Defined Contribution Legal and Regulatory Update

JULY 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.

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Legislative Developments
As the dog days of summer descend on our nation’s capital and with the August recess fast approaching, we’ll take a look at what pension-related legislative initiatives are winding their way through the halls of Congress. And the short answer is that we have a very thin legislative agenda.

On May 13, Senators Johnny Isakson (R-GA) and Christopher Murphy (D-CT) introduced the Lifetime Income Disclosure. The bill is similar to legislation introduced in prior Congresses and would require participant statements to include annuity equivalents. An annuity equivalent would be the monthly annuity payment that would be made if the employee’s total account balance were used to buy a life annuity that commenced payments at the plan’s normal retirement age (generally 65). The Department of Labor would be directed to provide the assumptions that would be used in converting the participants balance to a projected lifetime income stream. While we at Empower Retirement are proponents of retirement income projections, we would also express caution that they be implemented in a manner that fosters continued innovation.

In early June, the bipartisan Receiving Electronic statements To Improve Retiree Earnings (RETIRE) Act was introduced. This initiative has long been supported by the retirement industry and would allow electronic delivery of participant notice to be the default. Participants would have the ability to opt out and receive hard copy notices and would receive an annual notice of their ability to opt out on paper.

It is unlikely that either of these bills will move forward on a standalone basis, and it should be noted that the RETIRE Act faces significant opposition from AARP.

As we reported earlier this year, five working groups within Finance have been charged with arriving at bipartisan recommendations for tax reform. Their reports were made public on July 8. Working Group #3, Savings and Investment, considered pension-related matters, and their report identified three key principles:

• Increasing access to retirement savings.
• Increasing participation.
• Discouraging leakage while promoting lifetime income.

Specific recommendations include:
• Expanding Multiple Employer Plans to include employers without a common interest.
• Increasing start-up tax credits for small employers.
• Expanding automatic enrollment/increase safe harbor (for example beginning at 6% and allowing increase up to 10%).
• Allowing some percentage of distributions received in the form of a lifetime annuity to be non-taxable.
• Creating safe harbors for the selection of annuity providers.
• Extending the rollover period for plan loan amounts included as part of a distribution.

Senator Orin Hatch (R-UT), Chairman of the Senate Finance Committee, has also informally indicated that he may reintroduce his Secure Annuities for Employee Retirement Act (SAFE Retirement Act) if he is not satisfied with the Working Group’s efforts. The SAFE Act included a provision that would permit state and local governments to utilize private annuities for pensions and had a number of defined contribution pension reforms.

Practical Considerations
As noted earlier, the likelihood of standalone pension reform is low, but we need to continue to watch and express our thoughts and concerns with these efforts. If and when Congress considers tax reform, something that could happen in 2017, these initiatives could become part of that legislation. At Empower, we will continue to closely monitor all pension-related activity and work with our legislators for the best possible outcomes.
Department of Labor’s Proposed Fiduciary Rule

In April of 2015 the Department of Labor (DOL) published a proposed rule changing the definition of when someone becomes a fiduciary as a result of “providing investment advice for a fee” (Proposal). The Proposal and its accompanying guidance are almost 1,000 pages in length and, if enacted in its current form, would have a dramatic impact on how plans, participants and IRA owners receive help from their service providers. Some key potential impacts of concern are:

• The ability to help fiduciaries to small plans create and monitor fund lineups.
• Assistance to plan participants through call centers and other customer service contacts. This is of particular concern in the context of discussing plan distributions.
• Extension of ERISA fiduciary standards of care to advice provided to IRA owners.
• Disruption of fee and service arrangements that are working well and valued by plan fiduciaries.
• Excessive implementation costs.
• Encouragement of future litigation.

The comment period for the Proposal was extended from its original deadline of July 6, 2015, to July 21, 2015. There will be hearings from August 8 through the 13th, after which the comment period will be reopened. The DOL has already conducted meetings with various industry groups and other interested parties and is likely to receive a high volume of comments on the Proposal. There is also an effort to create a legislative alternative that would apply a “best interest of the customer” standard of care but would not contain some of the more problematic aspects of the Proposal. However, given the aggressive timeline the DOL is operating under, it appears unlikely at this point that a legislative alternative will be enacted before the Proposal becomes effective.

