employee benefits update

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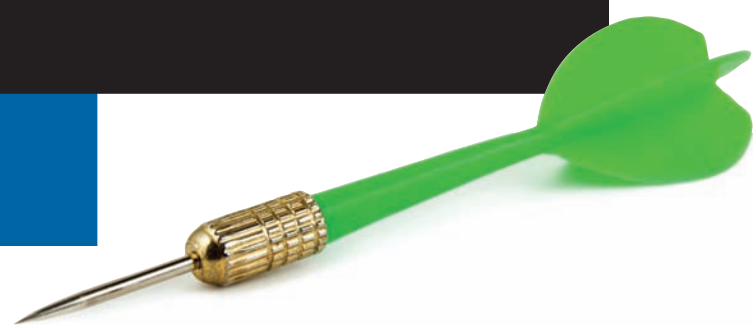

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Aiming for the target

ARE TARGET DATE FUNDS RIGHT FOR YOUR PLAN?

Target funds are mutual funds in which funds are invested based on a particular target date — usually the participant's anticipated retirement year. While target funds aren't a new option, there's uncertainty from many retirement professionals about them. In fact, since the market downturn in 2008, target funds have been scrutinized as being too aggressive and holding too much stock.

What are some target fund basics?

Target date funds hold an array of investments and asset classes which become more conservative as the target date approaches. This is known as a glide path. Two types of glide paths exist:

1. "Target to" funds assume that the participant will hold the fund only up to retirement, and
2. "Target through" funds assume that the fund will be held during retirement.

Target through funds can hold a higher percentage in equity and have greater risk because the fund is assuming a longer timeline.

In theory, target date funds make investing for participants easier. Why? Participants don't have to worry about reviewing and reallocating their portfolio because the fund handles this process for them. For participants lacking the time or knowledge to choose investments in their own retirement plan, target date funds may be an attractive option.

What about the participant's risk tolerance?

One problem with target date funds is that the majority of these types of funds don't take an individual's investment risk tolerance, goals and objectives into consideration. The fund is invested in terms of its own objectives, which may not apply to all participants.

Target date funds hold an array of investments and asset classes which become more conservative as the target date approaches.

Participants, as well as plan sponsors, should be aware that initial glide paths may be adjusted. According to Morningstar's *Target-Date Series Research Paper: 2011 Industry Survey*, because of market volatility, target date funds have changed and will continue to change their glide paths over the fund's course to better reflect market trends. A periodic review of the glide paths by the plan sponsor would help determine if the target fund is still in line with investment objectives.

What should you consider?

Before implementing a target date fund within your employee retirement benefit plan, review with your benefits specialist whether a target date fund is appropriate for your plan. In meeting

What's your fiduciary responsibility?

According to the Department of Labor (DOL), fiduciaries are subject to standards of conduct because they act on behalf of participants in a retirement plan and their beneficiaries. Fiduciaries must:

- Act solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them,
- Carry out their duties prudently,
- Follow the plan documents (unless they're inconsistent with ERISA),
- Diversify plan investments, and
- Pay only reasonable plan expenses.

Plan fiduciaries must ensure that the plan's selected investments are appropriate. As a fiduciary, you may be liable for incorporating a target fund. But you may transfer this liability to an investment manager. According to the DOL, when an employer appoints an investment manager that is a bank, insurance company or registered investment advisor, the employer is responsible for the manager's selection, but isn't liable for the manager's individual investment decisions.

However, the DOL requires employers, on a periodic basis, to review the manager to ensure that it's handling the plan's investments prudently and according to the appointment. If the fiduciary has the authority to make investment decisions, it must research the various available funds, underlying assets, fees and potential risk before including them in the investment selection.

your fiduciary duty (see "What's your fiduciary responsibility?" above), consider the following:

Outline your investment strategy. All retirement plans should consider having an investment policy outlining the plan's investment goals and objectives. Before selecting a target date fund to include in the plan's investment portfolio, research the fund to make sure it fits within your plan's investment policy terms. And if the glide path has changed, review the new glide path to determine whether it still fits within your investment goals.

Examine asset allocation. Remember, target date funds attempt to standardize asset allocation without consideration to individual investors. Understand the fund's asset allocation and how the ratio of stocks, bonds, cash and other investments changes over the fund's glide path.

Benchmark the target date fund. Many funds will be benchmarked against various indices. Because target date funds are newer, there is less to benchmark them against. Consider your fiduciary duties when attempting to benchmark a target date fund.

Analyze fees and expenses. Make sure to understand which fees and expenses apply to the target date fund. Question the investment advisor about fees for the target date fund itself and fees for any of the underlying mutual funds.

Are target funds right for your plan?

Review your investment policy to determine if a target date fund is suitable for your plan. Then discuss your options with your retirement benefits advisor. Offering target date funds may result in higher participant enrollment.

