Department of Labor has essentially pitched fiduciaries against service providers.

These disclosures are different from the disclosures that were provided in connection with the 2011 (and future) Form 5500 filings.

Below please find a letter which our firm has sent to many clients (with varying degrees of modifications for the specific client). We hope this letter is instructive for you. The letter is not a technical explanation of the rules nor a roadmap for the plan sponsor or fiduciary to comply. It instead provides practical advice to act upon.

Perhaps more interesting to at least some of our readers will be the footnotes which provide Jeff Mandell's personal commentary regarding the subject matter.

Our second article in this *Alert* provides a brief technical overview of the new rules.

DEADLINE

IMMEDIATE ATTENTION REQUIRED

Name
Company Name
Address

Re: Retirement Plan –
New ERISA Rules Require Immediate Attention and Action

Please take a few moments now to review the following important information.[1]

ACTION REQUIRED

By July 1, 2012, plan sponsors ("employers," for purposes of this communication) must comply with a new extensive set of ERISA regulations. July 1 is not the date by which work must begin, but rather it is the date by which it must be "finished." In short, by July 1, 2012, your plan's service providers must furnish you with certain detailed information about the plan services they provide, the fees they are charging, and the compensation they are receiving.

It is *your* legal responsibility as the employer and/or fiduciary to ensure that you receive correct, timely and compliant new plan information. If the new disclosures you receive fail in any respect (for example, they are incorrect, incomplete, insufficient, *etc.*) you, as the employer and/or fiduciary, will have engaged in an ERISA "prohibited transaction." A **prohibited transaction** has dire, and financial, consequences for you as the employer and/or the plan fiduciary.

ACTION STEP

Some of our clients are already receiving information or communications from their financial institutions and other plan providers regarding this mater. That is good. We recommend that without delay you provide any and all such correspondence (with all enclosures) to us.

We have excellent reason to expect that the disclosures your providers will furnish to you will need to be revised to comply with the new regulations and thus enable you to fulfill your legal duties. Without this legal involvement and revision, significant fiduciary and employer risks will exist. A cooperative effort among us, your various providers, and you as the employer/fiduciary will be necessary to adequately protect you.

Please contact us, or we will contact you, to meet the July 1 compliance deadline.[2] Practical, possibly short-term, compromises might be prudent financially and otherwise to meet the deadline.

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[1] The footnotes in this letter contain my personal commentary, observations and helpful information. Although I believe they are important, feel free to delay your reading of them until your schedule allows.

[2] The Department of Labor developed these rules over five to ten years. In customary ERISA government fashion, **it released its final regulations in February 2012 but with a July 2012 effective date.** Giving service providers and employers such a short time frame to comply with very complex rules, that took numerous years and many thousands of government hours to develop, unfairly burdens employers and providers without due consideration and respect of them and the businesses they run. Notwithstanding the new law's laudable purpose, the government's continued, steadfast insensitivities towards employers is exceedingly frustrating and difficult to justify (for lack of a more apt description by me, and at least from when I started my ERISA practice in 1982 and continuing unswervingly 30 years later). Notwithstanding vocal criticism of the July effective date, as of now the Department of Labor is sticking to this deadline.

WHAT'S THIS ABOUT?

The purpose of this new legal framework is to inform employers, fiduciaries and employees of the plan's fees and expenses, of the services that are actually being provided for the plan, and also of the underlying business and compensation arrangements among the plan's various providers which affect the fees, expenses and selection of plan investments. This information will describe, for example, the relationships and compensation structures between financial institutions, agents, third party administrators and recordkeepers, and the incentives employees may receive for selling one plan investment or platform rather than another.

