employee benefits update

august/september 2014

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401(k) plan management vs. fiduciary duties

Fees charged by recordkeepers and asset managers for 401(k) plan services paid from plan assets have come under greater scrutiny in recent years. The Department of Labor (DOL) has released fee disclosure regulations, and courts — from district courts all the way to the U.S. Supreme Court — have reviewed high-profile litigation over the issue. The topic isn't likely to settle down anytime soon.

Plan trustee negligence

The U.S. Court of Appeals for the Eighth Circuit made headlines with a ruling earlier this year. In *Tussey v. ABB Inc.*, ABB paid its recordkeeper, Fidelity Investments, for its services primarily through a fee-sharing arrangement, with asset management fees charged by the mutual funds used by the plan. Over the years, Fidelity provided additional administrative services to ABB unrelated to the plan. These services included processing ABB's payroll and acting as recordkeeper for ABB's defined benefit plans and health and welfare plans. Even though Fidelity incurred losses from these administrative services, it made substantial profits from the 401(k) plan. An outside consulting firm advised ABB it was overpaying for Fidelity's recordkeeping services and warned ABB that the plan might be subsidizing the other administrative services Fidelity provided to ABB under the revenue-sharing agreement.

ABB employees sued their employer, claiming that Fidelity was charging excessive fees and ABB allowed it to happen. Among the plaintiffs' other claims was that, when ABB's plan trustees decided to eliminate one of the plan's investment options and automatically funneled employee 401(k) assets from that fund into a new fund, the new fund chosen was a poor performer, causing those employees to lose money.

The district court found that ABB fiduciaries had violated their fiduciary duties to the plan. Both the ABB fiduciaries and Fidelity appealed the court's decision. The appeals court agreed with the trial

court's award of $13.4 million in damages to participants because of a fiduciary breach by plan trustees.

Elements of neglect

The plan document gave ABB's plan administrator "sole and absolute discretion to determine eligibility for, and the amount of, benefits under the Plan and to take any other actions with respect to questions arising in connection with the Plan, including … the construction and interpretation of the terms of the Plan." Under this language, the courts then review the plan fiduciary's decisions for an abuse of discretion, and defer to the fiduciary's interpretation if a reasonable person could have reached a similar decision, given the evidence.

Using this standard of review, the appeals court upheld part of the trial court's ruling, but reversed other parts. The court upheld the excessive fee allegations because ABB:

- Hadn't calculated the recordkeeping fees Fidelity charged the plan through the revenue-sharing arrangement,
- Hadn't attempted to determine whether those fees were reasonable because it hadn't determined the amount of the fees,
- Had failed to use its large size as leverage to negotiate a more competitive fee structure, and
- Had failed to "make a good faith effort to prevent the subsidization of administrative costs of ABB's corporate services" (which included services unrelated to the plan, such as payroll processing and recordkeeping for a separate retirement plan and its welfare plans).

However, the appeals court reversed the claim concerning the shifting of participant dollars after eliminating one of the fund choices. The court found that, by moving money out of a fund whose performance was deteriorating to age-appropriate target date funds, ABB had made a reasonable decision "given what it knew at the time." Under the "prudent person standard," courts review how the fiduciary acted at the time of the challenged decision, and not the decision's results.

Lessons learned

The lesson for plan sponsors? Pay attention to proper fiduciary procedure — in this example, monitoring and evaluating fees. ERISA is as much about procedure as outcome. Had ABB analyzed the fees, and found a reasonable basis on which to conclude they weren't out of line, the court's conclusion may have been different.

DOL proposes requirement for guide to plan provider fees

ERISA fee disclosure regulations that took effect in July 2012 are supposed to help plan sponsors clearly understand charges for various retirement plan services. However, the required disclosures can be lengthy and cumbersome to interpret.

Thus, the Department of Labor (DOL) has proposed additional regulations that would require "covered service providers" to provide a guide to where fees can be located in their disclosure document. Not all covered service providers would be required to provide the guide — only those whose disclosure documents are excessively lengthy or are in multiple documents.