Empower will be providing comment on the Proposal and we encourage any of you who are concerned with its potential impacts to do the same. There are a variety of ways to submit comment, but the easiest method may be to email comments to e-ORI@dol.gov and include RIN 1210-AB32 in the subject line of the message. For comments on the Best Interest Contract Exemption or any of the other prohibited transaction exemptions included in the Proposal, the email address is e-OED@dol.gov and the subject line should reference RIN 1210-ZA25.

The original definition the DOL is changing was drafted in 1975 and before the introduction of participant-directed 401(k) plans. Empower supports the DOL’s effort to update the definition to reflect current realities of the retirement plan marketplace. We further support the concept that the plans and participants we serve should receive help that is in their best interests and understand what they are paying for the help they receive. We are very concerned, however, that the impact of the Proposal will be to cut off access to valuable information provided to plans and participants today, with particular impact on small plans and participants who are low wage earners. We are also concerned that the Proposal ignores the proven value of advice in improving retirement outcomes, which is true regardless of whether or not the advice is provided by an ERISA fiduciary.

For more information about the Proposal, please see the April issue of Instant Insights where we discussed it in detail. For a hard copy, please contact your Empower representative.

Practical Considerations

If you are concerned about the potential impact of the Proposal on your business or your retirement plan, consider submitting a comment letter to express those concerns. The DOL has stated very publicly and persistently that they are interested in hearing comment, and they do read all comments, so it’s worth the effort to let them know what you think.
U.S. Supreme Court Holds That Plan Fiduciaries Have Ongoing Duty to Monitor Plan Investments

The U.S. Supreme Court recently determined in Tibble v. Edison International that plan fiduciaries have an ongoing duty under ERISA to monitor and remove imprudent plan investments. The Supreme Court overturned lower federal court rulings that held that plan fiduciaries only had a duty to review plan investments if circumstances changed since the plan fiduciaries initially selected the investments for inclusion in the plan.

In this case, Edison International sponsored a 401(k) plan with more than $1 billion in assets. In 2007, Edison plan participants sued Edison and the plan fiduciaries to recover investment losses from alleged breaches of fiduciary duty under ERISA for offering six retail share class mutual funds as investment options in the plan when lower-priced institutional share classes were available. Under ERISA, plan fiduciaries have the duty to act in the best interest of plan participants and to ensure fees are reasonable.

In 2010, a U.S. District Court in California held that Edison had breached its fiduciary duties under ERISA with respect to inclusion of three retail mutual funds by failing to act prudently by not thoroughly investigating all share classes available to the plan. However, the District Court dismissed the participants’ claims relating to three other retail funds added to the plan’s investment lineup, holding that the funds were added more than six years prior to the filing of the claim and therefore barred by ERISA’s six-year statute of limitations. In general, ERISA provides that breach of fiduciary duty claims may not be brought by participants more than six years after the last action that constituted part of the breach.

Edison plan participants appealed to the 9th U.S. Circuit Court of Appeals, arguing that ERISA’s statute of limitations should not apply as plan fiduciaries have an ongoing duty to monitor plan investments. The 9th U.S. Circuit Court of Appeals disagreed, holding that the “act of designating the investment for inclusion” in the plan starts the six-year statute of limitations period under ERISA unless “changed circumstances” give rise to a new duty to conduct a “full diligence review” of existing funds. Further, the 9th U.S. Circuit Court of Appeals noted that there was no obligation or requirement under ERISA that requires a fiduciary to scour the market to find and offer the cheapest possible funds. Edison plan participants appealed to the Supreme Court.

On appeal, the Supreme Court noted that ERISA is based upon the principles of trust law, which charges the trust fiduciaries with a continuing obligation to monitor and, if necessary, to remove imprudent investments. Accordingly, the Supreme Court concluded that there is a continuing fiduciary duty to monitor plan investments under ERISA, which is separate and distinct from the initial duty to act prudently when selecting plan investments. The Supreme Court also concluded that any claim that Edison plan fiduciaries violated their continuing duty to monitor would not be barred by ERISA’s statute of limitations provided that the alleged breach occurred within six years of the filing of the lawsuit.

