

MANAGING 401(k) PLANS

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DOL Lays Out Its Top 2006 Investigative Priorities and Identifies Key Sponsor Mistakes

A number of 401(k) activities are on the Department of Labor's (DOL) investigative radar for 2006. Juliane Majette, a deputy regional director for the DOL (San Francisco), spelled out those priorities and common sponsor mistakes the department finds in the course of its work at a general session on fiduciary responsibility at the recently held Midsized Pension Management Conference in San Francisco.

For 2006, the national office's pertinent projects include:

- The *employee contribution project* is about the timing and forwarding of employee contributions into the plan trust and segregating them. That project has been ongoing since 1995.
- The *orphan plan project* came about after the dot com demise caused a blowup in the marketplace. At the time that happened, "a lot of plan sponsors were abandoning their plans when their corporations went under and abandoning their responsibilities to respond to participants about their benefit programs," Majette explained. "Our job is to find the fiduciary and convince that person to become responsible again or, if we can't find them, to have an independent fiduciary appointed to the plan through the court system to terminate the plan and get the benefits to the participants."
- The *react plan project*, which often goes hand-in-hand with the orphan plan project, is generally put in place when a plan sponsor is having financial difficulty and potentially going into bankruptcy. "We get in as soon as we sense they are going into a downfall financially that may lead to bankruptcy. Our goal is to protect the plan and make sure the plan's assets do not become a part of the bankruptcy estate," Majette noted. The department, she added, has been doing a lot of outreach and training of U.S. trustees so they are aware of the fact that plan assets are not the assets of the corporate estate.

Post Spitzer, SEC Activities

In the wave of the Security and Exchange Commission's (SEC) and New York State Attorney General Eliot Spitzer's investigations, Majette admitted that the DOL does follow their lead. Although the issue of fees has been on the DOL's radar, "it has not gotten quite the attention it is getting now. So of course that will be the focus of all investigations," she noted.

In the area of fees, we will continue to look at what fiduciaries are doing to ask providers about the fee arrangements and find out if any service providers are hesitant to answer those questions, Majette added.

"As field investigators, we have the authority to direct the track of the investigators. When we were directed to look at the trade and practices issues of service providers and investment advisors by our national office that were targets of the SEC, we opened those cases, looked at them to determine whether or not the SEC investigators actually protected the plan's assets and if there was anything we should do. For most of the cases, we walked away, because activity had already taken place," Majette continued.

However, as a result of those cases, the regional offices will still be looking at those issues. "We will always be asking what sort of policies and procedures are in place to protect plan assets from market timing and late trading? Do providers have anything in their fund that says specifically that late trading is not permitted? If providers do have that, do they offer that to the fiduciaries when they are making decisions about funds? What are they doing to protect the plan from having market timing and late trading happen?"

Another area that the department is very interested in is revenue sharing. Quite often, Majette noted, the fiduciary doesn't know anything about the revenue sharing that occurs. Fiduciaries say they hired the service provider, are busy running their company, and expect the service provider to do the job it was hired for.

"So one of the things that we are encouraging fiduciaries to do through our investigation process is to make sure they know what the plan is paying for, make sure they understand what services the service provider is providing, and ask what kind of fees are related to their plan?"

Another area, following in the wave of the SEC, is concern over pension consultant industry practices. The department's stance on this issue was recently spelled out by DOL Assistant Secretary Ann Combs in a letter to Congressman George Miller, which is available on the DOL Web site.

She indicated in that letter, among many things like the DOL's definition of a fiduciary, that the Labor Department is being given investigative files of the SEC regarding consultants to consider whether or not to open investigations. The San Francisco regional office has received one from the national office and is investigating a consulting firm regarding bid rigging and contingent fees.

So are plan sponsors more at risk of an audit if one of their service providers or consultants is on the national office's list of targeted firms? According to Majette, the answer is "no." These levels of investigations, she assured, are at the service provider level. She conceded that the department might have to ask questions of fiduciaries on what information they were provided. But the DOL is investigating at a service provider level.

Sherwin Kaplan, of counsel at Thelen, Reid & Priest (Washington, D.C), a former deputy solicitor for the Department of Labor and a fellow member on the fiduciary responsibility panel, noted that virtually all of the big companies have been investigated and have been subpoenaed for one reason or another. "If you were to avoid doing business with any company that was a target of a government investigation, you would be out there by yourself with no help whatsoever," he said.

The key issue is not whether the government has investigated your service provider, Kaplan added. The key issues are what the government has found, to the extent that information has been made public, and, even more important, what they have done to correct it.

During the height of the mutual fund scandals, Kaplan was getting calls from clients every day, saying "I just read my mutual fund is in the paper because such and such occurred. Should I fire them and hire somebody else?"

"Our answer was always 'no you should not.' What you should do as a fiduciary at that point is not have a knee-jerk reaction of getting rid of the provider/consultant or going elsewhere. You should inquire. You should ask: What is going on? What has been found and what is the provider/consultant doing about it? Then make your decision," he advised, "based on the answers to those questions."

Common Mistakes to Avoid

With many plan sponsors understandably fearful of audits, Majette talked about 10 common mistakes the Labor Department sees in its investigations and suggested these mistakes as practices to avoid:

1. A failure to document fiduciary decisions;
2. A failure to maintain supporting documents related to the plan's investments, the administration of the plan, the monitoring of the plan, and the managing of the plan;
3. A failure to monitor the service providers and a failure to revisit the choices of those providers. "We've seen plans that have providers for years and have never reconsidered. We do not think that is automatically a violation, but it is a concern," she noted;
4. A failure to bid out the job for a service provider and document that process of bidding out;
5. A failure to clearly understand who is responsible for what as it relates to the plan; in other words, not really understanding how things are run;
6. A failure to take the time to interview and gather all the facts necessary to make a prudent decision regarding the choice of a service provider;
7. The failure to take the time to interview and gather all the facts necessary to understand the fee arrangements regarding the plan and its service providers regarding investments;
8. A failure to forward employee contributions within a reasonable amount of time;
9. A failure to understand the interrelationships of service providers and who is providing what services. In other words, providers using other providers to provide different services and what fees are being paid; and
10. A failure to clearly understand what the plan is invested in, especially if the plan is using investment options such as hedge funds and financial derivatives