RETIREMENT PLAN
ADVISORY GROUP

RETIREMENT LEGAL AND COMPLIANCE UPDATE

IN THIS ISSUE:

- Department of Labor Issues Guidance in Wake of Madoff Scandal
- Recent Fiduciary Cases Update
- Summary Prospectus Complies with 404(c) Requirements
- People in Review
- Compliance FAQ
- Paid Time-Off Contributions

DEPARTMENT OF LABOR ISSUES GUIDANCE IN WAKE OF MADOFF SCANDAL

In late December 2008, the SEC charged Bernard Madoff and his firm with securities fraud in the form of a Ponzi scheme. Many retirement plans were directly or indirectly impacted by the fraud. In February 2009, the Employee Benefits Security Administration (EBSA) of the Department of Labor (DOL) issued fiduciaries guidance regarding prudent procedures for plans subject to Title I of ERISA to follow in the wake of the scandal.

The DOL advises that fiduciaries request information from appropriate providers regarding each plan's potential exposure to the Madoff scheme to best determine whether, and to what extent, losses were incurred. Fiduciaries should be sure to inform other fiduciaries, and plan participants where appropriate, of the losses and potential impact of said losses, and any mitigating actions being taken.

Once the investigation is complete and it is determined that the plan is impacted, fiduciaries must endeavor to mitigate any further losses. Moreover, fiduciaries should determine, with the help of legal counsel, whether they have a cause of action that is reasonably likely to lead to recovery of Madoff losses, and against whom those causes of action exist. Finally, fiduciaries of impacted plans should make certain that they have filed all claims within required deadlines. The Securities Investor Protection Corporation issued customer claim packages to identifiable investors, but the DOL has also provided a website for the court-appointed trustee for the liquidation of the Madoff firm (www.madofftrustee.com) to help with deadlines, forms and additional applicable information.

Fiduciaries need to remember that they have a responsibility to act in a prudent manner that is in the best interests of participants and beneficiaries. The Madoff scandal and the DOL's guidance merely shed light on previously existing responsibilities. If you have any questions regarding your fiduciary responsibilities, contact your advisor.

RECENT FIDUCIARY CASES UPDATE

From recent court rulings it has become obvious that not all courts uniformly apply the protection afforded by ERISA section 404(c). As you are most likely aware, Congress intended to provide fiduciary safe harbor protection for plans compliant with ERISA section 404(c). Put very simply, the liability for investment-related decisions shifts from fiduciaries to participants who direct their own accounts in 404(c) compliant plans. But this simplicity has been both tested and expanded by the courts in recent court decisions.

Tullis v. UMB Bank

In the Tullis case, the court seemed to apply 404(c) in an expansive manner. The plaintiff (participant) empowered an agent (broker) for investing his account. The defendant (vendor) followed the broker's instructions for the participant's account. The broker had engaged in fraudulent activities (including investment in non-existent vehicles) and the participant alleged that the vendor knew of the activities and failed to inform the participant, and failed to provide the participant with accurate valuation of the participant's account. After its full analysis, the court held that because the vendor met the 404(c) requirements and the participant (through the broker) exercised independent control over his account, that 404(c) shielded the vendor from all causes of action. In fact, the court went so far as to state, ". . . ERISA Section 404(c) does not require a fiduciary to guarantee that all material facts are conveyed to participants; the regulations prohibit fiduciaries from concealing facts. All of the cases in which a fiduciary was found to have an affirmative obligation to disclose information first involved an inquiry initiated by a plan participant." In essence the court alleviated the defendant's duty to disclose known material facts if it refrained from actually concealing those facts and the plaintiff failed to request the specific information.

Bruner, et al. v. VLP Corp Services, et al.

The Bruner case is another in a long list of excessive/undisclosed fee lawsuits. This case is significant because the complaint does not name the plan sponsor as a defendant fiduciary, but rather names the record-keeper custodian and, for the first time, the investment advisor alleging excessive fees, prohibited transactions and lack of disclosure of material facts. Though these allegations may be familiar, this case is unique as it is one of the first filed against a small plan (only $2 million in plan assets), which dispels the notion that only large plans are targeted for these lawsuits. The case is also somewhat unusual in that it names the plan advisor as a defendant. This case has yet to be fully adjudicated, but it bears monitoring to see the level of standard of care these service provider organizations are held to in terms of their fiduciary responsibility to the plan.

