Pension ANALYST

IMPORTANT INFORMATION | **Plan Administration and Operation** | **February 2003***

DOL Provides Fiduciary Guidance

WHO'S AFFECTED This guidance applies to qualified defined benefit and defined contribution plans that are subject to the ERISA fiduciary responsibility rules, including multiemployer plans. It also applies to most 403(b) programs, but does not apply to governmental plans or non-electing church plans.

BACKGROUND AND SUMMARY In late 2002, the Department of Labor (DOL) issued a number of pieces of regulatory guidance relating to the operation of qualified plans that are subject to ERISA fiduciary requirements.

In particular, the DOL published guidance regarding:

- The application of ERISA fiduciary standards to multiemployer plan trustees (FAB 2002-2);
- A fiduciary's obligations with respect to "float" (FAB 2002-3); and
- The selection of an annuity provider by fiduciaries of either defined benefit or defined contribution plans (Advisory Opinion 2002-14A).

During this same period, the IRS also published a number of new rules and pieces of guidance relating to the operation of qualified plans. This guidance is discussed in detail in our February 2003 *Pension Analyst* titled "New Guidance from the IRS for the New Year."

More recently, the DOL has provided final rules regarding the provision of black-out notices under the Sarbanes-Oxley Act. These rules will be discussed in an upcoming *Pension Analyst*.

ACTION AND NEXT STEPS Sponsors of plans that are subject to the ERISA fiduciary responsibility rules should review this publication carefully. Questions about fiduciary duties should be discussed with the plan's legal counsel.

IN THIS ISSUE

*Republished December 2004 to reflect Prudential Financial's acquisition of CIGNA's retirement business.

Prudential Financial

Applying Fiduciary Standards to Multiemployer Plan Trustees

In general, expenses related to "settlor" functions performed by a plan sponsor (such as decisions to establish, amend or terminate a plan) are not considered to be part of the reasonable expenses of administering an ERISA Plan. As a result, these expenses may not be paid from plan assets. However, expenses for administrative activities (such as the preparation of plan amendments and the processing of benefit transactions) incurred in the performance of the plan fiduciary's duties are considered reasonable plan administrative expenses. As such, they may be paid from plan assets.

This manner of classifying plan sponsor functions creates a number of problems for multiemployer plans and their trustees. First of all, since multiemployer plan design decisions are made by the joint board of trustees, they are not a business decision made solely by one employer or a group of employers. Thus, the related expenses do not fit well into the "settlor expense" category. Secondly, if plan design decisions *must* be categorized as settlor expenses, this raises practical problems, since there is no single employer available to pay plan expenses and most plan trustees do not maintain a separate "plan expense fund" paid by participating employers.

In 2001, the DOL observed that certain activities that would be considered settlor activities in the context of a single employer plan may be considered fiduciary activities in the context of a multiemployer plan, since multiemployer plan trustees operate only in a fiduciary capacity. As a result, multiemployer plan assets may be used to pay these expenses. The drawback to this conclusion is that fiduciary determinations are subject to ERISA breach of fiduciary duty claims.

In its most recent guidance, the DOL determined that where plan documents (including collective bargaining agreements, plans and trust documents) provide a multiemployer plan's board of trustees with the authority to carry out activities that are normally considered settlor functions, those activities will be subject to ERISA's fiduciary rules. Related expenses may then be paid with plan assets. However, if plan documents are silent in this regard (as the DOL concluded was the case, according to the DOL, with the specific plan discussed in the Field Assistance Bulletin), the settlor activities will be considered settlor functions that are not subject to the fiduciary rules. As a result, expenses related to these activities cannot be paid for with plan assets.

Multiemployer plan trustees should consult the plan's legal counsel to determine whether current plan documents provide sufficient authority for the trustees to carry out what would otherwise be settler functions, and whether those provisions should be changed in light of this DOL guidance.

Obligations With Respect to "Float"

Service providers to ERISA plans often receive some investment earnings on funds in transit, typically into or out of a retirement plan. "Float" is the short-term interest earned on such funds.

