

Fiduciary Challenges in Retirement Plans 2012

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Question #1

What is the meaning of “fiduciary”?

Question #2

Why is the idea of “fiduciary” important to various retirement system stakeholders?

Question #3

“Fiduciary” creates certain boundaries.
Who do they apply to?

Question #4

What is the “big picture” view of the current landscape and how it is changing?

Four “Big Picture” Issues for ERISA Plan Fiduciaries

- A. Fiduciary Update
 - Clarifying Fiduciary Role
 - Status as 3(21) vs. 3(38) Fiduciary
 - Investment Advice Fiduciary

- B. Service Provider Disclosures to Responsible Plan Fiduciaries - the "408(b)(2) regulations"

- C. Plan Administrator Fee Disclosures to Participants - the "404(a)(5) regulations"

- D. Participant Investment Advice

A. Fiduciary Update

A. Fiduciary Update

Clarifying the Fiduciary Role

- Increased role, increased responsibility
 - Non-fiduciary service provider: settlement safekeeping, recordkeeping, processing benefits, etc.
 - Directed trustee: named in trust or appointed by named fiduciary, legal owner of plan assets, manages/controls plan assets
 - ERISA 3(21) fiduciary: either (a) discretionary authority or control, or (b) rendering investment advice for a fee
 - ERISA 3(38) fiduciary: contractually granted full discretion and authority over investments
- Specify role/responsibilities in agreements

A. Fiduciary Update

3(21) vs. 3(38) Fiduciary – Status

- ERISA Sec. 3(21)(A)(ii) Investment Advice Fiduciary - one who renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so
- ERISA Sec. 3(38) Investment Manager Fiduciary
 - has the power to manage, acquire, or dispose of any asset of a plan
 - is a registered investment adviser, a bank, or an insurance company, and
 - has acknowledged in writing its fiduciary status with respect to the plan

A. Fiduciary Update

3(21) vs. 3(38) Fiduciary – Services Provided

- Fiduciary Advisor [3(21)]
 - investment advice on plan assets to plan fiduciaries and/or plan participants
- Fiduciary Manager [3(38)]
 - investment selection for the plan
 - sales and purchases of plan assets
 - asset management

A. Fiduciary Update

3(21) vs. 3(38) Fiduciary – Qualifications

- Fiduciary Advisor [3(21)]
 - no specific requirements under ERISA
 - Financial Industry Regulatory Authority and state law requirements apply
 - can become an "accidental fiduciary" by advisor's actions
- Fiduciary Manager [3(38)]
 - Registered investment adviser under the Investment Advisers Act of 1940
 - Registered investment adviser under applicable state law
 - bank or insurance company

A. Fiduciary Update

3(21) vs. 3(38) Fiduciary – Effect on Other Fiduciaries

- Fiduciary Advisor [3(21)]
 - serves as co-fiduciary with plan trustee(s) on investment decisions
 - does not implement investment advice; other plan fiduciaries must do so
 - does not relieve other plan fiduciaries of liability for investment decisions
- Fiduciary Manager [3(38)]
 - relieves other plan fiduciaries from liability for investment decisions
 - other plan fiduciaries liable for selection and monitoring of manager

A. Fiduciary Update

3(21) vs. 3(38) Fiduciary Status – Effect on Participants

- Fiduciary Advisor [3(21)]
 - can provide investment advice directly to participants
 - assists participants in selecting the mix of investments
- Fiduciary Manager [3(38)]
 - does not provide investment advice to participants who direct their own investments
 - selects the investments from which the participants choose

A. Fiduciary Update

3(21) vs. 3(38) Fiduciary Status – The Marketplace

- Investment companies more willing to offer both 3(21) and 3(38) services
 - Financial institution partners with independent investment advisory firm or financial service company
- Presents risks
 - Market decline = increased litigation
 - Scrutiny over decisions to include own investments in plan assets
- Can minimize risks through effective selection and monitoring procedures
- Still, many institutions still not willing to accept 3(38) risks

A. Fiduciary Update

Investment Advice – Current Regime

- In 1975, DOL issued a 5-part regulatory test for “investment advice” that gave a very narrow meaning to this term
- To be an investment advice fiduciary, the advisor must
 - (1) make recommendations on investing in, purchasing or selling securities or other property, or give advice as to their value
 - (2) on a regular basis
 - (3) pursuant to a mutual understanding that the advice
 - (4) will serve as a primary basis for investment decisions, and
 - (5) will be individualized to the particular needs of the plan

