

Delta Paradigm.....changing Visions, for changing Times!

February 2, 2012

By: Ernest 'Rus' Chisena CFP®

Review of DOL rules 408(b)(2) and 404(a)(1) ERISA Update.

Why this regulation?

“Also common to all of the lawsuits is the plan participants’ assertion that they were not fully informed about the expenses associated with their accounts. This, they say, vitiates the protection from liability that plan fiduciaries might otherwise have had under Section 404(c) of ERISA. The implication is that participants whose 401(k) accounts suffered investment losses could seek to recover those losses from the fiduciaries, in addition to the allegedly excessive fees.” Gregory L. Ash, Esq., Spencer Fane Britt & Browne LLP, Chair ERISA Litigation Group, Overland Park, KS <http://www.spencerfane.com/>

Mr. Ash continues in his 2007 paper, “That statutory provision protects plan sponsors and fiduciaries from liability for any losses participants may incur when making their own investment choices. However, this protection applies only if participants are given sufficient information with which to make investment decisions. According to the participants, by failing to provide adequate information about plan expenses, the **fiduciaries did not comply with Section 404(c), and thus they remain responsible for any investment losses the participants may have suffered.**”

ERISA Code Section 404(a)(1) Was Voluntary, Now Mandatory.

When a plan assigns investment responsibilities to its participants, the plan administrator is required to ensure the eligible employees and beneficiaries receive sufficient information about the plan, including fees, expenses and investment alternatives. To establish uniform disclosure of this information, the Department of Labor has finalized regulations under Employee Retirement Income Security Act (ERISA) section 404(a), communications from plan sponsor to all eligible participants:

Which plan types are affected?

All ERISA-covered participant-directed plans, but not IRAs, SEPs or SIMPLEs.

Who must receive the disclosure?

All eligible employees (not just those actually enrolled in a plan) and beneficiaries with account balances in the plan.

What must be disclosed and how?

The required disclosures generally fall into three categories:

- Plan information

Plan-related disclosure includes the investments offered, general information about directing investments, plan-level administrative charges and individual participant charges that may be levied against an account.

- Investment information

Investment information includes investment results, comparisons of those results to a relevant benchmark/index, and investment fees and expenses. The investment information generally should be provided within a chart provided in the regulations to easily compare returns and expenses for all plan investment options. Also, disclosure must include reference to a website where participants can find additional information, such as portfolio turnover rates and current investment information.

- Charges deducted from participant accounts

Any fees actually assessed against participant accounts during the prior quarter — whether shared by all participants (such as recordkeeping fees) or specific to services used by individual participants (such as loan fees) — must be disclosed within a quarterly statement or similar disclosure. Also, fees must be reported in dollars and, if relevant, the statement must include disclosure stating that some plan expenses are paid through the expense ratios of the plan's investments.

ERISA code section 408(b)2

Who must provide information to plan sponsors (Trustees)?

Any service provider who reasonably expects to receive \$1,000 or more in direct or indirect compensation from a plan for providing services in one of these three categories:

1. Fiduciary or registered investment adviser services
2. Recordkeeping, brokerage and platform services through which designated investment alternatives are made available to participant-directed defined contribution plans
3. Other services, such as consulting, third-party administration, actuarial or legal services for which the service provider reasonably expects to receive indirect compensation from the plan.

Direct compensation refers to payments made directly from the plan; for example, deductions from participant accounts or from an unallocated plan or forfeiture account to pay for

plan expenses. Indirect compensation refers to payments made from plan investment options, such as 12b-1 fees.

Effective Date:

As per US Treasury Press Release Dated February 2, 2012,

Disclosure to plan participants (ERISA code section 404)

“The effective date of the final rule announced today works in conjunction with the compliance date of the department’s participant level disclosure regulation (29 CFR § 2550.404a-5) which requires plan administrators to give workers who direct their retirement accounts in 401(k)-type plans easy-to-understand information to comparison shop among the plan investment options available to them. Due to the extension of the effective date of the final rule announced today, plan administrators for calendar year plans now must make the initial annual disclosure of “plan-level” and “investment-level” information (including associated fees and expenses) to participants no later than **August 30, 2012**, and the first quarterly statement (for fees incurred July through September) must be furnished no later than November 14, 2012.”

Effective for plan-years beginning on or after November 1, 2011, revisions to ERISA Section 404(a) will require plan sponsors to disclose to their plan participants — and nonparticipating eligible employees — the fees paid directly or through their investments.

The regulations apply to any service provider that expects to receive \$1,000 or more in direct or indirect compensation from a plan for providing such services as participant education, recordkeeping and administration, and investment management.

Covered services include:

- Fiduciary or registered investment adviser services.
- Recordkeeping, brokerage and platform services
- Other services provided by consultants, third-party administrators, actuaries, Lawyers or anyone who will receive indirect compensation from the plan.

