

# Legislation Made Real



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Second Quarter 2008

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## Monitoring What Matters

By **Bridget Hagan, AVP Government Relations, Nationwide Financial®**

Every quarter, we strive to keep you current as to what's happening in the legislative and regulatory world of retirement plans. We hope you continue to find this information useful. As always, we appreciate the opportunity to serve you.

### PLAN FEE DISCLOSURE UPDATES

As in 2007, Congress and the Department of Labor have been working on new requirements regarding the disclosure of fees charged with respect to 401(k) and similar plans.

**Congressional activity.** Congressional activity continues to focus on two elements of fee disclosure: (1) disclosure by service providers to plan fiduciaries of all fees received directly or indirectly in connection with services rendered to the plan and (2) disclosure by plan fiduciaries to plan participants of all fees chargeable to their accounts.

Most recently, the "401(k) Fair Disclosure for Retirement Security Act of 2008" has passed the House Education and Labor Committee. The bill was sponsored by Congressman George Miller (D-CA), who is chairman of the committee. At this

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## Monitoring What Matters *(continued)*

point, it seems likely that a bill similar to this version will pass the House during 2008. The bill is unlikely to pass the Senate this year, but there is a good chance that Congress will return to the fee issues in 2009. On the other hand, it is possible that in 2009, Congress will decide that legislation is unnecessary because the Department of Labor regulations, which are expected to be finalized by next year, fully address the need for fee disclosure.

The committee-passed bill, which only applies to plans subject to ERISA, would require extensive disclosure of fees to both plan fiduciaries and plan participants. These fees would be required to be broken down into multiple categories, such as (1) recordkeeping and plan administration fees, (2) transaction-based fees (such as loads or special charges for certain transactions (e.g., plan loans)) and (3) investment management fees.

The committee bill would also provide that any plan that uses an available limited protection from liability—whereby the plan fiduciaries are not liable for losses resulting from the individual employee's investment choices — must offer what is effectively an index-based life cycle fund as one of its investment options. The plan sponsor or fiduciary remains liable for the prudent selection and monitoring of all investment alternatives for the plan.

At this point, the committee bill is not coordinated with the plan fee regulations that the Department of Labor is working on. This raises the possibility that if Congress moves forward with legislation, plans' administrative systems may have to be modified at least twice — once to comply with the regulations and once to comply with the new legislation.

**Regulatory activity.** The Department of Labor previously published proposed regulations on required fee disclosures from service providers to plan fiduciaries. The Department is expected to finalize those regulations this year after consideration of the many comments they received. It is widely expected that the proposed effective date of those proposed regulations — 90 days after the finalization of the regulations — will be delayed.

The issuance of proposed regulations with respect to fee disclosure to participants has been delayed and is now not expected until later this summer. The Department was originally planning to finalize these regulations by

the end of 2008. The delay in issuing the regulations in proposed form could delay the finalization until 2009.

### OTHER LEGISLATIVE ACTIVITY

Nearly one out of every two working Americans — up to 75 million people — has no employer-sponsored retirement savings plan. Americans also continue to save less each year, the limitations of Social Security are well known, and the Baby Boom generation will soon begin to retire. Legislators and policymakers who analyze these factors are seeking innovative ways to expand coverage.

Several state governments, such as West Virginia, Maryland, Michigan, Pennsylvania, Ohio, Indiana, Illinois, and, most recently, Connecticut and California, have examined opportunities to create the nation's first state-run retirement plan program for small businesses. Connecticut's plan recently passed the Connecticut Senate (which has a Democratic majority) by a 22-11 party line vote but failed in the House. Connecticut's legislative session ended on May 7. If the California bill passes, California's plan would be administered by the California Public Employees' Retirement System (CALPERS). If enacted, retirement plans established under any such program, such as SIMPLE IRAs and SEP IRAs, would be subject to all federal rules generally applicable to private sector retirement plans, including rules issued by the IRS and the Department of Labor. Traditional IRAs established under the program would be subject to rules issued by the IRS. Payroll IRAs established under the program would be subject to rules issued by the IRS and possibly rules issued by the Department of Labor.

On the federal level, there are also several bipartisan proposals to require small business employers without retirement plans to permit their employees to contribute to an IRA on a payroll-deduction basis. One leading proposal from Rep. Ron Kind (D-WI) would create an automatic IRA plan that would be voluntary on the part of the small business owner but would require participating owners to automatically enroll employees in an IRA unless the employees opt out. This legislation offers newly participating employers tax credits for start-up costs and each newly enrolled employee, removes the higher penalty on early SIMPLE IRA distributions, raises the annual contribution limit on SIMPLE IRAs to the same level as 401(k) plans, and allows participants greater flexibility to roll over their SIMPLE IRA assets.

