# Defined Contribution Legal and Regulatory Update

**for 403(b) Clients**

OCTOBER 2015

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.

## IN THIS ISSUE

**From the Hill**
New regulatory/legislative issues that plan sponsors should be aware of

**From the Courts**
Recent judicial decisions on plan administration and operational issues

**From the Regulatory Services Team**
Ideas for improving your plan

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# From the Hill

## The Future of Pension and Tax Reform

On September 8, lawmakers returned to Washington from their five-week summer recess facing a very full agenda. With a multitude of issues demanding attention, from spending bills and agency budgets to tax extenders, Congress has much to be accomplished prior to year-end. When we add in the presidential race kicking into high gear post-Labor Day, there seems to be very little attention for pension reform.

That being said, there remains the possibility that we may begin seeing the framework for pension legislation in the upcoming year. Traditionally, tax reform legislation has been a good vehicle for moving forward pension reform efforts. The chairs of the two committees with jurisdiction over taxes have made clear their interest in comprehensive tax reform. In December 2014, the Republican staff of the Senate Finance Committee released a 300-page report entitled "Comprehensive Tax Reform for 2015 and Beyond." Senator Orrin Hatch (R-UT), who chairs the Finance Committee, has long expressed his wish to be an architect of tax reform. Representative Paul Ryan (R-WI), chairman of the House Ways and Means Committee, has also stated that tax reform is one of his top priorities, and that he will be working with Senator Hatch.

It seems unlikely that we will see any tax reform bills hit the floor prior to a change in administration, but the discussions happening now could shape the direction that reform might take in 2017 and beyond. It's been 14 years since the Economic Growth and Tax Relief Reconciliation Act of 2001, the last major tax reform bill to be signed into law, and almost 30 years since the Tax Reform Act of 1986. It should be remembered that both of these acts included significant changes to the pension world.

So what might we expect? As we reported in our last issue, the Senate Finance Committee working groups on tax reform identified a number of key issues, including:

- Increasing the number of American workers covered by workplace retirement savings plans.
- Promoting higher participation levels and contribution rates.
- Encouraging more plans to offer lifetime income distribution options and encouraging workers to consider those options.

The good news is that many of these initiatives enjoy bipartisan support and would appear to be strong candidates for inclusion in a tax reform package. As reported earlier, bipartisan bills expanding the availability of Multiple Employer Plans have been introduced, and there remains a small possibility that this might move forward in the current Congress. Other issues, such as expanding the ability to use electronic delivery for participant notices, face some opposition and may be harder to include.

Another area that may be ripe for reconsideration is automatic IRA. A number of bills have been introduced in recent Congresses to require employers that do not sponsor a workplace savings plan to cover their employees through an automatic IRA arrangement. Employees would have the opportunity to opt out of participation, but the default would be automatic payroll contributions to an IRA. These proposals have never gained much traction, but recent developments on the state level may warrant a new look.

A number of state legislatures have passed or are considering bills that would require automatic IRAs at the state level for the employees of employers not providing a workplace plan. The Obama administration had directed the Department of Labor (DOL) to issue guidance on these efforts, and on September 1 a proposed rule entitled "Savings Arrangements Established by States for Non-Governmental Employees" was submitted to the Office of Management and Budget for review. This regulatory initiative was not included in the DOL's most recent unified agenda, and little information is available. There is speculation that the proposal may amend the definition of what is considered an employee retirement plan for purposes of ERISA coverage. We would expect to see the proposal released sometime later this year. Depending on the nature of the proposed rule, there may be renewed interest in considering an automatic IRA at the federal level.

