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Establishing Tax-Qualified Retirement Plans: Complicated Rules and Challenges for Employers and Plan Participants

IRS Determination Process; Minimum Standards; Plan Types and Formulas; Benefit Accrual, Nondiscrimination, and Funding Rules

WEDNESDAY, SEPTEMBER 28, 2022

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Fisher Broyles

September 28, 2022

Establishing Tax-Qualified Retirement Plans: IRS Rules, ERISA

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Qualified Retirement Plans – The Basics

The Basics

Why Offer a Qualified Retirement Plan?

- Tax-advantaged compensation through employee deferrals and employer contributions.
- Valuable fringe benefit for attracting and retaining employees.

Tax-Qualified Plans vs. Non-Qualified Deferred Compensation Plans

- Tax-qualified plans offer greater tax benefit, but are subject to minimum standards.
- Non-Qualified Plans are subject to “top hat” requirements and Code section 409A.

Defined Benefit Plans vs. Defined Contribution Plans

Regulatory and Legal Backdrop

ERISA – Law and Regulation

- Passed in 1974 primarily to remedy pension fraud and mismanagement
- Parallel labor and tax provisions
- Regulatory agencies impacting retirement plans:
  - Primary: Department of Labor, IRS/Treasury, Pension Benefit Guaranty Corporation (PBGC)
    - Directly regulate plans
  - Secondary: Securities and Exchange Commission
    - Regulates plan investments and advisers

Regulatory and Legal Backdrop

ERISA – Law and Regulation

- Title I: Labor Provisions
  - DOL enforces Fiduciary Standards, Prohibited Transaction Rules
  - Participants and Beneficiaries can bring actions for relief for benefits due, breaches of fiduciary duties or other equitable relief.
- Title II: Tax Provisions
  - IRS is responsible for plan qualification
- ERISA Preemption of State Laws

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Establishing a Plan

Legal Plan Documents

Plan sponsors are required to have a written plan.

- **Two basic options include:**
  - adopt an individually designed plan; or
  - adopt a pre-approved plan.
- **The old distinction between Master, Prototype, and Volume Submitter plans was abandoned by the IRS. They are now pre-approved plans.**
- **Pre-Approved Plans consist of a "basic plan document" and an "adoption agreement," both of which are tightly controlled by the IRS.**

Selecting Service Providers

- **The 401(k) Plan Industry is Robust:**
  - bundled providers like Empower and Fidelity
  - de-bundled providers
  - Pooled Employer Plans (“PEPs”)

- **Roles Include:**
  - the “provider” of the pre-approved plan
  - third-party administrator
  - recordkeeper
  - trustee
  - custodian
  - consultants such an investment consultant and consultants