# Shift in Contribution Collection Responsibility

The DOL has issued an interesting Field Assistance Bulletin (FAB). In FAB 2008-1, the DOL generally places responsibility on the plan trustee to oversee whether plan contributions are made.

This guidance redefines the responsibilities of named fiduciaries and trustees of ERISA-covered plans for the collection of delinquent employer and employee contributions. Questions have been raised in the past as to whether trust agreements and other documents defining a trustee's duties may exclude responsibilities for monitoring the plan's receipt of contributions, determining when they are delinquent, and taking appropriate steps for collection.

Many plan documents, for example, contain language which limits the responsibility of "directed trustees."

In FAB 2008-1, the DOL says: "Employer contributions are delinquent when they are due and owing to the plan under the documents governing the plan, but have not been transmitted to the plan in a timely manner. (Within a reasonable time after the legally enforceable obligation to make the contribution arises.)"

Technically, contributions become an asset of the plan only when the contribution has been made. However, when an employer fails to make a required contribution to the plan in accordance with the plan documents, the plan has a claim against the employer for the contribution, and that claim is an asset of the plan.

In their analysis, the DOL quoted a 1985 Supreme Court case, *Central States, Southeast and Southwest Areas Pension Fund v. Central Transport*. In that case, the Court noted that:

"One of the fundamental common-law duties of a trustee is to preserve and maintain trust assets, and this encompasses 'determin[ing] exactly what property forms the subject matter of the trust ....' The trustee is thus expected to 'use reasonable diligence to discover the location of trust property and to take control of it without unnecessary delay.'"

The DOL went on to say that:

"Section 404(a) of ERISA requires that a fiduciary discharge his duties prudently and solely in the interests of the participants and beneficiaries of the plan. The steps necessary to discharge a duty to collect contributions will depend on the facts of each case. In determining what collection actions to take, a fiduciary should weigh the value of the plan assets involved, the likelihood of a successful recovery and the expenses expected to be incurred. Among

the factors, the fiduciary may take into account in deciding whether or not to expend plan assets to pursue a claim is the employer's solvency. It is the DOL's long held view that if the plan is not making systematic, reasonable and diligent efforts to collect delinquent employer contributions, or the failure to collect delinquent contributions is the result of an arrangement, agreement or understanding express or implied, between the plan and the delinquent employer, such failure to collect delinquent contributions may be deemed to be a prohibited transaction under Section 406 of ERISA."

ERISA also provides that every employee benefit plan shall be established and maintained pursuant to a written instrument, and that the instrument "shall provide for one or more named fiduciaries who jointly or severally shall have authority to control and manage the operation and administration of the plan." Although trust documents cannot excuse trustees from their duties under ERISA, ERISA clearly gives named fiduciaries the authority to appoint multiple trustees and to allocate trustee responsibilities among those trustees (including directed trustees). Thus, in accordance with the statutory framework, authority over a plan's assets is subject to the trust requirements of ERISA, including a plan's legal claim for delinquent contributions, and must be assigned to:

- i) A plan trustee with discretionary authority over the assets (normal trustee),
- ii) A directed trustee subject to the proper and lawful directions of a named fiduciary, or
- iii) An investment manager (as opposed to a trustee).

## FIDUCIARY BREACH ISSUES

As explained in FAB 2004-03, a fiduciary is liable for the breach of another fiduciary if the fiduciary "participates knowingly" in the breach of the other fiduciary. In addition, a fiduciary is liable for the breach of another fiduciary if the fiduciary's failure to comply with Section 404(a) in the administration of his specific fiduciary responsibilities enables the other fiduciary to commit a breach. Also, a fiduciary is liable for the breach of another fiduciary if the fiduciary has knowledge of the breach of the other fiduciary, unless the fiduciary takes reasonable efforts under the circumstances to remedy the breach.

Efforts to remedy the breach may, depending on the circumstances, include:

- Advising the named fiduciary or the DOL of the breach,

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## Shift in Contribution Collection Responsibility *(continued)*

- Reporting the breach to other fiduciaries of the plan,
- Directly taking actions to enforce the contribution obligation on behalf of the plan,
- Seeking an amendment of the relevant plan and trust documents, or
- Seeking a court order mandating a proper allocation of fiduciary responsibility over contributions.

