



## Retirement Legal and Compliance Update

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### New Definition of “Fiduciary”

#### Background

The Department of Labor (DOL) issued a proposed regulation on Oct. 21, 2010, that would broaden the definition of “fiduciary” applicable to retirement accounts (IRAs and plans). Under the proposed regulation, anyone who gives advice to an IRA, an employee benefit plan or a plan’s fiduciaries, participants or beneficiaries, would now be considered a fiduciary.

#### Changes to Fiduciary Definition

The proposed regulation considers the following types of advice and recommendations in determining whether a person is a fiduciary:

- Advice, appraisals or fairness opinions concerning the value of securities or other property;
- Recommendations to purchase, hold or sell securities or other property; and
- Advice or recommendations regarding management of securities or other property (which includes proxy voting and the selection of other investment managers).

## New Definition of “Fiduciary” *Continued*

Providing the noted advice and recommendations would make you a fiduciary under the proposed regulation if you are doing so for a fee (including, but not limited to, brokerage, mutual fund sales and insurance sales commissions), and also meet any one of the following:

- Represent or acknowledge that you are acting as a fiduciary within the meaning of ERISA with respect to the advice or recommendations;
- Exercise any discretionary authority or discretionary control with respect to management of the plan or management or disposition of plan assets, or you have any discretionary authority or responsibility in administering the plan;
- Meet the definition of an investment adviser under the Investment Advisers Act of 1940 (or you provide services through an investment adviser) – some exclusions apply (see regulations for more detail); or
- Have an agreement with a plan (or plan fiduciary, participant or beneficiary) for these services, tailor your advice to the individualized needs of the plan, participant or beneficiary, and they consider your advice when making investment or management decisions. The agreement need not be in writing.

### Additional Changes

There are other differences from current regulations and interpretations. For example, you need not provide advice on a regular basis in order to meet the new definition of fiduciary. Also, there need not be an understanding with the plan or a participant or beneficiary that your advice serves as the primary basis for their investment decisions. An understanding that the plan, participant or beneficiary will consider your advice in connection with making a decision relating to plan assets is enough to make you a fiduciary.

### Exceptions

There are some exceptions to the proposed new definition of fiduciary. Generally, a person acting purely as a salesperson would not be a fiduciary under the proposed rule. You have to show the plan or its participants or beneficiaries knows, or should know, that you are providing the advice or making the recommendation in the capacity as a purchaser or seller of a security or other property (or as an agent of such a purchaser or seller) and their interests are adverse to the plan or its participants or beneficiaries. In addition, you could not undertake to provide impartial investment advice or otherwise represent you are a fiduciary to the plan or its participants or beneficiaries. In addition, creating a more limited menu of investment options from the total menu of investments available to a plan fiduciary for selection in their plan is excluded. Providing general financial information (such as historic performance of asset classes of the investments available through the plan's provider) would not necessarily make you a fiduciary under the proposed rule. However, you also would need to disclose in writing that you are not providing impartial investment advice to the plan with these services. Finally, the DOL maintained their investment education safe harbor and you would not be a fiduciary if you provided services (such as providing asset allocation models or providing interactive materials) in accordance with DOL Interpretative Bulletin 96-1.

### Additional DOL Updates

The DOL requested comments regarding whether to include in the definition of investment advice any recommendation for a plan participant to take an otherwise permissible plan distribution, including a recommendation on how to invest the distribution, into another account, such as an IRA.

### Current Status

The DOL recently extended the deadline for comments on the proposed regulation given the flood of responses it received from the retirement plan industry. Industry members, such as record keepers and broker/dealers, sent comment letters and testified to express their specific concerns with the proposed rule. Further, the application of the rule to IRAs seems to have caused concern to all industry participants.

We will continue to monitor this situation and provide updates as the DOL finalizes the new proposed regulation.

## DOL Intends to Extend Applicability Date for Service Provider Fee Disclosures

On Feb. 11, 2011, the DOL's Employee Benefits Security Administration announced that it intends to extend the applicability date for the new service provider fee disclosure rules under ERISA section 408(b)(2) from July 16, 2011, to Jan. 1, 2012.

