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Defined Contribution Legal and Regulatory Update

JANUARY 2016

We are committed to providing you with the information and tools you need to help meet your fiduciary responsibilities as a plan sponsor and to offer your employees an exceptional retirement plan. This newsletter is designed to inform you about the latest legal and regulatory developments that may affect your plan.

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EMPOWER RETIREMENT™

From the Hill

The Department of Labor Fiduciary Proposal – Latest Congressional Developments

To say that the Department of Labor's (DOL's) proposed rule on fiduciary advice (or as the DOL prefers to call it, the "conflict of interest rule") dominated the industry's attention in 2015 would be an understatement. Members of the retirement industry also made certain that Congress was aware of the proposal as well.

Throughout last year's rule-making process, members of Congress on both sides of the aisle expressed interest and concern with the scope and breadth of the proposed regulation and its potentially chilling effect on the availability of investment education and guidance, particularly for investors with low balances. During the year-end appropriations process, attempts were made to attach riders to the omnibus spending bill that would have delayed or defunded DOL efforts to move forward with the rule-making process. Ultimately, these efforts were unsuccessful, and a final rule was sent to the Office of Management and Budget (OMB) on January 28, 2016. While OMB has 90 days to review the rule, it is anticipated that the final rule will be published by the end of March or early April.

After the close of the appropriations process, two bipartisan bills were introduced in the House. The Strengthening Access to Valuable Education and Retirement Support (SAVERS) Act, introduced by House Ways and Means Oversight Subcommittee Chairman Peter Roskam (R-IL), would address matters related to the Internal Revenue Code. The Affordable Retirement Advice Protection (ARAP) Act, sponsored by House Education and the Workforce Health, Employment, Labor and Pensions Subcommittee Chairman Phil Roe (R-TN), would address the issue with regard to ERISA. Both measures were introduced with the support of Ways and Means Select Revenues Subcommittee ranking member Richard Neal (D-MA) and Ways and Means Committee member John Larson (D-CT).

At the center of both bills is a requirement that Congress must vote to approve the final rule before it may become effective. Should Congress fail to approve the rule, the bills set forth a set of fiduciary standards that would replace the DOL guidance, including:

- Requiring that advice must be in the recipient's best interest.
- Penalties if the advice does not meet the best-interest standard.
- Requiring disclosure of any financial interest of the advisor and any conflicts of interest.
- Restoring the requirement that there be a mutual understanding between the advisor and the recipient that advice is being provided.
- Creation of a seller's exception that would cover participants and beneficiaries if there is full disclosure that information is provided in a sales and marketing capacity (the current DOL exception covers only large plans in its seller's exception).

On the Senate side, similar legislation has been introduced by Senators Johnny Isakson (R-GA) and Mark Kirk (R-IL). To date, the Senate bills have not attracted democratic co-sponsors.

Practical Considerations

The bills are scheduled for committee markup in February, and it is likely that both the House Ways and Means and the Education and Workforce committees will hold additional hearings on the DOL rule. Given that the final rule has gone to OMB, it is unlikely that we will see passage of these bills. Even if they make it through both the House and Senate, there seems little likelihood that the president would sign off on the measures given their very vocal support of the DOL's efforts. There is hope that the introduced legislation may have influenced the DOL as it drafted the final rule, and, indeed, agency representatives have assured lawmakers that they are sensitive to the concerns that have been raised and that the final rule will address those concerns. If the final rule is viewed as ignoring those concerns, we may expect additional congressional activity. In all events, Empower Retirement will keep you notified of any new developments.

From the Hill

DOL Guidance on State-run Retirement Programs

In November 2015 the Department of Labor (DOL) published two pieces of guidance[i] intended to facilitate the creation of retirement programs for nongovernmental employees by individual states. The guidance addresses both IRA-based salary deferral programs and employer-plan-based programs. For a more complete description of this guidance, please see the December Instant Insights. While there is no debate about the fact that helping more people save for retirement is a good idea, there is a fair amount of controversy about the approach the DOL took.

