

employee benefits update

year end 2009



PLAN FEES AND THEIR DISCLOSURE

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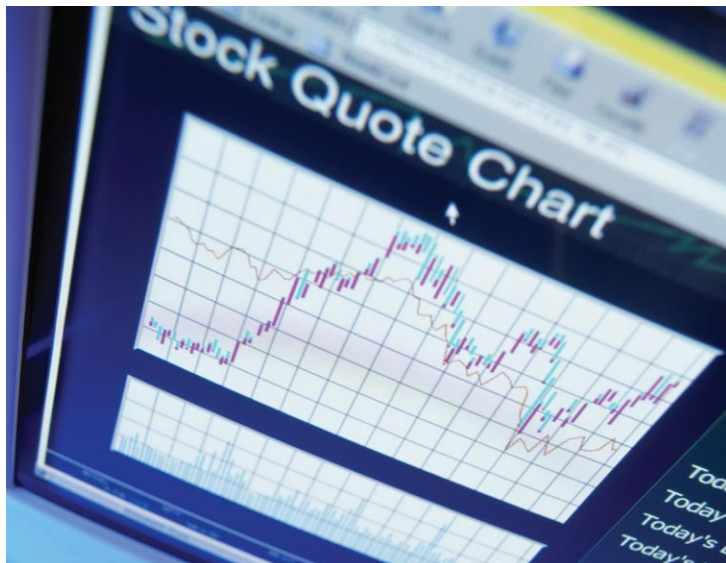


How one sponsor met its fiduciary obligation

With economic markets recovering from near record low levels, individuals are watching their investment account activity more carefully than ever. Maybe this is what inspired four retirement plan participants to take a closer look at their investment activity and file a class action suit for alleged high mutual fund fees and lack of fee disclosure to plan participants in *Hecker v. Deere & Co.*

The facts

Four participants in the two Deere 401(k) plans filed a class action suit against Deere (the plan sponsor), Fidelity Management Trust (the trustee and recordkeeper), and Fidelity Management & Research (the investment advisor for the Fidelity mutual funds offered in the plans).



Research, claiming that they were also fiduciaries and that they had intentionally selected funds with extremely high fees.

The plans and fees

In the 401(k) plans, Deere selected the investment options. Of these, 23 were managed by Fidelity Management & Research, and the remaining (which included two funds managed by Fidelity Management Trust, a Deere stock fund and a “Brokerage Link” option that gave participants access to 2,500 additional funds) were all managed by companies other than Fidelity.

Fidelity Management & Research shared its revenue from mutual fund fees with Fidelity Management Trust, which paid itself with those fees rather than billing Deere directly. From the information in the summary plan description supplements, the plaintiffs claimed that participants were under the impression that Deere covered the administrative costs for the plans. The plaintiffs claimed that Deere failed as a fiduciary by not disclosing to plan participants the fee structure or revenue sharing arrangement.

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The plaintiffs claimed that Deere had violated its fiduciary duty under ERISA in two ways:

1. By providing investment options that had excessive and unreasonable fees and expenses attached to them, and
2. By failing to adequately disclose the fee structure involved to plan participants.

The participants also filed suit against Fidelity Management Trust and Fidelity Management &

The outcome

The Seventh U.S. Circuit Court of Appeals ruled in favor of Deere and the Fidelity companies, finding that the plan sponsor acted correctly and within the law. While Deere may not have been as clear as it could have been in stating its mutual fund fee structure in the summary plan description, the court found that Deere hadn't violated its fiduciary duty because ERISA doesn't require disclosure of revenue sharing.

The court also dismissed the participants' claim that Deere had tried to limit the investment options to only those with high fees. Deere made available to plan participants numerous investment options with different levels of fees. The court noted that ERISA doesn't require that fiduciaries find and offer the least expensive funds. Fiduciaries cannot be held responsible if participants lose money in their investments or don't earn as much money as they would like to.

As for the Fidelity companies, the court concluded that Fidelity only offered professional advice and didn't have any fiduciary obligations. They didn't have the final say in the investment funds offered in the plans nor were they in charge of the plan disclosures.

Last, the court ruled that Deere complied with ERISA's Section 404(c) safe harbor, which allows plan fiduciaries who permit participants to direct their own funds to be protected from fiduciary liability.

