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IDENTIFYING AND MITIGATING FIDUCIARY RESPONSIBILITY FOR EMPLOYERS WITH 401(K) PLANS

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INTRODUCTION

Offering a retirement plan can be one of the most challenging, yet rewarding, decisions an employer can make. The employees participating in the plan, their beneficiaries, and the employer all benefit when a retirement plan is in place. Administering a plan and managing its assets, however, require certain actions and involve specific responsibilities.

To meet their responsibilities as plan sponsors, employers need to understand some basic rules, specifically the Employee Retirement Income Security Act (ERISA). ERISA sets standards of conduct for those who manage an employee benefit plan and its assets.[1]

EXECUTIVE SUMMARY

Employers who sponsor 401(k) and other qualified plans are fiduciaries responsible to the employee plan participants and their beneficiaries. As such, employers personally could be sued by any participant or beneficiary for breach of fiduciary duty. Recovery would likely be in the form of cash payment to restore perceived loss or under-performance of the participant's account.

The Congress and the Department of Labor have issued laws, regulations, and bulletins which define where fiduciary liabilities lie, and how to mitigate the liabilities.

Employers should implement these four steps in order to reduce liability:

- Keep records of actions you take to engage and supervise service providers in your Due Diligence File so that you can demonstrate proper procedure.
- Keep records, as well as the Investment Policy Statement (IPS of the review process for the various investment options, so that you can demonstrate that you have fulfilled the obligation to properly maintain the funds.
- Review the performance and all plan fee pricing of service providers periodically.
- Make sure your fidelity bond, asset valuations and appraisals, if applicable, are up to date.[2]

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WHO IS A FIDUCIARY?

A fiduciary is generally defined as someone acting in a position of trust on behalf of, or for the benefit of, a third party.[3] A plan's fiduciaries will ordinarily include the trustee, investment advisers, all individuals exercising discretion in the administration of the plan, all members of a plan's administrative and investment committee (if it has such a committees), and those who appoint committee officials. The key to determining whether an individual or an entity is a fiduciary is, broadly, whether they are exercising discretion or control over the plan.

Fiduciaries have important responsibilities and are subject to standards of conduct because they act exclusively on behalf of participants and their beneficiaries in a retirement plan. These responsibilities include:

- The duty of loyalty—acting solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them;
- Carrying out their duties prudently;
- Following the plan documents (unless inconsistent with ERISA);
- Diversifying plan investments. This helps to minimize the risk of large investment losses to the plan. Fiduciaries should consider each plan investment as part of the plan's entire portfolio. Fiduciaries will want to document their evaluation and investment decisions.; and
- Paying only reasonable and defendable plan expenses.[4]

The duty to act prudently is one of a fiduciary's central responsibilities under ERISA. It requires expertise in a variety of areas, such as investments. Lacking that expertise, a fiduciary will want to engage professionals with specific knowledge to carry out the investment functions.[5]

In the Final Regulation Regarding Participant Directed Individual Account Plans, the Department of Labor states that the act of limiting or designating investment options which are intended to constitute all or part of the investment universe of an ERISA [401(k)] plan is a fiduciary function which, whether achieved through fiduciary designation or express plan language, is not a direct or necessary result of any participant's direction of such plan. The position taken by the DOL is that plan fiduciaries are responsible when a retirement plan investment option no longer be offered in the plan.[6]

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DUE DILIGENCE

Fiduciaries can limit their liability in certain situations. One way fiduciaries can demonstrate that they have carried out their responsibilities properly is by documenting the processes used to carry out their fiduciary responsibilities. [7]

Most employers doubt their ability to decipher fee models, which leads to concern about potential legal action, higher plan expenses and participants selecting suboptimal investments.[8]

"Plans can save millions through portfolio redesign and revenue-recapture programs that result from fee studies and analyses," said Matthew Gnabasik, managing director of Blue Prairie Group in Chicago.

Gnabasik stressed, "As a plan sponsor, you need to account for every dollar in your retirement plan, especially in this heightened fee-lawsuit environment." [9]

While there is little companies can do to prevent participants from filing these claims, they are not without ways to protect themselves. [10]

According to data compiled by HR Investment Consultants, for a plan covering 500 participants with average account balances of $50,000, the shared fees paid by plan sponsors and participants ranged from $211 to $822. "Given today's legal climate, employers should be wary if they are paying more than the average cost [$599]," says Joe Valletta, a principal and co-author of the investment advisory firm's 401(k) Averages Book.