# From the Hill

Finally, any tax reform initiatives represent a potential threat to the tax expenditures associated with retirement savings. As we have mentioned in the past, incentives associated with retirement savings represent the second-largest tax expenditure behind employer-provided health and ahead of the home mortgage interest deduction. It is hard to imagine any discussion of tax reform not considering these expenditures as a potential source of revenue. Late last year former Representative Dave Camp (R-MI) introduced the Tax Reform Act of 2014, which would have split the maximum amounts that could be contributed to 401(k) plans between Roth and pretax contributions. It would also have imposed an excise tax on pretax contributions at certain income levels. Mr. Camp did not seek re-election in 2014, and his bill has not moved forward in the new Congress, but it remains out there as a possible blueprint on trimming tax expenditures.

### Practical Considerations

While much of the discussion above is speculative in nature, there remains a strong interest in tax reform, and the potential impact on pension plans would in all likelihood be significant. At Empower Retirement we have long been advocates of policies that encourage the adoption and maintenance of retirement savings arrangements and promote better retirement outcomes for American workers. We have worked directly with policy makers and through our leadership role within the industry to promote sound retirement policy and preserve the tax incentives associated with retirement savings, and we will continue to do so. As new developments arise, we will continue to keep you informed on new developments and directions.

## Developments With the DOL's Fiduciary Proposal

In April of this year the Department of Labor (DOL) published a proposed rule that would make significant changes to the definition of when someone becomes a fiduciary as a result of providing investment advice for a fee ("Proposed Rule"). Some key changes include:

- Extending fiduciary standards to the IRA market.
- Causing a recommendation about a distribution to be a fiduciary act.
- Causing the referral of a fiduciary to be a fiduciary act.
- Lowering the bar for when a communication crosses the line from educational to fiduciary advice.
- Creating a new prohibited transaction exemption, the "Best Interest Contract Exemption" or BIC, intended to allow current compensation methods to remain available if numerous conditions and requirements are met.

For a more complete description of the Proposed Rule, please ask your Empower representative for a copy of the April 2015 edition of "Instant Insights."

The comment period on the Proposed Rule ended on July 21, 2015, and the DOL received over 1,000 comment letters, some of which were over 200 pages long. From August 10-13, the DOL held hearings in Washington, D.C., and received testimony from over 75 witnesses, including AARP, the U.S. Chamber of Commerce, SIFMA, numerous industry groups, and Empower President Ed Murphy. While the perspectives of the witnesses varied, some common themes were support for the DOL's intent with concern over some of the unintended consequences that could result and, in particular, the potential curtailment of helpful information and planning tools that people saving for retirement rely on today. Based on the DOL's questions and comments during the testimony, we might expect to see modifications to the following aspects of the Proposed Rule when a final rule is issued.

**Sales to Small Plans:** Under the Proposed Rule there is a carve-out from fiduciary status when selling to large plans (i.e., plans with 100 or more participants or plan fiduciaries managing $100 million or more in plan assets), but not when selling to small plans. In addition, the BIC exemption is not available for sales to participant-directed plans. It is likely the DOL will address this gap by extending the seller's carve-out and/or making the BIC exemption available for sales to participant-directed plans.

# From the Hill

**Education vs. Advice:** The DOL may provide clarification on when a communication crosses the line from education to advice, particularly in the context of talking to participants about a potential plan distribution. It is also likely to make changes to the requirement in the Proposed Rule that no specific investments be identified in asset allocation models. For example, the final rule might say that specific investments can be identified in a model as long as they've been selected by a plan fiduciary and all investments available to a participant that fall within the asset category are identified.

**BIC Exemption:** The DOL is likely to make the BIC exemption more workable in the final rule. One change we might expect to see relates to the timing of when a contract must be entered into. Under the Proposed Rule, contracting must occur with the first sales conversation and before any hiring decision or other action has been agreed to. The DOL is likely to change that so contracting will occur with the hiring decision or first transaction, although the terms of the contract may be retroactive to the first conversation. The DOL is also likely to make changes to the disclosure requirements in the BIC exemption, which currently are extremely burdensome.

**Timing for Implementation:** Under the proposal, a final rule would become effective 60 days after it's published in the Federal Register and would become applicable eight months from that date. The DOL is likely to allow more time for implementation given the scope of changes that would need to occur.

