

## Message From The Firm

The purpose of our Plan Sponsor newsletter is to provide education on key legal and benefit issues for employers who sponsor qualified retirement plans, deferred compensation plans and health and welfare plans. We hope it serves that purpose for you.

As a quick update on current events, the following are the developments that we are paying the most attention to:

- The DOL has issued a regulation under ERISA §408(b)(2) that requires service providers to give more fee and expense information to plan sponsors. Once sponsors get that information, they will need to carefully evaluate it and benchmark against peer data.
- In addition, the DOL is working on a new regulation that will require that more investment and expense information be given to participants. That guidance should be out in the Fall.
- There is a major emerging issue of retirement income for 401(k) participants. We have reached the point in the development of 401(k) plans where we need to focus on whether they are providing adequate retirement benefits for participants and whether participants can withdraw the money in a way that it lasts, on average, for approximately 20 years in retirement for single retirees and approximately 30 years for a married couple. Needless to say,

## Adequate Benefit and Monthly Income



*By Fred Reish (FredReish@Reish.com)*

Phyllis Borzi, the Department of Labor's Assistant Secretary for the Employee Benefits Security Administration, has said that 2010 is the year in which we begin a national dialogue about retirement income for 401(k) participants. As a practical matter, though, that national discussion involves several other issues:

- Benefit adequacy . . . obviously, the hope is that the retirement income, plus social security, will be enough for people to live comfortably in retirement. How much is that? Most experts say 75% to 85% of final pay. Is your 401(k) plan providing that level of benefits for your employees?
- How do you measure the success of a 401(k) plan for benefit adequacy? Most people think of the account balance at retirement. But the real measure is the monthly income provided in retirement. After all, the electric company, the phone company, the water company, and your landlord or mortgage holder will still be expecting monthly payments. So, participants—and, therefore, plan sponsors and providers—need to think in terms of monthly income . . . and then participants need to be provided with the information they need to do their job right. What income will

their current account balance provide at retirement? How much income do they need at retirement? How do they close the gap between those two numbers?

- How do employees make their money last for their lifetimes? The typical 65-year-old has a life expectancy of almost 20 years—but that means that half of them live longer than that. For the typical 65-year-old couple, there is a 50% chance that one will live to 92 and a 25% chance that one will live to 97. How can they make their money last at least 25 to 30 years? It is difficult . . . very difficult . . . without some kind of guarantee. But, if there is no guarantee, they probably won't know they are going to run out of money until they are in their late 70's or 80's. At that point, their alternatives are severely limited. What products does your plan provide to "guarantee" that the money lasts for a participant's lifetime?
- How much can the retired couple withdraw each year? Based on several studies, if they want a 90% chance the money will last 30 years, the maximum withdrawal rate is 4% per year (adjusted for inflation). So, if they have \$500,000 in savings including their 401(k) account or rollover IRA, they can withdraw \$20,000 the

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## Common Mistakes in Preparing Plan Committee Minutes



By **Bruce Ashton** ([BruceAshton@Reish.com](mailto:BruceAshton@Reish.com))

In most 401(k) plans (and in ERISA 403(b) plans), the fiduciary function of selecting and monitoring investments and service providers is carried out by a committee—typically, the financial and human resources officers. The committee meets periodically, often quarterly (though in smaller plans, perhaps only annually), to consider information on investment performance and on how well the plan’s service providers are doing their jobs and meeting established plan goals.

These meetings are an important part of fulfilling the fiduciary obligation to act for the exclusive purpose of providing benefits to participants and defraying reasonable expenses of operating the plan. An important part of showing that the committee has met this requirement is the documentation of its meetings, the minutes—to show that the committee has engaged in a prudent process of analyzing and assessing relevant issues.

In our experience, committees frequently fail to treat the preparation of minutes of their meetings with the importance they deserve. Listed below are a number of the items that should—and a few that should not—be included in committee minutes.

