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Benefits News

May 2017

Adopting a New Pre-Approved 403(b) Document? It's a Good Time for a Plan Compliance Review

Evan Giller

In our previous **February** and **March** newsletters, we discussed the new "pre-approved" 403(b) document program now being rolled out by the IRS. A pre-approved 403(b) plan document is one that has been submitted to the IRS by a plan document provider and that has received a letter of approval from the IRS. The approval letter means that the IRS has reviewed the document and found that it meets all of the requirements, in form, under section 403(b) and its regulations. By using a pre-approved document, the sponsor ensures that the IRS will not question the form of a document on audit. However, the plan still must meet the requirements of 403(b) in operation.

The IRS has just started to release the first letters for pre-approved documents, and service providers have started to contact plan sponsors with news that the new documents are available. Many plan sponsors will want to take the opportunity to adopt a pre-approved 403(b) plan, both in order to be assured that their document will be in compliance with tax law requirements and also to take advantage of the special retroactive relief that we described in the earlier newsletters noted above. However, plan sponsors will need to take care that they choose a pre-approved document that can accommodate their plan design, and, once they select an appropriate document, that all of the plan's provisions are correctly restated on the new document.

The restatement of a plan onto a pre-approved document is also an opportunity to review the operation of the plan and to make sure that it is being administered in accordance with the terms of the document and applicable legal requirements. Conducting a periodic compliance review is a good idea even if the plan is not being restated, but a plan sponsor certainly wants to make sure that any current errors in the plan's operation are not carried over to a new document.

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In our experience working with 403(b) plans, there are a number of areas where we often find operational problems. As a starting point for plan sponsors conducting a compliance review, we have compiled the following high level list of provisions that bear scrutiny. This is not a complete list, but it highlights some common areas where the operation of the plan may not be consistent with the terms of the document or with applicable law:

1. The definition of compensation for determining benefits
2. Eligibility
    a. Compliance with the universal availability requirement
    b. Determining who is eligible for employer contributions
3. Compliance with IRS contribution limits
    a. Application of the 15-year catch up rule
    b. Imposition of the limit on maximum compensation that can be used to determine plan benefits
    c. The application of the various rules that limit the maximum contributions that can be made to the plan
4. Compliance with the non-discrimination rules that apply to 403(b) plans
5. Ensuring that plan loans and hardship distributions are being administered correctly, particularly when the plan has multiple investment providers
6. Compliance with statutory restrictions on the distribution of elective deferrals and statutory and plan rules on employer contributions
7. Enforcement of required minimum distributions
8. Consistency in terms between plan document and the annuity contracts and custodial accounts
9. Timely transmittal of elective deferrals to plan investment arrangements
10. Compliance with all applicable disclosure and reporting requirements
11. Meeting fiduciary requirements with respect to the plan's selection of investment options and other service providers

As mentioned, this is not a complete list, and other questions may well surface in the course of transitioning to a new document. Please let us know if you would like us to provide you with more information about either moving to a pre-approved 403(b) document or best practices in conducting a compliance review.

Time to Bench Some 404a-5 Notice Benchmarks

Jay Adams Knight

Of late, litigation against plans and plan sponsors has focused on value. What costs are involved in running the plan, what is the return as compared to those costs and how do the investment returns compare to other investments that could be made? These are all questions plaintiff lawyers ask in court, and plan sponsors should answer well before

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litigation is a gleam in the eye of plaintiff's counsel.

Regulations under ERISA require certain disclosures to participants in self-directed plans regarding plan investment results as compared to appropriate benchmarks.[1] The notice in which these disclosures are required to be included is referred to herein as the "404a-5 notice". Recently a strange disparity has been observed between some of the benchmarks used in the 404a-5 notice sent out by third party plan administrators and the actual returns experienced by the plan's investments. This disparity can be found in several places but seems to be most often apparent in the lifecycle investments. The issue is that over several measuring periods, the reported benchmark used on the notice was much higher than the return actually achieved by the fund. According to some investment advisors, the reason for this disparity is the fact that the benchmark investments are not a good match many times with the applicable fund; the investment objective, style and goals for the two funds do not match up. Advisors have been quick to point out that the differences apply to the 404a-5 notice and not how the investments may be viewed by the financial advisor or plan sponsor who generally carefully tailor their benchmarks to specific investments. However, a 404a-5 notice to participants with faulty benchmarks is a kind of fake investment news. The issue has been raised with third party administrators who are reluctant to provide custom benchmarks.