Thus, if you as fiduciary know that another fiduciary is not doing his or her job, you may have to go to court to force appropriate action. If the duty is not properly allocated, there may also be a need to have the plan documents amended.

The documents and instruments governing a plan cannot serve to absolve a co-fiduciary from liability for failing to take steps to remedy a known breach of another fiduciary.

It is the DOL's view that a named or functional fiduciary who has the authority to appoint the plan's trustee(s) must ensure that the obligation to collect contributions is appropriately assigned to a trustee, unless the plan expressly provides that the trustee will be a directed trustee with respect to contributions, or unless the authority to collect contributions is delegated to an investment manager.

Thus, although a fiduciary may enter into a trust agreement under which a particular trustee is not responsible for monitoring and collecting contributions, if no trustee or investment manager has the responsibility, the fiduciary with authority to hire the trustees may be liable for plan losses due to a failure to collect contributions because the fiduciary failed to specifically allocate this responsibility.

### THE DOL'S CONCLUSION

"The responsibility for collecting contributions is a trustee responsibility. If a plan has two or more trustees, the duty may be allocated to a single trustee. A plan may also provide that a named fiduciary may direct a trustee as to this responsibility or may appoint an investment manager to take on this duty. To the extent that the nature and scope of the trustee's responsibilities are specifically limited in the plan documents or trust agreement, it is generally the responsibility of the named fiduciary with the authority to hire and monitor trustees to assure that all trustee responsibilities with respect to the management and control of the plan's assets (including collecting delinquent contributions) have been properly assigned to a trustee or investment manager."

## 401(k) Supreme Court Case

In a 9-0 decision, the Supreme Court has ruled that ERISA allows a participant in a defined contribution plan to sue for reimbursement of investment losses suffered by the participant's individual account that resulted from a failure of the plan fiduciaries to follow investment directions (*LaRue v. DeWolff*, No. 06-856, Feb. 20, 2008).

The specific investment losses occurred during a market downturn in the early 2000s. Prior to this downturn, the participant provided the employer with instructions to make changes to his investment allocations. However, these instructions were not executed. As a result, the participant's account was reduced by \$150,000 before either party realized what had occurred.

### PRIOR LAW

Before *LaRue*, the federal courts had consistently maintained that ERISA provides remedies for entire plans rather than individuals. Thus, plan participants were limited to suing for "recovery on behalf of the plan." In *LaRue*, a plan participant sought to make his individual account whole. The employer argued that this was not

what was meant by "recovery on behalf of the plan" based on the Supreme Court's ruling in *Massachusetts Mutual Life Ins. Co. v. Russell*, 473 U.S. 134 (1985). The trial court and the federal appeals court each ruled in favor of the employer based on that precedent. However, the Supreme Court disagreed. Instead, it held that *Russell* arose in the context of an employer-sponsored disability plan, which was not relevant in a situation involving an individual account defined contribution plan.

### CURRENT RULING

The Supreme Court found that, while ERISA does not provide a remedy for individual injuries as distinct from plan injuries, it does authorize recovery for fiduciary breaches that impair the value of plan assets in a particular participant's individual account. (Note that ERISA allows recovery of compensatory damages only and that lawsuits for punitive damages are not permitted.)

The court then unanimously agreed that if an employer fails to follow a participant's investment direction and

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## 401(k) Supreme Court Case *(continued)*

the participant's retirement benefit is reduced as a result, then, as fiduciary, the employer is responsible. It is considered a breach of fiduciary duty to act or fail to act in the employee's best interest.

### OPENS POSSIBILITY OF LAWSUITS, BUT FIDUCIARY RESPONSIBILITY UNCHANGED

It seems that if an employer allows participants the right to direct their own investments and thus places the responsibility for the choice of investments upon the participants, then the employer should follow the investment direction of the participants.

The Supreme Court's decision seems fair in regard to making the participant "whole" under the plan. The fact that this case may open up the employer (as plan fiduciary) to lawsuits cannot be dismissed. However, the fiduciary requirements have not changed: They have always required employers to conduct themselves in a manner that protects plan assets. Employers that breach their fiduciary duty are not only subject to penalties and personal liability, they also face the possibility of a lawsuit, whether the breach affects the entire plan, or, as in the *LaRue* case, just one participant's account.

Fiduciary duties include many responsibilities, such as adhering to the exclusive benefit rule and the

prudent person rule, having a funding policy and reviewing it periodically, and, for plans with participant direction, potentially seeking to comply with ERISA Section 404(c). Perhaps more employers will wish to look into the fiduciary protection provisions from the Pension Protection Act of 2006, such as the prohibited transaction exemption for fiduciary advisers or the qualified default investment alternative.