Upcoming compliance deadlines:

6/30 Deadline for processing corrective distributions for failed ADP/ACP test from plan with eligible automatic contribution arrangement (EACA) without 10% excise tax

7/29 Summary of material modifications due (210 days after end of plan year in which the amendment was adopted)

7/31 Form 5500 is due or a request for an extension on Form 5558

7/31 Form 5330 to report excise tax on prohibited transactions is due

Follow the right path

DOL ISSUES FINAL RULE ON PROHIBITED TRANSACTION EXEMPTION PROCEDURES

The Department of Labor's (DOL's) final rule for prohibited transaction exemption procedures is now in effect and applies to all exemption applications. The final rule supersedes all prior DOL procedures, including 2010 updates to the filing and processing application procedures for exemptions from the Employee Retirement Income Security Act's (ERISA's) prohibited transaction requirements.

Defining a prohibited transaction

ERISA prohibits certain transactions between a plan and a disqualified person. For example, a prohibited transaction occurs when a disqualified person uses or transfers plan income or assets for his or her benefit.

However, certain prohibited transactions are exempt from being treated as such. These include statutory, administration, class and individual exemptions. For example, the law permits loans to plan participants and beneficiaries who are disqualified persons if the loan meets certain criteria.

Parties to the transaction must meet the conditions of the applicable exemption. The DOL considers each application on its own merits. Because most applications involve unique circumstances, the DOL considers each application individually and doesn't guarantee that it will grant an exemption based solely on the submission of an application.

Simplifying the exemption process

The final rule simplifies and clarifies the procedures for all exemption applications by giving applicants a comprehensive description of the prohibited transaction exemption process. The final rule contains 23 sections arranged by topic, and the steps involved in processing and completing the prohibited transaction exemption application are in chronological order. It also clarifies the types of information and documentation required for a complete filing and explains the information that applicants must include in every exemption application.

The final rule also states which applications the DOL won't consider. For example, the DOL generally doesn't consider applications that involve transactions that are under investigation. Also, the DOL won't consider an application that fails to contain all of the required information and otherwise fails to conform to the rule's procedural requirements.

Defining terms

The DOL modified the definition of various terms in the final rule. Two definitions sponsors should be aware of are "qualified independent appraiser" and "qualified independent fiduciary." To demonstrate the independence of the appraiser or fiduciary, a qualified independent appraiser or fiduciary who is engaged in connection with a prohibited exemption transaction cannot receive more than a de minimis amount of compensation from the parties-in-interest to the transaction.

The DOL will presume the appraiser or fiduciary is independent if the revenues it receives in the current tax year from the parties-in-interest are either:

- Not more than 2% of the appraiser's annual revenue based on its prior income tax year, or
- Not more than 5% of the appraiser's annual revenue based on its prior income tax year if other circumstances indicate the appraiser's independence.

When filing an exemption application, the applicant must include documentation disclosing the percentage of the appraiser's or fiduciary's income derived from any party-in-interest.

Considering other important changes

The final rule also provides guidance to applicants seeking retroactive relief for past prohibited transactions. The DOL will consider granting retroactive relief for transactions already consummated only if the safeguards necessary for the grant of prospective exemption were in place at the time of the transaction. The applicant must provide evidence that it acted in good faith at the time of the transaction by taking reasonable and appropriate steps to protect the plan from abuse and unnecessary risk.

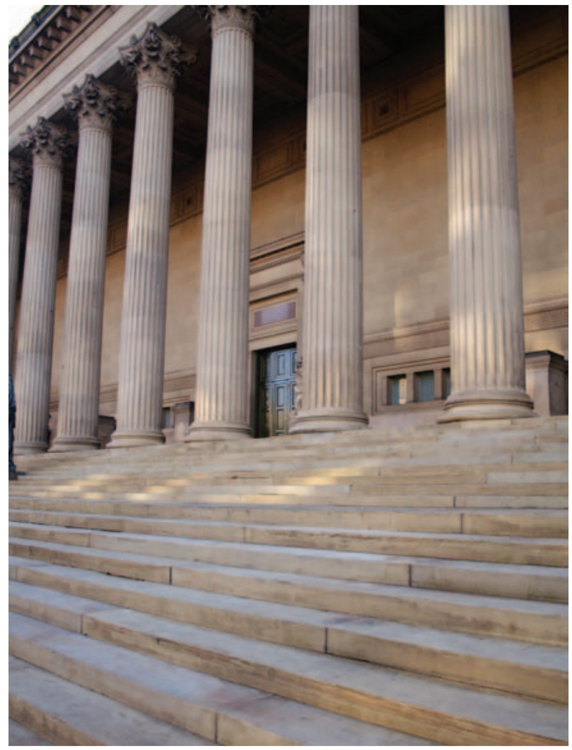
If an applicant discovers that any material facts have changed or weren't included in the original application, the applicant must promptly notify the DOL in writing. Also, if a party-in-interest becomes the subject of an investigation, the party must communicate this to the DOL. Finally, parties can now electronically file the exemption application information, including any comments related to the filing.