SUMMARY PROSPECTUS COMPLIES WITH 404(C) REQUIREMENTS

Plans that allow participant-directed investments seeking the fiduciary protection of ERISA §404(c), be advised. Mutual funds may now issue a summary prospectus instead of a full prospectus and still comply with §404(c). Remember, in addition to other requirements, plans intending to comply with 404(c) must meet very specific disclosure requirements.

ERISA Section 404(c) is meant to result in the transfer of responsibility for investment decision losses from fiduciaries to the participant (or beneficiary) that is exercising control over the investment of his/her plan account. One requirement under 404(c) is that plans must provide participants with a prospectus upon their first investment in a registered security. The plan must also provide participants with a description of transaction fees and expenses in connection with purchases or sales of these securities, but other relevant information must only be provided upon request.

However, on Sept. 8, 2009, the Department of Labor (DOL) issued Field Assistance Bulletin 2009-03, which describes the circumstances under which a participant-directed individual account plan may satisfy the prospectus delivery requirements of section 404(c) of ERISA by furnishing a "Summary Prospectus" pursuant to requirements established by the SEC.

In this FAB, the DOL concludes that a mutual fund Summary Prospectus may be used to comply with the prospectus delivery requirements in the ERISA 404(c). The Summary Prospectus is a short-form document, written in plain English, containing information on how to obtain the full statutory prospectus. The DOL also concludes that a Summary Prospectus would satisfy the ERISA 404(c) regulations because the required contents of the Summary Prospectus provide the type of key information about a mutual fund that allows participants

and beneficiaries to make informed investment decisions. If a participant (or beneficiary) requests a prospectus, and the most recent prospectus received by the plan is a Summary Prospectus, the fiduciary will comply with ERISA 404(c) if it provides such Summary Prospectus in response to the request.

Any plan participant (or beneficiary) desiring additional information about a plan's mutual fund may access the more detailed statutory prospectus via the website address, e-mail, and toll-free number that must be included at the beginning or on the cover page of the Summary Prospectus. Providing a Summary Prospectus also allows plans and their fiduciaries to save paper and postage.

In summary, employers hoping to limit their liability through compliance with ERISA section 404(c) should contact their service provider and/or advisor to learn how the prospectus delivery requirement is being met.

PEOPLE IN REVIEW

In this section, expect to see brief commentary highlighting prominent figures in the news or current administration that have an impact on the retirement community. In this edition, read how Phyllis Borzi, the new assistant secretary of the Employee Benefits Securities Administration, and Justice Sonia Sotomayer, most recent appointee to the Supreme Court, may impact the future of retirement plans.

Phyllis C. Borzi
Assistant Secretary, Employee Benefits Security Administration
Department of Labor

Phyllis Borzi was confirmed on July 10, 2009, as assistant secretary of the Department of Labor's (DOL) Employee Benefits Security Administration (EBSA). A distinguished attorney, former English teacher, professor, advisor to Hillary Clinton, and, most recently, a member of President Obama's transition team, Borzi is enthusiastic about continuing the Bush administration's goal of enhancing compliance assistance for retirement plans. She recently stated, "We're committed to better and smarter enforcement of the law … coupled with a strong, vigorous, comprehensive enforcement policy." This statement reinforces the idea that while plan sponsors and advisors should always practice diligence, it will be especially critical as the EBSA, DOL and other departments use enforcement resources to identify plans operating out of compliance.

It is expected that Borzi will strive to uphold several deadlines that are of special interest to retirement plan advisors and plan sponsors. Within a few months expect final regulations to be released requiring plan service providers to disclose fee and compensation information to plan sponsors. Following this, plan sponsors can expect to have new participant disclosures required. The EBSA's goal, with Borzi at the helm, is to make the disclosures simple for participants to understand, but robust with information. While Borzi has been involved in research and policy analysis for decades, employers can take comfort in the fact that she has a reputation for making sure policy theories actually work in practice for employers and employees.