Potential Disruption to Existing Plans: The IRA proposal would allow states to mandate payroll-deduction IRAs for employees who have not satisfied the eligibility conditions to enter a plan that their employer sponsors (e.g., part-time employees). This would require an employer to establish two or more payroll-deduction programs and could be a deterrent to offering a plan. Since plans have many advantages over IRAs in promoting retirement savings (including higher contribution limits, fiduciary oversight, and the opportunity for employers to contribute), this raises some policy concerns.

Complex Patchwork of Laws: Each state would be able to design its own program, and it would be possible for a single employer to have to participate in more than one state program. This would be a very complex undertaking for small employers and conflicts with the uniform federal system of retirement programs created by ERISA.

Major Policy Change With Insufficient Input: The DOL's guidance has major policy implications, including relinquishing, at least to some degree, the uniform system of laws created by ERISA and giving states a preference over private industry in the ability to offer retirement plan solutions to small employers. A key concern is that the guidance allows states to offer "Open MEPs," an arrangement whereby multiple employers can join together in a single arrangement with a single Form 5500 filing that reduces the cost, administrative time and effort, and fiduciary risk associated with offering a plan. President Barack Obama has publicly supported the idea of allowing Open MEPs to be offered by both states and private industry and there is bipartisan support for that concept in Congress, but the DOL proposal creates different rules for states and private industry. Of particular concern is the fact that the Open MEP guidance is in the form of an Interpretive Bulletin that becomes effective immediately and does not require consideration of public comment.

State Activity: Many states were already working on retirement solutions before the DOL's guidance was issued. Several states have introduced, and in some cases passed, legislation requiring a study on the need for and feasibility of creating a state-run retirement arrangement for private-sector employees. States opting to start with such a study bill generally cite the need to determine whether adding another retirement solution to the several options already available in the marketplace would be beneficial, and they generally also cite the need to understand the interaction of such state-run arrangements with federal laws. Although state activity is ongoing and very fluid, here is a summary of the recent status of these state initiatives.

States that have enacted legislation establishing a program include: California, Illinois, Massachusetts, New Jersey, Oregon and Washington. These bills differ in several respects. For example, the Massachusetts plan, enacted several years ago, is narrowly limited to nonprofit organizations with less than 20 employees and has not yet become operational. The Illinois program signed into law in early January 2015 will, on the other hand, automatically enroll most state residents in a state-sponsored, employer-based retirement account if their employer does not already offer a retirement plan option.

States that have legislative activity continuing in 2016 include: Indiana, Maine, New York and Rhode Island.

States that have appointed task forces or commissions to study the feasibility of a state-run retirement plan include: Connecticut, Maryland, Minnesota, Vermont and Virginia.

States that introduced legislation or studied the feasibility of a state-run retirement plan in prior years but have not advanced legislation include: Colorado, Louisiana, Kentucky, Nebraska, Ohio, New Hampshire, North Carolina, North Dakota, Utah, West Virginia and Wisconsin.

i Prop. Reg. §2510.3-2; Interpretive Bulletin 2015-02

From the Hill

States that have not enacted legislation addressing the issue of a state-run retirement plan include: Alabama, Alaska, Arizona, Arkansas, Delaware, District of Columbia, Florida, Georgia, Hawaii, Idaho, Iowa, Kansas, Michigan, Mississippi, Missouri, Montana, Nevada, New Mexico, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas and Wyoming.

Practical Considerations

Most of the state programs being developed target small employers, so people who offer or serve plans in that market are likely to be most affected. The IRA proposal, which poses the most complications for employers, has not been finalized or made effective, so there is some possibility a federal solution will be created before that happens. If states do begin to implement these programs, employers will need to pay close attention to what state laws they are subject to and how to comply.

Department of Labor Updates Regulatory Agenda

The Department of Labor (DOL) generally updates its regulatory agenda semiannually and recently published its updated plans for regulatory projects. The actual dates included in the agenda are often not adhered to, but the change in status from one agenda to the next is very informative. Following is a list of key projects impacting defined contribution plans.

Definition of Fiduciary: The next step is publication of a final rule. No date is specified in the agenda, but the time period for analyzing comments on the proposed rule was listed as ending in December 2015. The expectation is that a final rule will be published by the end of March or early April of 2016.

Form 5500 Revisions: The DOL is coordinating with the IRS and PBGC to make revisions that would facilitate various compliance initiatives. The projected date for a proposed rule was moved out from September 2015 to February 2016.

