Ballard Spahr LLP

Community Action Program Legal Services (CAPLAW)
Navigating Retirement Plan Fiduciary Rules and Correcting Plan Errors

March 1, 2017

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Retirement Plans

- Retirement plans subject to ERISA
  - Section 403(b) and 401(k) defined contribution plans
  - Defined benefit pension plans
  - Subject to Employee Retirement Income Security Act of 1974, as amended ("ERISA") fiduciary provisions
- Voluntary section 403(b) plans not subject to ERISA
  - Voluntary salary deferral plan only. No employer contributions. Limited employer involvement and decision-making.
  - Plan is not subject to ERISA if safe harbor requirements are met

Identifying Fiduciaries

- Named fiduciary in plan document
- Functional fiduciaries under ERISA – anyone who:
  - Exercises discretionary authority or control over plan management
  - Exercises any authority or control over plan assets
  - Renders investment advice on a regular basis for a fee
  - Has any discretionary authority or control over plan administration

Identifying Fiduciaries

- ERISA defines fiduciary in functional terms of control and authority over the plan. Examples of fiduciary functions:
  - Appointing other fiduciaries
  - Selecting and monitoring TPA
  - Interpreting plan provisions
  - Deciding claims for benefits and appeals
  - Determining QDRO status
- Does not include those performing ministerial tasks or (generally) professional service providers

Identifying Fiduciaries

- Consider fiduciary status of:
  - Organization's board?
  - Legal counsel, accountants, benefits consultants or others hired to give advice about the plans?
  - Third party administrators: TIAA-CREF?
  - Employees involved in plan administrative functions, such as calculating benefits, determining eligibility, preparing communications or government reports?
  - Employees involved in decision making for plan?

Limitations on Fiduciary Status

- "To the extent" of fiduciary functions
- Delegation. A fiduciary can generally avoid fiduciary liability by properly delegating a fiduciary function.
  - Board may create a plan committee and delegate fiduciary responsibility to committee for plan administration and/or investments
  - Fiduciary retains responsibility for prudent selection, retention and monitoring of the delegate
  - Delegate reports back to fiduciary.
- Settlor/employer vs. fiduciary functions

Limitations on Fiduciary Status

- Fiduciaries can wear two hats
  - Settlor (Business) Decisions
    - Establishment, amendment or termination of plans
    - Decisions as to the amount of any discretionary contributions
    - Decisions as to plan design
  - Fiduciary Decisions
    - Interpretation of plan terms
    - Investment of plan assets
    - Selection of service providers
    - Claims and appeals
    - Oversee compliance with ERISA reporting and disclosure requirements

Fiduciary Duties

Fiduciary Duties

- Duty of loyalty
  - Solely in the interest of the plan participants and beneficiaries
  - For the exclusive purpose of paying benefits and reasonable plan administration expenses
- Duty of care
  - In a prudent manner – Prudent expert standard
- Duty to diversify plan assets
- Duty to follow plan documents
  - To the extent not inconsistent with ERISA

Fiduciary Duties

- Duty of loyalty
  - Cannot lie or intentionally mislead plan participants
  - Cannot act in a way that is intended to benefit a third party to the detriment of plan participants
  - Plan assets can be used to pay reasonable plan administrative expenses if plan document permits
    - Limited to plan administrative expenses and not expenses related to settlor functions
    - May charge participant accounts and/or forfeiture accounts
    - Expenses must be reasonable in light of services provided

Fiduciary Duties

- Duty of loyalty
  - Types of expenses payable from plan assets:
    - Nondiscrimination testing
    - Form 5500 preparation and audit fees
    - Investment-related fees
    - Employee communication fees
    - Certain legal and professional expenses
    - Fiduciary training fees
    - Recordkeeping fees
  - Must be reasonable in light of services provided

Fiduciary Duties

- Duty of care
  - Fiduciary must discharge duties with the care, skill, prudence and diligence that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of a like character with like aims
    - Prudent expert standard- if you don't have the expertise, you have a duty to seek expert advice
    - Prudence is a procedural standard
      - No crystal ball required
      - Must be able to show investigation, deliberation and rational decision making
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Fiduciary Duties

- Duty of diversification
  - Must diversify plan investments to minimize risk of large losses unless clearly prudent not to do so
- Duty to follow plan documents
  - Review and understand terms of plan documents
  - Update documents on regular basis
    - Understand who is authorized to approve plan amendments. Bring amendments to the Board? Has Board delegated authority to a committee or individual to approve certain amendments?