- **DOL takes the view that selecting and retaining is a fiduciary act.**

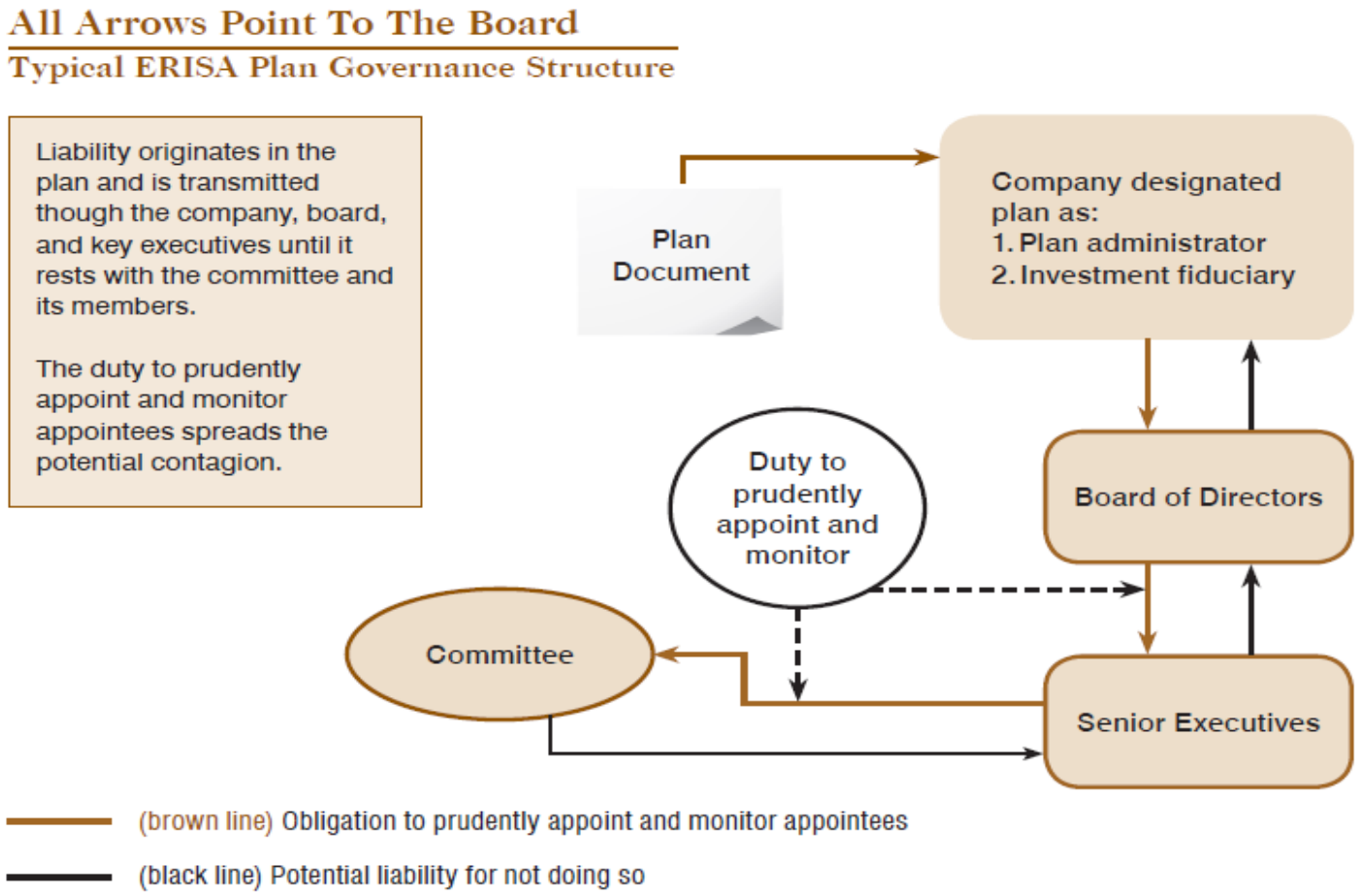
Plan Governance

- **The plan sponsor retains broad power to amend 401(k) plans subject to compliance with the IRC.**
- **With a pre-approved plan, the plan provides the sponsor is an ERISA "named fiduciary" and the "plan administrator."**
- **"Settlor" vs. Fiduciary Roles: The Two Hats Theory**
  - The "settlor" distinction: The creator or in legal jargon the "settlor" of a trust can prefer one beneficiary over another.
  - When the sponsor acts as the employer, those are business decisions, but when the employer acts as a Named Fiduciary, including exercise of the plan's investment functions, or Plan Administrator, those are fiduciary acts.
- **The key distinction is exercising discretionary control over the plan's assets or its terms.**

Plan Governance

- The Trustee is almost always a directed trustee.
- HR professionals are typically “ministerial” functions that are fiduciary in nature.
- Professional services firms are not ordinarily fiduciaries.

Plan Governance



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The Basic Standards

The Basic Standards

Basic Standards

- Minimum Age & Service
- Coverage & Nondiscrimination
- Vesting
- Year of Service
- Contribution Limits

The Basic Standards

Minimum Age & Service

- 410(a) – impermissible exclusions based on age or service
- Plan *may* exclude employees who are under 21 or who have not yet completed 1 year of service.
  - Limited exceptions – 2 years or age 26
  - Long-term part-time employees must be covered under SECURE and SECURE 2.0
- Plan *may not* impose *maximum* age limit

The Basic Standards

Coverage & Non-Discrimination

- Coverage Testing
  - Benefit at least 70% of non-HCEs OR
  - % Benefiting NHCEs / % Benefiting HCEs = at least 70% OR
  - Satisfy Average Benefit Percentage Test
  - Applies on controlled group basis
- Nondiscrimination Testing of Contributions
  - ADP & ACP testing for employee contributions, matching contributions
  - 401(a)(4) applies to nonelective contributions with some safe harbors (*e.g.*, for nonelective contributions at fixed percent of comp)
- Hire service provider for regular “nondiscrimination testing”

The Basic Standards

What is a Highly-Compensated Employee (HCE)?

