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Employee Benefits Update

Get your fiduciary house in order

DOL's newest regulations require plan sponsor action

The majority of the U.S. Department of Labor's (DOL's) complex regulations mandating fiduciary status for individuals dealing with retirement investment decision-making involve investment advisors. But the regulations, which are scheduled to take effect on April 10, 2017, also require plan sponsors to take certain steps. Remember, plan sponsors are always the fiduciary, and the regulations expand the definition of fiduciary status.

A primer

Remember, the rules *don't* remove fiduciary status from plan sponsor employees who already serve in that capacity. This includes investment committee members or any other individuals that have control over plan management or plan investments.

However, under the new rules, for an employee who provides advice to plan participants:

- The employee's job responsibilities cannot include providing investment advice or investment recommendations,
- The employee may not be registered or licensed under federal or state securities or insurance laws,
- The employee's advice may not require registration or licensing under such laws, and
- The employee may not receive any direct or indirect fee or other compensation in connection with the advice beyond the employee's normal compensation for work performed for the employer.

Now's the time for you to ensure that your in-house treasury, human resources and other investment staff can qualify for these exceptions.

Service provider questions

You'll need to have a clear understanding of changes your plan's service providers may make as they seek also to adjust to the new regulations. Service providers that already explicitly acted in a fiduciary capacity will continue to do so; the regulations don't require any particular action on your part.

However, some service providers may, without changes on their part, fall into the fiduciary category. It's up to you to determine whether they'll either acknowledge their fiduciary status, or change their role to avoid it. Any vendor that takes on a fiduciary status must say so in writing.

The rule doesn't impose fiduciary obligations on advisors if the advisor knows or reasonably believes that the fiduciary is a licensed and regulated provider of financial services or manages plans with $50 million or more in assets. Advisors seeking to rely on this provision may ask for a written representation that the employer is exercising independent judgment and is capable of evaluating investment risks. Further, the advisor must inform the employer of the existence of any financial interest in the transaction and the advisor cannot receive a direct fee in association with the advice being provided.

BICE agreements

One way service providers, particularly those that are compensated according to the investment choices you make, can avoid fiduciary status is to change their business model and enter into an agreement with you known as a best interest contract exemption (BICE). That changes the nature of the business relationship in a manner that will be spelled out in the signed agreement.

When entering into a BICE agreement, determine how service providers intend to comply with the fiduciary rules. Assess whether the documentation they'll provide (or already have provided) explaining any changes is sufficiently clear and complete. Then decide whether any changes in their role leave gaps in the services you need, particularly with respect to advice on investment solutions.

Rollover discussions

The regulations pull certain communications about IRA rollover options into the definition of advice — whether or not the plan sponsor urges participants to roll over plan funds into particular IRA investments. The DOL's concern is that advisors who manage retirees' IRAs will skew their communications about rollovers in favor of that option, to generate more revenue.

If communications merely explain the pros and cons of rolling over to an IRA in a completely neutral fashion, you're OK. But if materials or suggestions by call center representatives suggest that one option might be more suitable than another, this could constitute advice conferring fiduciary status.

So what should you do? Establish a routine procedure to monitor communication materials supplied to participants to ensure that they stay on the education side of the education-advice boundary.

Complex decisions

The DOL regulations are complex; it might take months or even years for their practical application to be fully understood. Meanwhile, reviewing the actions here and discussing the regulations with your benefits specialist will help you avoid inadvertently assuming fiduciary duty. □

Education or advice?

The recent U.S. Department of Labor's (DOL's) fiduciary regulations require taking a close look at the distinction between investment education and investment recommendations or advice. The regulations confer fiduciary liability on those giving advice, so you'll need to make sure the educational materials that you — or service providers — supply don't cross the line to become advice.

The DOL guidance from a decade ago, in Interpretive Bulletin 96-1, still is valid today. Generally, plan information, general financial and investment information, asset allocation models, and interactive investment materials will be deemed educational.

Its description of investment advice is relatively specific, but ends with a caveat that the "facts and circumstances of a particular case" ultimately determine the assessment. The new DOL fiduciary regulations hold plan sponsors responsible for monitoring education materials to ensure they don't evolve and stray across the line between education and advice. Be sure to review all of your educational materials with your benefits specialist.