### What to include:

- Identify everyone present, including guests, especially advisers and consultants.
- Identify all issues considered by the committee, such as performance of the investment options offered by the plan, whether the plan’s education

initiatives appear to be working by increasing participation, deferral rates or participant investing, the provisions of the investment policy statement (which should probably be reviewed every year or two), etc.

- Reference of all materials gathered and analyzed.
- Indicate decisions made...and where necessary, the rationale for the decision.
- Indicate any issues to be considered at a subsequent meeting, *e.g.*, an investment that is put on the watch list.

### What to leave out:

- Details of who said what .. unless this is *really* relevant.
  - Details of discussions or issues that aren’t resolved—*e.g.*, “John questioned why the plan doesn’t have a technology fund.” The point here is not so much about the minutes as it is about the committee’s process. If John raises the issue about the technology fund, the committee needs to address it, and either record the decision that was made or indicate that it will be put on the agenda for a future meeting. And then be sure to discuss it at the next meeting and record the decision.

Remember, the minutes are proof of the committee’s fiduciary process. Make sure that you address the issues, reach decisions... and then record the results. ❖

## Firm Message

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that is difficult to do. As a result, a number of insurance companies are developing guarantees that will help participants avoid the risk of outliving their 401(k) retirement income.

- Finally, both the SEC and the DOL are actively at work to modify the rules for target date funds. The primary reason is that, in 2008, many 2010 funds – for people within a year or two of retirement – lost 20 to 25% of their value in a single year. The common view is that participants had not been educated that their target date funds were invested in such aggressive styles that they could suffer losses of that degree. Both the DOL and SEC have already issued some guidance, and more is on the way.

We hope this newsletter is valuable to you.

-Fred Reish

## Southern California Rising Stars

Congratulations to Heather Bader-Abrigo, Pascal Benyamini, Meena Kotak and Jason Roberts. They were selected for inclusion in the “2010 Southern California Rising Stars.” The Super Lawyer’s Rising Stars listing is published in the July issue of Los Angeles magazine and the stand-alone Rising Stars magazine. Rising Stars are determined via a survey of Southern California attorneys who are 40 years old or younger, or have been in practice 10 years or less. Only 2.5 percent of lawyers in Southern California receive this honor.

## How Not to Apply For a Favorable Determination Letter



*By Marty Heming (MartyHeming@Reish.com) and Bruce Ashton (BruceAshton@Reish.com)*



A favorable determination letter is the IRS's way of telling you that your plan complies as to form with current legal requirements. In other words, it is a type of "insurance policy" that says your plan is qualified.

We recently handled a matter for a client in which the process of seeking a favorable determination letter (or FDL) went terribly wrong. Fortunately, through diligence and a bit of creativity, we were able to turn the process around.

By way of background, to get a FDL, the employer must file an application that includes the plan document, prior amendments and various other items of information. In reviewing the application, the IRS will look to make sure that the plan and all required interim amendments were adopted on a timely basis. If not, the plan is considered to be under audit, and the IRS gives the employer a choice: retroactively correct the error under the audit Closing Agreement Program (CAP) or have the plan disqualified. Under CAP, the employer must pay a penalty, which is often tens of thousands of dollars, to avoid having the plan disqualified.

The matter we handled involved a profit sharing plan to which the employer was adding a 401(k) cash or deferred feature. The restated plan was submitted to the IRS for a FDL. The reviewing IRS agent asserted that the plan was subject to disqualification because participant deferrals had been permitted prior to the date the restated plan was signed, in violation of the tax regulations. The agent said that this was an operational failure that must be corrected under the audit CAP program. The employer and the third party administration firm that had submitted the application assumed the IRS was correct and engaged our firm to try to get the lowest possible audit CAP penalty.