Disclosure to plan sponsors: (ERISA code Section 408)

Effective January 1, 2012, revisions to ERISA section 408(b)(2) will require plan service providers — including financial advisers, through their broker/dealer — to disclose plan fees and services to plan sponsors.

The plan provider must disclose to the plan administrator, in writing, the services it provides, a description of those services and how — in dollars, a percentage or a formula — the provider is compensated for these services. Compensation in this context

is defined as direct or indirect compensation the provider will receive from the plan. This includes nonmonetary compensation if it's expected to exceed \$250 over the life of the arrangement. Also, the provider must declare whether it serves as a plan fiduciary. The most recent deadline is **July 1, 2012**

- In addition, As **per US Treasury Press Release Dated February 2, 2012,**

“The Department today also announced that in the near future it intends to publish for public comment a separate proposal that would require service providers, in addition to providing the required fee and investment expense information, to furnish a guide or similar tool to assist plan fiduciaries in identifying and locating the potentially complex information that must be disclosed and which may be located in multiple documents.”

..... and from the same release, the DOL is planning to supply additional information as well:

“The U.S. Department of Labor's Employee Benefits Security Administration today issued a final rule that will provide employers sponsoring pension and 401(k) plans with information about the administrative and investment costs associated with providing such plans to their workers.”

- **Develop a written investment policy.**

Although having a written **investment policy statement** isn't required by ERISA, the DOL has stated that the adoption and maintenance of an investment policy statement is “consistent with the fiduciary obligations set forth in ERISA.” In other words, it's a good idea. Many of the ERISA duties can be addressed in this policy statement, including:

- the prudent selection and proper diversification of plan investments
 - the obligation to steer clear of “fad” investments that may be suggested from time to time.
 - an undertaking to demonstrate the discipline required to maintain both the plan's long-term investment objectives and the strategies in place to achieve those objectives
- A good investment policy statement should include descriptions of the plan's:
- overall investment strategy
 - prudent array of investments
 - strategy for monitoring the investments (including benchmarks against which the investments will be compared and the periods over which results will be evaluated).
 - intention to comply with section 404(c) of ERISA, if applicable.

The following table was developed by the author of this report as a general comparison outline:

Comparison of Qualified 401(K) and SIRA: for tax year 2012

	<u>401(K)</u>	<u>SIRA</u>
Salary Deferral Limit:	\$17,000	\$11,500
Catch-up limit	\$ 5,500	\$ 2,500
Match	subject to ADP testing	first 3% of comp.
Safe Harbor Match 1)	available	N/A
Loans	if provided in plan document	none
Top Heavy and Discrimination testing	yes	none
Eligibility	up to 1 yr and age 21	> \$5,000 comp,3 yrs
Vesting schedules	1-5 years for matches	100% vested
File 5500's	mandatory	none
Third Party Admin	fees	none
Profit Sharing Plan?	Available	no
Trustee Fiduciary Responsibilities	yes	none
Investment selected by Trustees	yes	each participant self directed
Compliant ERISA 408(b)(2) requirements	yes	exempt

1) Disclosure statement to be provided to Safe harbor plan participants each year:

(See next page)

Statement to all eligible Safe harbor plan participants prior to start of plan year:

- How the contribution is calculated and if eligible to use it. Including a description of the levels of safe harbor vesting.
- Whether contributions can be made to another plan.
- The type and amount of compensation that may be deferred
- How to make cash or deferred elections
- The period available for making the cash deferrals
- Information as to make it easy to obtain additional information about the plan, plan summary, telephone numbers, addresses and electronic addresses of individuals and offices to obtain such information.

Observations:

- Rules and Regulations continue to be written as we speak.
- Plan sponsors (Trustees) must meet full disclosure requirements or subject themselves to liability from participant's loss due to "unreasonable fees" and actual investment losses due to participants not having "sufficient" information to make informed decisions.
- All service providers must provide information about their costs associated with their services in a format that makes it easy for the Trustee to gather all the relevant information. This information would then be used by Trustee to put in a government approved "chart" and format to disseminate to the participants, both eligible and participating.
- Development of a written investment policy is critical to exhibiting a procedure for selecting the appropriate mix of investments and services according to the demographics of the plan participants as well as a way of establishing an ongoing review and analyses of the plan costs and fund performance. Investment policies should be reviewed on an "on-going" basis.
- Self-Directed IRA's, Simplified Employee Pension Plans (SEP) and Simple IRA's (SIRA) are exempt from compliance and liability because the participants all assume responsibility for their own investment selections.

Written and compiled by,

Ernest Chisena, III

Certified Financial Planner ®

Pho: 610-793-4430 email: echisena@latitudefinancial.net

website: www.deltaparadigm.net