Defined Contribution Legal and Regulatory Update

for Government Clients
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.

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

FOR INSTITUTIONAL OR PLAN SPONSOR USE ONLY
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 ERISA plans and participants and IRA owners receive help from their service providers. Although in its current form the new proposal would not apply to investment advice provided to a non-ERISA governmental or church plan or its participants with respect to plan investments, it will apply to advice a non-ERISA plan participant receives with respect to rolling plan assets to an IRA.

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.
10% Penalty Tax Exemption for “Public Safety Employees” Extended in 2016

Background
Code §72(t) generally imposes a 10% penalty tax on taxable distributions from a qualified retirement plan, including 401(a)/(k) and 403(b) plans, unless the participant has reached age 59 ½ or an exception applies. One exception is for a payment made to a participant who severed from service in or after the calendar year he or she attained age 55.

The Pension Protection Act of 2006 introduced a special exception for a distribution from a governmental defined benefit (DB) plan to a “qualified public safety employee” who severed service in or after the calendar year he or she attained age 50. This exception DID NOT apply to defined contribution (DC) plans. Qualified public safety employee was defined to include only state and local police, firefighting, and emergency medical services.

New Exemption for Governmental DC Plans
The Defending Public Safety Employees’ Retirement Act, signed into law on June 30, 2015, expands the public safety exception to apply to distributions from governmental DC plans such as 401((a)/(k) and 403(b) plans, not just DB plans. The change is effective for distributions made after December 31, 2015.

10% early withdrawal penalty for governmental 401(a)/(k) and 403(b) plans
As of January 1, 2016, there will be three different ages that are important with respect to the exemption from the 10% penalty on distributions from a qualified governmental plan - ages 59 ½, 55, and for qualified public safety employees only, age 50.

1. The exemption for distributions at age 59 ½ applies to all participants and is the easiest to understand. Quite simply, once a taxpayer turns 59 ½ years old, any type of distribution taken from a qualified plan will not be subject to the 10% early withdrawal penalty.

2. Distributions at age 55 are a little trickier. This exception to the 10% penalty applies to any participant who separates from service in or after the year in which he or she attains age 55. For example, a participant who retires at age 56 and elects to receive a distribution from a qualified plan would not be subject to the 10% early withdrawal penalty. Note: A participant who retires prior to the calendar year he or she attains age 55 cannot use this exception by waiting until after age 55 to take a distribution.

3. A special rule applies only to distributions from a governmental plan by a qualified public safety employee (police, fire, etc.) who separates from service in or after the calendar year he or she attains age 50. This rule currently applies to distributions from a governmental DB plan and will be expanded to cover governmental DC plans for distributions taken after December 31, 2015.

The age 55 and age 50 exemptions are lost if the participant elects to roll over the distribution to an IRA or another retirement plan (such as the employer’s 457(b) plan). In order to take a penalty free distribution from that IRA or other retirement plan, they would have to wait until 59 ½ years old or satisfy some other exemption from the penalty.

Practical Considerations
Affected governmental plan sponsors and their service providers should review distribution processes, and update participant communications right away so that participants who become eligible for relief from the 10% penalty tax are aware of the opportunity to delay their distributions until 2016 to take advantage of this change.
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