Unfortunately, the signature date on the restatement was after the date the first elective deferrals were made. But in our mind, the question was whether the restatement had been adopted prior to the date deferrals began, regardless of when it was signed. We based this position on the following:

- First, the tax regulations provide that "[a] qualified pension, profit sharing, or stock bonus plan is a definite written program and arrangement which is communicated to the employees and which is established by an employer." There is nothing that mandates that the only way a definite written program can be established by an employer is by a dated signature block on the plan document. Having an executed and dated plan document is one way to prove that a definite written program has been established, but not the only way.
- Second, we discovered documentation showing that, prior to the date deferrals commenced, the employer had taken all necessary steps to decide on the terms of the plan.
- Third, we provided evidence that the establishment of the plan had been communicated to the employees and steps taken to implement prior to the first deferrals. We showed this through documents provided to and election forms obtained from the employees at an employee meeting on the date the restatement was to go into effect.

Based on these facts, we argued that the employer had intended to adopt the plan before deferrals were to begin, had taken all steps needed to determine the terms of the plan and to communicate the plan to the employees and, therefore, had in fact established the plan on a timely basis. In the face of this information, the IRS reversed its earlier position and granted the FDL without the payment of any penalty.

We believe this case is important for two reasons. First, it serves as a reminder

not to submit the plan for a favorable determination letter without being sure that there are no preexisting errors—and taking steps to correct the errors before the application is filed. Second, it emphasizes that resolution of a proposed CAP settlement involves more than just negotiation of the penalty amount and, instead, should be a creative process to see whether a penalty can be avoided altogether. ♦

### Academic Studies on Participant Behavior

As a part of our support for academic research concerning participant investment behavior (including our support of research by Professor Shlomo Benartzi of UCLA), we post important academic and industry studies on our website.

We have recently posted a study entitled "The Efficiency of Pension Menus and Individual Portfolio Choice in 401(k) Pensions" by Ning Tang and Olivia S. Mitchell of the Wharton School and Gary R. Mottola and Stephen P. Utkus of Vanguard Center for Retirement Research.

The study was done to evaluate participant investment performance. It identified key portfolio investment inefficiencies and attributes them to offered investment menus versus individual portfolio choices. As noted in the study:

"We show that the vast majority of 401(k) plans offers reasonable investment menus. Nevertheless, participants 'undo' the efficient menu and make substantial mistakes: in a 20-year career it will reduce retirement wealth by one-fifth, in fact, more than what a naive allocation strategy would yield. We outline implications for plan sponsors and participants seeking to enhance portfolio efficiency: don't just offer or choose more funds, but help people invest smarter"

To view or print a copy of the study, visit [http://www.reish.com/publications/pdf/wp\\_2009-203.pdf](http://www.reish.com/publications/pdf/wp_2009-203.pdf).

## Tips for Documenting the Selection and Monitoring of Your Advisers



*By Jason Roberts (JasonRoberts@Reish.com)*

In working with our plan sponsor clients, we have found that while most go to great lengths to establish procedures to select and monitor plan investment options, many do not have adequate processes or documentation regarding the selection and monitoring of consultants or advisers that often assist the plan fiduciaries in investment-related matters. Fiduciaries of employee benefit plans are charged with carrying out their duties prudently and solely in the interest of participants and beneficiaries of the plan and are subject to personal liability to, among other things, make good any losses to the plan resulting from a breach of their fiduciary duties. In selecting service providers, the responsible plan fiduciary must engage in an objective process designed to elicit information necessary to assess the qualifications of the service provider, the quality of the work product, and the reasonableness of the fees charged in light of the services provided. In addition, this process should be designed to avoid self-dealing, conflicts of interest or other improper influence. The following steps are designed to assist fiduciaries in evaluating the adviser and the services to be provided.

*Step 1: Evaluate the credentials of the adviser and his or her experience with servicing employee benefit plans, the services to be provided and the fees to be charged.*

- You should also consider obtaining competing bids from other providers offering equivalent services and document the basis upon which you have selected your adviser, including any relevant industry experience and/or retirement-specific designation(s).