What Deere did right

In the end, Deere did everything right. While it could have been clearer in explaining its fee structure, plan participants were given all the information that was required of them under the relevant laws. By providing participants with numerous investment options with corresponding fees, Deere met its fiduciary obligations to its participants. 🕒

How you can prevent a breach of fiduciary duty

Retirement plan fees and expenses and their disclosure to plan participants are hot topics in pension news. The Department of Labor (DOL) has issued proposed regulations in an effort to improve the disclosure of fees and expenses to plan participants and to help participants make more informed investment decisions. However, as of this writing these regulations have been on hold under the new presidential administration. Once these regulations are finalized and effective, plan fiduciaries will need to be sure they're in compliance. Check with your legal counsel for the latest information.

Also, if you offer self-directed investment options, carefully review the investment options offered, the fees associated with these investments and the disclosures you're giving to the plan participants.

Taking these steps can help you minimize the potential for a violation of your fiduciary duty, including the possibility of finding yourself in court.





Upcoming compliance deadlines:

- 12/31** Deadline for making minimum distribution for Year 2 plans and later
- 12/31** Deadline for making corrective distribution for 2009 failed ADP/ACP with 10% excise tax, or making a QNEC
- 1/31** 2009 Form 1099s due to participants

Are your distribution consent notices up to date?

The Pension Protection Act of 2006 (PPA) mandated that plan sponsors give qualified retirement plan participants notice about the distribution of their benefits when the distribution requires the participant's consent. You should be providing notices currently.

Now the IRS has proposed regulations that provide guidance on the information that plan sponsors must include in this distribution notice. The regulations affect the content and timing of the distribution notices to ensure that participants are fully aware of the consequences of taking an immediate distribution and failing to defer.

When consent is required

If a qualified retirement plan participant's vested benefit is more than \$5,000, the plan sponsor may not distribute that benefit to the participant before the later of age 62 or normal retirement age (as set by the plan document) without the participant's consent. The plan sponsor must provide a notice to such participants informing them of their right to defer receipt of the distribution.

While many small plans have opted for the Economic Growth and Tax Relief Reconciliation Act of

2001's (EGTRRA's) automatic rollover rule, some plan sponsors who chose to avoid the rule also require consent for distributions between \$1,000 and \$5,000. These plans may prefer to provide right-to-defer notices to all participants making a benefits election.

Elements of notice

According to the proposed regulations, all distribution consent notices to plan participants must include information detailing the federal tax implications of failing to defer. Specifically, you must notify participants of:

- ▶ The differences in tax implications of taking a cash distribution vs. rolling over the distribution or deferring the distribution until normal retirement age,
- ▶ The imposition of 10% additional tax on distributions before age 59½, and
- ▶ The loss of future tax-favored treatment of earnings if the distribution is taken in cash instead of rolling over to an eligible retirement plan (for defined contribution plans only).

Most notably, the proposed regulations also require plan sponsors to give participants notice of a

variety of other consequences of not deferring distributions. For example, for defined benefit plans, the notice must inform participants of the benefit amount that would be payable at normal retirement age if they delayed the distribution. This will show how much larger their benefit would be if they deferred commencement of their distribution.

For defined contribution plans, the notice must inform participants that some of the plan's investment options might not be available outside of the plan. The notice should give participants contact information so they can discuss the plan's investment options. It also should inform participants that fees and expenses outside of the plan might differ from those that currently apply to their account, and it must give them contact information so they can obtain specifics about the plan's fees and expenses.

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Timing of notices

Certain retirement plans may contain a qualified joint and survivor annuity (QJSA) feature that provides the participant and their spouse with a lifetime annuity. Generally a plan participant may elect at any time during the "applicable election period" to waive the QJSA form of benefit with spousal consent. PPA changed the "applicable election period" from 90 days to 180 days. According to the proposed regulations, you must give participants notice of their right to waive the QJSA form of benefit during the "applicable election period" no less than 30 days and no more than 90 days before the annuity starting date.

Additionally, under the proposed regulations you must give participants a written explanation of the terms and conditions of the QJSA and certain other information "within a reasonable period of time before the annuity starting date." And the plan administrator must, "within a reasonable period of time" before making an eligible rollover distribution, give recipients an explanation of certain tax consequences of the distribution. The regulations state that 90 days is a "reasonable period of time."

The proposed regulations also extend the period for distribution of notices addressing rollover eligibility options and the tax treatment of such distributions. However, PPA requires that plan sponsors make reasonable attempts to comply before the final regulations are issued.