The DOL's long-standing position is that any float earned on benefit plan accounts is considered to be a part of the plan's earnings.. Service providers may keep the float as part of their compensation from the plans, but must fully disclose this arrangement to plan sponsors. Such disclosure avoids certain ERISA conflicts of interest. The DOL has now provided additional guidance to both service providers and plan fiduciaries regarding the specific elements of these disclosures.

To meet these disclosure rules, service providers must:

- Describe the specific circumstances under which float will be earned and retained;
- Establish, disclose, and follow specific timeframes within which cash awaiting investment directions will be invested once that direction is received from the plan fiduciary;
- Disclose when the float period begins and ends with respect to payments, and establish and follow practices that affect the length of the float period;

To satisfy ERISA's fiduciary responsibility rules, plan fiduciaries must:

- Review service providers and service arrangements and their treatment of float;
- Determine how float is generated;
- Evaluate the role of float in the overall compensation paid to the service provider.

Guidelines for Selection of Annuity Providers

In 1995, the DOL provided guidance regarding the selection of an annuity provider for purposes of pension plan distributions. In this guidance, the DOL set forth six factors that should be considered by plan fiduciaries in selecting an annuity provider. Generally, this guidance has been viewed solely in the context of defined benefit plans, particularly terminating plans. The DOL has now confirmed that it also applies to the selection of annuity providers by fiduciaries of DC plans. Please note, however, that the guidance only applies to the selection of annuities as a plan distribution form.

When selecting annuity providers, a plan fiduciary must evaluate each provider's claims-paying abilities and creditworthiness. This analysis should take into consideration the following factors:
(1) The quality and diversification of the annuity provider's investment portfolio;
(2) The size of the insurer relative to the proposed contract;
(3) The level of the insurer's capital and surplus;
(4) The lines of business of the annuity provider and other indications of an insurer's exposure to liability;
(5) The structure of the annuity contract and guarantees supporting the annuities, such as the use of separate accounts;
(6) The availability of additional protection through state guaranty associations and the extent of their guarantees.

With respect to the sixth factor, the DOL has now clarified that the fiduciary should determine whether the insurance company and annuity are covered by the state guarantees and the extent of those guarantees in terms of amounts and individuals covered. This new guidance suggests that no particular expertise would be needed to make this determination due to the readily-available and easily-accessible information available from state guaranty associations and state insurance departments.

In addition, the DOL notes that:

- If the fiduciary making the annuity provider selection has, at the time of selection, sufficient expertise and knowledge to evaluate the annuity provider's claims-paying ability and creditworthiness, there would be no need to engage a qualified, independent (from the annuity provider) expert to evaluate the six factors.

- While plan fiduciaries should consider both the costs and benefits of the annuity in making its selection, this new guidance emphasizes that "a lower cost cannot justify the purchase of an unsafe annuity that would pay a higher benefit amount."

- Unlike under a defined benefit plan, there is no possibility of an asset reversion to the employer upon the termination of a defined contribution plan. Therefore, there is no need for fiduciaries to obtain the services of an independent (from both the annuity provider and the fiduciary) expert advisor for evaluating annuity providers in connection with defined contribution plan terminations, because the same potential for conflicts of interest does not apply.

In recent years, sponsors of defined contribution plans have moved away from offering annuities under their plans, largely as a result of the related additional spousal notification and consent requirements required under the Internal Revenue Code. However, in situations where annuities are offered (for example, under money purchase pension plans), this DOL guidance may provide additional comfort for plan sponsors who were unclear about their fiduciary responsibilities.

Pension Analyst by Prudential Retirement
The Pension Analyst is published by Prudential Retirement, a Prudential Financial business, to provide clients with up-to-date information on current legislation and regulatory developments affecting qualified retirement plans. This publication is distributed with the understanding that Prudential Retirement is not rendering legal advice. Plan sponsors should consult their attorneys about the application of any law to their retirement plans. Prudential Financial is a service mark of The Prudential Insurance Company of America, Newark, NJ and its affiliates.

Editor: Mitzi Romano (860) 534-2768