- Generally employees who make more than a fixed dollar threshold (prior year's compensation), or who are in the top 20% if company elects, or certain 5% owners.
- 2022 threshold: $135,000

The Basic Standards

Vesting

- Employee contributions – Immediately 100% Vested
- Employer contributions – Plan *may* impose limited vesting schedule
  - Defined benefit plan: 100% vesting within 5 years or up to 7 year graded vesting schedule
  - Defined contribution plan: 100% vesting within 3 years or up to 6 year graded vesting schedule
- Plan may be *more* generous, but *not less*.
- Plan termination or partial termination requires immediate vesting of benefits of affected employees.

The Basic Standards

Vesting

- Vested amounts are **nonforfeitable**.
- When the employee receives their benefit, it needs to be at least as much as their accrued benefits, less investment losses.
- Plan can correct errors and deduct certain reasonable administrative expenses but cannot be amended to take away benefits (or associated rights or features).
- Employee cannot lose vested retirement benefits just because they are a bad employee or because the company is having financial struggles.

The Basic Standards

Vesting

- Benefits may be subject to forfeiture if employment terminates before vesting.
- Forfeited amounts may be (subject to plan terms):
  - Used to offset future employer contributions
  - Used to pay for plan administrative expenses
  - Allocated among participants
- May not be reverted to employer without penalties.

The Basic Standards

Year of Service

- Complex concept that is defined differently in different contexts
  - Entering the plan (participation service)
  - Vesting benefits (vesting service)
  - Earning benefits (benefit accrual service)
- Break in service—complex rules when employee is re-hired after a few years
- Controlled group basis
- Elapsed Time vs. Counting Hours
- Read the plan document

The Basic Standards

Contribution Limits

- 402(g) Limit – Maximum elective deferrals per year (Roth and non-Roth) to 401(k) plans
  - 2022: $20,500 + $6,500 (if at least 50)
- 415(c) Limit – Maximum total contributions per year (ER and EE)
  - 2022: $61,000
- 401(a)(17) Limit – Maximum compensation that may be recognized by plan
  - 2022: $305,000
  - Can’t contribute more than 100% to a plan

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Plan Design Considerations

Automatic Enrollment/Escalation

ACA – Automatic Contribution Arrangement

- Unless they opt out, employees automatically defer X% from each paycheck
- May include automatic escalation

EACA – Eligible Automatic Contribution Arrangement

- Automatic contribution with uniform deferral percentage
- Required notice
- Benefits:
  - Plan may permit employees can undo automatic enrollment retroactively within the first 30-90 days
  - Nondiscrimination testing relief

401(k) Plan Nondiscrimination Testing

Nondiscrimination Testing

- 401(k) plans have two main tests:
  - Average deferral percentage test (ADP)
  - Average contribution percentage test (ACP)
- Benefit rights & features testing (all plans)
- Safe harbor or general test for profit-sharing contributions

Safe Harbor 401(k) Plans

Nondiscrimination Testing

- Safe harbor 401(k) plans do not have to pass these tests
  - Basic match: 100% on first 3% plus 50% on next 2%
  - Enhanced match: At least as generous as basic at each tier
  - Non-elective contribution: 3% company contribution regardless of elective deferrals
- QACA – Qualified Automatic Contribution Arrangement
  - Automatic contribution with fixed escalation schedule
  - Match 100% of first 1%, 50% of next 5% OR 3% fixed contribution to all
  - Exempt from nondiscrimination testing; 2-year cliff vesting; no hardship distributions
- New safe harbor under Secure 2.0

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Secure Act 2.0 Highlights

Secure 2.0 Highlights

Overview

- Not final yet; may change.
- Three versions:
  - House – Securing a Strong Retirement Act of 2022
  - Senate Finance Committee – Earn Act
  - Senate HELP Committee – RISE & SHINE Act
- We do not discuss *every* provision.
- May be included in a must-pass spending bill near end of 2022.

