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Reducing Exposure for Your Company's Largest "Off Balance Sheet" Risk: Your Pension Plan

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Plan Document and SPD

Who in this room has read through the SPD and Plan Document and feels they understand all operational requirements in their Plan?

Summary of Session

Discussion on common plan errors found and best practices:

- General Risks
- Internal Control Processes
- Contributions
- Timeliness of Contributions
- Investments
- Hardship Withdrawals
- Loans
- Distributions
- Transfers

Meeting Fiduciary Duties

Who is a Fiduciary?

- The trustee
- Investment advisers
- All members of a plan's administrative committee (if it has such a committee) and those who select committee officials

Meeting Fiduciary Duties

Five ways to minimize liability

#1 Document, document, document

- Fiduciaries are rarely surcharged by the courts for poor performance results when investment decisions are prudently undertaken and properly documented
- Demonstrate that you have carried out your fiduciary responsibilities by properly documenting the processes used to carry out those responsibilities.

Meeting Fiduciary Duties

#2 Diversify. Make sure Plan charges reasonable fees

- Courts have been quick to find fiduciary liability when it was apparent that diversification did not exist and a loss occurred
- Follow asset allocation guidelines
- Diversification objectives should be outlined in a well-thought-out Investment Policy Statement.
- Discussion on fee disclosure and what your provider should show you
- Discussion on what is reasonable fee and how important fees are

Meeting Fiduciary Duties

#3 **Watch for conflicts**

- Courts have been quick to find conflicts of interest (technically, "prohibited transactions") when the fiduciary received "current economic benefit" from a transaction
- Common prohibited transactions include the sale, exchange or leasing of land between the plan and the fiduciary
- A fiduciary should always be able to provide a satisfactory answer to the question, "As the plan fiduciary, do I stand to benefit or gain personally, either directly or indirectly, by the handling of the plan assets?"

Meeting Fiduciary Duties

#4 Bring in the experts

- Congress, the IRS and the courts have strongly encouraged the appointment of professional investment advisors to manage plan assets.
- Fiduciaries may obtain a degree of protection from liability if the investment advisor has been prudently selected and monitored
- Although you can reduce your liability by hiring an investment manager, you are still responsible for selecting a prudent investment manager and monitoring the manager's performance.

Meeting Fiduciary Duties

#5 Monitor expenses

- ERISA requires the fiduciary for ensuring that investment transactions are executed at the best cost (reasonable cost)

- The U.S Department of Labor offers a downloadable 401(k) Plan Fee Disclosure Form on its website (www.dol.gov/ebsa/pdf/401kfefm.pdf) that helps compare investment product fees and plan administration expenses charged by competing service providers, regardless of how a particular service provider structures its fees

Internal Control Processes

What documentation must be kept on file?

(This depends on if processes are In-house or Outsourced)

- Enrollment Forms – Online vs. In-house
- Change in Deferral %'s/amount
- Investment Allocation Changes
- Loan Requests
- Distribution Request
- Hardship Withdrawals

Discrimination tests

Are all discrimination tests being performed?

(Some service providers do not perform all of the tests and your plan may be at risk.)

- ADP/ACP
- 410(b) Minimum Coverage Testing
- 415 Test(c) Annual Additions test
- 402(g) Annual Deferral Limit test
- 416 Top Heavy Testing

Timely Plan Amendments

- Is your Plan Administrator aware of the amendments required?
- Don’t rely solely on TPA (Discuss client issues and resolutions have been costly)

Tax Status

Can rely on prototype determination letter?

- Prototype plans required to receive new determination letter every six years
- Make sure to have letter on file

Contributions

Enrollment

- Enrollment testing/Auto Enrollment Testing
  - Are participants enrolled in accordance with the Plan Document?
  - Issues commonly found with Auto Enrollment

- Correction Method – (Generally Self Correction Method) Employee receives 50% of deferral they should have been able to make plus employer matching contributions, if required.

Contributions

- Understand key elements of Plan Document/IRS & DOL Regulations
- Contributions may be limited to a % of pay
- How often can participants change their contribution %? Are you complying with this?
- Understand matching formula – Who is entitled to receiving match; when/how to be contributed?
- Understand IRS Plan Limits
- Identify catch-up based on age of participant tested
- Definition of Compensation

Contributions

Best Practices - Internal Testing

- Recalculation of employee and employer match, if applicable
- Compare payroll journal to participant statements

Contributions

Common Errors

Not applying correct definition of plan compensation:

- How to fix: Amendment to the Plan Document to show true operating intent of the plan
- Contributions from Plan Sponsor to make participants whole or to reduce amounts contributed into participants account
- Recalculation of Discrimination testing
- Correct using self-correction method

Contributions

Common Errors

- Incorrect employee contribution or matching contribution
  - Self Correction method to make participant whole for missed contribution or incorrect amount including match
- Manual checks and or bonuses issued without following the Plan Document
  - Same correction as eligible wages

Contributions

Concluding

- Contributions exceed legal limits and or plan limits
- Contributions must be returned to participants and earnings must be forfeited

Contributions

Additional Suggested Areas to Review

- Key Employees
  - Select Key employees and review matching contribution to employee

- Common Error
  - Key Employee not receiving maximum match
  - Matching amount is above plan limit allowed
  - Contributions must be returned to plan and earnings must be forfeited