The Department of Labor felt, correctly with exception by some providers, that historically plan fees, expenses and arrangements were mysterious, hidden, not understood and not disclosed to either employers or participants. The government reasons that such mystery and lack of transparency has allowed plan fees and expenses to climb, all the while disabling fiduciaries from fulfilling their legal obligations to participants. This in turn has directly injured participants by reducing the plan's investment return (for example, either by paying higher fees or receiving less advantageous investment options).[3]

The government's hope is that employers, fiduciaries, and participants will become more knowledgeable and savvy, and that certain dishonest, questionable or conflicting business practices will be discouraged or cease. The end objective is to benefit employers and participants. My personal reaction, first many years ago and still now, is that this government initiative may in fact be a good thing for you and other plan sponsors, notwithstanding the short term pain and expense. Time will tell.[4]

YOUR NOTIFICATION TO PROVIDERS AND THE DOL

If one or more of your providers does not timely provide you with the requisite information, the new law requires that you notify the provider in writing of its shortcomings and that you demand corrected disclosure. If the provider does not properly comply with your request, that is, if your effort fails, you are required to notify the Department of Labor of the provider's noncompliance.

If you as the employer/fiduciary fail to take these initiatives, you will have engaged in an IRS and DOL prohibited transaction and ERISA breach. You also will or may pay sanctions and suffer other financial and punitive consequences.

DISCLOSURES TO PARTICIPANTS

After (assuming) employers receive the requisite information, they in turn are required to provide a summary disclosure of the fees, expenses and business arrangements to participants. Compliance is required by August 30, 2012 (the deadline might be different for plan years that do not run from January 1 to December 31). This so-named "participant level" disclosure is different than the disclosures the employer will receive from its financial institutions, TPAs and other providers. The plan's providers may furnish sample notices that employers will modify appropriately to furnish to participants.

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[3] The Department of Labor, in a creative side-door legal maneuver that uses an existing old ERISA regulation as its platform for this initiative, is hereby forcing financial institutions and certain other providers of plan services to disclose inside information about themselves. The government unabashedly is turning its spotlight on the stark potential, real, and often unknown conflicts of interest that have existed between financial institutions/TPAs/other providers and the employer/fiduciary/participants the providers have been servicing.

[4] Usually, I strongly rail against most every legislative or administrative change to ERISA, regardless of any stated correct benevolent (or sometimes sideways) objective. The extent of ERISA government regulations is so much overkill and needless paperwork that mere legal plan maintenance is a huge, burdensome, continual task. Being the eternal optimist (some may say naïve), perhaps (and I say only "perhaps") this government initiative actually will do some good for our clients and their employees.

As with the imminent service provider disclosures to you, we predict with much certainty that, should you wish to comply with the law, we will need to replace, supplement or modify the sample participant disclosures and/or instructions you may receive from your providers.

The disclosures must be provided at various times (annually and otherwise each plan year), and the new rules apply to both new arrangements between plans and their providers, and to existing relationships.

COMMENTARY

Short term, requiring this effort is unfortunate. Ongoing fee disclosure maintenance, after this initial push, will require attention yet be very manageable (until, however you change providers). On the bright side, if the objectives of the new law are achieved, you will better understand what you and/or your participants are paying, and for what service. You might choose better investments or platforms. Some of the practices, investments or arrangements that perhaps without your knowledge may have injured you and your participants, for example by reducing your plan's rate of return, should be eliminated or ameliorated. Your plan fees will hopefully decrease, and/or the quality of plan services should improve, and/or you will simply understand a heck of a lot better the financial engine running your plan. This knowledge hopefully will, in turn, allow you to fulfill your ERISA fiduciary duties[5] and decrease the heightened liabilities you are facing (and about which many employers are now being sued). Your written documentation, with legal counsel, of your fulfillment of ERISA duties will best position you. [6]

Finally, this latest government initiative to improve our country's retirement plan system, when taken with previous recent new burdens on employers, may encourage employers to rethink their investment platforms, strategies, and design. Section 401(k) plans, in particular, have become increasingly and unnecessarily more complicated. A good deal of these complications, added burdens, expenses and of course risks may be avoidable.[7]

ADDITIONAL INFORMATION

We sent a rather extensive **ERISA Alert** in September 2010 which provided substantive detail regarding the *proposed* fee disclosure regulations. You may access it on our website at www.erisalawgroup.com under the *Firm Publications* link. We intend to send another **ERISA Alert** that updates the 2010 Alert with the 2012 final regulations. It will address this subject matter in a more technical fashion than this letter conveys.