Nevertheless, increased due diligence seems in order, given sponsors' fiduciary obligations to protect the interests of employees. "If a sponsor doesn't know how the bundled fees are broken down into different buckets, it cannot compare them with the fees charged by other providers," says Pamela Hess, director of retirement research at Hewitt Associates. "Yet sponsors have a legal obligation to make sure their contracts are reasonable." [11]

DUE DILIGENCE CONT.

"The catch for corporate plan sponsors is they cannot simply go out and select only the cheapest funds on the market for their 401(k) plans," said Michael Epstein, partner in the employee benefits practice at law firm Montgomery McCracken Walker & Rhoads LLP, Philadelphia.
Other factors, such as investment performance and investment process, must be considered as well, he explained. And there will always be less expensive options available to plan sponsors, making the definition of "reasonable" or "excessive" fees subjective, and ultimately leaving corporations vulnerable.

"It's not necessarily about choosing the absolute best fund and always making the perfect decision," said Mr. Epstein.
"It really comes down to showing that there was a process behind your choices, and that you took the appropriate steps to truly make a prudent decision, and one that was justifiably in the best interest of participants." [12]

Consultants also are encouraging plan executives to review a variety of practices – particularly in light of the 2006 Pension Protection Act (PPA). That includes more emphasis on investment policy statements.
"The real issue is how often do they go back and update it for changes because of the markets or the PPA. Of that high percentage, I bet many haven't reviewed their (investment policy statement) in the last two or three years." [13]
Ted Benna, known as the "father of the 401(k)," and a frequent advisor to Congress and regulatory authorities, has long warned about the fiduciary requirement to provide sufficient information to make informed investment decisions.

"[Active and inactive] participants are entitled to documents such as new Summary Plan Descriptions (SPD), material modifications to the SPD, the Summary Annual Report, notice of all IRS filings, participant statements, and if requested, the Plan document and the entire Form 5500," Benna says. Every investment and provider change, including fund replacements, additions, or deletions, must also be communicated. [14]

FEES

The fact that Congress, the Department of Labor (DOL), the plaintiffs' bar and the Securities and Exchange Commission (SEC) are all focused intently on the subject of (high and undisclosed) fees in retirement plans is underscored by allegations in the lawsuits against some Fortune 500 companies. Those lawsuits allege companies breached their fiduciary duties under ERISA by failing to contain plan costs and paying unreasonable fees to plan service providers. [15]

Since 2006, several class-action lawsuits have alleged that plan sponsors failed to meet their fiduciary responsibilities by ignoring payments that investment managers paid to record keepers and other service providers. The suits also charge that plan executives failed to disclose these fees to participants, as required by ERISA.

According to Callan Associates, fee analysis and fee disclosure are priorities for plan sponsors in 2008. [16]

Plan expenses may be paid by the employer, the plan, or both. In addition, for expenses paid by the plan, they may be allocated to participants' accounts in a variety of ways. The Service Agreement of the vendor/providers should specify how fees are paid.

When the fees for services are paid out of plan assets, fiduciaries will want to understand the fees and expenses charged and the services provided. The law requires that fees charged to a plan be "reasonable." The plan's fees and expenses should be monitored to determine whether they continue to be reasonable. [17]

Some providers offer a number of services for one fee, sometimes referred to as a "bundled" services arrangement. Others charge separately for individual services. [18]

Some service providers may receive additional fees from investment vehicles that may be offered under an employer's plan. For example, mutual funds often include additional internal expenses to pay brokers and other salespersons for promoting and marketing the fund and providing other services. There also may be sales and other related expenses for investments offered by a service provider. [19]

FEES CONT.