So, why is this an issue or even important? The reason is that a plaintiff's lawyer could argue that the plan fiduciaries have not been doing their job if, year after year, the investments picked did not approach the benchmarks set for them. Put more simply, the argument is that a goal is set by the benchmark but year after year it is not met. Did the plan sponsor change the benchmark or advise participants? (Keep in mind that Warren Buffett is on target to win a half million dollar bet that an investment in a group of hedge funds over time would not beat his choice of investment in an index (think benchmark) fund. It may be reasonable that a fund does not meet or exceed a benchmark in any one year. But if the disparity is great, and it is obvious on the notice that over a number of measurement periods the return does not even approach the benchmark, one argument is that the fund should have been replaced. Of course, the other argument is that the benchmark is inappropriate, but that will not be a plaintiff's argument. If a third party administrator, who is responsible for the notice, will not change the benchmarks, what approach should the plan sponsor take short of replacing the TPA?

Here is a possible three-pronged prophylactic correction: 1) a written request to the third party administrator that the benchmark in the 404a-5 notice be replaced with one that is closer to the benchmark that the plan's financial advisor is actually using for monitoring the fund; 2) a discussion of the issue reflected in the minutes of the benefits committee meeting; and 3) a footnote in the 404a-5 notice to participants that the benchmark used in the notice is different from the benchmark which the plan sponsor's independent investment advisor deems appropriate for monitoring the fund. In addition, the plan sponsor may want to consider adding to the footnote the benchmark used by the advisor and why it was chosen.

[1] The regulations require that the following information, among other disclosures, be included in the 404a-5 notice: "Where a return for a designated investment alternative is not fixed, the name and returns of an *appropriate broad-based securities market index* over the 1-, 5-, and 10-calendar year periods (or for the life of the alternative, if shorter) comparable to the performance data periods provided under paragraph (d)(1)(ii)(A) of this section, and which is not administered by an affiliate of the investment issuer, its investment adviser, or a principal underwriter, unless the index is widely recognized and used. See 29 CFR § 2550.404a-5(d)(1)(iii) (emphasis added).

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Building Blocks of ERISA

FAQS ABOUT RETIREMENT PLAN INVESTIGATIONS BY THE U.S. DEPARTMENT OF LABOR

This month's *Building Block* answers a few frequently asked questions about U.S. Department of Labor investigations of retirement plans. Click below to read the article:

FAQs About Retirement Plan Investigations by the U.S. Department of Labor

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Fiduciary Rule to be Applicable June 9, 2017

In an **FAQ** posted on its website on May 24, 2017, the Department of Labor announced that the applicability date of the Fiduciary Rule and related exemptions will be June 9, 2017. See the **May 2016 edition of this newsletter** for a description of the rule. Separately, in **Field Assistance Bulletin 2017-02** dated May 22, 2017, the Department announced a temporary enforcement policy with respect to the Fiduciary Rule. The FAB provides that during the phased implementation period beginning June 9, 2017 and ending January 1, 2018, the Department will apply a "good faith" compliance standard in enforcing the Fiduciary Rule.

Firm News & Events:

Wil Gruszecki Has Joined Boutwell Fay LLP

May 17, 2017

Boutwell Fay LLP is proud to announce that Wil Gruszecki has joined our firm as a Senior Attorney. Wil is an employee benefits attorney who has extensive experience representing clients on all matters relating to employee benefit plans and executive compensation arrangements. Before focusing on employee benefits law, Wil engaged in a general corporate, estate planning, tax and transactional practice. He has also served as a lecturer on tax topics for the American College and has been a contributing author to several employee benefits law publications. We are very excited to have Wil on board, and he is looking forward to working with our clients to help meet their ERISA needs. Wil's direct line is **(949) 438-7942**. His email address is **wilgruszecki@boutwellfay.com**.

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Sherrie Boutwell and Evan Giller to Present a Boutwell Fay Webinar: 403(b) Update for 2017: Pre-Approved Plan Documents and More

June 21, 2017

Sherrie Boutwell and Evan Giller are presenting a webinar from Boutwell Fay regarding 403(b) plans on Wednesday, June 21, 2017.They will focus on the new pre-approved plan documents just released by the IRS, and discuss how a plan sponsor should decide whether or not to adopt a pre-approved plan. They will also discuss the claims underlying the wave of lawsuits against 403(b) plans in the last year and how plan sponsors can protect themselves. Finally, Sherrie and Evan will explore a number of common mistakes in the operation of 403(b) plans and how to avoid them. This webinar is open to all interested parties. Visit **403(b) Update for 2017: Pre-Approved Plan Documents and More** to register.

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