*Step 2: Evaluate any potential conflicts of interest and the adviser's policies and procedures designed to address those conflicts.*

- The SEC has warned that "business alliances" among pension consultants and money managers can give rise to serious potential conflicts of interest under the Advisers Act that need to be monitored and disclosed to plan fiduciaries. The following questions are designed to aid in determining whether conflicts, or potential conflicts, of interest exist:

- Is the adviser registered with the SEC? If yes, does the adviser comply with all disclosure requirements?
- Does the adviser have relationships with money managers that the adviser recommends?
- Does the adviser, or a related company, receive any payments from money managers?
- Does the adviser use plans that pay the adviser a consulting fee?
- Does the adviser consider him/herself to be a fiduciary under ERISA with respect to the recommendations the adviser provides for the plan?

*Step 3: Periodically review the performance of your service providers to ensure that they are providing the services in a manner and at a cost consistent with the agreements.*

*Step 4: Review plan participant comments or any complaints about the services and periodically ask whether there have been any changes in the information you received from the service provider prior to hiring (e.g. does the provider continue to maintain any required state or federal licenses).*

*Step 5: Prepare a written record of the process you followed in reviewing potential service providers and the reasons for your selection of a particular provider. ❖*

### Fixing Common Plan Mistakes: Improper Forfeiture Suspense Accounts

The Employee Plans Division of the IRS regularly publishes a newsletter entitled "Retirement News for Employers (RNE)." Each issue of the newsletter looks at a common error in retirement plans and explains the IRS' position on fixing the problem and reducing the probability of its recurrence. In the Spring 2010 issue, the IRS discussed the operation of suspense accounts (or "unallocated" accounts) that are attributable to forfeitures from participants' accounts.

*Each issue of the RNE examines a common error that occurs in retirement plans and provides information on fixing the problem and reducing the probability of its recurrence.*

#### **The Issue**

Many defined contribution plans require participants to complete a period of service before becoming fully vested in matching or nonelective employer contributions. If a participant leaves a company before completing the service required for full vesting, his or her non-vested account may be forfeited. Some plan administrators place these forfeited amounts into a plan suspense account, allowing them to accumulate over several years. The Internal Revenue Code does not allow this practice.

#### **Find the Mistake**

Forfeitures must be used or allocated in the plan year incurred. The Code does not authorize forfeiture suspense accounts to hold unallocated monies beyond the plan year in which they arise. Revenue Ruling 80-155 states that a defined contribution plan will not be qualified unless all funds are allocated to participants' accounts in accordance with a definite formula defined in the plan. This would preclude a plan from carrying over plan forfeitures to subsequent plan years, as doing so would defy the rule requiring all monies in a defined contribution plan to be allocated annually to plan participants. Revenue Ruling 84-156 states that forfeitures may be used to pay for a plan's administrative expenses and/or to reduce employer contributions. Treasury Regulations §1.401-7(a) notes that forfeitures must be used as soon as possible to reduce employer contributions.

The plan document's terms should have provisions detailing how and when a plan will exhaust plan forfeitures. A plan's failure to use forfeitures in a timely manner denies plan participants additional benefits or reduced plan expenses.

We hope this information will be helpful to you. If you have questions, contact any of our benefits attorneys.

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## Fund Facts Sheets Fail under 404(c)



*By Summer Conley (SummerConley@Reish.com)*

Many 401(k) plan sponsors design their plans to satisfy ERISA section 404(c) so that they can limit fiduciary liability for participant investment decisions. Essentially, if an individual account plan meets the 404(c) requirements, the plan's investment fiduciaries are responsible for the selection and monitoring of available investment options, but are not responsible for losses that result from the actual investment decisions made by plan participants.

Complying with 404(c) can be tricky as there are a number of specific requirements that must be satisfied, including providing various pieces of information to participants. For example, ERISA Regulation section 2550.404c-1(b)(2)(B)(1)(viii) requires that a participant be provided with an investment fund's prospectus immediately preceding or following the participant's initial investment in a fund. Participants and beneficiaries must also be able to request copies of prospectuses at any time. In 2009, the Department of Labor (the "DOL") issued Field Assistance Bulletin 2009-03 providing that for investment funds subject to the Securities Act of 1933, the plan fiduciary can provide the fund's "summary prospectus" in lieu of the full prospectus.

