RPA
RETIREMENT PLAN ACADEMY

NTSA
National Tax-Deferred Savings Association
Part of the American Retirement Association

TGPC-2: Tax-Exempt & Governmental Plan Consultant-2

Course Overview

This course covers many of the day-to-day issues that financial professionals encounter when working with 403(b), 457(b) and other plans maintained by tax-exempt and governmental entities. Some of the topics covered include contract exchanges and transfers, fiduciary standards, governmental plans, IRAs, investments, religious organization plans, top hat plans and professional ethics.

Additionally, if candidates choose to continue their education of tax-exempt and governmental plans, an additional course, Tax-Exempt & Governmental Plan Administration-1 (TGPC-1) is offered which completes the TGPC credential requirements. View additional information on the Tax-Exempt & Governmental Plan Consultant (TGPC) credential at www.asppa-net.org/tgpc.

Suggested Reading

TGPC-2: *The Source: Advanced Concepts in 403(b) & 457 Plan Administration & Consulting, 7th Edition*. Arlington, VA: ARA, 2018.

Bloom, Lauren. *Elegant Ethical Solutions*. Elegant Solutions Consulting: Goodlettsville, TN.

Suggested reading provided at the end of the syllabus:

fyi: Pension Protection Act–Impact on Governmental Plans, Volume 29: Issue 65, September 8, 2006. Buck Consultants, an ACS company.

Swisher, Pete. Investment Policy Statement. Excerpted and adapted from *401(k) Fiduciary Governance: An Advisor's Guide, 3rd Edition*. Arlington, VA: ASPPA, 2012.

Swisher, Pete. Understanding Plan Fees. Excerpted and adapted from *401(k) Fiduciary Governance: An Advisor's Guide, 3rd Edition*. Arlington, VA: ASPPA, 2012.

American Retirement Association Code of Professional Conduct.

Supplementary Study Materials

Practice examinations are available for purchase at www.asppa-net.org/practice-exams.

Educational Material Copyright

It is important to note that all ASPPA and NTSA examination and educational materials are copyrighted. No examination or educational materials can be copied, reproduced or shared in any form by any means without written permission from ASPPA. In an effort to provide educational opportunities, ASPPA does offer specific distributable products (see details under Multi-User Distributable Educational Materials).

Multi-User Distributable Educational Materials

Please note that only products noted as distributable can be distributed. Purchasers of these products are allowed to distribute to direct employees of their Company. In addition, authorized Universities offering ASPPA education are eligible to distribute the purchased materials to their students. Purchasers of this product are prohibited from distribution of these materials to any other parties unless agreed upon by ASPPA in writing. Materials may be e-mailed directly to the above-mentioned parties or published on a non-public portion of the Purchaser's website for access/distribution. Materials may not be placed on a site that has general public access. All other use or distribution of these materials is explicitly prohibited unless otherwise approved in writing by ASPPA.

Exam

The corresponding proctored exam will include 60 multiple choice questions for which a candidate will have 2½ hours to complete. Candidates will receive a grade immediately upon completing the exam. Exams are given in a proctored setting at Prometric Testing Centers.

Additional Information

All candidates are encouraged to visit Candidate Corner (www.asppa-net.org/candidate-corner) for additional information regarding this exam. It is the candidate's responsibility to check the website to obtain current information on examinations and publications. The Candidate Corner includes instructions for locating Prometric test centers and scheduling examinations, study tips, current information on regulatory limits and other helpful information. You may also contact ASPPA with questions at rpa@usaretirement.org.

Topic 1: An Investment Overview

Overview
This topic introduces the types of investments that can be offered in a 403(b) plan. It also covers the evolution of investment products that have been designed specifically for the 403(b) market.

Even though 403(b) plans may "look and feel" more like 401(k) plans than they have in the past, there are still significantly more 401(k) products than 403(b) products available to employers. A financial professional must learn to distinguish between experienced 403(b) providers and other providers who just dabble in the 403(b) marketplace.

Learning Objectives
The successful candidate will be able to:

1.01 Identify the types of investment options that may be offered in a 403(b) plan.
1.02 Identify the investment trends in the 403(b) market.

Exam Weighting
This topic will comprise approximately 2 to 4 percent of the exam questions.

Suggested Reading
Chapter 1: *The Source: Advanced Concepts in 403(b) & 457 Plan Administration & Consulting, 6th Edition*. Arlington, VA: ARA, 2018.

Topic 2: Non-ERISA 403(b) Plans

Overview
This topic covers bankruptcy protection available to participants in 403(b) plans. Also discussed is how K-12, higher education organizations and hospitals choose investments and vendors for their plans. There is also a discussion regarding the plan design that educational employers may use to encourage participation in their plans.

Learning Objective
The successful candidate will be able to:

2.01 Discuss the bankruptcy protection available to participants in 403(b) plans.
2.02 List the steps that K-12 public schools should take before implementing employer contributions in a 403(b) plan.
2.03 Describe the ways that employers use a qualified defined contribution plan to encourage participants to make elective deferrals to a governmental 457(b) or 403(b) plan.
2.04 Explain the process of how higher education organizations, K-12 schools and hospitals choose a vendor.

Exam Weighting
This topic will comprise approximately 5 to 7 percent of the exam questions.

Suggested Reading
Chapter 2: *The Source: Advanced Concepts in 403(b) & 457 Plan Administration & Consulting, 7th Edition*. Arlington, VA: ARA, 2018.

Topic 3: Contract Exchanges, Plan-to-Plan Transfers and Rollovers

Overview
A financial professional working with 403(b) plans must understand the rules for contract exchanges and plan-to-plan transfers if he or she is to be effective working with employers and participants. Candidates will learn about the required paperwork and the employer's procedures required in moving 403(b) accounts.

Additionally, this topic covers some of the unique areas of governmental plans, including the purchase of service credits in a state's defined benefit plan.

Learning Objectives
The successful candidate will be able to:

- 3.01 Describe the issues that a participant should consider before moving his or her 403(b) account to another investment vehicle or product provider.
- 3.02 Describe the types of 403(b) plan-to-plan tax-free transfers that are permitted in 403(b) plans.
- 3.03 Identify what a contract exchange is as it relates to 403(b) plans.
- 3.04 Describe the information sharing process that occurs between an employer and a 403(b) provider or TPA.
- 3.05 Describe the product provider and employer requirements for tax-free transfers and exchanges.
- 3.06 Describe the issues that eligible participants should consider when deciding whether to purchase service credits in a state's defined benefit plan.
- 3.07 Explain the advantages and disadvantages that participants should consider when making the decision to keep their account balance in a governmental 457(b) plan versus rolling it over to another eligible rollover plan or IRA.

Exam Weighting
This topic will comprise approximately 10 to 14 percent of the exam questions.

Suggested Reading
Chapter 3: *The Source Advanced Concepts in 403(b) & 457 Plan Administration & Consulting, 7th Edition*. Arlington, VA: ARA, 2018.

fyi: Pension Protection Act–Impact on Governmental Plans, Volume 29: Issue 65, September 8, 2006. Buck Consultants**,** an ACS company.

Topic 4: Fiduciary Standards and Responsibilities

Overview
For financial professionals to be successful working with retirement plans, an understanding of fiduciary standards is necessary. Financial professionals should be able to identify who is considered a fiduciary and what activities may lead to an individual being classified as a fiduciary.

Additionally, strategies and tools that fiduciaries use to help satisfy their obligations are covered, including using an investment policy statement (IPS), ERISA §404(c) and eligible investment advice arrangements.

Learning Objectives
The successful candidate will be able to:

- 4.01 List the parties that are considered fiduciaries under ERISA.
- 4.02 List a fiduciary's standard of conduct requirements under ERISA.
- 4.03 Explain the DOL's fiduciary rule as it relates to investment advice.
- 4.04 Discuss the impact of the DOL's fiduciary rule on financial professionals.
- 4.05 Describe the activities that may cause an individual to become a fiduciary under ERISA.
- 4.06 List the requirements of an eligible investment advice arrangement as defined under ERISA.
- 4.07 List the individuals and organizations that qualify as ERISA fiduciary advisers.
- 4.08 List the general duties and responsibilities of a plan administrator under ERISA.
- 4.09 Discuss why an employer would use an investment policy statement (IPS).
- 4.10 Identify the types of topics that are included in an IPS.
- 4.11 Discuss why a plan sponsor would want to satisfy the requirements of ERISA §404(c).
- 4.12 Identify prohibited transactions as defined by ERISA.
- 4.13 Discuss the penalties for fiduciary and prohibited transaction breaches as defined under ERISA.