On the down side, all the negotiated arrangements obscure actual plan costs. Not that the bundled fee isn't listed in the prospectus—it is. But the components of the fee (administrative expenses; trustee, audit, and legal costs; consulting expenses; statement fees; trading costs; potential performance bonuses; and the actual fund or investment management fees) may be unclear. "The difficulty is in peeling back the onion," says HR Investment's Valletta.[20]
A myriad of fees fall under the umbrella of revenue sharing. These are expense reimbursement payments for shareholder services, including recordkeeping and accounting, processing mutual fund sales and redemption transactions, custodial/trustee interface services to the plan and the development of enrollment materials. [21]

While transparency of fees is an aid to competition, that disclosure must be straightforward and provide employers and participants with useful information, or the costs of providing the disclosure will actually increase fees.

Fees are not profit centers for employer plan sponsors. Under employee benefits law, the employer as fiduciary must ensure that fees paid for services are reasonable and the retirement plan is used solely for the participants and does not inure to the benefit of the plan sponsor in any manner. Many compliance costs must be incurred whether the plan has 50,000 or five employees. In addition, high quality services and products may have greater fees to pay for valuable participant services such as: Internet access and voice response systems, online distribution and loan modeling, online calculators for comparing deferral options, investment advice and education services on deferral options.[22]

The point is to find the best value, not necessarily the lowest cost. "Plan sponsors have to understand what they're getting to make an informed decision—the lowest fee is not always the best value," says Jim Morris, senior vice president of institutional solutions at SEI Investments. [23]

LIMITING LIABILITY

Employers should assume fiduciary duties carefully, studying their workforce to consider risk tolerance, recommends Christopher Thompson, a managing director and head of investment product management at Putnam Investments, based in Boston. [24]
Fiduciaries who do not follow the basic standards of conduct may be personally liable to restore any losses to the plan. [25]
The first and easiest thing that plan sponsors and fiduciaries can do is to ensure that their liability insurance policy doesn't exclude coverages in the event a plan participant should sue due to losses in his or her account.
Meaningful issues for employers to consider in operating their plans:

- Communications with plan participants should clearly state who is -and who is not -responsible for carrying out participant and beneficiary investment instructions.

- When plan administrators become aware of an error on the part of an investment provider or service provider that results in damage to a participant's account, they may be obligated to demand that the company that made the error take action, at the investment provider or service provider's expense, to rectify the error. It is imperative that plan sponsors carefully review their contracts with investment providers. Do those contracts purport to relieve the provider of any wrongdoing in failing to carry out participant investment instructions? If so, plan fiduciaries should consider negotiating with the provider to eliminate any such terms, or provide some allowance for some benefit to the plan for allowing the term to remain in the provider's contract.

- Everyone involved in 401(k) plan administrations should review their agreements with the others involved in the process. [26]

LIMITING LIABILITY, CONT.

Post-PPA regulations help employers to create a framework for getting participants in retirement plans, they also "have the ancillary benefit of offering ways to minimize fiduciary liability and litigation risks," said Robert Doyle, director of regulations and interpretations at the Department of Labor.

"The regulatory goal here is to help employers to get the information they need, so that when plan sponsors work with service providers, they can walk away from the table, knowing that they satisfied their fiduciary duties," Doyle explained. [27]

A fiduciary can also engage a service provider, or providers, to handle fiduciary functions, setting up the agreement so that the person or entity then assumes liability for those functions selected. If an employer appoints an investment manager that is a bank, insurance company, or registered investment advisor (RIA), the employer is responsible for the selection of the manager, but is not liable for the individual investment decisions of that manager. However, an employer is required to monitor the manager periodically to assure that it is handling the plan's investments prudently.

"Successfully managing the liability exposure during a provider change is extremely important," notes Benna. "Providing complete communication regarding such changes, including the black-out notices that are distributed to active employees, is essential." Benna even suggests that former employees be given the opportunity to attend educational meetings that are held for active employees.

LIMITING LIABILITY CONT.