There is a brief reopening of the comment period (ending 14 days after the hearing transcripts are published on the DOL's website), after which the DOL will begin drafting its final rule. While the volume of comments received might suggest that a substantial amount of time will be needed for review, it is anticipated that the DOL will want to "lock down" a final rule before the next U.S. president takes office in January of 2017. With that perspective in mind, many commentators expect that a final rule will be published in the spring of 2016.

## Practical Considerations

Service providers who work with plans, participants or IRAs will want to become familiar with the Proposed Rule and how it might impact their products, services and businesses in general. While the DOL is likely to grant more than an eight-month implementation period, the changes required may be significant so there is risk in waiting for a final rule to be published before analyzing and planning for its potential impacts. Employers who sponsor plans will be impacted more indirectly but may want to talk with their service providers about any potential changes they foresee in how they currently serve plans and participants.

# From the Courts

## Federal Appeals Court Allows Participant to Sue for SPD Mistake

The U.S. Court of Appeals for the Sixth Circuit recently held that a participant could bring a suit against the plan for relief arising from a discrepancy between the language in the plan's summary plan description (SPD) and the terms of the plan document.

In this case, a 33-year employee of the plan sponsor and participant in the plan sponsor's ERISA pension plan was offered a voluntary severance package as part of a corporate downsizing. He declined the offer but terminated employment for other reasons shortly thereafter. Based on the terms of the pension plan's SPD, the participant believed that he was entitled to an early retirement benefit under the plan for employees with over 30 years of service as the SPD stated that a participant did not need to be actively employed at retirement to be eligible for the early retirement benefit. The plan administrator rejected the participant's request to receive the early retirement benefits, stating that the plan document required the participant to be an active employee at the time of retirement. The participant subsequently sued the plan for the early retirement benefits and the case was heard in federal district court.

After review, the federal district court dismissed the participant's ERISA benefits claim based on a U.S. Supreme Court holding that states that conflicts between an SPD and plan document must be resolved in favor of the plan document. However, in the same case, the Supreme Court also noted that a participant may have other ERISA claims against plan fiduciaries resulting from conflicts between an SPD and plan document. The participant appealed to the Sixth Circuit Court of Appeals.

The appeals court reviewed the terms of the pension plan's SPD and plan document and concluded that there was, in fact, a conflict between the SPD and plan document as the SPD did not indicate to the participant that receipt of the early retirement benefits was contingent on being an active employee at the time of retirement. The court stated that ERISA requires SPDs to be "written in a manner calculated to be understood by the average plan participant, and shall be sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of their rights and obligations under the plan."

The court noted that in prior cases it had held that any material conflict between the SPD and plan document would create potential liability for a plan. In this case, it stated that any material limitations on a participant's rights are required to be included in the SPD and that failure to note in the SPD that eligibility for the early retirement benefits was contingent on being an active employee at retirement was "anything but innocuous" and that, as a result, "the SPD affirmatively misled" the participant. Accordingly, it concluded that the material conflict between the plan document and SPD permits the participant to seek relief against the plan under ERISA and sent the case back down to the district court for further review.

### Practical Considerations

This case reflects the risks to plan sponsors resulting from conflicts and inaccuracies contained in an SPD. Although a determination has yet to be reached in this case, the court may require the plan sponsor to pay the participant the full value of the benefits described under the SPD even though not provided for under the plan document. Plan sponsors should review the terms of their plan documents and SPD to ensure they are consistent and that rights to benefits are accurately described in the SPD.

# From the Regulatory Services Team

## Correcting a failure to operate your 403(b) plan in compliance with the written plan document

Effective January 1, 2009, the final 403(b) regulations imposed new requirements on plan sponsors, including the duty to operate your 403(b) plan in compliance with the written plan document. The good news is that you can use the IRS's 403(b) Plan Fix-It Guide should you need to correct an operational failure. You may retroactively correct such a failure by adopting plan amendments that match the 403(b) plan to its prior operation or by correcting plan operation to match the 403(b) plan's written plan terms.