Exam Weighting
This topic will comprise approximately 15 to 19 percent of the exam questions.

Suggested Reading
Chapter 4: *The Source: Advanced Concepts in 403(b) & 457 Plan Administration & Consulting, 7th Edition*. Arlington, VA: ARA, 2018.

Swisher, Pete. Investment Policy Statement. Excerpted and adapted from *401(k) Fiduciary Governance: An Advisor's Guide, 3nd Edition*. Arlington, VA: ASPPA, 2012.

Topic 5: Public Safety Employees and Public Safety Officers

Overview
Public safety employees and public safety officers are subject to favorable taxation rules when taking distributions under certain scenarios. This topic covers who qualifies as a public safety officer or public safety employee and describes the circumstances that can achieve these favorable tax results.

Learning Objectives
The successful candidate will be able to:

- 5.01 Define a public safety employee and a public safety officer.
- 5.02 Explain the waiver of the 10% tax on early distributions to qualified public safety employees from governmental defined benefit and defined contribution plans and the potential tax implications if these distributions are rolled over and subsequently distributed from another retirement plan or IRA.
- 5.03 Describe how public safety officers may directly transfer taxable retirement distributions to pay for retiree medical or long-term care premiums on a pre-tax basis.

Exam Weighting
This topic will comprise approximately 4 to 6 percent of the exam questions.

Suggested Reading
fyi: Pension Protection Act–Impact on Governmental Plans, Volume 29: Issue 65, September 8, 2006. Buck Consultants**,** an ACS company.

Topic 6: Compliance Tools and Checklists

Overview
Checklists and sample forms are included in the course's required reading so that financial professionals may understand the compliance needs of their clients. This topic covers what is typically included in a service provider agreement and identifies the parties that must sign the agreement.

Learning Objectives
The successful candidate will be able to:

- 6.01 Explain the components of a service provider agreement and describe the purpose it serves.

Exam Weighting
This topic will comprise approximately 1 to 3 percent of the exam questions.

Suggested Reading
Chapter 7: *The Source: Advanced Concepts in 403(b) & 457 Plan Administration & Consulting, 7th Edition*. Arlington, VA: ARA, 2018.

Topic 7: 457 Plans

Overview
457 plans are often a mystery to retirement plan professionals. This topic will help demystify this plan type by outlining the different categories of 457 plans, describing their characteristics, and identifying the organizations that may sponsor them.

Financial professionals must understand the different types of 457 plans in order to present viable retirement plan solutions to employers for their key personnel.

Learning Objectives
The successful candidate will be able to:

- 7.01 List the characteristics of a nongovernmental tax-exempt 457(b) plan.
- 7.02 List the ERISA requirements that a nongovernmental tax-exempt 457(b) plan must satisfy.
- 7.03 Describe the considerations of using a rabbi trust in a nongovernmental tax-exempt 457(b) plan.
- 7.04 Discuss the fiduciary obligations of a local or state employer as it relates to a 457(b) plan.
- 7.05 Discuss what investments are permitted in governmental 457(b) plans and nongovernmental tax-exempt 457(b) plans.
- 7.06 Describe the differences between a governmental 457(b) plan and a 457(b) plan sponsored by a nongovernmental tax-exempt entity.
- 7.07 List the characteristics of a 457(f) plan.
- 7.08 Explain how IRC §409(A) affects the taxation of 457(f) plans.
- 7.09 Discuss when contributions to a 457(f) plan are included as income for federal tax purposes.
- 7.10 Explain what is a substantial risk of forfeiture and its tax consequences in a 457(f) plan.
- 7.11 Compare the characteristics of a 457(b) plan to a 457(f) plan.

Exam Weighting
This topic will comprise approximately 16 to 20 percent of the exam questions.

Suggested Reading
Chapter 9: *The Source: Advanced Concepts in 403(b) & 457 Plan Administration & Consulting, 7th Edition*. Arlington, VA: ARA, 2018.

Topic 8: Religious Organizations

Overview
Many financial professionals would like to prospect in the religious organization marketplace but are not sure how it works or where to start. This topic explains the nuts and bolts of this often misunderstood market by covering the different types of religious organizations, employee eligibility, nondiscrimination rules, contribution limits and distribution rules.

Learning Objectives
The successful candidate will be able to:

- 8.01 Define the potential marketing opportunities available in the religious organization marketplace.
- 8.02 Define a “steeple” church entity.
- 8.03 Define a qualified church controlled organization (QCCO).
- 8.04 Identify entities that are considered non-QCCOs.
- 8.05 Define an IRC §414(e) religious organization.
- 8.06 Explain the universal availability requirements that apply differently to churches and QCCOs and distinguish those from the rules that apply to IRC §414(e) organizations.
- 8.07 Explain the 403(b) nondiscrimination rules that apply differently to churches, QCCOs and IRC §414(e) entities.
- 8.08 Explain the two catch-up provisions under IRC §415(c) that are specific to churches and QCCOs.
- 8.09 Define what types of compensation are considered includible compensation for purposes of contribution allocations in religious organization's plans.
- 8.10 Describe differences in taxability in distributions from a 403(b)(9) retirement income account from other 403(b) plan types.
- 8.11 Differentiate between a 403(b)(9) retirement income account and a 403(b)(1) annuity or 403(b)(7) custodial account.
- 8.12 Identify the types of plans that an IRC §414(e) entity, church and QCCO may maintain.

Exam Weighting
This topic will comprise approximately 13 to 19 percent of the exam questions.

Suggested Reading
Chapter 10: *The Source: Advanced Concepts in 403(b) & 457 Plan Administration & Consulting, 7th Edition*. Arlington, VA: ARA, 2018.

Topic 9: Understanding Plan Fees

Overview
In order for plan sponsors to perform their fiduciary duties, they must determine whether plan expenses including investment fees are reasonable. And, as a financial professional, you will prepare and present fee analysis reports to your clients to help them satisfy their fiduciary duties.

This topic explains the different types of fees and expenses associated with plans and investments. It also covers the fee and investment information that must be disclosed to participants along with the timeframes for providing this information.

Learning Objectives

The successful candidate will be able to:

- 9.01 Explain mutual fund sales charges, 12b-1 fees and how mutual fund share classes affect investment fees.
- 9.02 Define investment management fees, custodial and transfer agent fees, transaction fees, sub-transfer agent fees and shareholder servicing fees.
- 9.03 Describe the potential contractual expenses that may be incurred in an annuity contract.
- 9.04 Explain the concept of revenue sharing.
- 9.05 Discuss the participant fee disclosure requirements under ERISA 404(a).
- 9.06 Discuss the service provider disclosure requirements under ERISA 408(b)(2).

Exam Weighting

This topic will comprise approximately 8 to 12 percent of the exam questions.

Suggested Reading

Chapter 4: *The Source: Advanced Concepts in 403(b) & 457 Plan Administration & Consulting, 7th Edition*. Arlington, VA: ARA, 2018.

Swisher, Pete. Understanding Plan Fees. Excerpted and adapted from *401(k) Fiduciary Governance: An Advisor's Guide, 3rd Edition*. Arlington, VA: ASPPA, 2012.

Topic 10: Ethics and Professional Responsibility

Overview

A financial professional must be bound by certain ethical duties to the plan sponsor and to the participants. The first reading is the *ASPPA Code of Professional Conduct,* which outlines the expected behavior of ASPPA members. The second required reading is *Elegant Ethical Solutions* which describes the factors that may lead to ethical dilemmas and also describes the steps that can be taken to safely navigate through them.

Learning Objectives

The successful candidate will be able to:

- 10.01 Identify actions that do and do not violate the American Retirement Association Code of Professional Conduct.
- 10.02 Describe the circumstances that may result in an ethical dilemma and the steps that should be taken when confronted with an ethical dilemma.