It's prudent to rollover the assets of retiring or terminating participants and roll-out the accounts of former employees into safe harbor IRAs.[28] On a preventative basis, be sure to:

- Keep records of actions you take to hire and supervise service providers, so that you can demonstrate proper procedure.
- Keep records of the review process for the various investment options, so that you can demonstrate that you have fulfilled the obligation to properly maintain the funds.
- Review the performance and pricing of service providers periodically..
- Make sure your fidelity bond and asset valuations and appraisals (if applicable) are up to date. [29]

A fiduciary retains the responsibility for selecting the providers of the investment options and the options themselves and monitoring their performance. [30]

Rather than wait for DOL to issue new regulations, some companies have called in retirement advisory firms to analyze and benchmark the breadth of fees that they and their employees pay for the services rendered by 401(k) providers. [31]

HIRING A CONSULTANT OR INVESTMENT FIDUCIARY

The term fiduciary adviser is defined as a person who provides investment advice to a plan participant or beneficiary with respect to plan assets for a fee or other compensation. [32]

[P]lan fiduciaries can avoid responsibility (and liability) for any investment decisions that they themselves might make. They can achieve this when the plan investment advisor complies with ERISA section 3(38)-defined “investment manager” criteria via a written agreement with the fiduciaries. By doing so, the advisor becomes an ERISA section 405(d)(1)-defined “independent fiduciary.” Even here, plan fiduciaries still retain the responsibility (and liability) for selecting, monitoring and replacing (if necessary) the investment manager periodically to ensure that the manager is handling the plan’s menu of investment options prudently.)

Plan fiduciaries can avoid responsibility (and liability) for the investment mistakes that plan participants might make. That solution is to retain a plan financial advisor that will assume ERISA sections 3(38)/405(d)(1) responsibilities (and corresponding liabilities) for managing the individual accounts of the participants in a revenue-neutral plan. In this situation, the advisor eliminates participant investment discretion altogether (i.e., plan participants aren’t able to direct the investment of their retirement accounts) by creating and managing sub-accounts (e.g., model portfolio investment options) that reflect appropriate asset allocations for participants with differing risk tolerances and investment time horizons. [33]

Department of Labor Employee Benefits Security Administration (EBSA) Field Assistance Bulletin (FAB) 2001-1 included guidelines on how the required “prudent” selection and periodic monitoring should be carried out. During an advice provider search, the department said, “[A] fiduciary should engage in an objective process that is designed to elicit information necessary to assess the provider’s qualifications, quality of services offered and reasonableness of fees charged for the service. The process also must avoid self dealing, conflicts of interest or other improper influence.”

HIRING A CONSULTANT.. CONT.

Some items fiduciary needs to consider when selecting a consultant or investment fiduciary include:

- Information about the firm itself: financial condition and experience with retirement plans of similar size and complexity;

- Information about the quality of the firm's services: the identity, experience, and qualifications of professionals who will be handling the plan's account; any recent litigation or enforcement action that has been taken against the firm; and the firm's experience or performance record;

- A description of business practices: how plan assets will be invested if the firm will manage plan investments or how participant investment directions will be handled; the proposed fee structure; and whether the firm has fiduciary liability insurance.

An employer should document its selection (and monitoring) process. [34]

"There is a fantastic need for fiduciaries in this marketplace, because the needs of the plan sponsors are diametrically opposed to the needs of the 401(k) venders," said Steven Kaye, president of American Economic Planning Group in Watchung, N.J. "The vendors want as much revenue with as little servicing as possible, while sponsors need just the opposite."
An investment fiduciary keeps the investment policy statement current and recommends the funds and share classes that should be offered. A 401(k) consultant makes sure the plan vendor stays on top of things.

"As an investment fiduciary, the adviser accepts a lot of responsibility, so it is the maximum way for a sponsor to limit their liability," Kaye said. [35]

Employers may decide to hire an investment adviser offering specific investment advice to participants. These advisors are fiduciaries and have a responsibility to the plan participants. On the other hand, an employer may hire a service provider to provide general financial and investment education, interactive investment materials, and information based on asset allocation models. As long as the material is general in nature, providers of investment education are not fiduciaries. However, the decision to select an investment adviser or a provider offering investment education is a fiduciary action and must be carried out in the same manner as hiring any plan service provider. [36]

HIRING A CONSULTANT.. CONT.

If a fiduciary adviser or its affiliates receives fees or other compensation that varies depending upon the investment options selected by the client, the employer would contract with a fiduciary adviser to provide advice using a certified computer model. The purpose is to eliminate the financial incentives or potential conflicts of interest the fiduciary adviser has in recommending investments that could increase his or her compensation.

If the fiduciary adviser's fees do not vary (referred to as "level"), the fiduciary adviser may provide personalized advice outside the advice generated by the computer model that participants and beneficiaries can use to develop asset allocations for their retirement accounts.

