Defined Contribution Legal and Regulatory Update

for Government Clients

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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.

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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.

DOL's Fiduciary Proposal: Potential Impact on Governmental Plans

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"). The new rule will not apply to investment advice provided to governmental plans as they are exempt from the Employee Retirement Income Security Act (ERISA). The new rule may apply, however, when a participant is eligible to take a distribution from a governmental plan and asks about the options available, such as the possibility of leaving the account in the plan, rolling out of the plan into another employer's plan, or rolling the savings into an Individual Retirement Account (IRA).

While, it's not known precisely how the new rule will impact governmental plans and participants until it is finalized, but potential changes include:

- Extending fiduciary standards to the IRA market.
- Causing a recommendation about a distribution to be a fiduciary act.
- Lowering the bar for when a communication crosses the line from education to fiduciary advice.

During the comment period that ended on July 21, 2015, the DOL received more than 1,000 comment letters and held hearings in Washington, D.C. from August 10-13. The DOL heard testimony from more than 75 witnesses, including numerous industry groups and Empower President Ed Murphy. The comment period was briefly reopened and closed again on September 24, 2015. The DOL is now drafting its final rule.

While the perspectives of those who provided comments to the DOL varied, some common themes included support for the DOL's intentions but concern over some unintended consequences that could result. In particular, there is concern about the potential curtailment of helpful information and planning tools that participants saving for retirement rely on today.

From the Hill

Based on the DOL's questions and comments during the testimony, there may be modifications to the Proposed Rule before it is finalized. Most importantly for governmental plans, the DOL was asked to make changes to expand the definition of education. There is general belief that a conversation with a participant about a potential plan distribution should be categorized as education, not financial advice. It is important for plan participants to be able to receive information about their right to remain in the plan at severance from employment, to elect a rollover to their new employer's plan, or to roll their savings into an IRA.

As proposed, the final rule would become effective 60 days after it's published in the Federal Register and would become applicable eight months from that date. Many believe it is likely, however, that the DOL will allow more time for implementation given the scope of the changes that need to occur. On the other hand, 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 commenters expect that a final rule will be published in the spring of 2016.

Practical Considerations

Service providers who work with ERISA plans, participants or IRA owners may want to become familiar with the Proposed Rule and how it might impact their products, services and businesses. The required changes may be significant, so there is risk in waiting for the rule to be finalized before analyzing and planning for its potential impacts.

Governmental employers who sponsor plans will only be impacted indirectly but may want to talk with their service providers about any potential changes they foresee in how they currently serve plans and participants, and whether they think such changes would impact governmental plans.

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

Potential Changes to the IRS Determination Letter Program

In recent days, I have received a number of questions regarding the need for governmental retirement plans to obtain an Internal Revenue Service (IRS) determination letter that the plan is qualified. These questions are primarily the result of IRS Announcement 2015-19 issued on July 21, 2015, which indicates IRS' intent to eliminate the determination letter program for individually designed plans at the end of 2016.

First, it is important to note that the IRS determination letter program applies to qualified plans described in Internal Revenue Code (Code) §401(a), including governmental grandfathered 401(k) plans, not eligible 457(b) plans. Individually designed qualified 401(a)/(k) plans have historically been able to obtain a determination letter once every five years, during a cycle established by the IRS. This provided ongoing assurance that the plan continued to be qualified.

Second, the determination letter program does not apply to eligible §457(b) plans. A plan sponsor wanting assurance from the IRS on the eligible status of its 457(b) plan must request a letter ruling, commonly called a private letter ruling (PLR). IRS Announcement 2015-19 does not affect the IRS private letter ruling process.

This article describes, in question and answer format, the impact of the IRS announcement on qualified plans maintained by our governmental employers.

Q: Are qualified plans required to obtain an IRS determination letter?

A: No. A 401(a) or 401(k) plan has never been required to obtain an IRS determination letter in order to be qualified.

Q: What is the value of obtaining a favorable IRS determination letter for a qualified plan?

A: A favorable IRS determination letter provides certainty in two respects:

- First, if the IRS issues a determination letter and later changes its position, the IRS will not impose penalties on the employer or the plan participants if the plan followed the IRS' original position and the factual statements used to obtain the letter were correct. Remember that a determination letter provides assurance that the written terms of the plan will not cause disqualification, but does not provide protection if the employer fails to operate the plan in compliance with the plan document.
- Second, most IRS auditing agents will accept a determination letter as evidence that a plan is qualified, unless they have reason to believe the plan has been operated in a way that would disqualify it.