The Supreme Court sent the decision back to the 9th U.S. Circuit Court of Appeals to further review the Edison plan participants’ breach of fiduciary duty claims related to the three retail class mutual funds. Most important, the Court specifically stated in the ruling that it expressed no view of Edison’s fiduciary duty with respect to the use of retail mutual funds in this case, but rather noted the general rule that ERISA fiduciary decisions must be made “with the care, skill, prudence and diligence” that a prudent person “acting in a like capacity and familiar with such matters” would use.

Practical Considerations

This case affirms the need for plan fiduciaries to have a strong process in place for thoroughly investigating and reviewing investment options and available fee structures when making plan decisions, both at the time of initial investment selection and for purposes of monitoring the investments for continued inclusion in the plan. The lower court decisions in this case note the requirement for plan fiduciaries to hire experts to assist with the review of investments when the fiduciaries lack the requisite education, experience and skill.

Although this case dealt with decisions related to mutual funds, the issues raised in the participants’ claim would apply to any fiduciary decision regarding plan investments. Plan sponsors should evaluate their plan investment review and documentation process with their plan advisors to ensure that it is thorough and demonstrates the exercise of procedural prudence.
The Evolving Question of Using Forfeitures to Fund Certain Plan Contributions

It likely comes as a surprise to nobody that the IRS and the retirement plan community don’t always see eye to eye when it comes to the many complex rules that govern qualified retirement plans. Below, we discuss one such instance, how it has developed, where it stands today and some considerations for our Empower Retirement clients.

The Issue

For quite some time, the IRS has answered the question “Can I use plan forfeitures to fund a Qualified Non-Elective Contribution (QNEC) or Qualified Matching Contribution (QMAC)?” with a resounding no. Somewhat more recently, a related question has come up: “Can I use them to fund my safe harbor contribution?” Again, the answer has basically been no. What has changed in still more recent times is that the IRS has effectively more firmly said no as well as essentially adding “and we plan to enforce this more vigorously than we used to” and finally “and you, plan sponsor, have to expressly state in your plan document that you won’t do it.”

To help ground this conversation, here is an example of the language being interpreted:

Amounts may be treated as QNEC/QMAC/Safe Harbor “...only if the amount attributable [is] immediately nonforfeitable... and the contributions remain nonforfeitable...” (See Treas. Reg. 1.401(k)-1(c))

Much of the retirement community respectfully disagrees with the way the IRS has interpreted such language and its decision to more actively enforce that interpretation.

In short, the community believes the intention of the regulation was not related to making sure that dollars allocated to participant accounts as QNEC, QMAC or Safe Harbor (other than Qualified Automatic Contribution Arrangements) contributions were 100% vested before they hit those accounts but rather that they be 100% vested upon allocation to those accounts.

Where Things Stand Today

The fact is reasonable minds may differ on this. The more salient fact is that, unless and until the IRS is persuaded by the retirement community to change its stance, the rule is what the IRS says it is.

What We Know

The IRS has shown no signs of backing away from its position. In fact, as noted above, it appears to be building out additional rules and enforcement to support its position. Starting with the restatement process for plan documents that is currently underway (the Pension Protection Act or PPA Restatement), the IRS is requiring that plan documents acknowledge that forfeitures cannot be used to reduce the above contributions.

What Empower is Doing

Empower has taken the above document requirements into consideration in our new prototype plan documents. We would also suggest sponsors utilizing individually designed plans check with their document provider on this topic. Empower would be happy to join in those discussions as well.

Sponsors using our prototype can be assured that our language with regard to this topic has been submitted to the IRS and that our prototype documents have received favorable Opinion Letters.

Empower best practice is to recommend against the use of any forfeitures within plans to fund the above contribution types. Of course, as guidance evolves in this area, Empower will likewise adjust.

From the Regulatory Services Team
Practical Considerations

Empower encourages our clients to familiarize themselves with this IRS restriction and to keep an eye out for updates as they become available. In the meantime, clients using our prototype documents should be confident their document language meets IRS requirements. If you utilize an individually designed plan, we again encourage you to contact us so that we can work together to make sure your document language is sufficient and answer any questions you may have.

Empower would also welcome the opportunity to discuss possible plan design changes for sponsors who may have previously utilized forfeitures for the above contributions and are looking for alternate uses. For instance, an additional discretionary contribution could be made yearly that would still satisfy Safe Harbor requirements and be equal to the amount of forfeiture. Some sponsors have found this to be an effective approach.

