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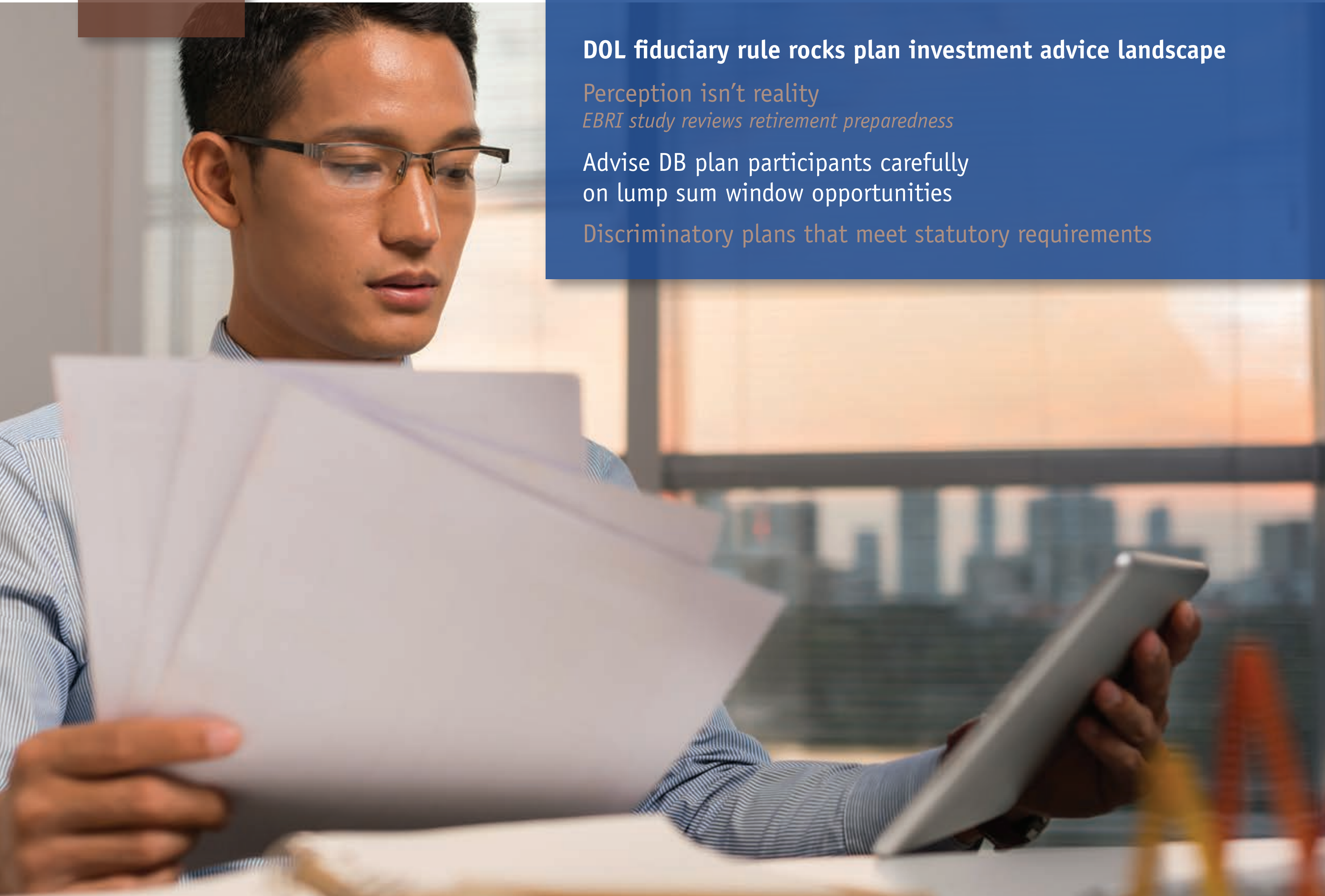
Employee Benefits Update



DOL fiduciary rule rocks plan investment advice landscape

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DOL fiduciary rule rocks plan investment advice landscape

When the final version of the U.S. Department of Labor's (DOL's) fiduciary standards rule for advisors to retirement plans was issued in April, the wait for the long-anticipated regulatory package was over. With the benefit of the intervening months, the implications for plan sponsors have become clearer.

A little background

For nearly a decade, concern was building within the DOL that retirement savers — whether through their IRAs or defined-contribution plan accounts — were being harmed by investment advisors who recommended investments that were more profitable for them rather than for their clients. With that in mind, the DOL had a call to action and issued regulations focusing on a more detailed definition of who is a "fiduciary."