As background, ERISA requires plan fiduciaries to avoid entering into certain prohibited transactions between a qualified plan and a party in interest. A "party in interest" may potentially include nearly every type of plan service provider (TPA, consultant, auditor, attorney, etc.). In order to avoid a prohibited transaction, plan fiduciaries must meet either a statutory, class or individual exemption. ERISA section 408(b)(2) provides a statutory exemption for plan service provider arrangements. To meet the requirements of 408(b)(2), the fiduciary must determine that arrangements with their service providers, including compensation for services, are "reasonable." To make that determination, it is fundamental that fiduciaries have the ability to obtain relevant information regarding their service providers and the arrangements into which the plan enters.

As a reminder, on July 16, 2010, the DOL issued interim final regulations under section 408(b)(2) requiring service providers to make certain specified disclosures to client-plan fiduciaries.

In addition to extending the applicability date of the section 408(b)(2) regulations, the Feb. 11 DOL announcement indicates that the extension will allow the DOL sufficient time to make sure the final rule is right, which may include providing a summary document to assist plan fiduciaries in their review of the new fee disclosures. The extension should be welcome news for both service providers and plan fiduciaries in their efforts to comply with the new fee disclosure requirements under section 408(b)(2).

## Department of Labor Semiannual Regulatory Agenda

Twice each year the DOL issues its Semiannual Regulatory Agenda; the most recent agenda was published in the *Federal Register* dated Dec. 20, 2010. The regulatory agenda lists the regulations the DOL expects to have under active development at any stage for the upcoming one-year period, as well as those actions completed within the past six months. This agenda provides valuable insight toward anticipated effective dates of guidance as well as the progress that the DOL is making toward accomplishing its goals.

Items of interest for retirement plans are discussed below, along with an update from items included in previous agendas.

- **Improved Fee Disclosure for Pension Plan Participants:** Since the last regulatory agenda was issued, regulations requiring additional disclosures to ensure participants receive information necessary to make informed decisions have been issued and are applicable for plan years beginning on or after Nov. 1, 2011.
- **Improved Fee Disclosure for Pension Plans:** Since the last regulatory agenda was issued, ERISA section 408(b)(2) regulations were issued to ensure disclosure of necessary information to determine reasonableness of plan contracts and are applicable for plan years beginning on or after Jan. 1, 2012.
- **Statutory Exemption for Provision of Investment Advice:** The agenda reports that final action establishing a statutory exemption from prohibited transaction rules for "fiduciary advisers" to provide individual investment advice is expected in May, 2011.
- **Definition of "Fiduciary":** A proposed definition was issued on Oct. 21, 2010, and comments on the definition were accepted through Jan. 20, 2011.
- **QDIA Target Date Disclosure:** A proposed rule was issued on Nov. 30, 2010, amending the QDIA regulations to require a narrative explanation of how a target date fund's asset allocation will change over time, including a graphical illustration and an explanation of the relevance of any dates included in the name of the fund. Comments were due by Jan. 14, 2010.
- **Lifetime Income Options for Participants and Beneficiaries in Retirement Plans:** DOL continues to explore initiatives it may take in enhancing retirement security by facilitating access to use of lifetime income arrangements and has an undetermined timetable for this agenda item.

## Compliance FAQ: What Is a Partial Plan Termination?

The general rule is that a plan is considered partially terminated if there is a significant event that affects the rights of employees to vest in their plan benefits. Examples may include when an employer terminates a large group of employees that are covered under the plan as part of a layoff or shutdown of a corporate division. Determining whether a partial plan termination has occurred is important because a partial termination of a plan triggers 100 percent vesting for the affected participants.<sup>1</sup>

1. Code §411(d)(3)(A)

## Compliance FAQ: What Is a Partial Plan Termination? *continued*

While the concept is fairly straightforward, actually determining whether a partial plan termination has occurred can be a difficult analysis as it turns largely on the specific “facts and circumstances” of each situation.