New Deferral Failure Corrections Available from the IRS

The chart below shows the new corrections available from the IRS under Revenue Procedure 2015-28. The chart shows the three different corrections that will be available to a client depending on the failure that is being fixed:

1) auto-enrollment failures
2) deferral failures not greater than three months
3) deferral failures exceeding three months

The chart details the type of correction needed, the timing on the correction, notice requirements and earnings calculations. Please note that these new correction options are in addition to the previous options provided in the past by Revenue Procedure 2013-12. The new corrections are only in regards to elective deferral failures — in other words, they apply to a missed pretax or Roth deferral situation. The new corrections do not apply to traditional after-tax contributions (non-Roth).

<table>
<thead>
<tr>
<th>Failure corrected by Revenue Procedure 2015-28 for 401(k) and 403(b) plans</th>
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<tbody>
<tr>
<td><strong>Auto-enrollment failures</strong></td>
</tr>
<tr>
<td>Fixing missed deferral in auto-enroll plan (applies to both missed automatic contribution feature — enrollment and increase — and failure to implement affirmative election in lieu of auto-enroll).</td>
</tr>
<tr>
<td>This correction is only available if the missed deferral failure does not extend beyond the end of the 9 1/2-month period after the end of the plan year of the failure.</td>
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**Missed deferral correction**

The correct deferrals must begin no later than the earlier of 1) the first payment of compensation made on or after the last day of the 9 1/2-month period after the end of the plan year in which the failure first occurred for the affected eligible employee; or 2) if the plan sponsor was notified of the failure by the affected eligible employee, the first payment of compensation made on or after the last day of the month after the month of notification.

Please note that a QNEC is not made for the missed deferrals. The correction is that the deferrals have started again within the specified time period. The new correction applies only to pretax or Roth deferrals. It does not apply to traditional after-tax contributions.

The correct deferrals must begin no later than the earlier of 1) the first payment of compensation made on or after the three-month period that begins when the failure first occurred for the affected eligible employee; or 2) if the plan sponsor was notified of the failure by the affected eligible employee, the first payment of compensation made on or after the last day of the month after the month of notification.

Please note that a QNEC is not made for the missed deferrals. The correction is that the deferrals have started again within the specified time period. The new correction applies only to pretax or Roth deferrals. It does not apply to traditional after-tax contributions.

The correct deferrals must begin no later than the earlier of 1) the first payment of compensation made on or after the last day of the second plan year following the plan year in which the failure occurred; or 2) if the plan sponsor was notified of the failure by the affected eligible employee, the first payment of compensation made on or after the last day of the month after the month of notification.

The corrective QNEC is based on 25% of the missed deferral rather than 50%. The new correction applies only to pretax or Roth deferrals. It does not apply to traditional after-tax contributions.

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### Auto-enrollment failures

**Missed match correction**

If the plan has a match, provide a corrective matching deferral opportunity based on the total missed match contribution. This must be made within the timing requirements for significant operational failures (the last day of the second plan year following the plan year in which the failure occurred).

### Deferral failures 3-months or less

If the plan has a match, provide a corrective matching deferral opportunity based on the total missed deferral opportunity according to the matching formula in the plan. This must be made within the timing requirements for significant operational failures (the last day of the second plan year following the plan year in which the failure occurred).

### Deferral failures greater than 3-months

If the plan has a match, provide a corrective matching deferral opportunity based on the total missed deferral opportunity according to the matching formula in the plan. This must be made within the timing requirements for significant operational failures (the last day of the second plan year following the plan year in which the failure occurred).

### Notice requirement

A notice is required within 45 days after the date on which correct deferrals begin. It must state the following: 1) general information regarding the failure; 2) statement regarding that deferrals have started or when they will start; 3) a statement showing all corrective contributions have been made or when they will be made; 4) an explanation that the participant may choose to increase his or her deferrals to make up for the missed deferrals; 5) name of the plan and contact information.

### Earnings calculation

If participant did not have an affirmative investment election, the correction may use the plan’s default investment fund. Please note that earnings are not allowed to reflect a loss. The correction may also use the earnings methods listed in Revenue Procedure 2013-12.
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PT#236235 (07/15)