The best interest contract exemption (BICE) provides a path for advisors who would otherwise violate certain ERISA prohibited transaction rules to continue to advise retirement plans and IRA owners on investments.

A transition rule gives plan sponsors and advisors time to adjust to the regulations' detailed requirements. Specifically, while the new rule overall took effect on June 7, key provisions are delayed: The revised definition of fiduciary advice becomes effective April 10, 2017, and the best interest contract exemption (BICE) isn't fully phased in until 2018.

Suitable vs. best interest

Previously, advisors were required to determine only that recommended investments were "suitable" for retirement

investors — the same standard that applies to stockbroker suggestions for ordinary investors. That suitability standard is below that which fiduciaries are held to — acting solely in the best interest of plan participants, regardless of the financial implications for the advisor.

The DOL's concern led to a proposed regulation in 2010 that was widely criticized within the financial industry. The proposed regulations would have disqualified the vast majority of advisors if they failed to change their business models and become conflict-free plan fiduciaries. The DOL went back to the drawing board, returning in 2015 with a substantially modified proposed rule.

The revised rule also unleashed a flood of industry-suggested improvements, many of which were incorporated into the final rule issued in April. A key feature of the 2015 proposal and final regulation is the creation of the BICE. It provides a path for advisors who would otherwise violate certain ERISA prohibited transaction rules to continue to advise retirement plans and IRA owners on investments.

Understanding BICE

The BICE "allows … registered investment advisors, broker-dealers and insurance companies, and their

agents and representatives, that are ERISA or [tax] Code fiduciaries by reason of the provision of investment advice, to receive compensation that may otherwise give rise to prohibited transactions as a result of their advice to plan participants and beneficiaries."

Rather than enumerating highly prescriptive requirements for exemption eligibility, the regulation articulates principles advisors must adhere to. Thus, if your financial advisor doesn't otherwise satisfy the traditional fiduciary requirement of having no conflicts of interest, he or she must:

- Acknowledge the advisor's and the financial institution's fiduciary duty to the investor and provide prudent advice that's in the customer's best interest,
- Disclose compensation and other fee information and receive no more than reasonable compensation ("reasonable" being subjective),
- Warrant that neither the advisor nor the financial institution will make any misleading statements about information pertinent to a transaction (including on such issues as fees, assets and conflicts of interest), and
- Provide a list of the steps the advisor or financial institution will take to mitigate potential conflicts of interest.

In addition, advisors must adopt policies and procedures reasonably designed to mitigate any harmful impact of conflicts of interest. This includes disclosing basic information about their conflicts of interest and the cost of their advice. The advisor and financial institution must supply this information to "retirement investors," but plan sponsors should be aware of all such communications.

What about fiduciary advisors who charge a flat fee? "Level fee fiduciaries," as the final rule refers to them, must provide plan participants and beneficiaries with a written statement of their fiduciary status, comply with the standards of impartial conduct, and document the specific reason or reasons for the recommendation of the level fee arrangement.

What is "advice"?

Investment advice, under the U.S. Department of Labor's (DOL's) fiduciary standards rule, means making a recommendation that someone take a specific action, or refrain from doing so, and being compensated, directly or indirectly, for doing so. But what exactly is this?

According to the Plan Sponsor Council of America, the following are *not* subject to the revised fiduciary rules:

- Providing an investment platform without regard to individualized investment needs,
- Identifying investment options that satisfy the pre-established investment criteria of an independent plan fiduciary, and
- Providing general investment communication that a reasonable person wouldn't view as investment advice, such as newsletters, general marketing materials and general market data.

Most important, the DOL's rule doesn't consider providing investment education, general financial investment and retirement information to be investment advice. Thus, human resources personnel that generally respond to employee questions aren't considered fiduciaries under the new rules.

Keep in mind that these rules also apply to recommendations associated with Individual Retirement Accounts (IRAs).

Time to act

The DOL's fiduciary standards rule pertains to providing investment advice, as opposed to general financial education and guidance. (See "What is 'advice'?" above.) Because the final rule is complex, consult your benefits specialist about how the regulation affects your particular arrangements with investment advisors. ◻

Perception isn't reality

EBRI study reviews retirement preparedness

The Employee Benefit Research Institute's (EBRI's) 2016 "Retirement Confidence Survey" provides helpful insights on employee behavior and benchmarking data for plan sponsors striving to help their employees attain retirement readiness. When it comes to retirement preparation, the study indicates that confidence often doesn't correlate to the underlying facts. Closing the perception/reality gap remains a significant challenge for many plan sponsors.