Contributions

Other Discussion Points

- How to avoid excess deferrals for highly compensated employees

- Is the cost worth it?
  - Safe-harbor plan

Timely Contribution Testing

Testing for Timely Contributions

- Department of Labor views employee elective deferrals to be similar to payroll tax deposits. Elective deferrals should be made on consistent basis and timely basis.
- We recommend reviewing policies and set a consistent and timely date to deposit contributions.
- Safe Harbor exception passed two years ago – If you deposit your contributions within 7 business days (Plan under 100 participants) the DOL will not consider this an error under audit.
- Correction method - Best Method VFCP
  http://www.dol.gov/ebsa/calculator/2006vfcpapplication.html

Client Best Practices

- Understand if you sign the Form 5500 and there are late contributions (Including inconsistent remittance) you are signing under penalties and perjury you are not aware of any late contributions

- Schedule H Part IV- Question 4a

Understanding Investments in Plan

Different types of Investments common in Plans

- Interest bearing cash
- US Government Securities
- Corporate debt instruments
- Mutual Funds
- Common Collective Trusts
- Guaranteed Investment Contracts
- Pooled Separate Accounts

Investments

Who considers themselves an investment expert?

- Diversification necessary
- Appropriate funds
- Appropriate fees
- Is the fund strategy matching the investment mix? Drifting can be an issue

Distribution Process

Distributions from a benefit plan may include the following:

- Hardship Withdrawals
- Loans
- Plan Rollovers
- Lump sum distributions
- Installment distributions
- Annuities
- Required Minimum distributions
- QDRO Payments
- In-Service Distributions

Hardship Withdrawals

General Requirements of a hardship withdrawal/See Company's Plan Document:

- Purchase participant's primary residence
- Pay college tuition, room and board, and related educational fees
- Pay for funeral expenses
- Repairs for damage to participant's PRIMARY residence which qualifies for a casualty loss deduction
- Avoid foreclosure/eviction
- Pay medical expenses

Reviewing Hardship Withdrawals

What are your processes – outsourced or in-house?

- Ensure distribution is allowed per plan document and amounts are removed from proper type of account. Common error. TPA's have made this error
- Example: Many plans allow only employee deferrals excluding earnings to be withdrawn
- Ensure all other distribution options were exhausted if required. (Most plans require this under safe harbor provisions)
- Make sure contributions are frozen for six months after withdrawal unless hardship are done under safe harbor provisions (Common Administrative Error)
- Review back up documentation kept by plan sponsor/TPA (third party administrator)

Reviewing Hardship Withdrawals

Common Issues

- Plan Administrator does not stop contributions
- Correction Method: Deferral are given back to employees via check from employer to employee
- Contributions plus earnings are forfeited to the forfeiture account

Review Hardship Withdrawals (continued)

Common Issues

- Hardship Withdrawals made although not allowed in Plan
  - If withdrawals met rules and requirements correction can be made through retroactive plan amendment. Allowed through Self Correction. One of the few exceptions to VCP program

- Hardship do not meet requirements of Plan Document
  - Repayment to plan of amounts that did not meet requirements

Loan Review

- Why review if it is outsourced?

- SPD (Summary Plan Description)
  - What's allowed under the plan?
    - Number of loans outstanding.
    - Minimum/maximum amount allowed.
    - Terms of the loan
      - Maximum/Minimum months outstanding
      - Maximum interest rate charge (i.e. prime + X%)

Loan Testing

Common Issues

- Loan Interest rate policy is not being followed or is not reasonable based on current interest rate conditions
  - Set interest rate policies to a reasonable interest rates
  - Prior loans do not have to be changed if rate was reasonable in the past when the loan was initiated

- 403(b) Plans
  - Loan repayments can be made outside of the Company (Not through payroll)
    - Many loans are in default which causes 1099’s to be sent out to plan participants
    - Amend plan to have all loans prospectively paid out of payroll

Distributions

Distributions at the participant level (continued)

- Death distributions
- Disability distributions-obtain evidence of disability.
- In Service Distributions – Age requirements are met?
- Termination Distributions – Participant is no longer on the payroll?
- QDRO – Documentation for the QDRO distribution.

Distribution

Common Errors

- Failure to obtain spousal consent if required
  - Generally required on Plan Loans and on Qualified Joint and Survivor Annuities
  - Failure to comply may result in other spouse contesting distribution and asking to be made whole

- The incorrect distribution amount is made to a participant
  - For example one plan we worked on last year vested participants 100% over age 55, otherwise they were required to work 5 years
  - Distributions were forfeited for employees over 55 with less than 5 years of service. Participants were found and made whole

Distributions – Best Practices

- Hardship Withdrawals – Ensure there are policies and procedures to discuss the impact on a participant when a hardship withdrawal is made

- Hardship Withdrawal – Review plan provisions for hardship withdrawals to ensure they are following the plan document

Distributions – Best Practices

Ensure you review with TPA policies and procedures for distributions at least annually

- TPAs are not immune to mistakes – We have found several issues where the TPA is not following the clients plan document

- Clear out the forfeiture right before the end of the year to avoid any issues

- Ensure you understand the Plan Document especially for Hardship Withdrawals and Early Plan Distributions. These distributions are usually limited to the types of accounts that can be withdrawn

Transfer Testing

Testing

- Compare the final transfer out to the total transfer in

- Review the transfer by employee selected by account type i.e. employee deferral, loan, employer matching, etc.

- If there are differences discuss and call current and prior TPA to reconcile difference

Other Issues

Common Errors

- What are forfeitures?
- Forfeiture Allocations
  - An annual allocation is required. For forfeitures not allocated within the Plan terms the Sponsor may be required to make the Plan participants whole from the Sponsor's assets

ERISA Budget Account

- What is this?
- How does it work?
- Are you taking advantage of it?

Questions?

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