Liability for Breach of Fiduciary Duty

- A fiduciary who breaches his fiduciary duties is <u>personally liable</u> to make good to the plan any losses resulting from the breach
  - Claims may be brought by the Department of Labor, plan participants, other fiduciaries
  - Six-year statute of limitations on claims
  - Equitable remedies and DOL can impose 20% civil penalty of the amount recovered in court or through a Department of Labor settlement
  - Criminal liability for willful violations of fiduciary responsibility
- Co-Fiduciary liability
  - Knowing participation in another fiduciary's breach
  - Having knowledge of another fiduciary's breach and not taking steps to remedy the breach

Liability for Breach of Fiduciary Duty

- Protection against risk of liability
  - Proper delegation of fiduciary duties
  - Fiduciary insurance policy
    - Covers plan fiduciaries against liability in case they breach fiduciary duty or commit negligent errors or omissions in their activities
    - "ERISA Rider"
  - Indemnification by organization
    - General indemnification of employees, officers and board members
  - Limited protection under ERISA section 404(c) for participant-directed investments

Plan Investments

ERISA Section 404(c)

- Participant should be responsible for his or her own investment decisions in defined contribution plans
- ERISA 404(c) is <u>not</u> a complete defense
  - Fiduciaries still have to provide a prudent "menu" of investment options
    - Initial selection and subsequent monitoring of investment performance and fees
  - If a prudent menu is provided, fiduciaries are protected from losses resulting from a participant's investment decisions
    - Prudent expert standard. Hire investment expertise, if necessary.

ERISA Section 404(c)

- Must provide a broad range of investment alternatives
  - At least three diversified alternatives
  - Allow each participant a reasonable opportunity to materially affect risk and return in his or her account. Minimize risk of large losses.
- Participants must have reasonable opportunity to provide investment instructions that must be followed
  - Permit investment instructions at least quarterly
- Must provide information about investment alternatives, including description of investment alternatives, procedures for giving investment instructions, and description of fees and expenses
  - Explain that the plan is intended to satisfy ERISA Section 404(c), thereby insulating fiduciaries from liability
    - Statement set forth in summary plan description for plan

Defined Contribution Plan Fees

- Trillions of dollars are invested in 401(k)/403(b) plans
  - Lots of opportunity to earn significant fees
- Types of fees
  - Investment fees
  - Record keeping and administrative fees
- Understand Fee Arrangements
  - "Hard" dollar fee arrangements
    - Flat rate per participant - fees do not change as plan assets grow
  - Revenue sharing ("soft" dollar) arrangements
    - Investment vehicles share portion of investment-related fees with the plan's record keeper and other service providers
      - Doesn't mean that record keeping is free
    - Higher expense ratios, lower investment returns
    - Fees increase as plan assets grow

Breach of Fiduciary Claims

- Duty of care claims:
    - Plan has selected and/or retained historically underperforming investments
      - Failure to monitor and/or consider alternatives
      - *Tibble v. Edison* – U.S. Supreme Court confirms DOL position that there is an ongoing fiduciary duty to monitor
    - Plan is paying excessive and unreasonable fees for investment options and recordkeeping
      - Failure by fiduciaries to understand fee structure, to review alternatives, and to negotiate fees, including negotiation for institutional share class instead of more expensive retail class
      - Failure by fiduciaries to solicit competitive bids
    - In both cases, need to show procedural prudence to defend

Selecting and Monitoring Service Providers

Selecting and Monitoring Service Providers

- The selection of a service provider is a fiduciary function
- Fiduciary should consider the following in selecting a service provider:
  - Information about the firm
  - Quality of the firm
  - Firm's business practices
  - Fee structure. Reasonableness of fees charged
  - References
  - Consider RFP process for significant service providers

