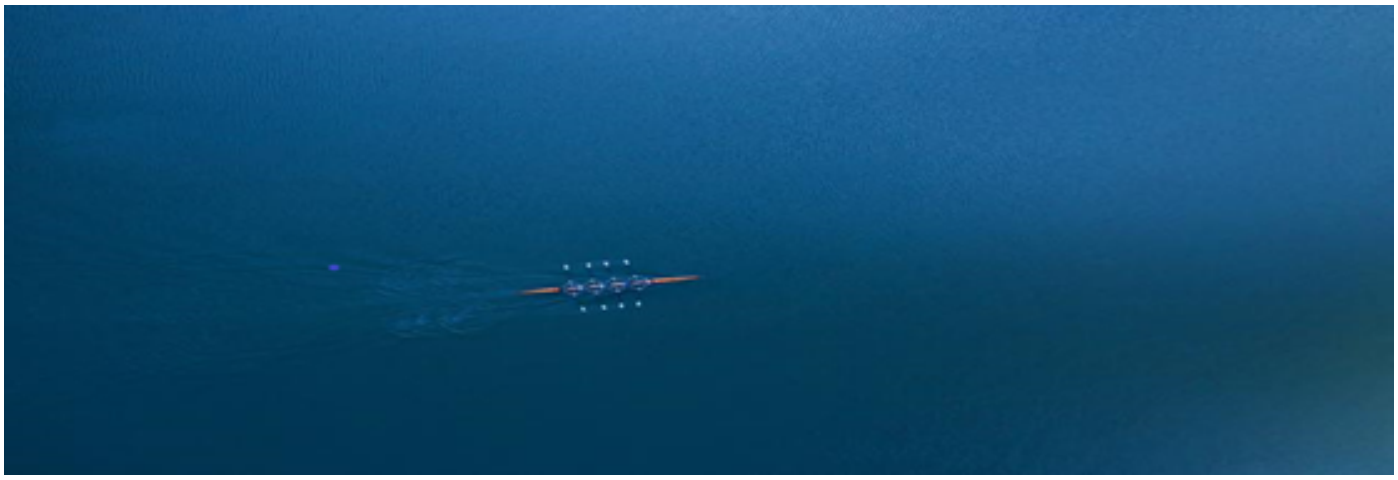
Graystone Consulting
from Morgan Stanley

Retirement Solutions



Quick Reference: Acting as a Fiduciary Under ERISA and Other Plan Considerations

SECTION 1

Roles: Define and Assign Responsibilities

Get familiar with your role as a plan sponsor, administrator, and/or fiduciary and choices you can make to manage those responsibilities while protecting yourself and your business.

What are a plan fiduciary's duties under ERISA?

By law, management of a qualified retirement plan (e.g., a 401(k) plan), must be performed up to fiduciary standards established by ERISA. As such, an ERISA plan fiduciary must act:

- Solely in the interest of plan participants and beneficiaries
- For the exclusive purpose of providing benefits to participants and their beneficiaries
- With the care, skill, prudence and diligence under circumstances then prevailing that a prudent man acting in alike capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims.
- To defray reasonable expenses of administering the plan
- To diversify the investments of the plan to minimize risk of large losses, unless under the circumstances it is clearly not prudent to do so
- In accordance with documents and instruments governing the plan (unless inconsistent with ERISA)

What kind of annual reporting is required under ERISA?

Under ERISA, plan administrators are required to file Form 5500, the plan's annual financial report. The most recent Form 5500 must be made available for participant examination or provided to participants upon request. Penalties may be imposed upon a plan administrator for failure to file a timely complete report.

SECTION 2

Investments: Govern and Monitor Plan Performance

Set investment policies, goals and monitoring procedures for your retirement plan.

As a plan investment fiduciary, you'll need to document the process of investigating, evaluating and making investment-selection decisions. This can be accomplished by maintaining documentation of an investment policy statement, investment contracts, investment reviews and all associated fees.

Who directs retirement plan investments — plan fiduciaries or plan participants?

Fiduciaries always retain responsibility for selecting the plan's investment options and for monitoring their performance. Within the investment options offered, plan participants can make selections about which funds they will invest in, and at what level.

What if participant investment choices create asset losses?

For participants to have control over their own investments and afford the fiduciary some protection from liability, the following three criteria must be met:

1. There must be at least three core investment alternatives
2. Participants must be given sufficient information to make informed investment decisions
3. Participants also must be allowed to give investment instructions at least once a quarter, and perhaps more often

What responsibility does a fiduciary hold regarding investment selection?

A fiduciary must act prudently when selecting the investment vehicles to be offered in the plan. Not only do the individual investment selections need to be scrutinized carefully, the fiduciary must also ensure that the offerings are adequately diversified so as to minimize the risk of large losses. When determining whether an investment option is prudent for a plan, a fiduciary may consider the following (non-exclusive):

- Complying with the investment policy statement
- Types of underlying investments (stocks, bonds, etc.)
- Investment styles and objectives
- Risk and return characteristics
- Historical performance
- Liquidity and future cash flows
- Fund manager (tenure, style)
- Fees and expenses

How can I handle participants who fail to select a plan investment option?