While the full prospectus must still be available on request, having to automatically provide only the summary may help simplify 404(c) compliance. However, plan sponsors should be careful. We recently looked at this issue for a client and discovered that what

the plan's recordkeeper thought was a summary prospectus was not!

The DOL authorized use of a fund's "summary prospectus" in lieu of the full prospectus based on the SEC's use of the term. Specifically, the SEC requires that a mutual fund provider prepare a summary prospectus in addition to the fund's full prospectus. The SEC sets out a number of specific requirements that must be met for a document to constitute a summary prospectus. In our recent situation, the plan's recordkeeper proposed using a "fund facts sheet" as the summary prospectus for purposes of 404(c) compliance. The fund facts sheet contained various pieces of information (e.g. portfolio composition, fees, and portfolio managers) about the fund. However, the fund facts sheet missed many of the SEC's specific requirements for a summary prospectus. Among other missing items, the fund facts sheet contained no reference to being a summary prospectus, had no investment return summaries, and no legend cautioning that prospective investors may want to review the full prospectus before investing and explaining how to obtain the full prospectus.

Fund facts sheets may provide useful information and it is not a bad idea to distribute them to participants. However, from what we have seen, they do not rise to the level of a summary prospectus. Plan sponsors who want the protection provided by 404(c) should be careful not to rely on mere fund facts sheets to satisfy their prospectus disclosure obligation. Plan sponsors should consider doing a periodic compliance check to make sure that all of the requirements for 404(c) protection are satisfied. ❖

### ERISA Education for Bank Regulators

Fred Reish recently presented an educational session for the FFEIC on ERISA fiduciary responsibility and prohibited transactions as they relate to banks, trust departments, federal thrifts, credit unions and similar institutions. The FFEIC includes representatives of the Board of Governors of Federal Reserve Systems, the Federal Deposit Insurance Corporation, the National Credit Administration, the Office of the Controller of the Currency, the Office of Thrifts Supervision, and the State Liaison Committee.

The program focused on ERISA Section 406(b) prohibited transactions. Those are the prohibited transaction rules that specifically apply to fiduciaries, including both discretionary and directed trustees. The program covered issues related to both ERISA plans and individual retirement accounts. Most of the materials were based on guidance that had been issued by the Department of Labor, including prohibited transaction exemptions, advisory opinions, and field assistance bulletins.

### Subscribing for PLANSponsor Magazine

Plan sponsors and committee members should keep informed about 401(k) developments—like law changes and new products and services—and about 401(k) practices, like the experiences of other plan sponsors. One of the best ways to do that is to subscribe to Plan Sponsor magazine, which is free to plan sponsors (and for which Fred Reish writes a monthly column).

To sign up for the PLANSponsor magazine, go to <http://www.plansponsor.com/Subscriptions.aspx>. Under "Manage Your Subscriptions" select the description that best describes your responsibility for your organization. You will then be sent to a subscription page with a form requesting your contact information and a few questions on the demographics of your organization.

## Figure Out if Your 401(k) Plan is in Compliance Before the IRS Does



*By Heather Bader-Abrigo (HeatherAbrigo@Reish.com) and Bruce Ashton (BruceAshton@Reish.com)*



In recent weeks, the IRS has sent Compliance Questionnaires to roughly 1,200 randomly selected 401(k) plans that filed a Form 5500 for the 2007 plan year. The IRS is asking for information about plan operations for the 2008 plan year (unless stated otherwise), including: (1) plan demographics; (2) participation issues; (3) employer and employee contributions; (4) top heavy and nondiscrimination rules; and (5) various other questions regarding the administration of the plan. The IRS will use the information it obtains from the Questionnaire responses to identify areas in which additional guidance or education is needed. More importantly, it will also allow the IRS to focus its enforcement efforts in areas where it finds wide-spread non-compliance.

