

**New Laws, More Regulations  
and Fiduciary Trends:**  
*WHERE ARE WE GOING?*

*presented by*  
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 ♦  
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**Where Are We Going?**

Change is here . . . and more is coming:

The big change . . . 401(k)'s are retirement plans.  
That means the focus will be on:

- benefit adequacy (income)
- participating
- deferral rates
- investments
- investing
- disclosures and conflicts of interest
- fees and expenses
- distributions

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**Disclosures**

The trend is towards full disclosure—at both the plan and participant level . . . disclosures about investments, services and conflicts:

- disclosure to fiduciaries and participants
- disclosure of providers and advisers
- disclosure of conflicts of interest
- disclosure of costs
- disclosure of compensation and revenue sharing (direct and indirect)

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## Expenses: Issues

The fiduciary concerns:

- Are the expenses reasonable?
- Is the compensation reasonable?
- Are there conflicts?

Note regarding benchmarking: quantitative versus qualitative.

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## Expenses: Fiduciary Responsibility

*The Law:*

As explained by the DOL in 1997, the primary plan fiduciaries are required to know and evaluate the compensation paid:

"... the responsible Plan fiduciaries must assure that the compensation paid **directly or indirectly** by the Plan to [the service provider] is reasonable, **taking into account the services provided** to the Plan as well as any other fees or compensation received by [the service provider] in connection with the investment of Plan assets."

*continued . . .*

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## Expenses: Fiduciary Responsibility

*The Law:*

"... The responsible Plan fiduciaries therefore **must obtain sufficient information** regarding any fees or other compensation that [the service provider] receives with respect to the Plan's investments . . . **to make an informed decision** whether [the service provider's] compensation for services is no more than reasonable." (DOL Advisory Opinion 97-15A.)

Note: The duties to investigate and to evaluate.  
The role of the adviser.

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## Expenses: Current Activity

### Litigation.

### Regulation:

- 2009 Form 5500, Schedule C.
- Disclosures to plan sponsors (408(b)(2)).
- Disclosures to participants (404(a) regulation).

### Legislation.

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## Schedule C for 2009 Form 5500

**REPORT TIME**

The DOL has released the 2009 Form 5500 package. The new Schedule C—for plans with 100 or more participants—requires reporting by plan sponsors of direct and indirect revenues received by service providers.

- Direct compensation
- Indirect compensation: eligible and ineligible

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## Schedule C

**REPORT TIME**

### Definition of compensation:

For Schedule C purposes, reportable compensation includes money and any other thing of value (for example, gifts, awards, trips) . . .

. . . received by a person, directly or indirectly, from the plan (including fees charged as a percentage of assets and deducted from investment returns). . . .

Note: The same definition was used for 408(b)(2) disclosure purposes.

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## Schedule C

### Failure to Provide Information:

If a service provider fails to provide the information needed to complete the Schedule C, the plan must report that information to the DOL on the Schedule C.

Part II		
Service Providers Who Fail or Refuse to Provide Information		
4 Provide, to the extent possible, the following information for each service provider who failed or refused to provide the information necessary to complete this Schedule.		
(a) Enter name and EIN or address of service provider (see instructions)	(b) Nature of Service Code(s)	(c) Describe the information that the service provider failed or refused to provide

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## ERISA section 408(b)(2): Disclosures

- What it says.
- What is the current status of the regulation?
- Where do we go from here?
- Risk management and best practices.

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## Disclosures: 408(b)(2) Proposal

"Covered" service providers must have a contract or arrangement with the plan and satisfy the following requirements:

- the terms must be in writing;
- the terms must require the service provider to disclose . . .

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## Disclosures: 408(b)(2) Regulation

- before the arrangement was entered into, to the responsible plan fiduciary:
  - a list of the services provided, and
  - for each service,
    - the compensation to be received, and
    - the manner of receipt.
  - potential conflicts of interest

Note regarding ADV Part II and RIA service agreements.

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## Disclosures: Conflicts of Interest

Whether the service provider (or an affiliate) will provide any services to the plan as a fiduciary either within the meaning of ERISA section 3(21) or under the Investment Advisers Act of 1940.

- This is a fundamental decision for advisers.
- Fiduciary and non-fiduciary services.

Note: Service agreement should distinguish between fiduciary and non-fiduciary services.  
Impact of 408(b)(2) proposed requirement.

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## Disclosures: Material Changes

The terms of the contract or arrangement must require that the service provider disclose any material change to the information to the responsible plan fiduciary.

Note: Agreement should have "Aetna provision."

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## Defined Contribution Fee Disclosure Act

Legislation has been proposed by Senators Harkin and Kohl that would enhance fee disclosures to plan sponsors (and participants) and thereby remove the need for the 408(b)(2) regulation.