Lifetime Income Illustrations on Benefit Statements: The date for publication of a proposed rule was pushed back from July 2015 to November 2016. While that pushes the project very close to the date when a new president and administration will be installed, including potentially a new secretary of labor, the DOL has stated publicly that it remains committed to completing this project.

Also notable in the agenda was the number of projects moved to the "long-term action" list. Given the amount of time the DOL will need to spend on the fiduciary rule, it is likely that none of these projects will be completed before a new president is installed. These projects include:

- Target date fund disclosures.
- Guide for 408(b)(2)/service provider fee and service disclosures.
- Revisions to the safe harbor for selection of annuity products.
- Fiduciary standards of care when offering brokerage windows.

Practical Considerations

In 2016 the main focus will be on the final rule redefining "investment advice for a fee" fiduciaries. The rule is likely to have an impact on the design of products and services, compensation practices, support and communications with both plan sponsors and plan participants and the IRA market.

From the Courts

Retroactive Application of Supreme Court Decision on Defense of Marriage Act

A U.S. District Court recently held that plan sponsors may need to retroactively apply the Supreme Court's 2013 decision to overturn the federal Defense of Marriage Act's definition of spouse as a person of the opposite sex.

In June 2013, the Supreme Court ruled that the definitions of spouse and marriage under the Defense of Marriage Act (DOMA) were unconstitutional. Following the decision, valid same-sex marriages were recognized for federal law purposes, including ERISA. The open question at the time of the decision was whether or not plan sponsors were required to recognize same-sex marriages retroactively or just with respect to benefit determinations made after the decision. The IRS subsequently addressed this issue and noted that a plan will not be treated as failing to meet the plan qualification requirements merely because it did not recognize a same-sex marriage prior to such date.

In this case, the plan participant and her spouse were a legally married same-sex couple residing in the state of California. The participant was a 26-year employee of a company that sponsored a traditional defined benefit plan who died six days before the Supreme Court's DOMA decision. Following the participant's death, her same-sex spouse submitted a claim for spousal benefits under the company's defined benefit plan. The company, as plan sponsor, rejected the claim, stating that at the time the participant died the definition of spouse under the plan utilized the federal definition, which did not recognize same-sex marriages. The same-sex spouse subsequently sued the plan sponsor.

In review of the plan sponsor's motion to dismiss the suit, the District Court agreed with the plan sponsor that the plan document did not provide for same-sex spousal benefits at the time of the participant's death but allowed the suit to continue based on the spouse's claim that the plan sponsor breached its ERISA fiduciary duty to her as surviving spouse. The court stated that a plan fiduciary is required to follow the plan documents only to the extent the documents are consistent with ERISA. Since ERISA requires defined benefit plans to provide spousal benefits upon the death of the participant, the court found that the spouse had adequately alleged that the plan sponsor may have violated ERISA by failing to provide her with the spousal benefits required under ERISA. Accordingly, the court denied the plan sponsor's motion to dismiss and allowed the case to move forward.

Practical Considerations

As same-sex marriages are now recognized under both federal and state law, few questions remain as to the ongoing administration of spousal rights and benefits under ERISA-covered retirement plans. In certain cases, as in the case above, questions as to same-sex spousal benefits that accrued prior to the DOMA decision or as to the validity of a same-sex marriage under prior law may arise. Plan sponsors should be cautious; simply following the terms of the plan that were in place and valid at the time may not be sufficient under ERISA. Plan sponsors should review any questions regarding same-sex spousal benefits with their legal advisors before making plan decisions.

Federal Court Holds That Plan Sponsor and Board of Directors Are Not Plan Fiduciaries

A U.S. District Court recently held that a company and the company's board of directors were not ERISA fiduciaries simply as a result of being the plan sponsor of the company's retirement plans. The court also held that neither the company nor the board of directors were liable for a breach of ERISA by their employees.

In this case, plan participants sued the company and the company's board of directors under ERISA for losses related to company stock offered as an investment option under several plans sponsored by the company. The participants claimed that the company as plan sponsor and the members of the board were ERISA fiduciaries with control over plan assets and should have frozen or liquidated the company stock in the plans.