The PPA also requires that a fiduciary adviser provide appropriate disclosure which would include disclosure and recordkeeping requirements of the Investment Advisers Act of 1940 and comparable state laws, as well as disclosure and suitability requirements for broker/dealers under rules of the National Association of Securities Dealers.

Registered representatives who receive a fee for their advice may be required to provide the necessary disclosure as required by Rule 202(a)(11)-1 (known as Rule 202) of the Investment Advisers Act for providing fee-based "brokerage" services to the client.

Investment adviser representatives should provide clients a copy of Form ADV Part II and any other necessary disclosures and advertising rules. [37]

MONITORING A CONSULTANT OR INVESTMENT FIDUCIARY

An employer should establish and follow a formal review process at reasonable intervals to decide if it wants to continue using the current service providers or look for replacements. [38] When monitoring service providers, actions to ensure they are performing the agreed-upon services include:

- Reviewing the service providers' performance;
- Analysis of any reports they provide;
- Verifying actual vs proposed fees charged;
- Asking about policies and practices (such as trading, investment turnover, and proxy voting); and
- Following up on participant complaints.

The following is a list of important questions for plan sponsors to ask administrators and recordkeepers in order to identify potential problems.

(1) Document plan amendments for all recent law changes?
(2) Does your plan cover a sufficient number of employees? To be non-discriminatory, qualified plans must cover a sufficient number of non-highly compensated employees.
(3) Have you quickly deposited employee contributions? DOL rules require employers to deposit employee contributions promptly in the plan's trust. Employers may be sued for self-dealing (using employee contributions for general corporate purposes) if they violate these rules.
(4) Have you provided employees with required notices and reports? The law requires that a summary annual report summarizing financial information in the 5500 be provided to participants each year. Many new notice requirements have also been added by recent law, including a new diversification notice for participants in certain plans holding public company stock and funding status notices.
(5) Are fiduciaries protected from liability for investment elections? If proper investment alternatives and default investments are available and explained to participants, fiduciaries may be protected from liability for losses caused by participant's investments. New rules on default investments and fee disclosures must be followed to protect your fiduciaries.
(6) Do you have safeguards to prevent your plan from holding excess contributions?**(7)** If your plan holds employer stock, have you complied with SEC requirements?

MONITORING.. CONT.

(8) Have you notified all providers servicing your plan about any plan changes?
(9) Is your plan's administrative processes based on written terms of your plan documents? A qualified plan must be operated in accordance with its terms. This means that administrative procedures must reflect the plan document, and a formal plan amendment will often be required when plan rules are changed.
(10) Do you have a proper claims and appeals procedure?
(11) Are your participant communications consistent with your plan document?
(12) Are you versed in 2008 rule changes? New rules came into effect in 2008, and employers need to be prepared to implement them. For example, new defined benefit plan funding requirements and new regulations on maximum benefits and contributions will apply in 2008. [39]

Declared Department of Labor Employee Benefits Security Administration (EBSA) in Field Assistance Bulletin (FAB) 2001-1: "[I]t is the view of the Department that a plan sponsor or other fiduciary that prudently selects and monitors an investment advice provider will not be liable for the advice furnished by such provider to the plan's participants and beneficiaries, whether or not that advice is provided pursuant to the (prohibited transaction) statutory exemption under ERISA section 408(b)(14)." [40]

In articulating its expectations on how plan sponsors and other fiduciaries are to carry out the required monitoring of investment advisers, DOL said, "[W]e anticipate that fiduciaries will periodically review, among other things, the extent to which there have been any changes in the information that served as the basis for the initial selection of the investment adviser, including whether the adviser continues to meet applicable federal and state securities law requirements, and whether the advice being furnished to participants and beneficiaries will be based upon generally accepted investment theories."

In addition, the DOL said it expected that advice providers "will maintain, and be able to demonstrate compliance with, policies and procedures designed to ensure that fees and compensation paid to fiduciary advisers, at both the entity and individual level, do not vary on the basis of any investment option selected. Moreover, it is anticipated that compliance with such policies and procedures will be reviewed as part of the annual audit required by section 408(g)(5)(A) and addressed in the report referred to in section 408(g)(5)(B)."