A. Fiduciary Update

Investment Advice – Withdrawn Regulations

- DOL issued proposed regulations on 10/22/2010 that:
 - (1) re-examined the types of advisory relationships that give rise to fiduciary duties
 - (2) updated the rigid 1975 regulation so that plan fiduciaries, participants and IRA holders receive the impartiality they expect when they rely on their adviser's expertise
- Proposed regulations withdrawn on 9/19/2011
- Status in limbo; re-proposed regulations expected soon

B. Service Provider Disclosures

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Background

- ERISA Sec. 404(a)(1) – fiduciary requirements of prudence; best interest; exclusive purpose
- ERISA Sec. 406(a)(1)(C) – prohibited transaction; furnishing of goods, services, facilities between a plan and party in interest
- ERISA Sec. 408(b)(2) – prohibited transaction relief from 406(a)(1)(C) if services are “necessary,” contracts and compensation are “reasonable”
- New 408(b)(2) regulations focus on “reasonableness”

B. Service Provider Disclosures

Status of Regulations

- Final regs issued February 3, 2012
- Interim final regs initially applicable July 16, 2011; final regs extend applicability date to July 1, 2012
- Regs apply to contracts and arrangements in force on the applicability date
- Objective of the disclosures – to enable the plan fiduciary to determine “reasonableness” of fees and expenses

B. Service Provider Disclosures

Impact of Regulations

- Affected plans: “Employee pension benefit plans” under ERISA
- Exempt plans: Governmental plans, non-electing church plans, unfunded excess benefit plans, SEPs, SIMPLE IRAs, IRAs, some 403(b) plans, welfare benefit plans
- Covered service provider is one who reasonably expects to receive \$1,000 or more in compensation from:
 - Fiduciary or registered investment adviser activities
 - Recordkeeping or brokerage services
 - Other services for indirect compensation

B. Service Provider Disclosures

Actions – Service Provider

- Covered service provider's disclosure to responsible plan fiduciary reasonably in advance of the date the contract is entered into, extended, or renewed
- Contents of initial disclosure:
 - Description of services
 - Status of Covered Service Provider
 - Compensation disclosures: direct/indirect, fiduciary investment information
 - Recordkeeping/brokerage services
 - Manner of receipt of compensation

B. Service Provider Disclosures

Actions- Plan Fiduciary

- Responsible plan fiduciary – the one with authority to cause plan to enter into, extend, or renew the contract
- Must decide whether the services are necessary for the establishment or operation of the plan and whether the amount paid by the plan is "reasonable"

C. Plan Administrator Fee Disclosures

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Background

- New participant fee disclosure regulations expand fiduciary standards that apply to the investment of plan assets in individual account plans with participant investment direction
- Objective – provide participants and beneficiaries with sufficient information to make informed investment decisions

C. Plan Administrator Fee Disclosures

Status

- Affirmative fiduciary duty to disclose plan-related and investment-related information
- Duty applies to a covered individual account plan
 - Any participant-directed individual account plan
- Rules do not apply to IRA-based arrangements
- Initial annual disclosures effective date tied to 408(b)(2) regulation effective date (i.e., 60 days after 408(b)(2) regulation effective date)
 - August 30, 2012
- Quarterly statements furnished no later than November 14, 2012 (i.e., 45 days after end of 3rd quarter)

C. Plan Administrator Fee Disclosures

Plan-Related Information – General Information

- Circumstances and methodology for giving investment instructions
- Specified limitations on investment instructions and transfers to or from a designated investment alternative
- Description of voting, tender, or similar rights associated with investment options
- Identification of any designated investment alternatives offered under the plan
- Description of any “brokerage windows,” “self-directed brokerage accounts,” or similar plan arrangements

C. Plan Administrator Fee Disclosures

Plan-Related Information – Expenses

- Timing: Initially, August 30, 2012. Then, on or before date participant can first direct investments and at least annually thereafter
- Administrative Expenses: Fees/expenses for general plan administrative services that can be charged or deducted from all individual accounts
 - Legal, accounting, recordkeeping expenses
- Individual Expenses: Fees/expenses that may be charged against an individual account, rather than on a plan-wide basis
 - Plan loan fees, qualified domestic relation order processing fees, investment advice fees
- Quarterly disclosure:
 - Dollar amount of fees actually charged
 - Description of services to which charges relate

C. Plan Administrator Fee Disclosures

Investment Information – Automatic

- Timing - on or before first investment; annually thereafter
- Identifying information – name and category of investment
- Performance data (1-, 5-, and 10-year returns)
- Benchmarks
- Fee and expense information – fixed and variable returns
- Internet website address
- Glossary of terms
- Annuity options (if applicable)

C. Plan Administrator Fee Disclosures

Investment Information – Comparative Format

- Dated chart or similar format that facilitates a comparison of information among each designated investment alternative
- Model comparative chart:
 - Performance information for variable and fixed
 - Fee and expense information
 - If applicable, annuity information