You can set up default investments using qualified default investment alternatives ("QDIAs"). QDIAs help ensure that participants that do not make their own investment elections are still investing via the plan.

Fiduciary concerns regarding their liability for undirected investment decisions may be eased by establishing a QDIA.

To offer QDIAs, your plan must:

- Invest assets of the participant's account in a QDIA
- Give participants an opportunity to provide investment direction, employing QDIAs when they have not done so
- Provide participants with a notice relating to QDIA in advance of the initial investment and annually thereafter
- Send participant investment information on the QDIA, such as prospectuses
- Give participants the ability to direct investments out of a QDIA as frequently as from other plan investments, but at least quarterly
- Ensure that fees for the QDIA are not greater than those that would have otherwise been charged to participants using that investment option
- Offer a "broad range of investment alternatives" as defined in the regulations under section 404(c) of ERISA

In order to obtain safe harbor relief from fiduciary liability for investment outcomes, plan fiduciaries and sponsors must conform certain conditions, including those listed above.

What investments qualify as QDIAs?

To be a QDIA, an investment must offer:

- A mix of investments that takes into account the individual's age or retirement date (e.g. a target date fund)
- An allocation among existing plan options based on individual's age or retirement date
- A mix of investments based on characteristics of the group of employees as a whole (e.g. a balanced fund)

Note that there are restrictions on QDIAs, including:

- A capital preservation product may be used for only the first 120 days of participation
- QDIAs generally may not invest participant contributions in employer securities

SECTION 3

Education for Plan Participants

Understand the ways you can help educate your employees about the options available to them in your retirement plan and their participation in it.

What do I need to communicate to my employees?

Employee communication is an integral component of fiduciary responsibility. Employees need to understand how the plan works and how their participation could affect their personal situations.

In addition, the following documents must be provided to participants and beneficiaries:

- Summary Plan Description ("SPD")
- Summary of Material Modification ("SMM")
- An individual benefit statement
- Summary Annual Report ("SAR")
- Any applicable blackout period notice
- Certain other plan-related documents must be available upon request

Participant education communication about the plan should also include:

- Information about the benefits of plan participation
- Benefits of increasing plan contributions
- The impact of pre-retirement withdrawals on retirement income
- The terms for the operation of the plan

SECTION 4

Other Plan Considerations:

Automatic enrollment design:

Consider the plan's objectives when considering incorporating an automatic enrollment plan design feature, the costs of matching contributions for the population to be automatically enrolled and the nondiscrimination testing requirements.

Each type of automatic enrollment arrangement has specific notice requirements. Prior to adding automatic enrollment or any new plan feature, plan sponsors should consult their legal advisors.

Plan sponsors with high employee turnover may consider an automatic enrollment plan design feature impractical, fearing it could create lots of low-balance accounts that are expensive and difficult to maintain. Plan sponsors can consider implementing automatic enrollment by incorporating a minimum service requirement to mitigate potential turnover challenges.

Plan sponsors and/or plan administrators can evaluate all aspects of their plan design to determine what options may best help drive participation and positive retirement outcomes for employees. Considerations include:

- Raising the preset deferral rate
- Adding automatic escalation (or increasing the annual rate of increase)
- Automating catch-up contributions for employees 50 and older
- Increasing the rate cap
- Automatically enrolling all employees, not just new hires
- Allocating contributions between pre-tax and Roth

Auto-enroll default deferral rate

When the Pension Protection Act of 2006 was enacted, 3% was considered an acceptable default contribution deferral rate for automatic enrollment. It was thought high enough to be meaningful, but not so high as to cause employees to opt out.

At the same time, a 3% contribution rate is often not enough for most people to be able to accumulate adequate retirement savings. Plan sponsors can act to address this by setting a higher default rate.

Automatically increasing contribution rates?

Automatic enrollment encourages participation, but contribution rates are critical for achieving retirement goals.

Plan designs that incorporate automatic escalation to increase participant contribution rates regularly over time can counter this issue, helping automatic enrollment plan designs achieve contributions on par with voluntary designs while also retaining the participation boost that comes with automatic enrollment.

Plans that add an automatic escalation feature must also establish a maximum contribution rate at which increases will stop. To determine your rate cap, evaluate the benefits that a higher cap could have on the retirement income adequacy of your employee base.

Auto-enrolling all employees

Automatic enrollment is designed to get everyone into the plan ensures all eligible employees will benefit from participation. Automatic enrollment designs that include existing employees as well as new employees can expect to see even higher average participation rates.

Roth contributions

While the advantages of having contributions allocated to Roth automatically will not be realized for years, participants will ultimately benefit in the form of tax-free distributions if certain conditions are met.

The IRS permits plans that accept designated Roth contributions to specify that automatic enrollment contributions be made on a Roth basis. You can also allocate them equally between Roth and pre-tax, or customize the ratio based on salary levels.

Fiduciary responsibilities can be a full-time job, however, you don't have to do it alone. Your Morgan Stanley Financial Advisor can help you comply with your fiduciary duties under ERISA. Make sure to also speak to your legal and tax advisors about your fiduciary responsibilities.

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