### CASE NOT MOOT

In a footnote to the ruling at the end of the majority opinion, the Court also ruled on the respondent's motion to dismiss the case because *LaRue* had withdrawn all his funds from the plan and is no longer a participant. The Court denied the motion, stating that although the funds have been withdrawn, the case is not moot since ERISA Section 3(7) defines participant to include a former employee with a colorable claim for benefits.

Employers should continue to be aware of the fiduciary responsibilities inherent in a qualified plan and see to it that they are properly discharged, year in and year out.

### HOW NATIONWIDE® CAN HELP

Our Bill of Rights gives plan sponsors the rights that help them stay compliant by providing many of the tools necessary to manage their responsibilities.

## Deferral Deposit Deadline Proposed Regs

The long-awaited guidance on the deadline for depositing elective deferrals arrived in proposed regulation format on Feb. 29, 2008. The proposal offers a "seven-business-day safe harbor" for employers with small plans (less than 100 participants as of the first day of the plan year) to make deposits to their plans.

The actual deadline would be the seventh business day following the day that amounts would have been payable to the participant in cash or received by the employer to repay a participant loan.

### EFFECTIVE DATE

The proposed effective date will be the date the final regulations are published in the Federal Register. Until these regulations are finalized, *the DOL will not assert a violation of ERISA if the seven-business-day safe harbor period in this proposal is followed.*

Participant contributions will continue to be considered deposited when placed in an account of the plan, without regard to whether the contributed amounts

have been allocated to specific participants or the investments of such participants. As proposed, the safe harbor would apply to participant contributions to both pension benefit plans and welfare benefit plans.

### NEW CLARIFICATION

The general rule — that amounts withheld by an employer become plan assets on the earliest date on which they can reasonably be segregated from the employer's general assets — has not changed. However, the DOL felt that clarification of the concept of depositing deferrals "as soon as possible" would benefit both employers and the DOL. The DOL noted that it devotes significant enforcement resources to cases involving delinquent employee contributions, and close to 90% of the applications under the DOL's Voluntary Fiduciary Correction Program involve delinquent employee contribution violations.

**Example: Employer A** sponsors a 401(k) plan. There are 30 participants in the 401(k) plan. **A** has one payroll period

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## Deferral Deposit Deadline Proposed Regs *(continued)*

for its employees and uses an outside payroll processing service to pay employee wages and process deductions.

**A** has established a system under which the payroll processing service provides payroll deduction information to **A** within one business day after paychecks have been issued. **A** checks this information for accuracy within five business days, and then forwards the withheld employee contributions to the plan. The amount of the total withheld employee contributions is deposited with the trust that is maintained under the plan on the seventh business day following the date on which the employees are paid. Under the safe harbor in paragraph (a)(2) of this section, when the participant contributions are deposited with the plan on the seventh business day following a pay date, the participant contributions are deemed to be contributed to the plan on the earliest date on which such contributions can reasonably be segregated from **A**'s general assets.

### MUCH-NEEDED GUIDANCE

Prior to the new proposed regulations, the specific method of measuring the exact day that the deferral deposit was considered late was unclear and was subject to benchmarking. Employers who wanted to make the best effort were often unaware that they potentially engaged in a prohibited transaction if they were even one day later than the normal number of days they took to make the deposit. The new guidance will provide a higher degree of compliance certainty with respect to timely deposits of participant contributions to the plan.

The DOL feels the seven-day safe harbor will not add any additional risk for employees. It performed a number of studies, and the seven-day rule seemed easiest to implement. The DOL had also considered five- and ten-day periods, but found both to be less viable.

The DOL has asked for public comments on these regulations regarding:

- The seven-business-day safe harbor.
- Whether a safe harbor is needed for larger plans and the corresponding size.
- The effective date of the final safe harbor amendment.
- The potential impact of the proposed rule on small entities.

### HOW NATIONWIDE® CAN HELP

Nationwide offers Fastpay, a contribution processing system which can help expedite deposits. Using the debit ACH feature within Fastpay sends money to Nationwide two business days after submission. Please contact your administrative representative if you have questions.

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## Questions?

**If you're a plan administrator, call your case acquisition specialist at 1-800-548-6436.**

**If you're an investment professional, call your internal retirement plan consultant at 1-800-626-3112.**

**If you're a plan sponsor, call your plan administrator or investment professional.**



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PNM-0587AO.6 (06/08) Valid through Sept. 2009.