Secure 2.0 Highlights

Contributions

- Employer contributions *may* be treated as Roth (employee election)
- Catch-up contributions *must* be treated as Roth (no election), possibly except for employees below $100,000.
- Increased catch-up limit for ages 62-64 (House version) or 60-63 (Earn Act)
- Matching contributions on student loan payments
- Certain retroactive amendments increasing benefits

Secure 2.0 Highlights

Automatic Enrollment/Escalation

- Required automatic contribution/escalation feature for most new 401(k) plans
  - Start between 3% and 10%
  - Increase by 1% per year
  - 10-15% maximum
  - Invested in QDIA
- Mandatory 3-year automatic re-enrollments
- New safe harbor plan design
  - Automatic enrollment at 6%+, automatic increases of 1% per year up to at least 10%
  - 100% match on first 2%, 50% of next 4%, 20% of next 4%
  - Small employers may be eligible for special tax credit

Secure 2.0 Highlights

Distributions

- Cashout limit increased from $5,000 to $7,000
- Domestic Abuse Withdrawals—Lesser of $10K or 50%
  - Exempt from 10% additional tax
  - 3-year recontribution window
  - Reliance on EE certification (House version only)
- Long-Term Care Withdrawals – Up to $2,500
  - Use for premium on long-term care contract
  - Exempt from 10% additional tax

Secure 2.0 Highlights

Distributions

- Terminally-Ill Distributions
  - Exempt from 10% additional tax
- Emergency Savings Account Withdrawals – up to $2,500 saved in plan on after-tax basis with ready access to employee
  - Earn Act: Up to $1,000. Not after-tax.
- Ongoing Disaster Relief – Up to $22,000 distributions from retirement plans and IRAs
  - Exempt from 10% additional tax
  - 3-year/principal residence recontributions
  - Loan relief

Secure 2.0 Highlights

Distributions

- Distribution of life annuities
  - Certain special features permitted (up to 5% annual increases, lump sum cashout, minimum death benefit, etc.)
- Specifying birth or adoption recontribution deadline
  - 3 years from date of withdrawal
- Reliance on employee certifications for hardship withdrawals

Secure 2.0 Highlights

Required Minimum Distributions (RMDs)

- Increasing age triggering RMDs from 72 to 75 gradually from 2022-2032
- Reduced excise taxes
  - Current: 50%
  - New: 25% (10% if corrected promptly)
- Roth accounts not required to be distributed prior to death of owner

Secure 2.0 Highlights

Other SECURE 2.0 Items

- Changes to notice requirements
- Changes to corrections programs
- De minimis financial incentives
- Retirement Savings Lost and Found
- Auto-Rollovers – 401(k) balance automatically transfers to new employer when EE changes jobs, unless EE opts out
  - Plans & service providers *may* set this up. Not required.

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ERISA's Fiduciary Rules

ERISA's Fiduciary Rules

- Duty of Loyalty
  - The duty of loyalty consists of an obligation to discharge fiduciary duties **solely in the interest** of plan participants and beneficiaries. A fiduciary must act for the **exclusive purpose** of providing benefits to participants and beneficiaries, and to pay plan expenses that are reasonable and relate only to plan activities
- Duty of Prudence: The Prudent Expert Standard
  - A fiduciary must act with the same care, skill, prudence, and diligence under the circumstances that a prudent fiduciary **acting in a similar capacity and familiar with these matters** would use in a similar plan with the same goals.
  - The ERISA prudence standard considers the relevant facts and circumstances and looks to what a hypothetical comparable fiduciary would do under comparable circumstances, not simply what a prudent person would do.
  - If a fiduciary lacks knowledge, the fiduciary is obligated to become proficient or engage an expert.

ERISA's Fiduciary Rules

- The Appropriate Consideration Doctrine
  - ERISA does not mandate specific plan investments or asset allocation policies. The prudence of a particular plan investment is analyzed in relation to the entirety of a plan's investment portfolio. Under DOL regulations, fiduciaries must give **appropriate consideration** to all relevant and material attributes of an investment, as well as the surrounding facts and circumstances.
- Self Directed Accounts: Section 404(c) of ERISA
  - The plans fiduciary are relieved of liability for selecting the investment elections from which the participant chooses, but the plan fiduciary must prudently select and monitor the investment menu.
- Duty to Diversify
  - Plans must diversify their investments to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.