In Revenue Ruling 2007-43, the IRS adopted a presumption of 20 percent turnover when determining partial plan terminations, which is an unofficial rule of thumb. This 20 percent figure also was the threshold used in the case *Matz v. Household International Tax Reduction Investment Plan*, 388 F.3d 570, 33 EBC 2569 (7th Cir. 2004). Some ERISA counsel recommend that plan sponsors begin investigating the possibility of a partial termination when the turnover rate hits 15 percent, just to be conservative. Generally, the IRS has stated that the turnover rate is determined by dividing the number of participating employees who had an employer-initiated severance from employment during the applicable period by the total number of participating employees during the same period. Generally, an employer-initiated severance from employment includes any severance from employment other than death, disability or retirement on or after normal retirement age. The ruling permits an employer to exclude a purely voluntary severance if personnel files, employee statements and other corporate records support a determination that the severance was voluntary.

The IRS also will look at other factors in determining whether a partial termination has occurred. If the facts and circumstances show that a turnover rate for an applicable period is routine for an employer, then the IRS could find that there was no partial termination.

Also important to note, the number of participants does not exempt a plan from having to determine whether a partial plan termination has occurred. There are other cases where several thousand participants lost coverage but the reduction did not constitute a partial plan termination based on the facts and circumstances as determined by the IRS.<sup>2</sup> Conversely, a plan with six participants was considered partially terminated when five participants lost coverage.<sup>3</sup>

Finally, when determining if a partial plan termination has occurred, if individuals who were terminated and potentially affected by a partial plan termination were already 100 percent vested, then this information is essentially irrelevant. It would only be relevant if the individuals were not already 100 percent vested, and would receive an increased vesting percentage if it is determined there was in fact a partial plan termination.

## Stock Drop Cases Dominating the Press

Dating back to the Enron and World.com cases, stock drop cases have continued to spring up in courtrooms across the nation. Recently a few of these cases have heated up, stirring the DOL's interest, and warranting the attention of plan sponsors that continue to provide company stock as an option in their 401(k) plans. The following paragraphs briefly discuss the developments of these cases and the potential implications for plans and fiduciaries.

***Howell v. Motorola, Inc.*, 2011 WL 183966 (7th Cir. 2011):** In this recent decision, the U.S. Court of Appeals for the Seventh Circuit held that ERISA section 404(c) protected fiduciaries from plaintiff's claims that fiduciaries failed to provide sufficient information regarding the employer's financial condition and failed to monitor appointees. However, the court did not go so far as to state that 404(c) would bar plaintiff claim that fiduciaries' selection of company stock as a plan investment option was imprudent. The Seventh Circuit thus joins the Fourth Circuit, and opposes the Fifth Circuit, in its reluctance to expand the scope of 404(c) protection. This ruling aligns the Seventh Circuit with the general DOL interpretation of 404(c), and reinforces the need for fiduciaries, even those of 404(c)-compliant plans, to adopt prudent processes for selection and ongoing monitoring of their plan's investment options. In the end, the Seventh Circuit ruled that fiduciaries had undertaken a prudent process, partially proven by the fact that the plan was adequately diversified, and that plaintiffs failed to prove that fiduciaries knew, or should have known, that Motorola stock was “so risky or worthless” as to require removal from the plan.

An additional interesting non-404(c) development from this case was the ruling that a participant could be barred from bringing a claim against the plan by signing a release. Essentially a participant may be barred from class representation in a stock drop suit if the participant has signed a release. It is not considered a violation of ERISA's anti-alienation rule. This is a good lesson for plan sponsors in dealing with potentially disgruntled terminating employees.

***Veera v. Ambac Plan Administrative Committee*, 2011 WL 43534 (S.D.N.Y.) and *In re American Express Company ERISA Litigation*, 2010 WL 4371434 (S.D.N.Y.):** A primary defense in some of the recent stock drop cases has relied on the existence of language in the plan's document requiring inclusion of company stock as a plan investment option.