Employers have 90 days to complete and return the form, though an extension may be possible. While completing the compliance check is voluntary, the IRS has stated that failure to complete the Questionnaire could result in enforcement action, including an audit of the plan. That said, the IRS has stated that the compliance check is not an audit, investigation or review of the plan sponsor's books and records.

The Questionnaire is long, detailed and complicated. Employers that receive the questionnaire should discuss their responses with the plan's ERISA counsel, third-party administrator, plan committee, or other service providers. We suggest this because if an operational error is discovered in the course of preparing the response, the employer will

have an opportunity to make correction voluntarily.

Obviously, most 401(k) plan sponsors did not receive the Compliance Questionnaire, but that doesn't mean they should ignore it. The Questionnaire provides sponsors a roadmap to review their plan operations and do an internal compliance check based on the items the IRS is asking about. Items of special importance:

- does the plan pass discrimination testing (for non safe-harbor plans)?
- does the plan properly include/exclude employees in compliance with Internal Revenue Code minimum coverage rules?
- are employee deferrals being deposited timely? (Failure to do so is a prohibited transaction, which subjects the plan sponsor to excise taxes and a requirement to add interest to the amount deposited.)
- are you properly administering plan loans pursuant to Code §72(p)?
- are participant notices properly being prepared and distributed?

If you uncover errors through this internal review process—using the Compliance Questionnaire as a guide—most of them can be corrected either through self-correction or by submitting an application under the IRS Voluntary Corrections Program (VCP). Determining whether an error is eligible for self-correction or should be submitted under VCP requires experience and judgment, so if you do uncover errors, we urge you to consult with your plan advisers or counsel. If you would like a copy of the Questionnaire, please contact Heather Abrigo at heatherabrigo@reish.com. ❖

## Monthly Income

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first year, \$20,600 the second year (assuming 3% inflation), and so on. What education does your plan provide to help your employees understand these retirement income issues?

In writing this article, I ended each paragraph with a question. My purpose was not to suggest that your plan has been deficient, but instead to support Phyllis Borzi's vision of a national dialogue. Plan sponsors need to think about these issues and to learn about the products and services available to address them. Now is the time. ❖

## Plansponsor's 15 Legends

This is our 14th installation of the 15 "Legends." Fred Reish was selected as one of the 15 "Legends of the Retirement Industry." These "Legends" are individuals who have, in the past decade and a half, made a lasting contribution to the nation's retirement security.

David Swensen has been the Chief Investment Officer of Yale University since 1985. He is responsible for managing and investing the University's endowment assets and investment funds that total to about \$16 billion. Over the last 10 years, David has added more than \$16 billion to Yale's coffers. As commented by PLANSPONSOR magazine:

"His success at generating returns at the \$22.5 billion fund - an annual 17.8% over the last decade—sets him apart from his peers and, on it's own, merits his inclusion as one of the PLANSPONSOR's 15 Legends."

Congratulations to David Swensen for having invented what has become known as "The Yale Model" which is an application of Modern Portfolio Theory.

## Suggestions for Managing Your Benefit Programs

We asked several of our ERISA attorneys to provide tips for plan sponsors about the management of their employee benefit programs. Here are some ideas that should be helpful to you.

### Tips For Plan Sponsors

**Tip #1:** In the next year or two, service providers will be required to provide plan sponsors with disclosures about: their total compensation, both direct and indirect; the services that they render to the plan and the participants; and their material conflicts of interest in providing those services. However, plan sponsors should not wait for the law to require those disclosures. Instead, plan sponsors should require that their service providers give them clear, complete and accurate disclosures on each of those matters. Why? First, so that the plan and the participants can be protected against the possible consequences of the unknown and, second, because under the current state of the law, plan sponsors are required to know and consider that information in their decision making. The new legal changes are just to make it easier for plan sponsors to perform a job that they already have.