Make sure your notice complies

The IRS will treat a plan as complying if the plan administrator makes a reasonable attempt to give participants notice of their right to defer a distribution. The proposed regulations become effective for notices provided on or after the first day of the first plan year beginning on or after Jan. 1, 2010, unless the final regulations aren't issued by that date. In that case, the proposed regulations would be effective 90 days after the final regulations are issued. 🕒



What you should know about measuring fair value before your next audit

The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, defines fair value, establishes a framework for measuring fair value and outlines necessary financial disclosures about fair value measurements. Formerly referred to as FASB Statement of Financial Accounting Standards No. 157 (SFAS 157), ASC 820 significantly changes how companies disclose fair value in their financial statements and how they can fairly value certain assets or liabilities for which no market exists. Why should you know about ASC 820? Let's take a closer look.

Fair value and audits

Many employee benefit plan sponsors have their plan audited. In preparing for an audit, you'll need to value your plan's assets. All employee benefit plans that prepare financial statements according to generally accepted accounting principles (GAAP) must implement ASC 820 without regard

to whether the auditor is engaged to perform a full scope or limited scope audit.

ASC 820 changed the way fair value is defined, measured and disclosed effective for fiscal years beginning after Nov. 15, 2007. The previous definition of fair market value was the price that would be *paid* to acquire an asset or price received to assume a liability — an “entry price.” Now, using ASC 820, the definition has changed to the price that would be *received* to sell an asset or paid to transfer the liability — an “exit price.”

Fair market value determined

Because not all investments have readily available quoted market prices, ASC 820 provides guidance on how to determine the fair values based on three levels of “inputs”:

1. Level 1 inputs (quoted prices in active markets for identical assets). Assets that have prices quoted on exchanges such as the NYSE, NASDAQ or the Chicago Board of Trade could rely on Level 1 inputs. For example, exchange traded mutual funds and equity securities fall into this group. If your plan invests in these assets, you'll find it easier to comply with ASC 820 because you can readily determine the fair values of these investments.

2. Level 2 inputs (quoted prices in active markets for similar assets or other observable inputs). If an asset isn't traded in an active market, but similar assets are, the prices of the similar assets can be used as a basis for the asset's value. Other observable inputs, such as thinly traded securities, also can be used. Examples of assets that might rely on Level 2 inputs include restricted securities or private investments in public companies.



3. Level 3 inputs (unobservable inputs). These include inputs such as option-pricing models using historical volatility. Assets that may need to be valued using these inputs include limited partnerships, hedge funds, venture capital and real estate, because of limited trading. You may have a harder time complying with ASC 820 if your plan holds such assets, because valuing these assets is more challenging.

When preparing your financial statements, keep in mind that participant loans are also subject to ASC 820. The outstanding loan value isn't the fair market value, because market interest rates

often change daily. While the regulations don't make it clear, this highly debated issue may cause participant loans to be allowable as Level 2 inputs.

Make correct valuations

If you haven't familiarized yourself with ASC 820 already, schedule extra time to comply. Have a good understanding of how you calculate the fair values in your plan's financial statements and be prepared to answer questions from the auditors about them. Failure to do so may result in increased costs as you prepare for an audit, as well as higher audit costs themselves. ☹️

Truth in Lending Act disclosures soon won't be required for plan loans

Starting July 1, 2010, retirement plans that offer loans to participants will no longer be required to provide Truth in Lending Act (TILA) disclosures. This change is a result of the Federal Reserve Board amending TILA's Regulation Z to include an exemption for retirement plan loans.

Regulation Z currently covers any entity or individual that offers or extends credit to a consumer primarily for personal, family or household purposes. The loan must include a finance charge or be payable in more than four installments and the lender must make more than 25 loans a year. A lender who meets these criteria must make certain disclosures to borrowers under Regulation Z.

Under the amended regulation, employer-sponsored retirement plans are exempt from disclosing information to borrowers about plan loan terms. The Fed allowed the exemption after acknowledging the difference between a commercial loan and a plan loan taken from a participant's account balance. For example, a participant's interest and principal payments on plan loans are reinvested in the participant's own account. In addition, no third-party creditor imposes finance charges. Finally, the costs of a loan taken against assets invested in a plan aren't comparable to a third-party loan because participants pay the interest to themselves.

However, plan loans are exempt from TILA's disclosure requirements only if the loan proceeds consist of fully vested funds from a participant's account and the loan complies with the Internal Revenue Code (IRC). Plans that offer loans in excess of a participant's vested account balance aren't exempt from TILA disclosure requirements. But because many plans allow participants to generally only borrow up to 50% of their vested account balance, the exemption should apply to most loans.

Although this amendment will offer plan administrators some relief, you'll still need to ensure your plan complies with the IRC. And if your plan is subject to ERISA, you must still follow ERISA disclosure requirements, including plan administration fees.