Q: Are there other benefits of obtaining a favorable determination letter on a qualified plan?

A: Yes. For example, when a participant elects to do a rollover to another employer's plan or to an IRA, your determination letter is all the new plan sponsor needs to ensure the rollover is coming from a qualified plan.

Q: What does Announcement 2015-19 provide?

A4. The IRS announcement states that effective January 1, 2017, the IRS intends to eliminate the staggered five-year determination letter remedial amendment cycles for individually designed plans. In addition, the announcement would narrow the scope of the current determination letter program (beginning in 2017) for individually designed plans to initial plan qualification and qualification upon termination only.

Q: What impact would the closure of the determination letter program have on governmental qualified plans?

A: If determination letters are only available when a plan is first adopted and when terminated, the period from February 1, 2015 through January 31, 2016 may be the last chance for existing state and local retirement systems and other governmental plans to obtain formal IRS assurance that their 401(a)/(k) plans are qualified.

Q: What is the IRS' intent in eliminating determination letters for individually designed plans?

A: Due to substantial budget cuts, the IRS's intent seems to be to encourage plans to adopt prototype or volume submitter plans. This would drastically reduce the number of plans the IRS would need to review. Prototype and volume submitter documents are used by many employers, whereas an individually designed plan is used by a single employer.

Q: Does the IRS announcement cause specific concerns for governmental plans?

A: Yes. Governmental employers, particularly large ones, are likely to have special issues in dealing with the changes proposed in Announcement 2015-19 for several reasons:

- Plans of governmental employers are subject to very different regulations from plans of private employers. Thus, most prototype plans (i.e., standardized plans designed to be used by numerous employers) do not fit their special circumstances.
- Governmental plans can often be modified only by state legislative action.
- The longer a plan is in existence, the more likely plan amendments will cause the plan terms to be different from the plan for which the determination letter was originally obtained.
- It will be increasingly important to consult with an attorney before making any substantial changes to a plan since IRS assurances regarding a plan's continuing qualified status may not be available.

Q: Is the IRS' decision to eliminate the determination letter program final?

A: No. The IRS allowed taxpayers to comment on the proposal until October 1, 2015. Several organizations have asked the IRS to reconsider, claiming that most large employers and governmental employers do not use prototype or "off the shelf" retirement plan documents. The inability of such plans to receive the IRS' seal of approval on the qualified status of the plan could create uncertainty about the tax consequences for the plans and plan participants.

Q: What options may be available to governmental qualified plan sponsors if the determination letter program is eliminated?

A: Although it is not possible to know at this point, there may be greater demand for prototype plans specifically tailored to governmental and church plan employers. Hopefully, the IRS will have a program to review such governmental plan prototype documents.

Q: Are sponsors of 457(b) plans required to obtain a PLR on the eligible status of their plan, and if not, what is the value of obtaining such a letter?

A: Similar to the rules applicable to the qualified plan determination letter program, §457(b) plans have never been required to obtain a PLR in order to be eligible. A favorable IRS PLR does, however, provide certainty if the IRS later changes its position or the plan becomes subject to an IRS audit. See Q&As 2 and 3 above for a description of the advantages of obtaining a favorable PLR on your plan document.

Practical Considerations:

First, governmental employers who did not obtain a determination letter on their qualified 401(a) or 401(k) plan during the period from February 1, 2013 to January 31, 2014 may want to consult their attorney about the advisability of applying for a determination letter before the current cycle ends (January 31, 2016). This will ensure that the plan as it exists now is qualified.

In order to obtain an IRS determination letter, three steps must be taken by January 31, 2016:

- The 401(a)/(k) plan must be amended to comply with all qualification requirements;
- If the plan has been out of compliance with qualification requirements in the past, corrective action must be taken; and
- The plan must be filed with the IRS using Form 5300 accompanied by a filing fee of $2,500.

Second, if you are contemplating substantial changes to your qualified plan, consider adopting a new plan rather than amending your existing plan document. It appears that new plans will still be allowed to apply for a determination letter under the new regime.

Third, if the state legislature or other governmental body must approve amendments to your plan, the legislature may want to consider delegating the right to make any IRS-required changes to the plan fiduciaries. This would allow the timely adoption of any changes needed to keep the plan compliant with the Code and regulations, especially if the legislature does not meet every year.

Fourth, Announcement 2015-19 does not impact a 457(b) plan's ability to request a PLR with respect to the eligible status of the plan.

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.

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.

From the Regulatory Services Team

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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