Each plan sponsor is responsible for keeping the plan in compliance. First, try to avoid operational mistakes by notifying everyone who provides services to your plan of any changes made to your written plan and what those changes mean to the plan's operation. Communication among the people who service your plan is essential for a compliant plan.

For example, if you amend your plan document to change the definition of compensation, you should communicate that change to everyone involved in determining deferral amounts withheld from your participants' pay, performing your plan's nondiscrimination tests or allocating employer contributions. Conversely, if you decide to use a different definition of compensation in operation, make sure you amend the plan in a timely manner to reflect this change.

**How to find a mistake:** The IRS recommends that you do an annual review comparing your plan's operation with your written 403(b) plan to ensure that the plan and procedures are consistent. For example:

- If your plan or plan vendors allow for loans or hardships, the written 403(b) plan must provide for those programs and must explain how such loans are to be administered.
- If your plan or plan vendors allow for any catch-up contributions, the written 403(b) plan must specifically permit such catch-up contributions.
- All optional provisions that your plan permits, such as Roth contributions, must be contained in the written 403(b) plan.
- Plan benefits must be computed properly and provided to plan participants as specified by the terms of the written 403(b) plan.

**How to fix a mistake:** If, for plan years on and after 2009, you haven't operated your 403(b) plan consistently with its written plan, there are several steps you can take to fix it using Revenue Procedure 2013-12.

**The IRS provides examples of corrections on its website, including:**

Example 1 – Public School Y adopted a written plan by December 31, 2009, with 300 participants. In 2013, Y's 403(b) administrator realized that it had made participant loans and hardship distributions during 2013 even though loans and hardship distributions weren't included in Y's written 403(b) plan.

Example 2 – Organization X, a 501(c)(3) organization, has a written 403(b) plan with 98 participants. The written plan, which X adopted by December 31, 2009, stated it would provide matching contributions to all participants who made employee elective deferrals. In 2013, Organization X's 403(b) plan administrator realized that six eligible plan participants hadn't received any matching contributions in the 2012 plan year and in the first half of 2013.

**Self-Correction Program**

Example 1 – If Y determines that it had proper practices and procedures in place, it may correct using the SCP by retroactively adopting plan amendments that match the written 403(b) plan to the plan's prior operation. This correction through plan amendment is one of the few plan amendment corrections permitted under the Self-Correction Program (SCP) (per Revenue Procedure 2013-12 Section 4.05 and Appendix B Section 2.07).

Example 2 – If X determines that it had proper practices and procedures in place, it may correct using the SCP. X must make a corrective contribution, adjusted for earnings through the date of correction, equal to the matching contributions that it should have provided to the six participants for 2012 and part of 2013. Correction by retroactive plan amendment to match the written plan to the plan's operation would not be allowed under the SCP, although the Voluntary Correction Program (VCP) or Audit Closing Agreement Program (Audit CAP) may provide options that are more flexible.

# From the Regulatory Services Team

**Note:** In both examples, there may be a time limit on correcting the qualification failure if it is deemed significant, as defined in sections 8 and 9 of Revenue Procedure 2013-12. Additionally, sponsors of 403(b) plans subject to ERISA may have additional requirements.

### VCP

Example 1 – Y may correct using VCP. Correction would be the same as under the SCP. Y is encouraged to make its VCP submission using the model documents in Form 14568, Appendix C Part I Model VCP Submission Compliance Statement, including Form 14568-I, Schedule 9 – Correction by Plan Amendment (in accordance with Appendix B), when preparing the submission. The fee for the VCP submission (based on 300 participants) is $5,000. Y must include forms 8950 and 8951.