Get the exemption right

By clearly explaining each step in the exemption procedure and the information that applicants must include in an exemption application, the final rule provides plans and other interested parties with a clearer understanding of the prohibited transaction exemption process. This should help all parties when applying for an exemption from a possible prohibited transaction.

Court decision may affect health plan reimbursement provisions

ERISA covers most private sector health plans. Historically, plan sponsors and administrators have come to rely on an ERISA provision for full reimbursement of medical expenses paid to participants if the plan document contains specific language to this effect and injured participants recover money from third parties. However, the U.S. Court of Appeals for the Third Circuit recently refused to enforce such a provision. In making this decision, the court significantly departed from existing case law.



The facts

In *US Airways, Inc. v. McCutchen*, a participant in US Airways' employer-based health insurance plan was involved in a serious car accident and sustained numerous injuries. US Airways paid medical expenses on his behalf. The participant was later awarded monetary damages in a lawsuit. After paying his legal fees, the participant recovered less than the amount of the medical expenses US Airways had paid.

The US Airways health plan document included specific language entitling the plan to full reimbursement of medical expenses to the extent of monetary compensation awarded from third parties. When US Airways requested full repayment under this clause, the plan participant refused, arguing that, because US Airways hadn't contributed in any way to his legal fees, it would be unjustly enriched if it were permitted to recover from him.

Under ERISA, a participant, beneficiary or fiduciary (such as the plan administrator) may file a civil action to obtain "appropriate equitable relief" to enforce a plan's provisions. Equitable relief generally orders a party to do — or not do — something. In its role as plan administrator, US Airways filed a lawsuit seeking equitable relief in the form of full reimbursement from the plan participant. The trial court awarded US Airways full reimbursement based on the plan document's express language — without considering "equitable defenses" (defenses based on inherent rules and principles of equity, or justice).

The court's decision

The question before the Third Circuit was whether ERISA's appropriate equitable relief provision is limited by equitable defenses. The plan participant argued that "appropriate equitable relief" means more than just that the relief sought must be of an equitable type; courts must also exercise their discretion to limit the equitable relief to what is "appropriate," using traditional equitable defenses such as unjust enrichment.

The Third Circuit agreed. It denied enforcement of US Airways' reimbursement provision, finding that full reimbursement was inappropriate and *in*equitable relief. The court concluded that the importance of the written benefit plan isn't inviolable. Rather, it's subject to modification, including equitable reformation (the re-forming of a contract to correctly express the parties' intentions) based on equitable defenses.

The future

Whether this decision will have wide-reaching implications is unknown. Either way, it gives rise to practical concerns that application of equitable principles may affect whether courts enforce even well-drafted plan document provisions.

Service providers' fee disclosure date is on the horizon

The Department of Labor (DOL) released a final rule requiring service providers to disclose fee and expense arrangements to simplify comparisons between investment options. Service providers must give disclosures to participants and beneficiaries on or before the date that they can first direct their investments, and then annually for following years. The disclosures must use a chart or other format designed to provide a comparison of all the plan's investment options.

Some requirement disclosures from the final rule include:

General plan disclosures. This includes an up-to-date list of the plan's investment options and a description of any arrangements that allow a selection of investments beyond those offered.

Plan fees and expenses. Service providers must disclose fees and expenses for legal, accounting and record-keeping services, plus any other general plan administrative services that may be charged to or withheld from all accounts.

Performance data. Service providers must disclose one-, five- and 10-year returns for investment options, such as mutual funds that don't have fixed rates of return. For investments that have a fixed rate of return, service providers must disclose the investment's annual rate and term.

Benchmark information. For investment options that don't have a fixed rate of return, service providers must disclose the name and returns of an appropriate broad-based securities index over one-, five-, and 10-year periods. Options with fixed rates of return aren't subject to this condition.

Fee and expense information. For investment options that don't have a fixed rate of return, service providers must disclose the total annual operating expenses and any fees or restrictions on a participant's ability to purchase or withdraw from the investment.

Website access. The disclosure must include a website address that provides access to additional information about the investment options.

The final rule's effective date of July 1, 2012, pushed back the participant-level fee disclosure to Aug. 30, 2012, for calendar year plans. This gives providers and responsible plan fiduciaries additional time to provide these initial disclosures to participants or beneficiaries.

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  - ESOPs and ownership succession planning and implementation
  - Assisting fiduciaries to reduce liability and comply with legal requirements
  - Transitioning benefit plans in mergers and acquisitions
- Tax and Business Planning/Corporate and Business Representation
- Business Mergers and Acquisitions
- Tax and Regulatory Dispute Resolution
- Trusts, Estate Planning and Probate
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MISSION STATEMENT:

M&J is committed to continuing its tradition of delivering personalized legal services by working together to provide effective solutions for its clients.

W. Terence Jones has over 30 years experience in benefits and corporate matters. He received his B. A. from Yale University and received his law degree cum laude and a Master in Laws (in Taxation) from Boston University School of Law. He may be reached at **tjones@maselanjones.com** or 617-310-6565.