AUTO ENROLLMENT

Many experts in the field expect the 2006 Pension Protection Act to have enormous repercussions. For instance, one provision of the act offers incentives to companies that adopt auto enrollment. [41]

"The new 401(k) [model] defaults participants into their investments and into the plan," says Mark Fortier, defined contribution investment manager at Alliance Bernstein, an asset management firm based in New York City. "Behind all of this is the behavioral finance perspective that inertia and procrastination are forces that unfortunately keep many people from saving and investing." [42]

In 2004, Oregon-based Evraz Oregon Steel Mills started to automatically enroll new hires and use target-date retirement funds as a default. "Feedback from employees has been excellent. People have voted with their feet because we have gone from a 50% to 98% participation rate," says John Worcester, manager of benefits compensation.
"We say to them we are going to put you in at 5% unless we hear otherwise. A handful of employees have said they didn't want to do it because they were in the middle of a divorce, about to retire or in bankruptcy," Worcester says. "That's the 2%, but 98% of workers say, 'Great, thanks for taking care of it.'"

Research on retirement confidence also "shows the employees are basically saying, 'Please make me do it; if you default me in, then I will stay in,'" says Dallas Salisbury, president of the Employee Benefit Research Institute.

Meanwhile, Worcester believes workers are happy to be auto-enrolled in target-date retirement funds because they are easy to follow, have low administrative fees and automatically reallocate. [43]

The Plan Sponsor must ensure the "maturity glide path" of the selected "Target Date" funds are fully disclosed to participants to provide realistic expectations of risk.

Qualified Automatic Contribution Arrangements (QACA). The PPA created the QACA as one of a series of provisions designed to encourage automatic enrollment plans. A QACA is an automatic contribution arrangement that will satisfy the average deferral percentage test (ADP) applicable to 401(k) plans and the average contribution percentage test (ACP) applicable to all 401(k) plans with employer-matching and/or after-tax contributions. Under a QACA, employees who do not make a contrary election will automatically have their salaries

AUTO ENROLLMENT CONT.

reduced by at least the amount shown in the following schedule:

Plan Year	Percentage
1st	3%
2nd	4%
3rd	5%
Subsequent years	6%

In addition, under a QACA, for each non-highly compensated employee, the employer must make a matching contribution of 100% of elective deferrals up to 1% of an employee's compensation and match 50% of elective deferrals up to the next 5% of an employee's compensation—essentially a matching contribution of up to 3.5% of compensation. Alternatively, an employer can make a 3% non-elective contribution for each non-highly compensated employee.

Faster vesting for employer non-elective (employer non-matching) contributions. Employer non-elective contributions will be subject to the same vesting requirements as matching contributions. In other words, vesting schedules for non-elective contributions must either provide for a cliff vesting schedule of 100% vesting after three years of service, or for incremental vesting, under a schedule at least as rapidly as that shown in the following table:

Years of Service	Percentage
2	20%
3	40%
4	60%
5	80%
6 or more	100%

CURRENT ECONOMIC AND LEGAL ENVIRONMENT

On Wednesday, February 20, 2008, the United States Supreme Court released its decision in LaRue v. DeWolff, Boberg & Associates. The decision paves the way for individual participants and beneficiaries to sue plan fiduciaries for money damages when only individual participants are adversely affected. [45]

Further, as the economy continued to worsen and a recession emerges, there will be more 401(k) loans, hardship withdrawals, and cash-outs. Robert Pascuzzi, lead of Creative Planning 401(k) in Kansas City, MO, sees this as worrisome, given the latest ruling. "You have to wonder if these employees who take money out of their accounts will eventually sue plan managers for not providing adequate guidance. This new ruling opens the door for that."[46]
New rules from the U.S. Department of labor regulating fee disclosures are meant to help 401(k) plan participants better understand what they're paying for, but complying with these regulations will be an arduous task.