Example 2 – Organization X may correct using VCP. Correction would be the same as under the SCP. Organization X can make its VCP submission using Form 14568, Appendix C Part I Model VCP Submission Compliance Statement. The fee for the VCP submission (based on 98 participants) is $2,500. X must include forms 8950 and 8951.

### Audit CAP

Under Audit CAP, correction of this mistake is the same as described under the SCP. The plan sponsor and the IRS enter into a closing agreement outlining the corrective action and negotiate a sanction based on the maximum payment amount.

## Practical Considerations

The IRS' 403(b) Plan Compliance Checklist contains guidelines to help not-for-profit organizations, including churches and religious organizations, keep a 403(b) plan in compliance with 403(b) regulations. This compliance checklist, located at **http://www.irs.gov/pub/irs-tege/pub4546.pdf**, is a quick tool that assists plans in complying with many important tax rules. You can easily correct mistakes — without penalty and without notifying the IRS.

Should you find a mistake in operating your 403(b) plan, consult with your legal counsel and review the correction procedures contained in the IRS' 403(b) Plan Fix-It Guide, which is located at **http://www.irs.gov/pub/irs-tege/403(b)_fixit_guide.pdf**.

## A Timely Reminder Regarding 5500 Filings

### Current Timing

It is that time of year when 5500 filings are wrapping up. For calendar-year plans that filed for an extension for their 2014 5500, the due date for filing is October 15, 2015 (if no extension was filed then the due date would have been July 31, 2015). As technology has advanced over the years, the 5500 process has become more efficient, offering the capability to submit electronically and to know the status of the filing (whether it has been received or not). However, despite the advancements in technology, sometimes a filing can still be missed. Should that ever happen it is important to know how to get your filing back on track.

### Getting a Late Filing Back on Track

The Department of Labor (DOL) has a Delinquent Filer Voluntary Correction Program (DFVCP). This is a very useful program to fix late 5500 filings at a very inexpensive cost. The important part is to make sure you meet the eligibility for this program — namely that the plan administrator has not been notified by the DOL that it is late. Filing the late return under the DFVCP as soon as possible is key to being able to take advantage of the program.

Like any governmental program, there is a procedure involved that can be broken down into two steps.

- Step one requires that a complete form 5500 be filed electronically via EFAST2 according to the directions under efast.dol.gov. One critical item for the late 5500 filing is to check the box stating that you are filing under the DFVCP.
- Step two requires the use of the online calculator to compute the penalty amount. The fee for the delinquent filing is capped at $750 per filing for small plans (those under 100 participants) and $2,000 per filing for large plans (for those with 100 or more participants). Please note that if multiple filings are being made at the same time for a single plan then an overall cap will apply to further limit the fee to $1,500 for a small plan or $4,000 for a large plan.
- The fee can be paid electronically, which is often recommended.

# From the Regulatory Services Team

**Future Legislative Change on Filing Timing**

The 5500 process has recently received some attention in the legislative arena. On July 31, 2015, President Obama signed the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015. One of the provisions within this act is that a 5500 extension period will increase by one month — so an extension would be for 3½ months rather than the 2½ months currently allowed. This increased extension would only be available for taxable years beginning after December 31, 2015. This means that the 2016 5500 would not be due until November 15, 2017, if the extension was filed.

### Practical Considerations

As always, it is important to ensure that your 5500 is filed on time. While the government will allow an extra month for extensions in the future, that extension will not be available until the 2016 5500 filings. Should a sponsor discover that its filing has not been made in a timely manner, then it is imperative to take advantage of the DFVCP (before the DOL notifies the sponsor) so that the cost of a late filing is manageable.

## USERRA Revisited

From time to time, questions arise about service men and women returning to employment with Empower Retirement clients. Here in the ERISA consulting group, we have received some questions on this topic just recently.

This FAQ aims to draw attention to this important area and help guide plan sponsors. As we hope is clear, Empower seeks not only to provide the best possible consulting to our clients, but also to help them honor the service of these brave men and women.