Looking at the numbers

According to the EBRI, overall confidence levels (covering active retirement plan participants as well as those not currently covered by a plan or a spouse's plan) have essentially remained flat during the past two years, following a rebound after the 2008 financial crisis. In the latest survey, 21% of workers report that they're "very" confident about having enough money for a comfortable retirement, 42% are "somewhat" confident, 16% are "not too" and 19% are "not at all" confident.

A bit of good news for plan sponsors: Employee confidence about having enough money for a comfortable retirement correlates with whether they or their spouse participates in a plan. For example, 26% of plan participants report they're "very confident," vs. only 10% of nonparticipants.

Retirement confidence also correlates with personal debt burdens. According to the study, 32% who report that debt isn't a problem are very confident about their retirement prospects, compared to 9% for whom debt is a major issue.

Employee confidence about having enough money for a comfortable retirement correlates with whether they or their spouse participates in a plan.

A relatively large (28%) proportion of employees award themselves high marks for their ongoing efforts to prepare for retirement. 43% report being "somewhat confident" about the job they're doing, with the remainder nearly evenly split between those who aren't too confident or not at all confident about the matter.

Perceptions vs. reality

Authors of the EBRI report found a disconnect between retirement confidence levels and actions. "The percentage of workers who reported they and/or their spouse had [ever] saved for retirement peaked in 2009 at 75%, but declined thereafter," they wrote. Currently, the proportion of employees who reported they're currently saving for retirement was 63%. Yet 2009 generally marked the beginning of an upswing in retirement confidence.

One perspective on the basis for employee retirement confidence (or lack thereof) is reported levels of retirement savings assets. (See the "Retirement savings distribution"

Retirement savings distribution (for workers covered by a retirement plan)	
Less than $1,000	9%
$1,000–$9,999	15%
$10,000–$24,999	16%
$25,000–$49,999	13%
$50,000–$99,999	13%
$100,000–$249,999	17%
$250,000 or more	18%

Source: *2016 EBRI Retirement Confidence Survey*

chart above.) That a majority of plan participants have less than $100,000 in retirement savings is broadly indicative of a significant shortfall. However, the picture isn't entirely clear, since the data isn't adjusted for employee age, income level or years of service.

Savings rate expectations

When asked to estimate the percentage of their income needed to meet retirement saving goals, 18% of respondents covered by a retirement plan indicated that they didn't know. But responses from the remaining 82% varied widely, with the largest proportion (20%) estimating a required savings rate between 20% and 29% — a highly unrealistic target for most workers with average incomes.

On the opposite end of the spectrum, 9% of survey respondents estimated that a savings rate below 10% would be sufficient, and an equal percentage stated that they need to be saving at least 50% of their income annually. The survey data doesn't specifically address the accuracy of those estimates. What it does show, however, is that employees generally aren't saving at the rate they believe they should be. This may be a source of the expectation by 13% of survey respondents that they'll need to postpone retirement beyond the age they had once expected to retire.

As for when they'll retire, 26% of surveyed employees expect to retire at age 65. The number is the same as those expecting to retire at age 70 or beyond. And 6% don't expect ever to retire.

Educating is key

On a positive note, employees recognize a need for receiving advice on retirement investing — with a strong preference for getting it in person. Only 2% were "very interested" in using online advice providers.

What does this mean for plan sponsors? In guiding employees toward retiring at their desired retirement age, technology-based systems alone are insufficient to get the job done. Invest in education that employees will use and learn from.

Closing the gap

Generally, employees with false confidence in their ability to retire when they want have no motivation to change their retirement saving pattern. Making sure your plan participants fully understand the reality of their retirement savings goals can result in a successful retirement plan. ◻

Compliance Alert

Upcoming compliance deadlines:

9/15 Extended deadline for corporate tax returns

9/15 Extended deadline for partnership tax returns

9/30 Summary Annual Report (SAR) due for Form 5500 that was due July 31, unless extension was granted (for returns extended to October 15, SAR deadline is December 15)

Advise DB plan participants carefully on lump sum window opportunities

There are sound reasons why defined benefit (DB) plan sponsors may offer participants lump sum payout windows. Principal among them: lowering the plan's financial exposure, thereby providing greater long-term financial security to participants who elect to stay in the plan. However, the consequences of accepting a lump sum payout can be good or bad for participants.

Suggestions from the GAO

Concern that many employees are making bad decisions has prompted scrutiny of lump sum windows. A report last year by the Government Accountability Office (GAO) found that, although sponsors' decisions to make certain lump sum window offers may be legally permissible, participants' understanding of the financial tradeoffs associated with their choice was questionable.