Under the proposal, the disclosure must contain a specific locator that identifies the document and where the information is located within the document. It must describe services to be provided, and include a statement concerning services to be provided as a fiduciary.

The fee disclosure document must also describe all direct and indirect compensation, any compensation that will be paid among related parties, compensation for termination of the contract or arrangement, and compensation for recordkeeping services. Finally, it must include the required investment disclosures for fiduciary services and recordkeeping and brokerage services, including annual operating expenses and ongoing expenses or, if applicable, total annual operating expenses.

The requirements will take effect one year after final revisions are made to the proposed regulations.

Upcoming compliance deadlines:

9/15 Extended deadline for corporate tax returns
9/15 Extended deadline for partnership tax returns
9/30 Summary annual report due for Form 5500 that was due July 31, unless extension was granted

How *Windsor* may affect your plan

IRS DETAILS RETIREMENT PLAN RULES FOR SAME-SEX COUPLES

The IRS has previously addressed unresolved questions about how the U.S. Supreme Court's decision in *United States v. Windsor* applies to qualified retirement plans. That 2013 ruling concluded that the 1996 Defense of Marriage Act (DOMA) unconstitutionally denied same-sex couples the right to marry. While the decision directly affected federal treatment of same-sex married couples, it didn't mandate that states recognize their marriages.

The ruling and qualified plans

In its original guidance issued following the *Windsor* decision, the IRS stated that qualified retirement plans must treat a same-sex spouse the same as opposite-sex spouses under federal tax laws relating to qualified retirement plans. And qualified plans must recognize a same-sex marriage that occurred in a jurisdiction that recognizes same-sex marriages, even if the state where the plan sponsor is based doesn't recognize same-sex marriages.

Registered domestic partnerships and civil unions don't qualify as "marriage" or create bona fide spouses for retirement plan rules. For example, a retirement plan isn't required to provide a death benefit to a surviving registered partner, unless the deceased participant had instructed the plan to do so. Plans can make a surviving domestic partner the default beneficiary, absent any prior direction to the contrary from the deceased participant.

If your plan document defines "spouse" by referring to DOMA, or as a person of the opposite sex, you'll need to amend your plan document.

Effective date clarification

The original rules took effect Sept. 16, 2013, and are applied prospectively. However, some ambiguity remained regarding possible retroactivity of the date for recognition of the marital status of same-sex couples. In a subsequent set of IRS rules, plans aren't required to recognize such marriages any earlier than June 26, 2013, the date of the Supreme Court's ruling. The Sept. 16, 2013, effective date means that the IRS won't penalize a plan that didn't comply with the *Windsor* decision before that date, but the plan must still use the June 26 date as the starting point.

So when do plans need to amend their plan documents to reflect *Windsor*? IRS Notice 2014-19 set a Dec. 31, 2014, deadline for qualified plans that had formally excluded spouses of employees in same-sex marriages from the benefits given to spouses of heterosexual couples. For example, if your plan document defines "spouse" by referring to DOMA, or as a person of the opposite sex, you'll need to amend your plan document. In a later Notice, 2014-37, the IRS stated that 401(k) or 401(m) safe harbor plans can adopt mid–plan year amendments to satisfy the requirements of Notice 2014-19. It's best to consult with a benefits expert to make sure your plan complies in a timely manner.

Pre-*Windsor* marriages can be recognized

Plans that didn't have provisions treating same-sex couples differently aren't required to file a plan amendment. However, plans can opt to recognize as married same-sex couples who were married prior to that date, and amend their documents accordingly. But be cautious, because this involves some complexities and possible limitations.

The IRS warns that recognizing same-sex spouses for all plan purposes before June 26, 2013, may trigger requirements that are difficult to implement retroactively and may create unintended consequences. For example, the IRS points out that amending a plan permissively this way may affect ownership attribution rules that identify key employees and determine if corporations are members of a controlled group under the Internal Revenue Code.

If a plan satisfies applicable qualification requirements, choosing a pre–June 26, 2013, effective date won't affect a plan's qualification status. For example, according to the IRS, a plan sponsor may amend its plan to reflect *Windsor* earlier than June 26, 2013, solely with respect to qualified joint and survivor annuity and qualified preretirement survivor annuity requirements and, for those purposes, solely with respect to participants with annuity starting dates or dates of death on or after a specified date.