Anatomy of an Investment Fiduciary Meeting

- The Investment Fiduciary meets from time to time, but this is usually quarterly.
- Likely Participants
  - investment committee members
  - investment consultant
  - HR staff
  - service providers such as a representative from the third-party administrator
  - legal counsel
- Call to Order
  - confirm quorum, which may be set forth in the investment fiduciary's charter
  - approve minutes from prior meeting, which are typically circulated prior to the meeting

Anatomy of an Investment Fiduciary Meeting

- The Investment Consultant Takes Over
  - overview of macroeconomic situation and external events impacting markets
  - provides overview of general fund performance
  - highlights compliance and non-compliance with investment policy statement
- Investment Committee Q&A
  - members of the investment committee typically ask questions from time to time
  - where all funds are performing within the acceptable parameters of the IPS, the meeting may conclude early
- Major Issues
  - if funds are underperforming, the investment consultant will provide updates
  - if a fund is being removed and replaced, there should be some degree of discussion

Protecting the Attorney Client Privilege

- Summary of the Attorney Client Privilege (the "Privilege")

An attorney cannot be compelled to, nor volunteer to, reveal confidential communications made by the client to the attorney.

- Purpose of the Privilege

The Privilege is the backbone of the legal profession. It encourages the client to be open and honest with his or her attorney without fear that others will be able to pry into those conversations. Further, being fully informed by the client enables the attorney to provide the best legal advice.

- Strength of the Privilege

The Privilege is one of the oldest and most respected privileges. Courts, however, generally prefer not to apply the Privilege.

Protecting the Attorney Client Privilege

- As licensed attorneys, there are also ethical rules regarding the confidentiality obligations owed to clients.
- For example, American Bar Association ("ABA") Model Rule 1.6 provides as follows:

> (a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).
>
> * * * * *
>
> **(c) A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.**

- Rule 1.6 as well as subsequent related rule intersect with and are rooted in the Privilege.

The Fiduciary Exception

- The Fiduciary Exception: Its Origins and Current State
  - The fiduciary exception to the attorney client privilege may be summarized as follows . . .

When a trustee acts in a fiduciary capacity, the attorney client privilege does not protect communications that would otherwise be privileged unless there is an exception to the exception.

- The fiduciary exception does and should not apply when the Trustees are acting in a settlor capacity.
  - Legal counsel will oftentimes intentionally couch matters in terms of amending the plan so that the fiduciary exception will not apply.
  - However, if a plan's assets are used to pay legal fees, the fiduciary exception applies.

Exception to the Fiduciary Exception

- Exceptions to the Exception
  - The first line of defense is to protect the attorney client privilege. If the fiduciary exception applies, exceptions to the exception may save the privilege. The fiduciary exception gives way when:
    - the fiduciaries are seeking legal counsel regarding the administration of plans to protect themselves from liability, whether civil or criminal; or
    - there is a divergence of interests between the plans and participants or beneficiaries.
  - A divergence of interest recognizes that at some point the plan's fiduciaries are obligated to protect the plan when there is a controversy between a plan and a participant or beneficiary.
  - Traditionally, a divergence of interest occurs when:
    - a participant exhausts the claims procedures; and
    - a participant commences a legal action against a plan, which intersects with ERISA's claims procedures.

The Work Product Doctrine

- The Work Product Doctrine
  - An Overview of the Rule
    - The purpose is to protect the attorney's documents and tangible things prepared in anticipation of litigation.
    - The rationale is to protect others from "piggybacking" on the efforts of other attorneys, subject to an exception for undue hardship.
  - Writings produced by in-house counsel and outside counsel that include mental impressions and legal analysis are protected by the work product doctrine.
  - Since the work product doctrine may be waived – more on this in a minute, documents prepared by counsel should be closely guarded.
  - The fiduciary exception does not apply to the work product doctrine.