From the Courts

In its review, the District Court noted that ERISA recognizes "named" and "functional" fiduciaries. Named fiduciaries are named or identified as a fiduciary in plan documents and are expressly provided authority and control of the plan, whereas functional fiduciaries do not need to be named but instead simply need to have exercised control over the plan. The court held that the act of sponsoring a retirement plan and being named as the plan sponsor do not make a company an ERISA fiduciary. The court specifically noted that "a company cannot be subject to fiduciary liability simply by virtue of its role as a plan sponsor."

In this case, the plan documents named a specific plan investment committee as the plans' investment fiduciary and provided the investment committee with control regarding plan assets. As the plan documents did not vest any control or authority in the plan sponsor and as the plaintiffs did not allege any facts suggesting that the company or board actually exercised any control over plan assets, the court held that the company and its board of directors were not fiduciaries of the plans.

The court also reviewed whether or not the company and the board were responsible for their employees' breaches of ERISA fiduciary duties. Under federal law, an employer is only responsible for breaches of ERISA by its employees if the employer actively and knowingly participated in the breach or exercised control over the employee with respect to the breach. As the court had already concluded that there were no facts in this case that suggested that the company or board exercised any control over the plan or over the alleged breaches of their employees, it held that the company and board were not liable for any alleged breaches of fiduciary duty by their employees.

Practical Considerations

This case reflects the value and importance of carefully planning the structure of plan documents and written policies and procedures. The company in the case established a separate plan investment committee and vested the committee with authority and control over plan assets. By doing so, it shifted fiduciary responsibility for plan investments away from the company. Under many plan documents, the plan sponsor by default has responsibility for plan investments. Plan sponsors should review the terms of their plan documents and plan policies to ensure they are structured appropriately and vest fiduciary responsibility for plan administration and plan investments in the intended manner.

From the Regulatory Services Team

5500 Update – New Questions Added to 2015 5500s

The Form 5500 has received quite a bit of attention in the last year. The Department of Labor (DOL) and IRS have an initiative underway to modernize the Form 5500 in order to assist the IRS in assessing the nature and degree of plan compliance so that it may target its enforcement efforts more efficiently. To that end, in March of last year the IRS issued a series of compliance-related questions proposed for retirement plan returns in the 5500 series, which have now been incorporated into the 2015 Form 5500 itself under Schedules H, I and R.

Please note that the additional compliance questions are optional for the 2015 Form 5500. The IRS has also put forth an FAQ on its website regarding these questions, and further clarification will most likely be provided by the DOL and IRS in the future. Below are the compliance questions that are currently on the 5500:

- Is the plan a 401(k) plan?
- If yes, does it perform ADP/ACP testing or is it a 401(k) safe harbor plan?
- If ADP/ACP testing is used, does it use the current year testing method?
- Does the plan satisfy coverage testing by the ratio percentage test or the average benefit test?
- Does the plan satisfy nondiscrimination testing by aggregating with another plan?
- Has the plan been timely amended for all required tax law changes?
- What was the date the last plan amendment/restatement was adopted for the required tax changes?
- If using a prototype/volume submitter plan document, what was the date of its IRS favorable opinion/advisory letter and serial number?
- If the plan is an individually designed plan that had a favorable determination date, what was the date of the favorable letter?
- Is the plan maintained in a U.S. territory (such as Guam, Puerto Rico, American Samoa, Northern Marina Islands, or U.S. Virgin Islands)?
- Did the plan trust incur unrelated business taxable income (UBTI)?
- Were in-service distributions made during the year?

Practical Considerations

As noted above, plan sponsors are not required to answer the additional compliance questions included in the 2015 Form 5500. However, it is likely that such questions will become mandatory in the future. As a result, plan sponsors will want to become familiar with these questions so they can be answered correctly on the 5500 in the future.

5500 Update – Repeal of Increased 5500 Extension

As discussed in the last quarterly regulatory update, the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 contains a provision that changed the Form 5500 filing extension from 2½ months to 3½ months effective for plan years beginning after December 31, 2015. As can happen in the political arena, another law was passed — Fixing America's Surface Transportation Act (FAST Act) — on December 4, 2015, that repealed the increased extension, so it's back to being only 2½ months long.