Hardship withdrawal programs require strict administration

Although not required, most 401(k) plans feature a hardship withdrawal option. The IRS maintains strict rules surrounding these provisions and recently updated its guidance on how plan sponsors can remedy errors in the administration of hardship withdrawals.

Why have the option?

What if your plan doesn't offer a hardship withdrawal option? It'll still be subject to "plan leakage": employees' retirement dollars leaving your plan prematurely, whether due to hardship withdrawals or other reasons, such as plan loans that go into default on an employee's termination of employment. Whatever the reason for the leakage, withdrawals affect employees when they retire.

To discourage employees from tapping into retirement assets for reasons other than under the most dire of circumstances, consider forgoing a hardship withdrawal option, particularly if you have a loan option. On the other hand, if you believe the lack of a hardship withdrawal provision will be seen by employees — and prospective employees — as a negative, you may want to consider offering hardship withdrawals.

Is the need immediate and heavy?

The rule governing hardship withdrawals requires that the withdrawal be made to satisfy only an "immediate and heavy" financial need of the employee (including the employee's spouse and minor children or nondependent beneficiary) as defined in the rule. In addition, the sum is limited to the amount that cannot be met from other sources. Those could include savings; a plan loan or any other kind of loan; or increasing the participant's paycheck by suspending 401(k) deferrals.

As the plan sponsor, you must determine whether a requested hardship withdrawal is justified, based on IRS rules, your plan provisions and your assessment of the situation. You can rely on a participant's written statement that he or she has no alternative means of addressing the financial need, unless you have evidence

to the contrary (the regulations set out examples of this knowledge), and you may outsource this process to your third party administrator (while maintaining responsibility).

What expenses are eligible?

Under the safe harbor definition of hardship withdrawal, there are several expense categories that are automatically eligible for a hardship withdrawal, including:

- Medical expenses for the employee, spouse or child,
- Costs directly related to the purchase of a principal residence (except mortgage payments),
- Funds needed to prevent eviction from a rented property or foreclosure on a primary residence,
- The cost of repairing damage to a principal residence,
- Tuition and related postsecondary school educational expenses for the next year for the participant or a spouse, child or beneficiary, or
- Funeral expenses for the employee, spouse, child or beneficiary.

The participant can only withdraw amounts consisting of contributions to the employee's 401(k) account, not earnings on those contributions. For funds derived from employee deferrals, you can apply withdrawal standards that are different from those stemming from employer-matching or nonelective contributions (such as profit sharing contributions).

Plan documents generally require that participants not resume elective deferrals for at least six months after the hardship withdrawal. Generally, hardship withdrawals, unless taken from a Roth 401(k) plan, are taxable. Also, if taken before age 59½, they may also be subject to a premature-withdrawal 10% tax penalty.

How can you fix errors?

What happens if you make a mistake in administering a hardship withdrawal program? That depends on the mistake. For example, if you were allowing hardship withdrawals but discovered that your plan document doesn't provide for them, you need to amend your plan, make the amendment retroactive, and then seek approval for that action through the IRS's "voluntary compliance program" (VCP).

In a more typical scenario, a mistake would be made by granting a hardship withdrawal for a purpose not specifically provided for in the plan document. In that situation, you would also need to amend your plan retroactively through the VCP.

Another example of a common hardship withdrawal error identified by the IRS is failing to suspend plan contributions for at least six months following the withdrawal. The IRS offers two possible options to remedy that error:

1. Suspend employee deferrals for a six-month period "going forward," or
2. Have the employee return the hardship distribution.

The catch, according to the IRS, is that neither of the options guarantees to put the employee in the same position as he or she would have been in had the contributions been suspended immediately following the hardship withdrawal. This would be true, for example, if you changed the plan's matching contribution in the interim or if the employee lacked the funds to return the distribution. One way or another, however, the error must be addressed.