Waiving the Privilege or the Work Product Doctrine

- Waiver: The General Rule
  - Waiver may be found …
    - where mere words or conduct express an intention to relinquish a known right;
    - when there is a partial disclosure, which would make it unfair for the client to invoke the privilege thereafter; and/or
    - whether or not it is subjectively intended by the holder.
  - The essential function of the privilege is to protect a confidence which, once revealed by any means, leaves the privilege with no legitimate function to perform.
  - However, the privilege cannot be overthrown by theft or fraud, but rather a waiver must at least be voluntary.

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Plan Administration

Reporting and Disclosure

- Form 5500
  - Form 5500 is a publicly available informational return that is filed annually.
  - Regulatory authorities use information obtained from Form 5500 filings for their enforcement efforts and in developing policy.
  - Participants and beneficiaries may find the Form 5500 informative and useful.
- Scope of the Form 5500 Reporting Obligations
  - Depends on the type of plan.
  - Depends on whether the plan is a “large plan” – more than 100 participants – or a “small plan” -- fewer than 100 participants (or that meets the 80-120 rule).
  - The 80-120 participant rule applies if both:
    - The number of participants is at least 80 but no more than 120, on line 5 of the 5500 filing.
    - In the prior year, the plan filed either a Form 5500 or Form 5500-SF.

Reporting and Disclosure

- Three Types of Form 5500
  - Form 5500: (100 or more participants on the first day of the plan year and smaller plans that are ineligible to file the short-form Form 5500-SF (for example, a plan that invests in employer securities)). The filing includes:
    - the three-page Form 5500;
    - nine Schedules, the completion of which depends on the type of plan and investments; and
    - attachments to the Form 5500 and the Schedules.
  - Form 5500-SF: (have fewer than 100 participants on the first day of the plan year). Eligible if:
    - eligible for the small plan audit waiver;
    - do not invest in employer securities; and
    - invest in assets with a readily ascertainable fair market value.

Reporting and Disclosure

- Three Types of Form 5500
  - Most plans that file a Form 5500-SF are not required to file any Schedules.
  - Schedules may be required for defined benefit and money purchase plans filing a Form 5500-SF.
- Form 5500-EZ (Annual Return of A One-Participant (Owners/Partners and Their Spouses) Retirement Plan or a Foreign Plan).
  - The Form 5500-EZ is filed for certain "solo" retirement plans that are not subject to ERISA § 104(a).
- SECURE Act Group Plans: Single Form 5500
- PEPs and Multiple Employer Plans can use a single Form 5500 if:
  - are individual account plans or defined contribution plans;
  - have the same trustee, fiduciaries, and plan administrator;
  - have plan years that begin on the same date; and
  - provide the same investments or investment options to participants and beneficiaries.

Reporting and Disclosure

- A Note about the Audit Requirement
  - An auditor's report must be included as part of the Form 5500 unless the plan both:
    - is small; and
    - qualifies for the small pension plan audit waiver (complex rule).
  - An audit is not a forensic audit of a plan designed to unearth all potential errors and omissions.

Reporting and Disclosure

- Common Disclosure Rules
  - There are a variety of documents that must be provided in connection with the administration of a 401(k) plan.
- A Summary Plan Description (an “SPD”)
  - According to the DOL:

> One of the most important documents participants are entitled to receive automatically when becoming a participant of an ERISA-governed plan is a summary of the plan, called the summary plan description or SPD. The plan administrator is legally obligated to provide to participants, free of charge, the SPD. The summary plan description is an important document that tells participants what the plan provides and how it operates. It provides information on when an employee can begin to participate in the plan and how to file a claim for benefits.

  - DOL has in a detailed regulation set forth information that must be included in an SPD, which includes but is not limited to providing information about name of the plan, name and address of the employer and the plan's requirements respecting eligibility for participation and for benefits are covered by the plan.

Reporting and Disclosure

- A Summary of Material Modifications (an "SMM")
  - According to the DOL:

    If a plan is changed, participants must be informed, either through a revised SPD, or in a separate document, called an SMM summary of material modifications, which also must be given to participants free of charge.