Practical Considerations

The silver lining of the passage of the FAST Act is that the extension for the 5500 will remain at 2½ months. Basically, it is business as usual and likely easier for everyone to remember and keep their current processes in place.

From the Regulatory Services Team

IRS Further Scales Back and Clarifies Its Determination Letter Program

Background

Historically, the IRS has issued determination letters on retirement plan documents in response to requests from plan sponsors (the "Determination Letter Program"). These letters are intended to provide plan sponsors with assurance that the written terms of their particular retirement plan are in compliance with the requirements of the Internal Revenue Code and related regulation.

While there has never been a requirement to utilize this program and receive such letters for a plan, it has generally been viewed as a prudent step sponsors ought to take to protect themselves and their plan participants from the risk of written plan terms not aligning with qualified plan rules. In fact, over the years, requesting and receiving such determination letters has become so common that it was a safe presumption that almost all plans would have such a letter (or potentially by an opinion letter — a slightly different concept that relates to prototype plan documents).

However, in recent years the IRS has been scaling back its Determination Letter Program and the general trend is toward such letters only being provided in certain narrow circumstances.

Changes to the Program

Previously, Revenue Procedure 2007-44 set specific five-year remedial amendment cycles (Cycles A through E) for individually designed qualified plans based on the last digit of the sponsoring employer's employer identification number (EIN). The effect of this system was that plan sponsors needed to apply for new determination letters generally only once every five years in order to avoid allowing any gap periods where there was not a current letter on which they could rely.

More recently, on July 21, 2015, the IRS announced further changes. Specifically, the IRS eliminated the staggered five-year remedial amendment cycles for individually designed plans effective January 1, 2017. However, plan sponsors of Cycle A will be permitted to submit determination letter applications during the period beginning February 1, 2016, and ending January 31, 2017. The IRS is also limiting the scope of the Determination Letter Program to initial plan qualification and qualification upon termination. Further, the IRS will not be accepting determination letter applications that are submitted off-cycle unless the plan is new or terminating and only through December 31, 2016.

And still more recently, on January 4, 2016, the IRS provided additional guidance on the Determination Letter Program via Notice 2016-03. This notice has several impacts, including a determination that expiration dates on determination letters issued prior to January 4, 2016, will no longer apply. Prior to this change, all determination letters had a specific expiration date, but this will no longer be the case.

Notice 2016-03 also modified the deadline to apply for a determination letter for employers that currently sponsor individually designed plans and intend to utilize a preapproved plan after January 1, 2016. These employers will have until April 30, 2017, to apply for a determination letter. Similarly, sponsors of certain multiple-employer plans were granted additional time to request letters if they met certain requirements.

Future of the Program

The IRS is making these changes to the Determination Letter Program in an effort to focus its limited resources more efficiently. That said, the IRS has stated it will continue to consider alternate ways for plan sponsors to be assured they're meeting retirement plan rules. Ideas that are being considered by the IRS include:

- Providing model amendments and allowing for minor changes to these.
- Not requiring certain plan provisions or amendments if they are not relevant to the particular plan.
- Expanding plan sponsors' option to document qualification requirements through incorporation by reference.
- Making it easier to correct document failure under the Employee Plans Compliance Resolution System (EPCRS).
- Expanding the Determination Letter Program for preapproved plans.

From the Regulatory Services Team

Plan Sponsor Considerations

Based on the changes in the Determination Letter Program, plan sponsors who file during Cycle A (those with EINs ending in one or six) will likely want to make sure they submit their plans to the IRS by January 31, 2017, in order to obtain a determination letter — ensuring they gain the benefit of the program while they still can.

Pending further IRS guidance, all plan sponsors will also want to consider taking advantage of whatever future opportunities they may have to gain IRS approval regarding the terms of their plan documents.

In-plan Roth Rollovers of Non-Roth After-tax Contributions: Potential Impacts and Considerations

In early 2013, President Barack Obama signed into law the American Taxpayer Relief Act of 2012 (ATRA), extending the existing in-plan Roth rollover rules to amounts not otherwise distributable under the plan. In terms of tax impact to the federal government, this change actually increases revenue because it tends to lead to individuals paying taxes earlier than they would under traditional retirement concepts, like pretax 401(k) plans or IRAs.