Lump sum distributions can be taxable if not rolled over to a qualified retirement plan, and participants younger than age 59½ can face a 10% surtax on lump sum distributions.

The GAO urged the U.S. Department of Labor (DOL) to improve oversight by requiring plan sponsors to notify the DOL when they implement lump sum windows. The report also encouraged the IRS to review interest rates and mortality tables used in calculating lump sums and reassess regulations governing relative value statements.

Considerations for participants

Regardless of what regulators do, DB plan sponsors can take steps to ensure that participants have enough information to make a smart choice before opting for a lump sum payout. Here are some factors participants should consider when making their decision:

Investment management. When participants take a lump sum payout, they'll need to invest the proceeds wisely to avoid being worse off than if they'd left the money in the plan. Are they confident of their ability to take on that challenge?

Value comparison. How does the present value of the anticipated pension annuity benefit compare to the value of the lump sum? If a participant could buy a larger retirement benefit from an annuity provider with a single premium purchased with the lump sum proceeds, the participant might consider taking the lump sum and buying the annuity. If not, declining the offer might be a better idea.

Health considerations. If participants are fit and have a long life expectancy, they'll generally come out ahead staying with the pension. Otherwise, because pension benefit calculations are based on average life expectancy, participants might do better by taking the lump sum.

"Last chance" possibility. A lump sum opportunity may be attractive because of unique employer circumstances indicating that no other lump sum window will open in the future.

Estate planning. With a DB pension annuity, the benefit ends when the participant (or possibly a surviving spouse) dies. With a lump sum, any residual assets can be willed to heirs.

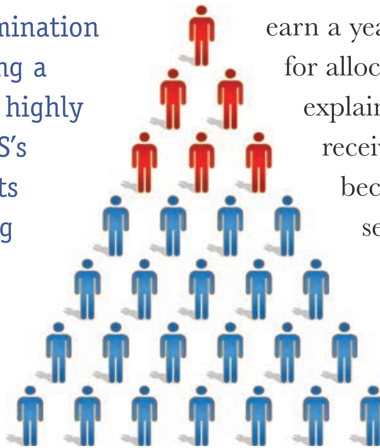
Tax considerations. Lump sum distributions can be taxable if not rolled over to a qualified retirement plan. Also, participants younger than age 59½ can face an additional 10% premature-distribution penalty unless the distribution is made after separation from service during or after the calendar year in which a participant attains age 55.

Provision of sound guidance

These are just some of the considerations plan participants will need to weigh if given the opportunity for a lump sum payout. Providing sound guidance to participants is a fiduciary obligation. In addition, if the GAO's request for increased oversight happens, you'll be ready to make the correct notification to the DOL. ◻

Discriminatory plans that meet statutory requirements

The IRS issued a warning to plan sponsors whose plan designs satisfy numeric antidiscrimination tests, yet still have the effect of steering a disproportionate amount of benefits to highly compensated employees (HCEs). The IRS's message: Simply satisfying numeric tests doesn't guarantee that you're complying with antidiscrimination regulations.



IRS findings and examples

In a recent announcement, the IRS reported seeing an uptick in plan designs that provide significant benefits to HCEs. Specifically, it noticed plans benefiting a group of non-highly compensated employees (NHCEs) who work few hours and receive little compensation. These plans tend to exclude other NHCEs from plan participation.

The IRS provided some examples of such designs. In one, the plan bases participation eligibility on job classification, and the classification formula covers a small group of low-pay or short-tenure employees. In another, coverage is available to only NHCEs who work on an as-needed basis and earn a meager salary each year.

Another example: Plans that require 1,000 hours to earn a year of service for vesting purposes, but not for allocation purposes. "In these plans," the IRS explains, "the low paid or short service NHCEs receive an accrual or allocation, but don't vest because they never complete a year of vesting service." A variation on that theme is requiring 12 consecutive months of employment to satisfy a vesting requirement, allowing the NHCEs to vest, but only "in the very small plan benefit."

The IRS also provides an extreme example in which a participant who earns only $200 in annual compensation receives a $200 profit sharing allocation — 100% of compensation. To allow the plan to clear the antidiscrimination test, an HCE earning $200,000 would receive a $50,000 benefit, or 25% of compensation.

IRS warning

The IRS warns that these plan designs don't pass muster. The relevant regulations require that all antidiscrimination rules be reasonably interpreted to prevent discrimination in favor of HCEs. ◻

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