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[5] As I have mentioned to clients hundreds or thousands of times, the United States Supreme Court years ago stated in unequivocal unchallenged terms that there is no higher, more stringent standard of duty of care under our country's laws than the duty an ERISA fiduciary has to act *exclusively* in the best interests of plan participants. This duty will be tested now, more so than ever, as the government and plaintiffs' bar has sharpened its focus on it.

[6] Employers (and most all providers), large and small, in general historically have focused almost entirely on complying with the Internal Revenue Code component of ERISA in order to achieve significant tax savings. Compliance with Title I of ERISA, its heart and soul over which the Department of Labor has jurisdiction, and among other things which deals with decision making, investments, prudence, fiduciary loyalties and disclosures to participants, has received dangerously little legal attention by many if not most employers. Indeed, some very large institutional providers of retirement and health plan documents (and many small providers as well) simply ignore the critical existence of Title I of ERISA in their provision of services to employers. It primarily is in litigation when employers and fiduciaries get burned by their inattentiveness to material Title I legal requirements. That era, including the infrequent occurrences of lip service to ERISA, if any, might be and should be changing.

[7] 401(k) and other plans are no different than other marketed products – trendy and popular has a certain panache, which the consumer may later regret.

In Closing

Your immediate action is required now to position the employer and individual fiduciaries against possible significant penalties and liabilities. Your exposure is to the Internal Revenue Service, the Department of Labor, and to participant litigation which is occurring with resounding alacrity with regard to plan expenses and plan investments.[8] Full compliance, however, likely will be a work in process that will be achieved over the next several years.

Very truly yours, Jeffery Mandell

[8] The government and plaintiffs' bar has loudly and consistently sounded the alarm these past five to ten years. It is time for all employers and fiduciaries to seriously heed their (and our) warnings that legal attention to these matters is compelling. The excellent news is this – compliance with Title I of ERISA is less burdensome, mind-boggling, expensive and far easier to achieve than compliance with the Internal Revenue Code component of ERISA. To obtain fiduciary and employer protection (which in turn helps employees) requires considerably less time, effort, legal attention and expense than keeping your retirement, health or other employee benefit plan in compliance with the Internal Revenue Code. When it comes to Title I, an employer's or fiduciary's dollar goes a lot farther than when dealing with a plan's tax qualification requirements.

Brief Technical Summary of Fee Disclosure Rules

The Department of Labor ("DOL") recently published its final rules regarding service provider fee disclosures to plans. This article discusses several aspects of the new rule; however, the take away point is simple: It is critical that employers and plan fiduciaries obtain and review the new required information from their service providers. Otherwise, penalties apply and fiduciaries will be breaching their duties to plan participants and engaging in prohibited transactions.

The Reason for Change

The DOL believes that changes in the way services are provided to plans have resulted in increased complexity and made it difficult for plan sponsors and fiduciaries to understand the services for which they are paying. Despite these complexities, ERISA requires that fiduciaries act prudently and solely in the interest of the plan's participants when selecting and monitoring service providers and investments. The DOL states that: "[f]undamental to a plan fiduciary's ability to discharge these obligations is the availability of information sufficient to enable the plan fiduciary to make informed decisions about the services, the costs, and the service provider." To this end, the regulations modify existing DOL regulations that address reasonable and necessary services.

The Existing Rules

Generally, the furnishing of services between a plan and any provider of services to a plan will result in a prohibited transaction under ERISA and the Internal Revenue Code. Prohibited transactions result in the automatic imposition of potentially significant taxes and penalties.

There is an exemption from the prohibited transaction rules for contracts or arrangements between a service provider and a plan if no more than reasonable compensation is paid for the services, the services are necessary for the establishment or operation of the plan, the contract or arrangement is reasonable, and the plan may terminate the contract or arrangement without penalty on reasonably short notice.