Exam Weighting

This topic will comprise approximately 5 to 7 percent of the exam questions.

Suggested Reading

ASPPA Code of Professional Conduct. Available online and also provided within.

Bloom, Lauren. *Elegant Ethical Solutions*. Elegant Solutions Consulting: Goodlettsville, TN.

[buck research]

for your information®

Volume 29 | Issue 65 | September 8, 2006

Pension Protection Act – Impact on Governmental Plans

The Pension Protection Act of 2006 (PPA) includes many provisions that will impact governmental plans. New flexibility in the minimum distribution rules gives governmental employers the opportunity to offer new payment options and protect existing ones. Special rules apply to benefits for school teachers, public safety officers and public safety employees. Many general provisions of the new law will also be of interest, including provisions regarding in-service distributions from pension plans, permissive service credit purchases, distribution timing and rollovers.

Background

President Bush signed the Pension Protection Act of 2006 (PPA) into law on August 17th. Although the primary focus of the PPA is the funding of private sector defined benefit plans, it has many provisions that affect governmental retirement plans. The PPA creates opportunities that many governmental employers, especially employers of school teachers and public safety employees, will want to take advantage of.

Many of the provisions affecting governmental employers are effective upon enactment and some have retroactive effect. Governmental employers have until the last day of the plan year beginning on or after January 1, 2011 to retroactively amend their plans to comply with the applicable PPA provisions (as long as they are operated in accordance with the provisions from their effective dates).

An overview of the PPA provisions that affect governmental employers is provided below.

PPA Provisions Directed at Governmental Employers

Minimum Distribution Rules

Code Section 401(a)(9) imposes minimum distribution standards on qualified retirement plans, including governmental plans. Current IRS regulations permit annuity distribution options in governmental plans in place before April 17, 2002 to satisfy Section 401(a)(9) by meeting a reasonable good faith compliance standard.

The PPA directs the IRS to issue regulations for governmental plans clarifying that a plan's distribution options will be deemed to be in compliance with Section 401(a)(9) for all years that the section applies to them as long as they represent a reasonable good faith interpretation of the rules.

explore excellence℠

© 2006 Buck Consultants®, LLC. All rights reserved

buckconsultants an ACS company

__BUCK COMMENT.__ Governmental plans should already be operating in good faith compliance with the minimum distribution rules and existing distribution options will continue to be protected. The PPA may encourage employers to offer new annuity distribution options under this reasonable good faith standard.

Public Safety Officers and Employees

Retiree Medical Premiums for Public Safety Officers. An important PPA provision allows public safety officers who separate from service at the plan's normal retirement age or on account of disability to elect to have up to $3,000 per year of their otherwise taxable retirement distributions from a qualified retirement plan, a Section 403(b) plan or a Section 457(b) plan transferred directly to pay for retiree medical or long-term care insurance premiums on a pre-tax basis. A "public safety officer" is defined as a law enforcement officer, firefighter, chaplain, or member of a rescue or ambulance crew. This provision is effective for distributions in taxable years beginning in 2007.

__BUCK COMMENT.__ Thus, it appears that a public safety officer who is eligible for an early retirement benefit or an unreduced retirement benefit before normal retirement age will not qualify for this exclusion from income. Plan sponsors must amend their plans if they wish to take advantage of this provision.

Distributions to Public Safety Employees Over Age 50. Distributions from a governmental defined benefit plan made after August 17, 2006 to qualified public safety employees who separate from service after attaining age 50 will not be subject to the 10% early distribution penalty tax. A "qualified public safety employee" is any employee of a state or political subdivision of a state who provides police protection, fire-fighting services, or emergency medical services for any area within the jurisdiction of such state or political subdivision.[1]

__BUCK COMMENT.__ This provision was driven by the tax treatment of deferred retirement option plans (DROPs). An employee who retired prior to attaining age 55, who elected a lump sum DROP benefit, and who elected not to roll over the distribution was subject to income taxes and the 10% early distribution penalty tax. Public safety employees who retire before attaining age 50 and elect a lump sum DROP benefit are still subject to the penalty tax unless they roll over the distribution. A plan amendment is not needed to take advantage of this provision.

[1] Article Update: On June 29, 2015, President Obama signed into law the "Defending Public Safety Employees' Retirement Act." This law expands the exemption of the 10% early distribution penalty tax to distributions from defined *contribution* governmental plans to qualified public safety employees who separate from service after attaining age 50. The law applies to distributions made after December 31, 2015.

© 2006 Buck Consultants®, LLC. All rights reserved

School Teachers

Early Retirement Incentive Plans. Prior to the PPA, if a school district or tax-exempt educational association provided early retirement subsidies or temporary supplements outside of a defined benefit plan, the benefits were considered deferred compensation subject to Section 457. These benefits could also violate age discrimination standards under the Age Discrimination in Employment Act (ADEA) because they are typically more valuable to younger early retirees than older retirees.

The PPA amends Section 457 to provide that early retirement incentive plans that are coordinated with governmental defined benefit plans will be treated as bona fide severance plans and therefore not subject to the Section 457 limits. The law amends ERISA to provide that they are treated as welfare plans for ERISA purposes. Finally, the law amends ADEA to provide that they will be treated as defined benefit plans and not as providing severance pay for purposes of ADEA. These provisions are generally effective August 17, 2006. The amendments to Section 457 apply to taxable years ending after August 17, 2006. The ERISA amendment is effective for plan years ending after August 17, 2006.

Employment Retention Plans. The PPA provides that school districts and tax-exempt educational associations may provide a retention benefit of up to two times the applicable Section 457(b) limits on deferrals (e.g., two times $15,000 in 2006) without the benefit being treated as deferred compensation subject to Section 457(f) – i.e., the amounts are not includable in income until paid. In addition, the PPA provides that these plans are treated as welfare plans under ERISA. This provision is effective August 17, 2006 and applies to taxable years ending after August 17, 2006.

Permissive Service Credit Purchases

Governmental defined benefit plans often allow participants to be credited with permissive service credit if they make voluntary contributions in an amount necessary to fund the benefit attributable to the service credited. Code Section 415(n) permits a governmental plan to ignore Section 415(c) (which limits employee after-tax contributions to a retirement plan) when an employee purchases service credits with after-tax contributions, and instead to include the benefit attributable to those contributions in the employer provided benefit in testing for compliance with Section 415(b). The IRS had ruled earlier that Section 415(n) was only available if the employee had actually performed service not considered by the governmental plan and had also ruled that Section 415(n) was not available when an employee made an after-tax contribution to become eligible for an early retirement subsidy (e.g., a buy down of the actuarial reduction for early commencement).

Effective retroactively to plan years after the enactment of the Tax Reform Act of 1997, the PPA amends Section 415(n) to clarify that no actual performance of service is required and that Section 415(n) is available for actuarial reduction buy downs.

© 2006 Buck Consultants®, LLC. All rights reserved

Effective retroactively to plan years after the enactment of EGTRRA, the law provides that permissive service credits purchased through trustee-to-trustee transfers from Section 457(b) and Section 403(b) plans are not subject to the limitations on nonqualified service and that the amounts transferred are subject to the defined benefit plan's distribution rules.

Exemption from Nondiscrimination and Minimum Participation Rules

Retirement plans sponsored by state and local governmental or other political subdivisions are exempt from the Code's rules regarding discrimination in favor of highly-compensated employees and minimum participation. Certain other governmental plans (e.g., international organizations) have been subject to these rules, although a moratorium on the application of these rules has been in effect indefinitely pending the issuance of final IRS guidance. (See our February 14, 2003 *For Your Information*.)

The PPA now explicitly exempts all governmental plans from the nondiscrimination and minimum participation rules, effective August 17, 2006.

Indian Tribal Plans

The new law amends the Code and ERISA to include plans maintained by Indian tribal governments in the definition of governmental plans – but only for employees performing governmental functions and not commercial functions. This provision is effective for any year beginning on or after August 17, 2006.