  - It is a common practice to provide an annual SMM when changes are made to a plan that result in modifications to an SPD.
- Summary of Benefits and Coverage (an "SBC")

  According to the DOL:

  Plans also must provide an SBC that accurately describes the benefits and coverage under the applicable plan. The SBC is a uniform template that uses clear, plain language to summarize key features of the plan, such as covered benefits, cost-sharing provisions and coverage limitations. Plans and issuers must provide the SBC to participants and beneficiaries at certain times (including with written application materials, at renewal, upon special enrollment and upon request).

Reporting and Disclosure

- Form 5500
  - Forms 5500 are not routinely distributed to participants. If participants are unable to get the annual report from the plan administrator, they may be able to obtain a copy by writing to the DOL or accessing a copy on the DOL's publicly available online database.
- Automatic Enrollment Notice
  - Prior to automatically enrolling an employee in either an EACA or QACA plan, the employer must give the employee a notice before the employer automatically enrolls the employee. When an employee is a new hire and is immediately eligible, then the employer may give the employee this notice on the hire date.
- Individual Benefit Statement
  - An individualized IBS discloses the benefits earned by a participant and his or her vested amounts. It must be given to a participant upon his or her written request, but no more than once in a 12-month period, and automatically to certain participants who have terminated service with the employer. Plans that provide for participant-directed accounts must furnish individual benefits statements on a quarterly basis. Plans that do not provide for participant direction must furnish statements annually.

Reporting and Disclosure

- There are a variety of other notices, including:
  - distribution notice and election forms;
  - rollover notices when a lump-sum distribution is made;
  - notice given to participants when they leave a company;
  - notice of suspension of benefits
- Reputable third-party administrators typically provide a sponsor's HR staff with models and routinely distribute notices.

Problem Areas

- Default Beneficiary Provisions and Beneficiary Designations
  - A sample:

    "Beneficiary" means any person, persons or entity designated by a Participant in the case of the Participant's death. Provided, however, a married Participant's Spouse shall be the Participant's sole Beneficiary unless or until the Participant elects another Beneficiary with Spousal Consent. If no Beneficiary designation is in effect at the Participant's or Beneficiary's death or if no person, persons or entity so designated survives the Participant shall be the sole Beneficiary; otherwise, the Beneficiary shall be the personal representative of the estate of the Participant.
- Qualified Domestic Relations Orders (a "QRDO")
  - Make sure to adopt excellent QDRO procedures and an annotate model form because attorneys handling divorces struggle with QRDOs.
- Following ERISA's Claims Procedures
  - Follow ERISA's claims procedures to get deferential standard of review by court.

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Investment Issues

Selecting and Monitoring Investment Options

Selecting and Monitoring an Investment Option Is a Fiduciary Function

- Relevant factors to consider include:
  - Benchmarking of historic fund performance against industry standard
  - Operating expenses
  - Track record, sector reputation and financial controls of fund manager
  - Team experience and stability
  - Expert advice from investment consultant

ERISA Section 404(c)

ERISA §404(c)

- Plan Fiduciaries will be relieved of fiduciary liability for participant-directed investment decisions if ERISA §404(c) requirements are satisfied:
  - Plan must have “broad range” of diversified investment options with ability for participants to change investments
    - Materially different risk and return characteristics
  - Participants and beneficiaries must be informed the plan is intended to satisfy §404(c) and that plan fiduciaries may be relieved of liability for participant decisions
  - “Default” funds should satisfy qualified default investment alternative (QDIA) requirements
  - ERISA §404(c) is not a defense to imprudent fund selection.

401(k) Plan Fee Litigation

Fee Litigation

- Litigation has proliferated over the last decade. Key issues include:
  - Retail vs. Institutional Share Classes
  - Revenue Sharing Payments/Float Income
  - Number of Investment Options
  - Managed Account Arrangements
  - Proprietary Funds
  - Default Investments

401(k) Plan Fee Litigation

***Hughes v. Northwestern University* (2022)**

- Affirmed the duty to monitor each investment option.
- Did not address important procedural questions:
  - Higher cost option chosen when fiduciaries could have chosen similar, lower cost investment options?
  - Implications of other low-cost options available to participants under plan?
  - Must there be any indication of a defect in the procedural process?
- Glimmer of light:
  - "At times, the circumstances facing an ERISA fiduciary will implicate difficult tradeoffs, and courts must give due regard to the range of reasonable judgments a fiduciary may make based on her experience and expertise."