Selecting and Monitoring Service Providers

- A fiduciary is obligated to monitor service providers and such monitoring is a fiduciary function
- A fiduciary should check that:
  - Service provider is complying with the terms of the plan and contract
  - Service provider continues to charge reasonable fees
  - Service provider is acting in accordance with its established role, *i.e.* fiduciary or recordkeeper

Plan Governance

Develop a Plan Governance System

- Develop a process or system intended to assure compliance with law and adherence to the terms of the plan documents, which will reduce risk of fiduciary liability
- Consider every plan related activity
- Look to terms of plan documents, Internal Revenue Code and ERISA requirements
- Focus on these questions:
  - What needs to be done for proper plan administration?
  - Who is best qualified to perform these functions?
  - How can we monitor and improve performance?

Develop a Plan Governance System

- Identify necessary tasks for proper plan administration and compliance with terms of plan and applicable law
  - Examples: Managing plan loans, approving hardship withdrawals, identifying eligible employee, updating plan documents, selecting and monitoring plan investments
- Determine appropriate responsible party. TIAA? Individuals in Human Resources Department? Third parties?
- Delegate responsibilities
- On-going monitoring of performance
- Document plan governance procedures and delegations

Correcting Plan Errors

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Common Plan Errors

- Plan qualification failures threaten tax-qualified status of plan:
  - Plan Document Failure
  - Operational Failure
  - Demographic Failure
  - Employer Eligibility Failure
- Fiduciary violation – Failure to remit salary deferral contributions timely
- Failure to file Form 5500

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Correction Programs

- Tax qualification failures via IRS procedure (the Employee Plans Compliance Resolution System "EPCRS")
  - Self-Correction Program ("SCP")
  - Voluntary Correction Program ("VCP")
  - Audit Closing Agreement Program ("Audit CAP")
- Correction of prohibited transactions under the DOL Voluntary Fiduciary Correction Program ("VFCP")
- Department of Labor Delinquent Filer Voluntary Compliance ("DFVC") Program

IRS Correction Principles under EPCRS

- Encourage plan sponsors to voluntarily make corrections, and maintain tax-qualified status of plan
- IRS requires full correction of all taxable years
- General principle is to restore the plan to where it would have been had the failure not occurred
- Revenue Procedure provides acceptable correction methods, including limited retroactive plan amendments and exceptions to full correction

IRS Correction under EPCRS

- Examples of common errors to correct under EPCRS
  - Erroneously included ineligible employees
  - Erroneously excluded eligible employees
  - Excessive contribution failures
  - Overpayment errors
  - Failure to implement salary deferral election
  - Failure to make minimum required distributions

Self-Correction under EPCRS

- Generally for insignificant failures & significant failures corrected within two years
- No disclosure to IRS, no fee, no sanction
- Limited to operational failures
- Make correction in accordance with guidance, notify affected participants and document correction
- Must have established practices & procedures to ensure ongoing compliance
- Self-correction is not available if the plan is under audit

Self-Correction Under EPCRS

- Factors to consider in determining insignificant versus significant errors:
  - Percentage of assets/contributions involved
  - Number of years involved
  - Percentage of participants impacted
  - Correction within reasonable period after discovery
  - Reason for the failure

Correction Under VCP

- Plan document, demographic and operational failures
- Requires correction in accordance with guidance, filing with IRS and payment of user fee
- Single submission for multiple failures permissible
- VCP fee for large plan with over 10,000 participants is $15,000. VCP for small plans with 20 or fewer participants if $500
- Legal fees
- Reduced fees for certain failures, such as interim amendments

Correction Under VCP

- IRS works with plan to find acceptable correction
- Common VCP filings
  - Correction of failure to distribute Minimum Required Distributions- Waiver of excise tax
  - Correction of failure to amend plan by required deadline
  - Correction of failure to adopt written 403(b) plan document
- Anonymous submission is possible
- Compliance statement at end of process shows that IRS approves correction method

Audit CAP

- Settlement to close negative IRS Audit or determination letter application
- IRS imposes a sanction. Factors used in determining sanction:
  - Practice in place to identify and prevent plan failures
  - Steps taken to correct
  - Reason for failures
  - Cost of VCP had the plan filed prior to audit
- Make correction, enter into Closing Agreement with IRS and pay sanction