Since ATRA, many plan sponsors looking to assist participants in their efforts to limit their future tax liabilities have implemented plan design changes to permit participants to make non-Roth after-tax contributions with the intent of converting them to an in-plan designated Roth account. The interplay between non-Roth after-tax rules and Roth rules can generally allow for a higher rate of retirement savings than might otherwise be allowed.

That said, plan sponsors who are contemplating similar plan design changes should first consider the potential impacts (both pros and cons) of such changes on their plans (and, in particular, on nondiscrimination testing).

Background

As you may know, qualified defined contribution plans may permit two types of after-tax contribution options — Roth contributions and non-Roth after-tax contributions. Both types of after-tax contributions are made with dollars withheld from a participant's after-tax pay and contributed to a retirement plan; however, Roth contributions offer a distinct advantage over the more traditional non-Roth after-tax contributions. Specifically, investment earnings on Roth contributions are not taxable when they are distributed as long as the distribution is "qualified" (i.e., it is made after the five-year period beginning with the first taxable year for which a Roth contribution was made, and it is made on account of death, disability or attainment of age 59½).

However, despite the potential for reducing a participant's future tax liability, the benefits of Roth contributions are somewhat diminished when one considers that these contributions are subject to the annual deferral limitations set forth in Internal Revenue Code (IRC) Section 402(g) ($18,000 for 2016). With this in mind, the Small Business Jobs Act, as later amended by the ATRA, created "in-plan Roth rollovers," which allow participants to convert their non-Roth account balances (including pretax elective deferrals, matching contributions, and non-Roth after-tax contributions) to Roth account balances, provided the plan permits Roth contributions.

Seeing an opportunity to potentially get around the annual Section 402(g) deferral limits imposed on Roth contributions, many plan sponsors have amended their plans to not only permit a participant to make Roth contributions, but also to make non-Roth after-tax contributions, which can then be converted to the participant's designated Roth contribution account via an in-plan Roth rollover.

Under this plan design, a participant could make non-Roth after-tax contributions to a plan up to the defined contribution plan limits set forth in IRC Section 415(c) (currently $53,000) and, if the plan permits, immediately roll over the non-Roth after-tax contributions to a designated Roth account within the plan. Without this plan design, the same participant would only be permitted to make direct contributions to his or her designated Roth account and those contributions would be limited by IRC Section 402(g) to $18,000 minus any pretax elective deferrals made during the calendar year.

From the Regulatory Services Team

Potential Impact on Nondiscrimination Testing

While it would appear that the strategy of making after-tax contributions and then converting them to a designated Roth account within a plan is permissible under IRS regulations, it is important that plan sponsors consider certain factors before they decide to amend their plan's design. These factors include increased administrative complexity, participant education difficulties, and, most notably, additional nondiscrimination testing requirements.

Specifically, non-Roth after-tax contributions would be subject to the Actual Contribution Percentage (ACP) test, the purpose of which is to ensure that the average matching and after-tax contributions of highly compensated employees (HCEs) are within a certain range of the average matching and after-tax contributions of non-highly compensated employees (NHCEs). Since HCEs are more likely than NHCEs to take advantage of the additional flexibility such a design allows and, therefore, would be more likely to increase their after-tax contribution rate, the ACP test may be more likely to fail, resulting in corrective distributions to a plan sponsor's most highly paid employees. Note also that while "safe harbor" plan designs can generally exempt a plan from ACP testing in certain cases, it is not available to remove the need for ACP testing of after-tax contributions.

Plan Sponsor Considerations

With all of this in mind, plan sponsors should discuss with their ERISA counsel the potential impact of offering in-plan rollovers of after-tax contribution assets to a designated Roth account, as well as potential ways to mitigate that impact (e.g., limiting the frequency of conversions or limiting non-Roth after-tax contributions to an amount below statutory limits) before implementing any changes in their plan document or communicating with their employees. And, of course, we invite you to contact us if you would like to discuss the topic further.

This new wrinkle in retirement plan design may be a great choice for certain employers, but for others it could create more issues than it solves.

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