**Tip #2:** I am serving as an expert witness in an ERISA lawsuit, where the expert for the plaintiffs, a well-known investment adviser, has taken the position that ERISA requires that plans have an investment policy statement (IPS). While that is not the law (and, in fact, many plans do not have an IPS), the judge is not an ERISA expert and, unless the attorneys and other experts are successful in educating the judge, a mistake could be made. Thus, plan sponsors should consider, as a risk management technique, either developing investment policy statements or, alternatively, at least documenting the criteria that are used to evaluate the investments.

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### E-Fast 2 Filing Form 5500

As of January 1, 2010 all Forms 5500 required for ERISA plans must be filed electronically using E-Fast 2. Generally, this will not have a direct impact on plan sponsors because they hire experts to prepare the Form 5500 on their behalf. However, one consequence of the new filing system will be to effectively eliminate the current practice of filing the Form 5500 timely, but without attaching the required independent CPA audit report. Why? Under prior practice it would take the DOL several months to realize that the audit report was not attached. Under the new system, the DOL will know immediately upon filing that the CPA report was not attached, and therefore there will be no waiting or preliminary notices sent. According to a DOL spokesman, the sponsor can expect a letter almost immediately giving the sponsor 45 days to file a statement of reasonable cause, or provide the missing CPA report.

Marty Heming  
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### Don't Forget About Initial COBRA Notices!

We all know that a plan administrator must provide COBRA election notices upon a COBRA qualifying event. But many administrators forget that they also must provide an initial COBRA notice when an employee or his or her spouse first enrolls. Among other things, this notice informs participants of their obligation to notify the administrator of certain qualifying events within 60 days of the event (*e.g.*, divorce). If a participant was never provided the initial COBRA notice, he or she may plead ignorance of such a requirement, resulting in an extension of that 60-day notice period. Additionally, the administrator may be liable for penalties under ERISA and the Code.

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### Have You Read Your Contract Lately?

Plan sponsors sign legal contracts with third party vendors to provide services, ranging from investment advice to record keeping and plan administration and actuarial calculations and accounting. In addition to key ERISA provisions, it is important to understand terms and conditions that are contained in the "boilerplate" of the contract.

For example: Does the plan sponsor have the "actual authority" to execute the agreement? Or has such authority been delegated to a corporate officer or a special committee? The right signatures need to be obtained for contract execution to have a valid and binding agreement. Does the plan document allow for the use of plan assets for payment of certain expenses? The Plan sponsor must be certain this is permitted before it makes such a standard representation and warranty in the contract. If the service provider relies on technology and the internet to deliver its services, does it provide for any disaster recovery or back-up of data in the event of a computer malfunction or some other force majeure event which otherwise allows for non-performance of its services? Does the service provider maintain adequate privacy and plan data safeguards to protect the integrity of any information shared by the plan sponsor? These measures should be spelled out in the contract, and may be governed by federal and state laws in certain instances which are designed to benefit the plan sponsor. It is easy to lose focus on these important provisions after paying attention to the more obvious ERISA sections of the agreement.

A thorough review of all the provisions of service contracts before execution will benefit the plan sponsor and participants in the event of problems down the road.

Stephen Wilkes  
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## Allocation of Revenue Sharing



By **Fred Reish** ([FredReish@Reish.com](mailto:FredReish@Reish.com))

In my experience, most 401(k) fiduciaries—like plan committees—have not focused on properly allocating the revenue sharing received by their plan's recordkeeper. In fact, it is possible that many plan fiduciaries are not aware that their recordkeepers are receiving revenue sharing from the investments, while others may assume that the recordkeepers are handling the matter properly . . . and perhaps also assume that it is not an issue of concern for plan sponsors. Those are dangerous assumptions.

As background, recordkeepers receive revenue sharing (such as sub-transfer agency fees and administrative services fees) from most of the mutual funds used by 401(k) plans. In most cases, the recordkeeper collects those amounts and either takes them into account in setting its fees or, alternatively, directly offsets them, dollar for dollar, against a stated fee. In some cases, the recordkeeper deposits

the revenue sharing into an expense recapture account in the 401(k) plan and then pays its fee—as approved by the plan sponsor—from that account. That is an example of full transparency.