Justice Sonia Sotomayor
Justice
Supreme Court of the United States

The newest addition to the Supreme Court, Justice Sonia Sotomayor has an extensive ERISA- related background and has been a prominent force during her time on the United States Court of Appeals for the Second Circuit and as a United States District Judge. Justice Sotomayer brings more federal judicial experience to the Supreme Court than any justice in 100 years. Although concern regarding previous, off-hand remarks surfaced during her confirmation hearings, an analysis of her ERISA-related history shows that Sotomayor's decisions are generally fact-driven, based off existing legal interpretations and utilizing supportive documentation as support for her judgments.

The following two cases appear to show an ability to use existing law to support her decision. In Layaou v. Xerox Corporation, Sotomayer ruled against the plan administrator of Xerox, stating that a summary plan description did not contain enough detailed information so as to provide adequate notice to employees regarding calculation of benefits. However, in Lanahan v. Mutual Life Insurance Company of New York, Sotomayer ruled in favor of the corporation, finding that Lanahan failed to provide sufficient evidence that his ERISA benefits were deprived. As the present economy indicates that

retirement benefits of millions of employees are at the mercy of judicial interpretations of ERISA, it will be ever important for plan administrators to look to the law for guidance when ensuring their plans are operating in compliance.

COMPLIANCE FAQ

Question: When do employee salary deferrals need to be deposited?

Answer: The Department of Labor (DOL) plan asset regulations currently state that "participant contributions become plan assets on the earliest date on which they can be reasonably segregated from the employer's general assets." This is the DOL's most recent attempt to speed up the deposit of participant salary deferrals. The DOL is devoting significant enforcement resources toward employers who have previously misunderstood that requiring participant contributions to be deposited by the 15th business day of the month in which the deferrals were withheld from a participant's wages was never intended to be a safe harbor nor a guideline, but rather an exception.

There is currently a proposed rule from the DOL that was issued on Feb. 29, 2008, which would establish a "safe harbor" period of seven business days for deposits to be made for employers with less than 100 participants. In addition, the DOL is expecting to issue a safe harbor that would apply to large plans when this regulation is finalized. While this is a proposed rule, it is clear that employers may rely on the proposed seven day safe harbor period without penalty. Therefore, employers with less than 100 participants should be depositing all salary deferrals in no more than seven business days, and employers with 100 or more participants should deposit salary deferrals as soon as the assets can be reasonably segregated.

PAID TIME-OFF CONTRIBUTIONS

The IRS recently issued Revenue Rulings 2009-31 and 2009-32 regarding the use of dollar equivalents of unused paid time-off as contributions to qualified plans. The rulings address both annual unused paid time-off (2009-31) and unused paid time-off at time of termination of employment (2009-32).

In essence, this guidance supports employers' ability to allow unused leave to be converted into either deferrals or non-elective employer contributions in 401(k) plans. That said, this remains a voluntary plan design. Employers need not allow their employees this option. Employers wishing to provide this design will likely need to amend their plans. Attendant with the plan amendment are potential administrative burdens. The employer's payroll and human resources teams must be ready to administer the design, and the plan's vendor (and if the plan is a prototype, the adoption agreement) must be able to accommodate the design. Because the amounts contributed will differ based on the amount of each participant's unused paid time-off additional testing will likely be necessary. Moreover, this is not an additional benefit design, but rather contributions of dollar equivalents of unused paid time-off must still fall within already existing plan and legal limitations.

Thus, it is important for employers to consider (a) if they allow for cash outs of unused paid time-off, (b) if they want to allow for same, (c) whether they want to take on the additional administrative burden inherent in allowing contributions of unused paid time-off dollar equivalents and (d) are willing to undertake (and often pay for) both the amendment of the plan and the additional testing that would be required – all for a new source of contributions, rather than an additional benefit, within their 401(k) plan. If you have any questions regarding these new plan designs, contact your advisor.

This material is intended for informational purposes only and should not be construed as legal advice and is not intended to replace the advice of a qualified attorney, tax adviser, investment professional or insurance agent.