> ***BUCK COMMENT.*** *We understand that there will be an attempt to have the governmental function requirement modified in a technical corrections bill.*

Participation Rules for Section 457(b) Plans

The PPA provides that an individual that received a distribution of $3,500 or less under Section 457(e)(9) before the enactment of the Small Business Job Protection Act of 1996 is not precluded from participating in a Section 457(b) plan.

General PPA Provisions that Affect Governmental Employers

Extension of EGTRRA Provisions

Certain provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) affecting retirement plans (e.g., the increases in benefit, contribution and compensation limits, the availability of Roth 401(k) and Roth 403(b) contributions, pre-tax catch-up contributions to defined contribution plans) have been made permanent. Many of these provisions directly affect Section 403(b) plans and Section 457 deferred

© 2006 Buck Consultants®, LLC. All rights reserved

compensation plans.

Phased Retirement

IRS regulations define a defined benefit pension plan as one that provides for payments after retirement or separation from service. Although IRS rulings have permitted in-service distributions from pension plans after an employee attains normal retirement age, they have not allowed employers to offer in-service distributions prior to a plan's normal retirement age (i.e., phased retirement).

Effective for distributions in plan years beginning after January 1, 2007, the PPA provides that a pension plan may make in-service distributions to employees who have attained age 62 and are still actively employed.

> ***BUCK COMMENT.*** *This provision is more restrictive than IRS' proposed approach under which in-service distributions would be allowed starting at age 59½.*
>
> *Employers who want to offer phased retirement will need to carefully consider all of the issues before implementing it – e.g., whether additional accruals should be offset for the value of the distributions, whether in-service distributions at age 62 will be available to all employees or only employees that agree to work part-time, and how to distribute any new accruals.*

Changes to Rollover Rules

402(f) Notices. Employees receiving eligible rollover distributions must receive a notice not more than 90 or less than 30 days prior to the distribution advising them of their rollover rights and the rules on tax withholding (the 402(f) notice). Effective for years beginning after 2006, the 402(f) notice may be provided up to 180 days prior to the distribution.

Non-Spouse Beneficiary Rollovers to an IRA. Surviving spouses may roll over eligible rollover distributions (e.g., lump sums and installment payments for less than 10 years) from a qualified plan, a Section 403(b) plan or a Section 457(b) plan to an IRA. Currently, a non-spouse beneficiary may not roll over such a distribution to an IRA.

Effective for distributions after 2006, the PPA allows a non-spouse beneficiary (e.g., child, domestic partner) to make a direct transfer of the distribution from a qualified plan, a Section 403(b) plan or a Section 457(b) plan to an IRA (but not to another qualified plan). This transfer is treated like a non-spouse inherited IRA. In general, distributions from the rollover IRA must either be paid in full within five years of the employee's death or must commence within 12 months of the employee's death over the life expectancy of the non-spouse beneficiary.

> ***BUCK COMMENT.*** *This provision will permit the non-spouse beneficiary to spread the taxation of the distribution over a 5-year period or over his or her lifetime.*
>
> *Although eligible rollover distributions not rolled over are subject to mandatory 20% federal income tax*

© 2006 Buck Consultants®, LLC. All rights reserved

withholding, the non-spouse distribution not rolled over will be subject to the 10% voluntary withholding andnot the mandatory 20% withholding. The IRS is expected to issue a new model 402(f) notice that would address this change.

After-Tax Rollovers. EGTRRA permitted an employee to roll over after-tax amounts to an IRA or a qualified defined contribution plan that separately accounts for the after-tax amount and the earnings on the after-tax rollover.

Effective for taxable years beginning after 2006, rollovers of after-tax amounts to defined benefit plans and Section 403(b) plans that agree to accept them will also be permitted – provided the recipient plan separately accounts for the rollover and the earnings on the rollover.

Roth IRA Rollovers. Currently, an employee may not roll over an eligible rollover distribution from a qualified plan, a Section 403(b) plan or a Section 457 plan directly to a Roth IRA. The employee must roll over the distribution into a regular IRA, and then convert that IRA into a Roth IRA.

Effective for distributions from these plans beginning in 2008, an employee may elect a direct rollover to a Roth IRA, provided the current rules for converting a regular IRA to a Roth IRA are satisfied (e.g., amounts generally are subject to income taxation for the year of the transfer).

Hardship Withdrawals

Active employees may not receive in-service distributions from Section 401(k) and Section 403(b) plans prior to attaining age 59½, or from Section 457(b) plans prior to attaining age 70½, unless the participant (or spouse or tax dependent) has a hardship or unforeseen emergency.

The PPA directs Treasury to issue guidance by February 17, 2007 allowing plans to permit a hardship distribution to an employee based on the financial hardship or unforeseen emergency of the employee's plan beneficiary (who may be other than a spouse or tax dependent – e.g., a domestic partner). For example, a Section 457(b) plan can be amended to provide that if the employee's adult child or domestic partner is the beneficiary of the employee's Section 457(b) plan and that beneficiary has a financial hardship (such as unreimbursed medical expenses or expenses for the repair of a principal residence), the employee may receive a hardship withdrawal. The withdrawal will be taxable to the employee.

Distributions to Active Duty Military Reservists

A distribution between September 11, 2001 and December 31, 2007 from an IRA or from a Section 401(k) or Section 403(b) plan that is attributable to employer contributions to an employee who is called to active military service for a period of at least 180 days will not be subject to the 10% early distribution penalty tax. The reservist

© 2006 Buck Consultants®, LLC. All rights reserved

may repay the withdrawal to the IRA within two years following the end of active duty, or August 17, 2008 if longer, without violating the limits on contributions to IRAs. The contribution will not be deductible by the individual.

Automatic Enrollment

The PPA contains many provisions that encourage defined contribution plan sponsors to set up automatic enrollment features to boost participation. Many private sector plan sponsors are expected to add automatic enrollment provisions to their plans – governmental plan sponsors may also wish to consider adding these provisions.

Cash Balance Plans

The PPA now prescribes rules under which hybrid pension plans, including cash balance plans, may be designed or conversions may be made to these plans without running afoul of IRS and ADEA rules. ADEA is amended to state that any defined benefit plan will not discriminate on the basis of age if under the terms of the plan, the accrued benefit of any employee is not less than the accrued benefit of any similarly situated younger employee. In light of this more certain environment, governmental entities may wish to review whether a cash balance or other hybrid plan is a feasible alternative for providing pension benefits to their employees.

Conclusion

Governmental employers should be pleased with the new law, as it clarifies and liberalizes many provisions that they were concerned with. International organizations will be relieved that nondiscrimination testing has once and for all been eliminated. In any event, governmental employers have greater flexibility and many opportunities to improve their benefit offerings in light of changes made by the PPA.

Buck’s consultants would be pleased to discuss the provisions of the new law affecting governmental employers and help in implementing any changes to your plans.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.

© 2006 Buck Consultants®, LLC. All rights reserved

Investment Policy Statement

"The maintenance by an employee benefit plan of a statement of investment policy designed to further the purposes of the plan and its funding policy is consistent with the fiduciary obligations set forth in ERISA." —Interpretive Bulletin 94-2

ERISA requires fiduciaries to have an investment policy—*i.e.*, a prudent process for managing plan assets—but not an investment policy *statement* (IPS*)*. Yet as the DOL states in the quote from IB 94-2 above, the use of an IPS is "consistent with the fiduciary obligations set forth in ERISA."

An IPS or "statement of investment policy" is defined as a written statement that provides the fiduciaries that are responsible for plan investments with guidelines or general instructions concerning various types or categories of investment management decisions. A written IPS is not required under ERISA; however, the DOL may request a copy of the statement or an illustration of how the fiduciaries fulfilled their obligations pertaining to the selection and monitoring of investments if the plan comes under audit.

SHOULD THE PLAN HAVE AN IPS?