<u>The New Requirements</u>

The new regulations expand on the foregoing exemption by clarifying the meaning of "reasonable" contract or arrangement. In order for service contracts and arrangements between a "covered plan" and a "covered service provider" to be considered reasonable, the service provider must disclose specified information to a "responsible plan fiduciary." A responsible plan fiduciary is a fiduciary with authority to cause the plan to enter into, extend, or renew a contract or arrangement.

In general, the service provider must disclose in *writing* descriptions of or statements regarding:

1. The services to be provided;
2. If applicable, a statement that the service provider (and/or affiliate or subcontractor) will provide or reasonably expects to provide services as a fiduciary or as an investment advisor registered under the Investment Advisors Act of 1940 (or any state law);
3. Direct compensation that the service provider (and/or affiliate or subcontractor) expects to receive;
4. Indirect compensation that the service provider (and/or affiliate or subcontractor) expects to receive;
5. Compensation that will be paid among related parties and its affiliates and/or subcontractors;
6. Compensation that the service provider (and/or affiliate or subcontractor) reasonably expects to receive upon termination of the contract or arrangement; and
7. The manner in which the compensation will be received by the service provider (and/or affiliate or subcontractor).

There are additional, more detailed, disclosures for those covered service providers who provide recordkeeping services and also for service providers who act as fiduciaries to investment products or entities that hold plan assets in which the plan is invested.

Covered service providers include those who reasonably expect to receive at least $1,000 in direct or indirect compensation, and provide services generally described as follows:

1. Fiduciaries under ERISA;
2. Fiduciaries to investment products or entities that hold plan assets in which the plan is invested;

3. Registered investment advisors;
4. Recordkeeping or brokerage services to a defined contribution plan allowing for participant directed investments if designated investment alternatives will be made available in connection with such services; and
5. Other professional services (*e.g.*, legal, actuarial, accounting, recordkeeping) if indirect compensation is expected.

Not surprisingly, given the DOL's keen interest in plan expense related issues, there is much more detail than we discuss here.

<u>Plan Fiduciaries Must Be Acting Now</u>

Compliance with the regulations will impact and require effort by service providers and plan fiduciaries. The consequences of noncompliance will primarily consist of the imposition of excise taxes and penalties associated with prohibited transactions and the risk of liability for fiduciary breach (*i.e.*, personal liability for losses resulting from the breach). Notwithstanding, potential relief will be available to fiduciaries in narrow instances where the service provider refuses to make the necessary disclosures.

Plan fiduciaries are required to comply with these new ERISA rules. They must:

- Identify all providers of plan services;
- Determine those who are covered service providers under the new rules;
- Contact them and request the required information; and
- Analyze the information that is disclosed by those providers and ensure it meets the DOL's conditions.

Compliance will require effort, particularly in the initial efforts to ensure compliance by July 1, 2012. The work should have begun and must be completed <u>before</u> July 1, 2012, and then on an ongoing basis as services or costs change.

Firm News – New Publication

We are delighted to announce that the *401(k) Advisor, The Insider's Guide to Plan Design, Administration, Funding & Compliance* (by Aspen Publishers, part of Wolters Kluwer Law &Business) is now under our firm's leadership. We are delighted to assume our new role as chief editors and architects of this monthly publication.

In addition to articles by John Hughes and Jeff Mandell, other experienced lawyers, TPAs, financial advisors, actuaries and other professionals will contribute.

We compliment our friend and predecessor Greg Matthews for the wonderful job he has done as editor/architect for the *401(k) Advisor* for over the last 20 years. We are already enjoying this exciting venture.

If you are interested in contributing an article to the *401(k) Advisor* or doing a Question/Answer with us, we welcome that; please contact John or Jeff.

For a complimentary copy and/or a 20% discount, please contact assistant@erisalawgroup.com.

For additional information or if you have questions,
contact Jeffery Mandell or John Hughes at 208-342-5522 or 866-ERISALAW.