**Q: What is USERRA and what other recent laws have expanded it?**

**A:** USERRA is the Uniformed Services Employment and Reemployment Rights Act of 1994. It has subsequently been expanded by additional statutes, regulation, and Department of Labor (DOL) and IRS guidance. One of the more recent and impactful additions to rights under USERRA came with the 2007 enactment of HEART — the Heroes Earnings Assistance and Relief Tax Act. Together, these statutes, regulations and guidance seek to support retirement plan participants (and recipients of certain other employer benefits) in the event they are called into active duty in the military.

It is interesting to note that some of the rules designed to protect such individuals, strictly speaking, run counter to general retirement plan principles. As you might expect, though, there is very broad support for these rules nonetheless. These men and women (and their families and friends) sacrifice greatly for the good of the country; meeting the USERRA and related requirements of retirement plans is a small price to pay in return.

**Q: What are the major impacts of USERRA and related requirements to retirement plan administration?**

**A:** The overall complexity of retirement plan administration and the overarching goal of support for members of the armed services combine to create far-reaching impacts. To name just a few, these rules affect how compensation is determined (including, potentially, differential wage payments), when participant loans may be due, plan testing, employee reporting (e.g., W-2s), break-in-service rules, distribution rules and notice requirements.

Perhaps the most "outside the box" concept in USERRA, relative to the general concepts of defined contribution retirement plans, is Make-Up Contributions. Make-Up Contributions allow service members returning to work after active duty to "make up" for the deferrals they could have contributed had they not been away. Moreover, such employees can be given up to five years to make such Make-Up Contributions to cover the amounts they could have deferred while away. As you might imagine, this leads to some significant accounting complexities as amounts flowing from the participant get reported by the employer (on W-2, box 12) as contributed to the plan on a before-tax basis. Still, as noted above, the benefits here clearly outweigh the administrative costs and complexities.

# From the Regulatory Services Team

**Q: I sponsor a plan and utilize the Empower prototype plan document. Do I have to make any document changes to align with USERRA? What if I sponsored an individually designed plan?**

**A:** Empower's prototype and volume submitter plans are already updated to take into account USERRA, HEART, and related regulation and guidance. Those sponsors who have already restated their Empower prototype plans for PPA will see these terms integrated into their adoption agreements and basic plan documents. Prior to the PPA restatement (and for those who have not yet restated), the terms of HEART are incorporated in a "snap-on" amendment at the end of the document.

Those sponsoring documents that are individually designed should consult their plan counsel to ensure their documents reflect all necessary provisions.

**Q: Does USERRA contain specific requirements for detailed plan administrative procedures?**

**A:** The short answer is no. That said, many plan sponsors and their counsel decide such procedures are a very good idea. Thankfully, the number of men and women being called to active duty in recent years has significantly declined. That said, for employers who need to apply these rules, having a written procedure in place can be very helpful. Like any set of rules that are not in regular day-to-day use, having a written guideline can aid the employer in making sure the rules are followed and the returning employee gets all benefits he or she is entitled to.

**Q: How is compensation determined for the time the employee is away?**

**A:** This depends on the circumstances. Ideally, the employer will have a set rate of pay that would have applied had the employee not been away. In that case, the calculation is fairly easy. If the employee was to be paid $X for the period of absence, then calculations can be based directly off this number. Alternately, if the pay rate for the time of absence is less clear, employers might use the amount of pay earned in the 12 months immediately preceding the absence to establish a rate and then apply that rate to the period of absence. The goal here is to approximate the rate as accurately as the sponsor practically can based on available information.

### Practical Considerations

As with all plan sponsor decisions, Empower recommends sponsors discuss their application of USERRA and related rules with plan counsel. This is a complex area of the law and counsel review is the best way to ensure operational compliance with all of the applicable rules.

Of course, sponsors are also always welcome to reach out to their plan contact here at Empower Retirement. We stand ready to assist in any way we can.

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