There is a fairly wide consensus in the 401(k) industry that having an IPS is a necessity of procedural prudence, but the consensus is not universal. Detractors are concerned that having a written policy creates additional liability for the fiduciaries in that it opens up the plan to lawsuits if the IPS is not consistently followed. As a compromise of these two positions, an IPS should not be too comprehensive but may safely include a listing of fiduciary responsibilities clearly required by ERISA. Some of these responsibilities include:

- Managing plan assets in the sole interests of plan participants;
- Establishing general investment guidelines and restrictions, including risk and return objectives;
- Providing supporting documentation of policies and processes, such as procedures for communicating among all parties involved;
- Diversification of plan assets;

- Defining asset allocations; and
- Setting forth criteria for monitoring the investment manager by the use of specific benchmarks and performance goals.

COMPONENTS OF AN IPS

There is no specific guidance from ERISA on what an IPS should exactly contain. But, the following guidance from sources such as the ERISA §404(a)-1 regulation, DOL Interpretive Bulletin 94-2, the Uniform Principal and Income Act, and the Foundation of Fiduciary Studies suggest the following topics can be included in an IPS depending on the needs and objectives of the Plan.

- Goals of plan: List the goals and purposes of the plan.
- Goals of IPS: List the goals of the IPS. One of the primary goals is to act as a guide to plan fiduciaries and investment advisors in fulfilling their roles.
- Roles and responsibilities: List the applicable fiduciaries and advisors involved with the investment management of the plan's assets. Identify and define each of their roles and responsibilities.
- Available investment options: List and elaborate on the asset classes, investment options and vehicles that may be considered for use inside the plan. Guidelines for socially responsible investment strategies may be included here, where applicable.
- Investment selection process: List how funds will be chosen for use inside the plan.
- Investment performance evaluation and reporting: List the procedures by which plan investment options will be monitored and reported on. Outline the factors that may be considered in the evaluation of an investment option including performance, risk, concentration issues, style consistency, etc. List how often reports will be generated and how often plan fiduciaries will meet to review the plan reports and investment options. Plan fiduciaries typically meet quarterly, semi-annually, or, at the very minimum, annually to review plan investment options.

  This section may also include individual peer categories and benchmark indexes to monitor and compare each of the investment options used in the plan. A customized

benchmark is often incorporated to compare the overall asset allocation of the plan and provide a more holistic reference to monitor overall plan performance.

- Addition and replacement of plan investment options: List the procedures by which new investment options may be considered for addition to the plan. List the process by which underperforming investment options will be reviewed, monitored, and removed from the plan, if necessary. Often, this process involves placing an underperforming investment option on a watch list for a period of time. If the investment option improves, it may be removed from the watch list. If the investment option does not improve, it may be removed from the plan.

  It is also important to note that the replacement process should be flexible enough to bypass the use of a watch list, which takes time, when a sudden material event results in a definitive need to remove the fund from the plan on an immediate basis to help protect plan participants.

  These last two bullet points above are crucial in the IPS process. They provide the procedure by which a plan fiduciary conducts a full investigation of the facts and circumstances that the fiduciary knows or should know are relevant (procedural prudence) and then acts accordingly (substantive prudence).

- Ongoing vendor evaluation: List the procedures by which a vendor will be monitored, as well as the suitability and viability of the investment universe it provides for the plan. Vendor evaluation is typically performed annually, but can be done on a more frequent basis.

- Default investment election: Lists the investment option and protocol for use when a participant fails to make a positive investment election. For example, if target maturity funds are the default investment option, it would be stated here as would the protocol on how participants would be assigned a particular target maturity fund typically based on their birth date. Any QDIA (qualified default investment alternatives) or ACA (automatic contribution arrangement) options would be discussed here as well.

- Review of IPS: List the timeline and standards by which the IPS will be reviewed and modified by plan fiduciaries. Often, this is done on an annual basis.

- Self regulation: The plan sponsor or fiduciaries must periodically review its own effectiveness in meeting fiduciary responsibilities and reviewing investment options.

- Control process and proxy voting: List control procedures for compliance issues such as best execution, soft dollars, and proxy voting.

- Review of investment advisor: If the plan uses an investment advisor, this section outlines the process by which the investment advisor will be evaluated along with guidelines for replacement.

- Individually-directed brokerage accounts: If the plan allows the use of outside brokerage accounts, their use and relevant procedures should be listed here.

- ERISA 404(c) compliance: List the steps involved by which the plan intends to comply with 404(c).

- Participant education: List the process involved for participant education.

- Signature page – An IPS should be signed by all relevant plan fiduciaries who are involved in the plan investment review process.

This is not an exhaustive list as there are many other factors that can go into an IPS. Some plan sponsors may find the above list not comprehensive enough. Some may find it too comprehensive. An IPS is not a template that can be used indiscriminately from plan to plan. An IPS must be customized and tailored to meet the unique objectives of the plan.

Some of the material used in this article is from the following book:

Swisher, Pete. ***401(k) Fiduciary Governance: An Advisor's Guide, 3rd Edition.*** **Arlington, VA: ASPPA, 2012.**

Special thanks to Pete for these contributions.

Understanding Plan Fees

MUTUAL FUND FEES AND COMMISSIONS

Mutual fund operating expenses can be divided and reported in many different ways. A place to begin exploring mutual fund expenses and commissions is a prospectus. Below is a sample taken from the 2007 prospectus for the American Fund Growth Fund of America (GFA). Prospectuses have changed only slightly since that time and this sample remains valid for instructional purposes.

Fees and expenses of the fund

These tables describe the fees and expenses that you may pay if you buy and hold shares of the fund.

Annual fund operating expenses (paid directly from your investment)

	Class A[1]	**Class B[2]**	**Class C[1]**	**Class 529-E[2]**	**Class F[1,3]**
Maximum initial sales charge on purchases (as a percentage of offering price)	5.75%[4]	none	none	None	none
Maximum sales charge on reinvested dividends	none	none	none	None	none
Maximum contingent deferred sales charge	none[5]	5.00%[6]	1.00%[7]	None	none
Redemption or exchange fees	none	none	none	None	none

Annual fund operating expenses (deducted from fund assets)				
	Class A	Class B	Class C	Class F
Management fees[8]	0.28%	0.28%	0.28%	0.28%
Distribution and/or service (12b-1) fees[9]	0.25	1.00	1.00	0.25
Other expenses[10]	.012	0.12	0.19	0.11
Total annual fund operating expenses[8]	0.65	1.40	1.47	0.64

	Class 529-A	Class 529-B	Class 529-C	Class 529-E	Class 529-F
Management fees[8]	0.28%	0.28%	0.28%	0.28%	0.28%
Distribution and/or service (12b-1) fees[11]	0.18	1.00	1.00	0.50	None
Other expenses[11, 12]	0.22	0.24	0.24	0.22	0.22
Total annual fund operating expenses[8]	0.68	1.52	1.52	1.00	.50

[1] Includes corresponding 529 share class. Accounts holding these 529 shares are subject to a $10 account setup fee and an annual $10 account maintenance fee, which are not reflected in this table.
[2] Available only to employer-sponsored 529 plans. Accounts holding these shares are subject to a $10 account setup fee and an annual $10 account maintenance fee, which are not reflected in this table.
[3] Class F and 529-F shares are generally available only to fee-based programs of investment dealers that have special agreements with the fund’s distributor and to certain registered investment advisers.
[4] The initial sales charge is reduced for purchases of $25,000 or more and eliminated for purchases of $1 million or more.
[5] A contingent deferred sales charge of 1.00% applies on certain redemptions made within one year following purchases of $1 million or more made without an initial sales charge.
[6] The contingent deferred sales charge is reduced one year after purchase and eliminated six years after purchase.
[7] The contingent deferred sales charge is eliminated one year after purchase.
[8] The fund's investment adviser is currently waiving 10% of its management fee. The waiver may be discontinued at any time in consultation with the fund's board, but it is expected to continue at this level until further review. The fund's investment adviser and board intend to review the waiver as circumstances warrant. Expenses shown above do not reflect any waiver. Information regarding the effect of any waiver on total annual fund operating expenses can be found in the Financial Highlights table in this prospectus and in the fund's annual report.
[9] Class A and F 12b-1 fees may not exceed .25% and .50%, respectively, of each class’ average net assets annually. Class B and C 12b-1 fees may not exceed 1.00% of each class’ average net assets annually.
[10] Includes custodial, legal, transfer agent and sub-transfer agent/recordkeeping payments and various other expenses. Subtransfer agent/recordkeeping payments may be made to third parties (including affiliates of the fund’s investment adviser) that provide subtransfer agent, recordkeeping and/or shareholder services with respect to certain shareholder accounts in lieu of the transfer agent providing such services. The amount paid for sub-transfer agent/recordkeeping services will vary depending on the share class and services provided, and typically ranges from $3 to $19 per account.
[11] Class 529-A and 529-F 12b-1 fees may not exceed .50% of each class’ average net assets annually. Class 529-B and 529-C 12b-1 fees may not exceed 1.00% of each class’ average net assets annually. Class 529-E 12b-1 fees may not exceed .75% of the class’ average net assets annually.
[12] Includes .10% paid to a state or states for oversight and administrative services.