2. *Admin. Comm. of the Sea Ray Employees' Stock Ownership & Profit Sharing Plan v. Robinson*, 1996 U.S. Dist. LEXIS 22772 (E.D. Tenn. 1996) (1990 plan year), aff'd, 164 F.3d 981, 22 EBC 2513 (6th Cir. 1999); *Halliburton Co. v. Comm'r*, 100 T.C. 216, 16 EBC 1929 (1993), aff'd, 25 F.3d 1043 (5th Cir. 1994)

3. *Collignon v. Reporting Servs. Co.*, 796 F. Supp. 1136, 15 EBC 2049 (C.D. Ill. 1992)

## Stock Drop Cases Dominating the Press *continued*

The rationale behind such a provision is that it takes the discretion out of the fiduciaries' hands. ERISA section 404(a)(1)(D) basically states that it is a fiduciary duty, under the prudent person standard of care, that a fiduciary discharge his/her duties "... in accordance with the documents and instruments governing the plan ..." Crafty ERISA attorneys interpret that language to mean that if a plan document states a plan must offer company stock, that fiduciaries have no choice in the matter, and without discretion to remove the company stock from the plan, therefore also have no liability in the event the company stock is an imprudent offering to participants. But not all courts have agreed on such a defense. In fact, two courts in the same federal district (Southern District of New York, which is in the jurisdiction of the U.S. Court of Appeals for the Second Circuit) have come to contrary conclusions in two separate cases.

In November 2010, U.S. District Court Judge John Koeltl ruled in favor of such a defense in the American Express case. The court ruled that fiduciaries are not required to remove company stock from the plan's investment menu where their plan document explicitly requires it to be provided as an investment option and where the plan's trust document explicitly precludes the defendants' discretionary authority over the company stock. The court bolstered this ruling with the fact that even if the plan document did not require company stock, the plaintiffs would still have been unable to overcome the company stock presumption of prudence set out by the U.S. Court of Appeals for the Third Circuit (*Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995) (though this doctrine has not yet been adopted by the Second Circuit).

Alternatively, in January 2011, U.S. District Court Judge Harold Baer, Jr. rejected a similar defense on a motion to dismiss the Veera case, and has allowed plaintiffs to move forward with their stock drop lawsuit. The court saw this defense as being form over substance and agreed with the plaintiff's argument that fiduciaries may not follow plan documents that may be contrary to dictates of ERISA. The court recognized that district courts within the Second Circuit had arrived upon different conclusions regarding this defense and went so far as to distinguish the American Express case by stating that although the plan document language was similar in both cases, in the Veera case no document explicitly precluded the defendants' authority over managing the company stock in the way that the trust document did in the American Express case. In fact, the trust document in Veera did the opposite and expressly imposed a duty of prudence on those defendants.

**DOL Amicus Briefs:** In a few recent cases the DOL has stepped in with amicus, or "friend of the court," briefs. The amicus briefs, by and large, argue that courts are misinterpreting ERISA and as a result are providing overbroad application of its protections. Recently the DOL requested that an Eleventh Circuit appellate court overturn a lower court ruling, *In re ING Groep, N.V. ERISA Litigation*, 2010 WL 1704402 (N.D. Ga.), that absolved ING fiduciaries of stock drop liability based on the "it's in the plan document" defense. The crux of the DOL's argument was that ERISA "... expressly provides that fiduciaries must override plan terms if they conflict with ERISA." Thus fiduciaries "must make prudent investment decisions regarding employer stock even if plan documents require such investment."

In a different case *Lanfeer v. Home Depot, Inc.* the DOL argues that the court again misinterprets ERISA in allowing fiduciaries immunity based on the "it's in the plan document defense," and by ruling that presumption of prudence (established in *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995)) may be relied upon by the court in determining fiduciary liability in stock drop cases. The DOL argues that "[a] presumption of prudence finds no basis in ERISA's text and contravenes ERISA's purposes" and that "... no presumption should apply to the purchase of stock that the fiduciaries allegedly knew or should have known was inflated."

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