Monitoring Plan and Investment Fees

Considerations for Fiduciaries in ensuring reasonableness of fees:

- Paying recordkeeping expenses directly or through revenue sharing
- Institutional shares vs. retail shares
- Mutual funds vs. collective investment trusts
- Passive vs. actively managed funds
- Managed accounts
- Requests for Proposal/Requests for Information

ESG Factors and Proxy Voting

Does Socially Responsible Investing Conflict with Duty of Loyalty?

- Investment returns cannot be sacrificed for economic, social or corporate governance (ESG) objectives.
- But ESG factors may potentially be considered:
  - When ESG factors are relevant to financial performance of an investment.
  - As a tie-breaker for investments that are otherwise indistinguishable based on financial considerations.
- Is proxy voting in the interest of participants given the cost?

DOL issued proposed regulations in October 2021 that would modify final regulations issued in 2020, which it viewed as having a “chilling effect” on ESG investment and shareholder activism.

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Correction Programs

Correction Programs

Nuclear Option

- In theory, the smallest mistake in operating a plan results in the complete loss of tax qualification.
  - All participants are retroactively taxable on deferrals and investment returns.
  - The plan's trust is retroactively taxable.
  - The company retroactively loses deductions for its contributions.
- Way too harsh for an honest mistake.
- Only imposed in extreme cases in practice.

Correction Programs

Tax Qualification Failures (IRS)

- EPCRS
  - SCP – No filing, no fee
  - VCP – Up to $3,500 fixed fee
  - Audit-Cap – More significant penalties
- Pilot Pre-Audit Program

Correction Programs

Fiduciary Failures (DOL)

- VFCP
  - Failure to timely remit participant contributions & loan repayments **as soon as possible**
  - Also need to pay excise taxes (Form 5330) to IRS or fit into PTE 2002-50 exception
- DFVCP – Delinquent Filer Voluntary Compliance Program
  - Reduced penalties for late filing of Form 5500

Correction Programs

Possible Secure 2.0 Changes

- Nearly all overpayments eligible for self-correction
- No longer required to ask participants to repay
  - May seek return of exempt overpayments, but:
    - Not earnings
    - No more than 10% offset
    - No recovery from spouse or beneficiary
    - Not more than 3 years old
- Not ineligible for rollover
- IRS directed to create more safe harbors including for earnings calculation

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Agency Compliance Audits

Agency Compliance Audits

Authority to Conduct Audits

- The Internal Revenue Code ("IRC") and ERISA give IRS and DOL authority to conduct investigations to determine whether any person has violated or is about to violate the IRC or ERISA.
- These agencies may:
  - Investigate on-site
  - Require submission of reports, books, and records
  - Inspect books and records
  - Interview individual fiduciaries (e.g., Investment Committee members or those responsible for plan administration)
  - Subpoena plan records and testimony in connection with investigation
  - Subpoena records and testimony of service providers

Agency Compliance Audits

DOL Enforcement Priorities include:

- Ensuring active effort made to get all participants paid (e.g., missing participants)
- Employee contributions
- Plan expenses/settlor fees
- Ensuring funded plans are “made whole” when overpayments (with earnings) are not 100% recovered
- Cyber security

Agency Compliance Audits

Who gets audited?

- Larger plans
- Random review by geography, industry or plan type
- Participant complaints
- Publicity
- Form 5500 targeting
- Specific national office initiatives

Agency Compliance Audits

Cybersecurity

- The DOL issued cybersecurity guidance in 2021
  - DOL asserted that plan sponsors have a fiduciary duty to monitor and ensure that plan assets are appropriately protected from cyber-attack.
  - DOL now routinely asks questions about cybersecurity during its audits of retirement plans.
- Employers and other plan fiduciaries have a fiduciary duty to monitor the performance of plan service providers after they are engaged.
  - This review should be reflected in the formal documents of the fiduciaries, such as in meeting minutes of an investment or administrative committee.
- The DOL's cybersecurity initiative may cover any company systems that are involved in employee benefit plan administration.
  - It is important to document that appropriate privacy and security policies and procedures are in place.

Thank You

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