C. Plan Administrator Fee Disclosures

Electronic Disclosure

- Technical Release 2011-03
- Disclosures included in pension benefit statement
 - Applies only to plan-related information (not investment-related information)
 - Furnish in same manner as other information in same pension benefit statement
 - Can use DOL safe harbor rule or IRS electronic delivery procedures
- Disclosures not included in pension benefit statement
 - Investment-related information and plan-related information not included in pension benefit statement
 - DOL safe harbor rule or modified affirmative consent approach

C. Plan Administrator Fee Disclosures

Comparative Action Summary

- Initial disclosure by August 30, 2012
- Do the regs apply to my plan?
- Gather info from service and investment providers
- Determine manner in which disclosures will be provided
- Review and/or update summary plan description, as required
- Review plan's designated investment alternatives
- Determine any impact on ERISA 404(c) disclosures

D. Participant Investment Advice

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Background

- ERISA §408(b)(14) and §408(g)
- Field Assistance Bulletin ("FAB") No. 2007-01
- Advisory Opinions No. 97-15A and No. 2005-10A
- Advisory Opinion No. 2001-09A
- Interpretive Bulletin No. 96-1
- Final 408(g) Regulations

D. Participant Investment Advice

Eligible Investment Advice Arrangement – Prohibited Transaction Exemption

- Pension Protection Act of 2006 amended ERISA and the Code to add a statutory exemption for provision of investment advice
- ERISA §408(b)(14) - exemption for investment advice rendered by an investment advice fiduciary to participant or beneficiary in an individual account plan
- ERISA §408(g) - Eligible Investment Advice Arrangement
 - fees paid do not vary based on investment options; or
 - computer model used to determine investments

D. Participant Investment Advice

Field Assistance Bulletin (“FAB”) No. 2007-01

- Pension Protection Act 2006 eligible investment advice provisions (i.e., EIAs) did not invalidate or otherwise affect prior DOL investment advice guidance
- A plan fiduciary that prudently selects and monitors an investment advice provider under an EIA will not be liable for the advice furnished to participants
- An affiliate of a fiduciary advisor will be subject to the level fee requirement of ERISA §408(g) only if the affiliate provides advice to plan participants or beneficiaries

D. Participant Investment Advice

Advisory Opinions Nos. 97-15A and 2005-10A

DOL explained that a fiduciary investment advisor could provide investment advice with respect to investment funds that pay it or an affiliate additional fees without engaging in a prohibited transaction if those fees are offset against fees that the plan otherwise is obligated to pay to the fiduciary advisor

D. Participant Investment Advice

Advisory Opinions Nos. 97-15A and 2005-10A

- So-called "Sun America" opinion
- No prohibited transaction where advice by investment fiduciary with respect to investment funds that pay additional fees to a fiduciary is the result of the application of methodologies developed, maintained, and overseen by a party independent of the investment advice fiduciary

D. Participant Investment Advice

Summary of Options for the Advisor

- EIAA - ERISA §§408(b)(14) and 408(g)
- Advisory Opinions 97-15A and 2005-15A. Offset advisory fees against fees that the plan otherwise is obligated to pay the fiduciary
- Advisory Opinion 2001-09A. Additional fees to the advisor are the result of methodologies developed, maintained, and overseen by a plan fiduciary independent of the investment advice fiduciary

D. Participant Investment Advice

Interpretive Bulletin §2509.96-1 –

Participant Investment Education

- Furnishing following categories of information and materials does not constitute rendering of investment advice
 - plan information
 - general financial and investment information
 - asset allocation models
 - interactive investment materials
- Fiduciary duty to select and monitor educators and advisers

D. Participant Investment Advice

Investment Advice in Connection with Rollovers – Advisory Opinion No. 2005-23A

- Is a person who advises a participant, in exchange for a fee, on how to invest assets a fiduciary? "Yes"
- Does a recommendation that a participant roll over his account balance constitute investment advice? "No"
- Would an advisor who is not otherwise a plan fiduciary and who recommends that a participant withdraw funds from the plan and invest the funds in an IRA engage in a prohibited transaction if the advisor will earn management or other investment fees related to the IRA? "No"

D. Participant Investment Advice

Final 408(g) Regulations – Background

- DOL published final regulations on October 25, 2011
- Regulations became effective as of December 27, 2011
- Implements Pension Protection Act exemptions permitting “level fee” and “computer model” advice for retirement plan participants and IRA beneficiaries
- Does not “invalidate or otherwise affect prior regulations, exemptions, interpretive or other guidance issued by the Department of Labor pertaining to the provision of investment advice”