Plan for withdrawals now

Read your plan document to refresh yourself on the intricacies of your hardship withdrawal requirements. Make sure that anyone administering your plan — either in-house or a third-party administrator — do the same. This will go a long way toward avoiding mistakes in the first place. □

Compliance Alert

Upcoming compliance deadlines:

2/15 Quarterly benefit statements due for defined contribution plans with calendar year plans

2/28 Deadline for filing paper 2016 Form 1099 with IRS (electronic filing deadline is March 31)

3/15 Deadline for making corrective distribution for failed 2016 actual deferral percentage (ADP) / actual contribution percentage (ACP) tests without 10% excise tax penalty

3/15 Deadline for filing 2016 corporate tax return and making contributions eligible for deductibility without extension

4/1* Deadline for taking first required minimum distribution for participants attaining age 70½ or retiring after age 70½ in prior year

4/17* Deadline for corrective distribution of 2016 402(g) excess deferral failures

4/17** Deadline for filing 2016 individual and/or partnership tax returns and making contributions eligible for deductibility without extension

** The due date of April 1, 2017, falls on a Saturday. The IRS historically hasn't extended due dates for required disclosures, contributions or distributions.*

*** This date reflects an extension of the normal deadline, which falls on a Saturday this year.*

Who's to blame?

Court equitably apportions fiduciary misdeeds

When a fiduciary breach occurs, some fiduciaries may be more culpable than others. And when that's the case, the court can order those parties to indemnify other fiduciaries who were, despite their technical status as fiduciaries, without blame. That was the opinion of the U.S. Court of Appeals for the Seventh Circuit in a recent case.

The facts of the case

In *Chesemore v. Fenkell*, the CEO was the controlling owner of a company that sponsored an employee stock ownership plan (ESOP). Under the ESOP's terms, participants could sell their employer stock shares back to the company after a prescribed period. A senior executive was approaching the date when he could do this, which would have required the company to make a substantial cash outlay.

The CEO didn't want to see that happen, so after failing to find independent buyers willing to pay his price, he engineered the sale of the company to the ESOP at a price the court deemed "inflated." The CEO also installed ESOP trustees beholden to him, according to the court.

Courts can provide an award to make the injured plan whole, while also equitably apportioning the damages among wrongdoers.

The ESOP had to borrow heavily to buy all of the shares, and the burden of servicing that debt contributed to the company's subsequent demise. The employees sued, and the trial court ordered the CEO to compensate the employees and pay their attorneys' fees.

The court decides

On appeal, the CEO didn't deny liability, but argued that it should be spread among all of the ESOP's fiduciaries. The court found that the trustees appointed by Fenkell "lacked the experience and the incentive to assess" the sale and that the CEO "orchestrated the entire complex transaction." Therefore, his culpability "vastly exceeded theirs."

The appeals court noted that, although ERISA "contemplates the allocation of fiduciary obligations among cofiduciaries, thereby limiting subsequent losses," it's not an absolute standard. Noting that the Supreme Court has interpreted ERISA as "incorporating the law of trusts," the appeals court reasoned that trial courts are permitted to order "appropriate equitable relief."

This court had ruled similarly in an earlier case. Courts can provide an award to make the injured plan whole, while also equitably apportioning the damages among wrongdoers.

Technically, this ruling applies only in the Seventh Circuit, which covers Wisconsin, Illinois and Indiana. But the Second Circuit, covering New York, Connecticut and Vermont, has ruled the same way. The ruling also could sway courts in other circuits that haven't already dealt with a case involving this question. Two other circuits, the Ninth and the Eighth, have taken the opposite view, leaving five more circuits and 30 states in limbo.

The moral of the story

The ESOP trustees in the *Chesemore* case appear to have dodged the bullet. Of course, the moral of the story is to not put yourself in a situation like this in the first place. Be sure that all plan fiduciaries act in the best interests of plan participants. □

2016 vs. 2017 retirement plan limits

Type of limitation	2016 limit	2017 limit
Elective deferrals to 401(k), 403(b) and 457(b) plans	$18,000	$18,000
Annual benefit for defined benefit plans	$210,000	$215,000
Contributions to defined contribution plans	$53,000	$54,000
Contributions to SIMPLEs	$12,500	$12,500
Contributions to IRAs	$5,500	$5,500
Catch-up contributions to 401(k), 403(b) and 457(b) plans	$6,000	$6,000
Catch-up contributions to SIMPLEs	$3,000	$3,000
Catch-up contributions to IRAs	$1,000	$1,000
Compensation for benefit purposes for qualified plans and SEPs	$265,000	$270,000
Minimum compensation for SEP coverage	$600	$600
Highly compensated employee threshold	$120,000	$120,000