Note the level of complexity. A client unfamiliar with prospectuses is not sure where to look or what to look for. Is a plan sponsor supposed to read and understand every page? Part of a modern fiduciary's dilemma is that failing to read and understand the prospectus for each of the funds in the plan could be construed as a breach of fiduciary duty.

LESSONS FROM THE PROSPECTUS

Management Fee Waivers

Here is an excerpt from the GFA prospectus:

> The fund's investment adviser is currently waiving 10% of its management fee. The waiver may be discontinued at any time in consultation with the fund's board, but it is expected to continue at this level until further review. The fund's investment adviser and board intend to review the waiver as circumstances warrant. ***Expenses shown above do not reflect any waiver***. [Emphasis added] Information regarding the effect of any waiver on total annual fund operating expenses can be found in the Financial Highlights table in this prospectus and in the fund's annual report.

Investigating further, we see from the table that management fees are 28 basis points. Since the 10% waiver is not reflected in the fee, it would appear that the correct management fee is 25.2 basis points, not 28 basis points. That would make the total operating expense for the fund 62.2 basis points instead of 65.

Fee waivers are common in funds of all types, and not just mutual funds: the practice is also common in annuity separate accounts. It reserves the right of the fund family or insurance company to deduct more money toward year end. Competitive pressures mean that they rarely, if ever, do so.

The Correct Expense is in the Financials

As we noted in the previous section, total operating expenses should be 62.2 basis points, not 65 basis points. We will find this reflected (rounded to .63%) in the financial highlights table, in the audited financial statement.

ds and distributions							
Distributions (from capital gains)	Total dividends and distributions	Net asset value, end of period	Total return[3]	Net assets, end of period (in millions)	Ratio of expenses to average net assets before reim-bursements/ waivers	Ratio of expenses to average net assets after reim-bursements/ waivers[4]	Rati n inc (los ave n ass
$(.23)	$(.42)	$31.93	9.66%	$78,854	.65%	.63%	.8
—	(.09)	29.51	21.20	67,793	.68	.66	.7
—	(.01)	24.43	8.65	52,432	.70	.70	.2
—	(.02)	22.49	21.23	41,267	.76	.76	.2
—	(.05)	18.57	(19.80)	30,644	.75	.75	.1

Carrying this one step further, what is the expense reported by financial information services? On www.morningstar.com, the expense ratio for GFA during this time period was shown as 63 basis points. Morningstar appears to be reporting the (rounded) actual expense, not the nominal expense.

Searching for Sub-T/A Fees

Footnote 10 to the expense section tells us that the "Other Expenses" column:

> …Includes custodial, legal, transfer agent and subtransfer agent/recordkeeping payments and various other expenses. Subtransfer agent/recordkeeping payments may be made to third parties (including affiliates of the fund's investment adviser) that provide subtransfer agent, recordkeeping and/or shareholder services with respect to certain shareholder accounts in lieu of the transfer agent providing such services. The amount paid for subtransfer agent/recordkeeping services will vary depending on the share class and services provided, and typically ranges from $3 to $19 per account.

For illustration purposes we chose the A share for Growth Fund of America. The five R or "retirement" share classes offer sub-T/A fees as basis point payments only—the practice of paying a per capita fee per fund is no longer available except on grandfathered A shares. Obviously, understanding the nature and impact of the sub-T/A fees is important to understanding the total cost and compensation of the vendor arrangement, yet the detail necessary to that understanding is not found in the prospectus. Instead we have only a general statement about the range of possible payments, and the total actual cost is stated as a percentage and includes other expenses, so the portion attributable to sub-T/A fees is not known. Since revenue

sharing arrangements vary by vendor, the only source for an accurate estimate of sub-T/A expenses is the vendor.

FUND SHARE CLASSES

SEC proposed changes to rule 12b-1 in 2010 that would eliminate 12b-1 fees, replacing them with a combination of payments that would fall mostly under rules 12b-2 and 6c-10. The rules have not been finalized as of publication and are thus not discussed here other than to make mention that share classes and payment structures may likely be changing in the future.

Mutual fund share classes generally include the following, the actual names of which will vary from one fund family to another:

- **A Shares.** Front-loaded shares that charge a sales charge to the client as a percentage of the investment. Often a 1% CDSC will apply if the shares are redeemed in the first year, after which there is no CDSC. If this class is available for a 401(k) plan, the front-end sales charge is usually waived.
- **B Shares.** Back-end loaded (i.e., with a CDSC). A typical B Share will have annual expenses roughly .75% higher than the similar A Share, but no up-front sales charge. The broker is paid an upfront commission, which the client pays directly only if he or she redeems the shares before the fund family has had time to recoup the sales charge via the higher annual operating expense. Most fund families automatically convert B shares to A shares, thereby eliminating the CDSC, once the CDSC period runs out (usually 6-7 years), but this is not always the case.
- **C Shares.** These shares have a 1% 12b-1 fee, typically, with no up-front commission. C Shares are a way for brokers to use a fee-type approach with no upfront sales charges, but with higher annual expenses. The long-term expenses of C Shares are often the highest of any share class for a fund.
- **Institutional Shares.** No revenue share, though some fund families have shares they describe as institutional but still pay revenue sharing.
- **Retirement Shares.** For retirement plans only, with varying levels of revenue sharing.
- **Various others.** F Shares, N Shares, 529 plan shares, and a host of others as defined by each fund.

INSURANCE SEPARATE ACCOUNT AND COLLECTIVE FUND SHARE CLASSES

Insurance companies and banks, like mutual fund families, divide their funds into different share classes for business purposes. The shares will go by different names that are unrelated to the share class names for mutual funds, as a rule. The responsible

fiduciary should be aware that collective investment funds (CIFs) frequently quote returns gross of expenses, not net as mutual funds are required to do. Insurance separate accounts generally quote net performance.

Understanding Revenue Sharing

The term "revenue-sharing" means different things to different people in our industry. In the ERISA world, revenue-sharing refers to virtually any payment from a fund or manager to a platform or provider. In the SEC and securities world, however, 12b-1 fees, shareholder servicing fees and sub-transfer agency fees are distinct types of payments called by their distinct names, and "revenue-sharing" refers to payments by a fund family from its own assets for business purposes. The distinction might seem merely semantic, but it is important to securities regulators. The emphasis for fiduciaries is dramatically different than the emphasis SEC has for funds and brokers.
Regardless of what they are called, mutual funds and money managers make these payments to vendors as a legitimate marketing or servicing fee, and the payments typically take the form of rebates of fund expense ratios (or "revenue sharing" in the SEC sense, meaning the payments come from the fund family's own assets) in amounts ranging from .25% to .50%, though the full range historically has been more like 0 to 1.00%. We can divide revenue sharing into the following five primary types of payments:

- **Finder's Fees.** Typically a 1.00%, one-time payment to the broker of record that does not incur any sales charge to the client. The payment comes from the fund family's pocket. These payments have rapidly become a thing of the past as fund families realize the economics do not support these payments, and most of the big load fund families (only load funds pay finder's fees) have long since discontinued most finder's fee payments.
- **12b-1 fees.** Another form of commission to the broker of record, typically a .25% "trail" payment commencing as soon as assets are transferred or, for funds paying a finder's fee in year one, commencing in the thirteenth month. 12b-1s are likely to be phased out by SEC and replaced by a combination of a 25bp "marketing and service fee" and an "ongoing sales charge."[1]
- **Shareholder Servicing Fees.** A name for 12b-1 fees paid by "no load" families, since 12b-1 fees are considered a commission, or load. Fund families known as "no load" families can pay up to .25% and not be required to call it a 12b-1 fee, but only service providers, not brokers, can receive these payments.