D. Participant Investment Advice

Final 408(g) Regulations – Fee Leveling Arrangement

- Arrangement that uses fee leveling is an eligible investment advice arrangement if:
 - Investment advice is based on generally accepted investment theories that consider historic risks and returns of different asset classes over defined periods of time;
 - Investment advice considers investment management and other fees/expenses relating to recommended investments;
 - Investment advice considers, to the extent furnished by plan participant or beneficiary, information relating to age, time horizons, risk tolerance, current investments in designated investment options, investment preferences, or any other info requested and provided; and
 - Fiduciary adviser (and employee, agent, registered representative) that provides advice cannot receive from any party any direct or indirect fees that vary depending on participant/beneficiary's selection of particular investment option

D. Participant Investment Advice

Final 408(g) Regulations – Computer Model

- Arrangement based on computer model must use model designed and operated to:
 - Apply generally accepted theories that consider historic risks and returns of different asset classes over defined periods of time;
 - Consider investment management and other fees and expenses related to recommended investments;
 - Appropriately weigh factors used in estimating future returns of investment options;
 - Request from participant/beneficiary and use info relating to age, time horizons, risk tolerance, current investments in designated investment options, other assets or sources of income, investment preferences, or any other info requested and provided;
 - Use appropriate objective criteria to provide asset allocation portfolios comprised of investment options available under plan;
 - Avoid recommendations that inappropriately favor:
 - Options offered by fiduciary adviser or person with material affiliation or material contractual relationship with fiduciary adviser over other options, or
 - Options that may generate greater income for fiduciary adviser or person with material affiliation or contractual relationship with fiduciary adviser; and
 - Consider all designated investment options under plan without giving inappropriate weight to any investment option unless participant or beneficiary requests the option to be excluded from consideration.

D. Participant Investment Advice

Final 408(g) Regulations – Other Requirements for Fee Leveling and Computer Model Arrangements

- Plan fiduciary must expressly authorize eligible investment advice arrangement. Some fiduciaries cannot authorize:
 - Person authorizing arrangement;
 - Person providing designated investment options under plan; or
 - Any affiliate of above
- Annual audit
 - Independent auditor must audit advice arrangement to determine if it complies with regulations
 - Within 60 days of audit completion, auditor must issue written report to fiduciary adviser and each other fiduciary authorizing the arrangement that includes detailed findings

D. Participant Investment Advice

Final 408(g) Regulations – Other Requirements for Fee Leveling and Computer Model Arrangements

- Must provide participants and beneficiaries written notification of:
 - Role of any party with material affiliation or contractual relationship with fiduciary adviser in development of investment advice program and selection of plan investment options;
 - Past performance and historical rates of return for designated investment options under plan (if not otherwise provided);
 - Fees/compensation fiduciary adviser or affiliate would receive in connection with
 - (1) provision of advice;
 - (2) sale, acquisition, or holding of any investment option pursuant to advice;
 - (3) rollover or other distribution of plan assets or the investment of distributed assets in any investment option pursuant to advice;
 - Any material affiliation or material contractual relationship with fiduciary adviser or affiliates in investment option;
 - Manner/circumstances under which participant/beneficiary info provided under advice arrangement may be used/disclosed;

D. Participant Investment Advice

Final 408(g) Regulations – Other Requirements for Fee Leveling and Computer Model Arrangements

- Must provide participants and beneficiaries written notification of (cont.):
 - Types of services provided by fiduciary adviser in connection with provision of investment advice;
 - Fact that adviser is plan fiduciary in connection with advice; and
 - Fact that recipient of advice may separately arrange for provision of advice by another adviser with no material affiliation with and who receives no fees/compensation in connection with the investment option.
- Timing/Fee: Before providing investment advice; free
 - Must also be provided annually and upon request
 - Must also notify of any material changes to required information
- Clear and conspicuous manner calculated to be understood by average participant
- Can be provided in written or electronic form

D. Participant Investment Advice

Final 408(g) Regulations – Other Requirements for Fee Leveling and Computer Model Arrangements

- Fiduciary adviser must provide written notice informing authorizing fiduciary that:
 - Fiduciary adviser intends to comply with conditions for ERISA statutory exemption for investment advice;
 - Advice arrangement will be audited annually by independent auditor for compliance with statutory requirements; and
 - Auditor will furnish authorizing fiduciary with findings within 60 days of audit completion
- Additional Requirements:
 - Adviser provides disclosures relating to sale, acquisition, holding of investment option in accordance with securities laws;
 - Any sale, acquisition, holding of investment option occurs solely at discretion of recipient of advice;
 - Compensation received by adviser and affiliates in connection with sale, acquisition, holding of investment option is reasonable;
 - Terms of sale, acquisition, holding of investment option are at least as favorable to plan as they would be in arm's length transaction