Delinquent Remittance of Employee Contributions

- Department of Labor priority issue
- Employee contributions become assets of the plan when it is deferred from paychecks or contributed by the participant
- Time period between deferral from paycheck and submission to the plan is technically a loan from the plan to the employer
- Extension of credit from the plan to the employer may be a prohibited transaction

Participant Contributions Defined

- Amounts withheld from participant's wages for contribution to the plan
- Amounts paid by a plan participant
- Includes:
  - Pre-tax elective deferrals
  - Roth elective deferrals
  - After-tax contributions
  - Loan repayments
  - Rollovers

Delinquent Participant Contributions – General Rule

- Employers contribute or repay participant contributions as soon as reasonably segregated from general assets, but in no instance beyond the 15th day of the month following the month of withholding
- Ten day safe harbor for small plans, DOL rejected its use by large plans. DOL generally requires no more than 3 – 5 day period.

Reporting of Late Contributions

- Plan must report delinquent contributions to the plan on Form 5500
  - Specific question on the form
  - Plan must report and correct late contributions, in addition to filing under VFCP
- Excise tax applies via Form 5330. Excise tax does not apply to 403(b) plans.

Correction under DOL VFCP Program

- The DOL's Voluntary Fiduciary Correction Program (VFCP) is available to correct prohibited transactions, including delinquent contributions
- Self-correction is not available for fiduciary violations
- No filing fee
- Make corrective contributions, adjusted for earnings. Use of VFCP program permits usage of DOL calculator rather than plan earnings.
- Receive "no action" letter from DOL at end of process

Delinquent Form 5500 Filer Program

- Department of Labor also offers a Delinquent Filer Voluntary Compliance ("DFVC") Program to encourage voluntary submission of delinquent Form 5500
- DFVC penalties for small plans (fewer than 100 participants) reduced to $10 per day, capped at $750 per filing or $1,500 per plan (or $750 per plan for small plans sponsored by tax-exempt organizations). Penalties for large plans (100+ participants) is reduced to $10 per day, capped at $2,000 per filing or $4,000 per plan.
- Waives more costly DOL & IRS penalties
- Requires full correction of all years
- File under DFVC electronically. Submit delinquent forms and calculate and pay penalty.

Best Practices for Plan Administrators

Best Practices for Plan Administrators

- Review and become familiar with plan documents
- Administer plan in accordance with plan documents, Code and ERISA requirements
- Keep plan documents current: Amend for all required and discretionary changes
- If compliance issues arise, correct under IRS or DOL correction programs
- Review organization's indemnification for fiduciaries and fiduciary insurance

Best Practices for Plan Administrators

- Develop a plan governance system -- review current delegations of responsibility, make additional delegations and document accordingly
- Undertake diligent selection and monitoring of plan service providers and fees
- Review service provider agreements
- Prudent selection and monitoring of plan investment options offered on fund line-up
- Review and negotiate plan investment fees

Best Practices for Plan Administrators

- Document fiduciary decisions, such as benefit claims and interpretations of plan provisions
- Hire expertise when necessary
- Provide fiduciary training to plan fiduciaries. Periodic review of fiduciary responsibilities and provide additional training as appropriate

Final Note

- Remember that ERISA does not require the best possible results, but it does require a diligent and prudent process and procedures in administering retirement plans

- Questions?

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Additional Information

The questions below were posed during the webinar and the answers were provided by Michele Golkow, the webinar presenter, following the webinar.

1. **What is the timing rule for salary deferral remittances?**

   We say a 10 day rule for small plans , meaning calendar days, but the safe harbor limit is actually 7 business days. There is no safe harbor rule for larger plans, so it's not clear whether the 3-day period is business or calendar days.

2. **How long must a plan sponsor retain retirement plan records?**

   Regarding record retention, there is no statute of limitations for the payment of benefits under a plan, so plans must keep records to calculate benefits and determine vesting and distribution rights indefinitely. However, there is a 6 year statute of limitations for IRS purposes and for breach of fiduciary duty claims.