However, this situation is even more complicated than that. That is because different mutual funds pay revenue sharing in different amounts. Assume, as an easy example, that a 401(k) plan had only two investments. The first investment is in an actively managed mutual fund (Fund A) that invests in equities and has an expense ratio of 1% per year (or 100 basis points). Assume the other investment is an S&P 500 Index Fund (Fund B) with an expense ratio of .20% per year (or 20 basis points). In this hypothetical, the first fund pays one quarter of a percent (or 25 basis points) per year in revenue sharing to support the operation of the 401(k) plan, while the second mutual fund does not pay revenue sharing—because its expenses are so low. Finally, assume that half of the participants are invested in Fund A and half in Fund B.

In that case, the participants who invest in the first mutual fund are paying all, or substantially all, of the expenses for operating the plan, while the participants who invest in the second fund are not paying anything for the operation of the plan. Is it fair . . . or even legal . . . for half of the participants to be charged for operating the plan, while the other half are not? That's the question.

Another common example would be when one of the investment options is a company stock fund, which pays little, if anything, for the operation of the 401(k) plan.

While 401(k) industry insiders have been concerned about this issue for several years, it is just now emerging as a legal issue for plan sponsors.

There are a number of considerations (which we will address in future articles), but the point of this article is that the allocation of revenue sharing is a fiduciary responsibility and that, therefore, plan sponsors and their committees must engage in a prudent process to determine the proper allocation. That process, and the resulting decision, should be documented. ♦

### Around the Firm

**Speeches:** On June 2nd and 3rd, **Marty Heming** presented "Plan Mistakes, Department of Labor, IRS Audits," at the CalCPA Education Foundation, Retirement Plans Conference held in Burbank and San Francisco, respectively. On June 15th, **Jason Roberts** presented "Washington Update – What 'Change' Could be Coming to Your Benefits Programs," at the Plansponsor National Conference in Chicago, IL. On June 16th, **Jason** presented "Overview of Pending Legislation and Regulation Affecting Plan Sponsors," at the Intercare University's 401(k)/403(b) Fiduciary Boot Camp in La Jolla. At the Western Benefits Conference, held in Los Angeles on July 18th-20th, **Fred Reish** presented a workshop on "401(k) Fiduciary Safe Harbors: What are They and Do They Work?" He will also be the guest speaker for the San Diego Chapter of NIPA meeting on "A Day with Fred Reish" on August 10th, in San Diego. On August 11th, **Jason** will conduct a webinar on "Tips and Traps for Service Providers to Qualified Retirement Plans and IRAs" on behalf of the Financial Service Professionals. At the ASPPA DOL Speaks Conference, held at National Harbor, MD on September 20th-21st, **Fred** will co-present a workshop on "Fee Disclosures" and **Bruce Ashton** will moderate the workshops "Form 5500 Update" and "Governance Part 2: Investment Process." On September 21, **Marty** will present "408(b)(2)" to the San Diego Chapter of Western Pension and Benefits in San Diego.

**Quotes:** In June, **Jason** was quoted in the following articles: "Wealth Manager-Will Brokers be Forced Out of 401(k) Business?" published on *Reuters.com*; "House 401(k) Plan 'Slap in the Face' to Obama Administration," published on *InvestmentNews.com*; and "DOL 401(k) Fee Regs Delayed: Industry Battles Over Bill" and "IRS 401(k) Compliance Questionnaire Worries Plan Sponsors," both published on *Ignites.com*. In the June issue of *Treasury & Risk*, **Fred** was quoted in the article "Auto IRAs on the Way?" He was also quoted in the article "Employee Allegations of Excessive 401(k) Fees Gain Ground," published in the *Los Angeles Times* on July 29th.

**Articles:** In the June issue of the *Plan Sponsor* magazine, **Fred** wrote a column entitled "The 401(k) Destination: If You Don't Know Where You Are Going..." In the June issue of *ASPPA Advisor Update* newsletter, **Jason** wrote an article on "Overview of Pending DOL Regulations and Recommended Action Items."

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