One of the newest attempts to improve disclosure is a revamped form 5500, an annual report that qualified retirement plans must file with the IRS. The new form must include total direct compensation paid by the plan, whether any party receives indirect compensation and the total amount of non-eligible indirect compensation.[47]

The Law offices of Ilene H. Ferenczy, LLC have been retained recently by a few different clients in the Atlanta area to represent them in regard to an investigation by the U.S. Department of Labor (DOL) of their retirement plans. These clients have undergone a review process spanning several months, which has resulted in a lengthy letter from the DOL investigator as to possible charges of fiduciary breach or mismanagement of the plans by the fiduciaries. The firm has spoken with professionals elsewhere in the country, and it appears that the Atlanta regional office is more active about these issues than other parts of the country. Nonetheless, it is quite concerning, and plan sponsors and service providers everywhere should take notice.
Issues that have arisen include:

- Lack of proof of investment policies and procedures.
- Lack of written demonstration that the sponsor or trustee has engaged in periodic reviews of service providers to ensure that their services are effectively undertaken at a reasonable cost.
- Failure to properly maintain the required fidelity bond. Plan sponsors and administrators must be sure to be in compliance with the bonding rules. Often, the failure to be sufficiently bonded requires the plan to be audited annually by a CPA.[48]

CURRENT ENVIRONMENT.. CONT.

Both the U.S. House of Representatives and the U.S. Department of Labor (DOL) have proposals under review that will, if approved, mandate increased transparency and disclosure in 401(k) retirement plans.
Whether the new regulations are approved or not, transparency and simplicity is a trend that plan providers must accept as a new reality.

The 401(k) Fair disclosure for Retirement Security Act (H.R. 3185), recently cleared the House Education and Labor Committee. The similarly-themed DOL regulations are also under consideration. In general, these proposals will require 401(k) service providers and plan administrators to:

1. Provide complete disclosure of fees charged on 401(k) plans;
2. Provide education for participants to understand investment risk, return, and investment objective;
3. Disclose financial relationships and potential conflicts of interest.
4. A broad menu of non-proprietary investment options – including index funds – will help avoid conflict of interest concerns. Providers that do not offer proprietary funds can more easily base their fund options on what they feel is the best value for their clients.[49]

A suit against Wal-Mart claims the company breached its duties as a fiduciary by allowing 401(k) plan participants to be charged "unreasonably expensive" fees.
The suit alleges the fees were too high because Wal-Mart's $9.5 billion 401(k) plan offered participants retail mutual funds, as opposed to less expensive insti-tutional funds, "despite the ready availability of reasonably priced options … particularly for a massive plan like Wal-Mart's with tremendous potential to leverage economies of scale."

The retail funds described in the suit carry expense ratios ranging from 0.3% to 1.59% of assets.
The suit against Wal-Mart alleged the basic fees weren't the only factor that adversely affected workers' 401(k) savings. It stated that most 401(k) plan fund options are actively managed funds, which carry higher management fees. The Wal-Mart plan's actively managed funds, which cost more because they aim to garner better returns than market indexes, often did not meet or exceed their investment benchmarks, according to the suit. This underperformance compounded the effect of the fees, as participants paid more for lower returns, the suit said.

Overall, the suit claims, if the Wal-Mart 401(k) had been invested in passively managed funds, it would have been worth an estimated $140 million more for the six-year period.
The merits of these claims, and the extent to which Wal-Mart might have breached its fiduciary duties, will ultimately be determined by court trials.[51]

CURRENT ENVIRONMENT.. CONT.

Defined contribution plan executives are unprepared for upcoming accounting changes, leaving themselves open to IRS scrutiny, according to a new survey.
DC plan executives are not providing adequate oversight of their service providers, according to the survey.

"Sponsors still seem to have an unwarranted comfort that everything is going fine with their plan administration. They seem to be reasonably simplistic in looking at and trying to uncover compliance issues and trying to correct them," said David Wolfe, partner at Drinker Biddle & Reath LLP, Chicago, who assisted with the survey.

"It has become apparent that not nearly enough plan sponsors are utilizing SAS 70 as a tool to help them understand what controls have been implemented by their service providers, as only 49% of respondents suggested they requested or reviewed the SAS 70 plans," she said.[51]

CONCLUSION

Employers who offer 401(k) plans are fiduciaries. The regulations and current case law make them liable for any reduction in participant account balances. Employers can reduce this liability through "safe harbor" steps that are defined in the Pension Protection Act and Department of Labor regulations as well as being actively engaged in the over-sight of the plan.

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