[1] Proposed in 2010 and unlikely to be effective before the end of 2012, with a five year transition period, if they are finalized.

- **Sub-Transfer Agency Fees (Sub-T/A Fees).** Originally a payment to a recordkeeper with an "omnibus" account at the fund family, which allows the fund family to eliminate hundreds or thousands of individual client accounts in exchange for one big account. Eliminating all those small accounts saves money, and the fund family passes part of the savings on to the recordkeeper. In recent years, however, the use of sub-T/A fees has expanded to become an alternate means of providing revenue sharing to various service providers, not just recordkeepers. For example, the same no load fund families that are limited to a .25% shareholder servicing fee often offer an "Advisor" or similarly-named share class that offers an additional .25% sub-T/A payment, for a total of .50% revenue sharing. Again, however, brokers are not eligible to receive these payments.
- **"Revenue-sharing" in the SEC sense of the term.** Payments from a fund family's assets as opposed to from a fund's assets. For example, a fund family might offer a high-producing broker or broker/dealer an additional 10bp trail commission as a reward for production.
- **Commissions.** A sixth form of revenue sharing is the standard sales commissions paid by load funds. Since virtually no qualified plans pay up-front sales loads anymore, loads are generally considered to be separate from revenue sharing.

THE IMPACT OF SUB-T/A FEES

Sub-transfer agency fees, when paid per capita instead of as a basis point amount, can have a distinct impact on product and service arrangements. Sub-T/A fees were formerly paid almost exclusively as a dollar amount, stated as a flat fee per capita, per year, per fund. This tended to lead to the sales practice of loading a plan's investment menu with high sub-T/A funds. If a participant chose 5 funds paying $12 each—not uncommon in many arrangements—the recordkeeper could anticipate $60 per participant of revenue sharing.

Let's take a look at another example. Assume a recordkeeper charges a flat fee of $3000 plus $30 per participant. If the actual sub-T/A revenue is $60 per participant, the recordkeeper could make a promise in its sales quote to waive the $30 per participant charge. The excess of the sub-T/A revenues above $30 is kept by the recordkeeper. If the recordkeeper were a fiduciary subject to the Frost model, the excess would have to be returned to the plan, but a non-fiduciary may keep the excess.

The impact of loading the plan with funds paying high sub-T/A fees can be either of the following:

- Higher cost. The recordkeeper keeps the added revenues.

- Lower cost. The recordkeeper reduces its fees due to the higher sub-T/A revenue.

As a practical matter virtually all sub-T/A payments have been converted to basis points and per capita payments are a rarity.

WHO SHOULD PAY THE BILL?

One reason plan sponsors buy products where the funds have revenue sharing is simply that the plan sponsor has to pay the bill and therefore desires to see the number be as low as possible. When revenue sharing payments are high enough, the explicit, billed administrative expenses can be reduced or eliminated. This argument would make a certain amount of sense if the plan sponsor were required to pay plan expenses out of pocket, but sponsors can elect to have the plan pay all costs of administering and operating the plan *i.e.,* not "settlor" expenses, but virtually any ongoing cost of service.

In other words, the plan can be "free" regardless, so an "advantage" of pursuing high revenue share is to hide expenses that would otherwise be paid by the plan. An oft-stated purpose for this approach is that the sponsor does not want participants to complain. Unless the funds chosen are clearly those that serve participants' best interests, regardless of revenue sharing, fiduciaries should beware of this approach to choosing investments.

Again, there is nothing inherently wrong with finder's fees or any other form of revenue sharing payment or commission--brokers and consultants need to be paid. In some cases, progressive brokers were fully disclosing all commissions and even passing through finder's fees to the larger plans they serve long before regulatory transparency arrived. The great difficulty with the finder's fee approach is that the broker is strongly incentivized to move assets but poorly compensated for ongoing service, not to mention the potential PT if the broker is a fiduciary.

Analyzing Group Annuity Contracts

One of the choices that a plan sponsor has when choosing a service provider is an insurance company that offers a group annuity arrangement. Annuities are complex financial instruments, and their contracts may contain provisions that are difficult to analyze and understand. Below are provisions that need to be reviewed. Not every provision is in every contract—and there can be extensive differences between carriers and products. Many of the same methods and provisions are used by other service providers, not just insurance companies, so this is a helpful list for analysis of any service provider agreement.

DECLINING SURRENDER CHARGES

Some contracts provide for a surrender charge that goes down each contract year. For example, it may have a 7% surrender charge in year one, declining by 1% per year and disappearing after year seven.

"ROLLING" SURRENDER CHARGES

An example of a rolling surrender charge is a 5% charge that disappears after five years following date of contribution. For every new contribution, the clock starts for a brand-new surrender charge solely with respect to that new contribution.

Rolling surrender charges are problematic from a fiduciary standpoint. These charges are typically found in outdated annuity contracts, especially 403(b) contracts and old B-share mutual funds (i.e., "old" in the sense that a newer B-share class has been issued for the same fund, but money in the old share class does not automatically move to the new). ERISA §408(b)(2) requires that plan service providers receive no more than reasonable compensation for the services that they provide. DOL regulations interpreting the statute explain that a contract is not reasonable if the plan cannot terminate the contract without penalty to the plan on reasonably short notice to prevent the plan from being locked into an arrangement that has become disadvantageous.

In other words, rolling surrender charges may represent PTs, putting the plan fiduciary at risk of being deemed to have committed a breach and of having allowed a PT, and putting that fiduciary in the position of having to take *affirmative action* to get the charge reduced, or possibly having to pay it out of pocket as restitution if the charge is deemed to represent a fiduciary breach.

MARKET VALUE ADJUSTMENTS

When an investor pulls his or her money out of a stable value fund or GIC, there may be a penalty called a market value adjustment, or MVA. This penalty is similar to that for early withdrawal from a bank CD.

Legitimate Purpose for MVA

The point of an MVA is to protect the shareholders of a fixed account who remain invested in the account when others leave. Since a stable value fund, for example, generally has as its underlying assets a portfolio of short and intermediate term bonds and other fixed income investments, the portfolio is subject to interest rate risk. The insurance company guarantees the value, but that guaranteed value can suffer if a shareholder pulls out at a time when the market value of the underlying assets is below

the guaranteed value. Therefore, the best interests of long-term investors may be served by penalizing certain withdrawals just as a bank penalizes early withdrawals from a CD.

Not All MVAs Are Created Equal

Some stable value funds and GICs charge a "pure" MVA that simply gives the lesser of book or market value. For example, suppose a plan sponsor terminates its service provider and withdraws from that provider's stable value fund. The fund contract provides that individual participants will never be charged an MVA for withdrawing assets from the fund for any reason, but that an MVA applies if the sponsor terminates the plan's contract.

Other funds provide for a charge that they refer to as an MVA, but its computation is sufficiently configured to look simply like a surrender charge.

FEES AND EXPENSES

It would be convenient if all charges were listed in a single section of a contract to make the discovery process easier, but this is frequently not the case. For example, separate sections might be used to describe:

- Startup expenses
- Administration expenses
- Participant level expenses
- Investment expenses.

Investment provider expenses can take many forms. Here are examples of methods used by providers within annuity contracts and other products.

1. **Contract level charge or "wrap" fee**. A percentage charge against assets at the contract level. Some contracts charge against all assets, other contracts may make an exception for fixed account assets.
2. **Fund level charges**.
    a. Some contracts charge a global amount in addition to the expense ratio of every fund, such as .25%. If the fund expense ratio is 1%, the total charge for that fund would therefore be 1.25%.
    b. Other contracts charge a specific amount for each fund based upon expected revenue from that fund. For example, an index fund with no revenue share to the vendor might have an added charge of 50 basis points (above and beyond the expense ratio of the fund), while a proprietary fund of the vendor might have no additional charge. These

charges are called various names, such as "Additional Asset Charge" or "Account Investment Charge."

c. Combination of wrap fees and fund level charges.