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## Fee Disclosure Act

The proposed legislation would require that, before a plan can enter into a contract for services, the ERISA Plan Administrator (typically, the plan sponsor or an officer) must receive a written statement which:

- describes the services;
- provides and allocates the expected annual charges (as a dollar amount or a formula);
- discloses certain conflicts.

Note: Generally for services costing \$5,000 or more.

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## Fee Disclosure Act

The allocation must, at the least, break the fees into the following four categories:

- charges for investment management;
- charges for recordkeeping and administration;
- sales charges, including commissions and fees for advisory services; and
- other charges.

Note regarding estimates and material changes.

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## Fee Disclosure Act

The conflict disclosures include:

- payments received from unaffiliated persons;
- any financial or personal relationship with the plan, the plan sponsor, another service provider, if those relationships result in material benefits;
- use of proprietary investments;
- explanation of share classes;
- free or discounted services.

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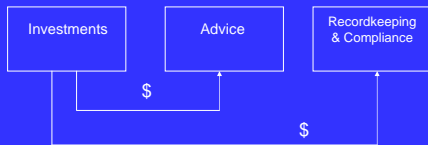
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## Expenses: What Should Fiduciaries Do?



Notes: Compare to market data.  
Recapture of excess revenues: ERISA accounts.  
Share classes.

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## Expenses: ERISA Budget Accounts

Issues for these accounts:

- plan asset?
- plan document provisions?
- permitted expenses?
- allocation to participants?

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## Participant Investing

- QDIAs – design
- PPA fiduciary adviser
  - pure level fee
  - conflicted advice

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## Investing: Special Issues for Advisers

- Fiduciary advice for participants
- Advice regarding distributions
- Referrals to investment managers
- Capturing rollovers: fiduciary considerations prohibited transactions

RLRC Bulletins.

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## Investing: PPA Fiduciary Adviser

Under ERISA, a person who gives individualized investment advice to a participant, based on the particular needs of the participant, is a fiduciary. That implicates the:

- fiduciary responsibility rules; and
- 406(b) prohibited transaction rules.

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## Investing: PPA Fiduciary Adviser

Prior to the PPA 2006, fiduciary investment advice could be given to participants if it was "pure" level fee. The PPA and/or the DOL regulation allow:

- statutory level fee advice
- statutory computer model advice
- class level fee advice
- class third party computer advice
- class off-model advice

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## Investing: PPA Fiduciary Adviser

Other issues for statutory and class exemption advice:

- independent certification
- annual audits
- disclosures
- effective date

Note: CEFEX certification.

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## Fiduciary Safe Harbor for Defaults

The Pension Protection Act added section 404(c)(5) to ERISA to create a defense (sometimes called a "safe harbor") for fiduciaries who invest the accounts of defaulting participants.

The purpose was to encourage the adoption of automatic enrollment, but the fiduciary benefits go beyond that to all defaults.

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## Secondary Effects of QDIAs

The 404(c)(5) legislation and the DOL's regulation (the "QDIA" regulation) reflect a strong policy in favor of investing participants in "portfolio" investments, rather than in individual mutual funds.

Further, portfolio investing is consistent with ERISA's investment principles, which are based on generally accepted investment theories, such as modern portfolio theory.

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## What Doesn't It Do?

The QDIA safe harbor does not relieve plan sponsors from their duty to prudently select and monitor all plan investments, including the QDIA investments.

However, fiduciaries do not need to engage in a prudent process to select one category of QDIA over another.

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## Seeking the Safe Harbor

The fiduciary safe harbor for defaults into QDIAs may be obtained in a number of ways:

- Automatic enrollment
- Regular enrollment
- Change of investments
- Change of providers
- Any other default
  - Consider re-enrolling plan

Note: Reversal in thinking.

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## Investing: Target Date Fund Issues

The issues:

- 2008 losses in 2010 funds: most = 25% to 30%; one was 40%.
- Query: How to balance preservation with appreciation? What actually happens at retirement?

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## Participation

The retirement plan perspective:

- Small employers with no plans: automatically enrolled, deferral only, IRA-based plans.
- Employers with 401(k) plans: mandated automatic enrollment.

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## Benefit Adequacy and Deferrals

- Benefit adequacy defined
- Impact of deferral rates
- Automatic deferral increases
- Gap analysis
- Impact of recession

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## Distributions

- The 4% draw-down
- Retirement income guarantees
- Real people, real needs

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## Guaranteed Distributions

The concept of GMWB (guaranteed minimum withdrawal benefits):

- benefit base
- account value

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## Impact of Changes

- Re-define 401(k)s as retirement plans.
- Increase focus on compliance and risk management.
- Cost of compliance and focused advisers.
- Movement to the RIA model.
- Benefit of disclosures and transparency (in writing).
- Risk management through well-drafted ADVs and agreements.
- The concept of a successful plan.

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*Parting thoughts . . .*

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