3. **Expense adjustments based on average account balance**. Frequently, a provider will adjust various charges based on the average account balance of the participants. Higher account balances are charged less. The effect can be a savings that is not apparent, and could also be a cost that is not apparent. The fiduciary should take care to understand what can happen if the demographics of the plan change such that the average account balance causes plan expenses to change.
4. **Recordkeeping charge assessed to third party administrator**. Historically some providers might assess a per participant charge, such as $12 per year, that is described as being a charge paid by the TPA. The TPA may have the option of passing it on to the plan with the plan's approval. Or, the TPA can charge a higher amount on its own fee schedule and pay this charge directly.
5. **Reference to separate fee schedules.** For example, the annuity contract might contain two separate paragraphs, each referencing a separate document containing a particular fee schedule. One might be a recordkeeping services fee schedule, the other a trustee fee schedule.
6. **Reference to prospectus.** In some cases an annuity separate account will invest solely in the shares of an underlying mutual fund, and the charges listed for the separate account do not include the expenses of the underlying fund. The contract refers fiduciaries and participants to the fund prospectus for this information. Without the prospectus in hand, the discovery process is not complete.

Material in this reading was taken from the following book:

Swisher, Pete. *401(k) Fiduciary Governance: An Advisor's Guide, 3rd Edition.*
Arlington, VA: ASPPA, 2012.

Special thanks to Pete for these contributions.

AMERICAN RETIREMENT ASSOCIATION

Working for America's Retirement

CODE OF PROFESSIONAL CONDUCT

The purpose of this Code of Professional Conduct ("Code") is to identify the professional and ethical standards with which a Member must comply, in order to fulfill the Member's responsibility to American Retirement Association and its affiliate organizations, other Members, and the public. Members are required to adhere to the high standards of conduct, practice, and qualification set forth in this Code.

DEFINITIONS

Actuary: an individual who is a Member of the American Retirement Association and holds an MSPA or FSPA from the ASPPA College of Pension Actuaries or an actuarial credential from another organization that is a member of the International Actuarial Association (IAA) or is an enrolled actuary in good standing with the Joint Board for the Enrollment of Actuaries.

Advertising: all communications by whatever medium, including oral communications, which may directly or indirectly influence any person or organization to decide whether there is a need for Professional Services or to select a specific person or firm to perform such services.

Confidential Information: information not in the public domain of which the Member becomes aware during the course of rendering Professional Services to a Principal. It may include information of a proprietary nature, information which is legally restricted from circulation, or information which the Member has reason to believe that the Principal would not wish to be divulged.

Credential: a membership designation (*e.g.*, Certified Pension Consultant; Member, Society of Pension Actuaries; or Associated Professional Member) conferred by American Retirement Association. Law: statutes, regulations, judicial decisions, and other statements having legally binding authority. Member: An individual who is a Member of American Retirement Association or any affiliate organization of American Retirement Association.

Principal: any present or prospective client of a Member or the employer of a Member where the Member provides retirement plan services for their employer's plan.

Professional Communication: a written, electronic or oral communication issued by a Member with respect to Professional Services.

Professional Services: services provided to a Principal by a Member, including the rendering of advice, recommendations, findings, or opinions related to a retirement or other employee benefit plan.

Titles: leadership positions, volunteer experience, awards and other honors conferred by American Retirement Association.

ADVERTISING

Member shall not engage in any Advertising with respect to Professional Services that the Member knows or is reasonably expected to know are false.

COMMUNICATIONS

A Member who issues a Professional Communication shall take appropriate steps to ensure that the Professional Communication is appropriate to the circumstances and its intended audience.

COMPLIANCE

A Member shall be knowledgeable about this Code, keep current with Code revisions and abide by its provisions. Laws may impose binding obligations on a Member. This Code is not intended to supplant, contradict or supersede Law (*e.g.*, Circular 230) or other Codes of Conduct that establish professional standards for Members in the rendition of Professional Services and that have been sanctioned by the federal or a state government. Where the requirements of Law or such governmentally-sanctioned Codes conflict with this Code, the requirements of Law or such governmentally sanctioned Codes take precedence.

CONFIDENTIALITY

A Member shall not disclose to another party any Confidential Information obtained in rendering Professional Services for a Principal unless authorized to do so by the Principal or required to do so by Law.

CONFLICTS OF INTEREST

A Member shall not perform Professional Services involving an actual conflict of interest unless:

- The Member's ability to act fairly is unimpaired; and
- There has been full disclosure of the conflict to the Principal(s); and
- All Principals have expressly agreed to the performance of the services by the Member.

If the Member is aware of any significant conflict between the interests of a Principal and the interests of another party, the Member should advise the Principal of the conflict and include appropriate qualifications or disclosures in any related communication.

CONTROL OF WORK PRODUCT

A Member shall not perform Professional Services when the Member has reason to believe that they may be altered in a material way or may be used to violate or evade the Law. The Member should recognize the risk that materials prepared by the Member could be misquoted, misinterpreted or otherwise misused by another party to influence the actions of a third party and should take reasonable steps to ensure that the material is presented fairly and that the sources of the material are identified.

COURTESY AND COOPERATION

Ⓐ A Member shall perform Professional Services with courtesy and shall cooperate with others in the Principal's interest. A Principal has an indisputable right to choose a professional advisor. A Member may provide service to any Principal who requests it even though such Principal is being or has been served by another professional in the same manner.

Ⓑ When a Principal has given consent for a new or additional professional to consult with a Member with respect to a matter for which the Member is providing or has provided Professional Services, the Member shall cooperate in assembling and transmitting pertinent data and documents, subject to receiving reasonable compensation for the work required to do so. In accordance with Circular 230, the Member shall promptly, at the request of the Principal, return any and all records of the Principal that are necessary for the Principal to comply with federal tax Law, even if the Member is not subject to Circular 230. The existence of a fee dispute generally does not relieve the Member of this responsibility except to the extent permitted by applicable state Law. The Member need not provide any items of a proprietary nature or work product for which the Member has not been compensated.

DISCLOSURE

A Member shall make full and timely disclosure to a present or prospective Principal of all sources of direct or indirect material compensation or other material consideration that the Member or the Member's firm has received or may receive in relation to an assignment for such Principal. The disclosure of sources of material compensation or consideration that the Member's firm has received, or may receive, is limited to those sources known to, or reasonably ascertainable by, the Member.

PROFESSIONAL INTEGRITY

A Member shall perform Professional Services, and shall take reasonable steps to ensure that Professional Services rendered under the Member's supervision are performed, with honesty, integrity, skill and care. A Member has an obligation to observe standards of professional conduct in the course of providing advice, recommendations and other services performed for a Principal. A Member who pleads guilty to or is found guilty of any misdemeanor related to financial matters or any felony shall be presumed to have contravened this Code and shall be subject to American Retirement Association's counseling and disciplinary procedures.

QUALIFICATION STANDARDS

A Member shall render opinions or advice, or perform Professional Services, only when qualified to do so based on education, training and experience.

TITLES AND CREDENTIALS

A Member shall make truthful use of the membership Titles and Credentials of American Retirement Association to which the Member is entitled, and only where that use conforms to the practices authorized by American Retirement Association. A Member who is not an Actuary as defined in section 1 of this Code shall not professionally represent to the public to be an actuary or knowingly allow such misrepresentation by others.

ADDITIONAL OBLIGATIONS

A Member whose professional conduct is regulated by another membership organization shall abide by the professional Code of Conduct (or similar rules) of such organization. For example, a Member who is an Actuary shall also abide by the Code of Professional Conduct for actuaries.

A Member shall respond promptly in writing to any communication received from a person duly authorized by American Retirement Association to obtain information or assistance regarding a Member's possible violation of this Code. The Member's responsibility to respond shall be subject to Section 5 of this Code, "Confidentiality," and any other confidentiality requirements imposed by Law. In the absence of a full and timely response, American Retirement Association may resolve such possible violations based on available information.

4245 North Fairfax Drive | Suite 750 | Arlington, VA 22203
P. 703.516.9300 • F . 703.516.9308 • usaretirement.org