Sigh of relief

For the IRS to not require retroactive application of *Windsor* probably comes as a relief for many plan sponsors. It means that plans aren't liable for death benefits to same-sex married couples when the death predated June 26, 2013. For example, it's possible that beneficiary designations (for beneficiaries other than the same-sex spouse) made before that date may be invalid unless the same-sex spouse consented to the arrangement prior to that June date.

Also, if a plan participant retired before June 26, 2013, and began receiving a payout based not on a joint and survivor annuity schedule but instead on a 10-year certain and life annuity with a nonspouse beneficiary, the participant may need to change the beneficiary to the same-sex spouse, or that spouse would need to consent to the arrangement.

Get advice

Plan sponsors should consult with their professional administrators, consultant or legal counsel about possible implications of the rules with respect to pre–June 26, 2013, actions. An assessment by a professional is advisable to make sure your plan complies with the law.

Understanding bonds

WHAT DO YOUR PLAN PARTICIPANTS KNOW ABOUT BONDS?

Bonds have a place in retirement portfolios. However, recent research suggests that many 401(k) plan participants may have some misperceptions about what that place is — and how bonds perform under various market conditions. In view of this research, taking the pulse of your 401(k) participants might be a prudent thing to do.

What the research says

The research, from State Street Global Advisors' (SSgA's) latest defined contribution plan participant survey, shows that, overall, most investors have recovered from the 2008–2009 financial crisis, in which many saw their 401(k) accounts drop by as much as 40% or more. Five years later, nearly half (49%) of surveyed participants consider themselves in "somewhat" or "much" *better* shape than they were. Only 24% consider themselves "somewhat" or "much" *worse* than they were.

Participants appear more reconciled to the inevitable ups and downs of financial markets.

Participants appear more reconciled to the inevitable ups and downs of financial markets. Given a choice of carnival ride metaphors to describe saving for retirement, about half identified with a Ferris wheel. (Alternative choices included roller coasters and bumper cars.) The Ferris wheel choice was most prevalent among older investors who've witnessed more than one market meltdown.

Still, the SSgA survey revealed a shift in participants' mindsets toward a more conservative posture. The proportion of 401(k) plan participants who reported investing more conservatively today than they did five years ago (about half) dwarfed — by 7-to-1 — those who reported investing more aggressively.

Shift in mindset

One troubling survey result is the general lack of knowledge about bonds. Generally, bonds can help younger participants diversify their 401(k) plan portfolio, while older plan participants may use bonds as a small, but stable, income. However, inflation threatens bonds' returns by reducing interest and principal payments.

Of participants asked to identify the perceived benefits of bonds, only about half picked "lower risk than stocks." About 40% of respondents believed bonds provided a better portfolio diversification and only 30% said they reduced volatility. "The relative dearth of participants identifying these characteristics suggests that many people

don't fully grasp the function of fixed income in a retirement portfolio," survey analysts concluded.

What many participants appear not to understand, SSgA believes, is that a high allocation to bonds constrains a portfolio's capacity to offset the effects of inflation and "generate the growth needed to provide for sufficient retirement income."

What to do

Plan sponsors should review their participants' bond allocations and consider them in light of participants' ages. The results of such an inquiry may be an educational initiative on age-appropriate asset allocation. Encourage participants to optimize asset allocations and adjust them as participants approach and enter retirement.

IRS issuing updated preapproved master and prototype plans for adoption

The IRS compiles determination letters that approve particular plan designs and documents every few years, and offers them to plan sponsors and administrators for adoption as master and prototype (M&P) plans. The IRS issued the last compilation of preapproved plans in 2010. Recently, the IRS announced it has begun updating that set to reflect laws and regulations that have been enacted since then.

M&P elements

An M&P plan consists of:

- A basic plan document containing nonelective provisions,
- An adoption agreement containing elective provisions that an adopting employer selects, and
- A trust or custodial account, which may or may not be included in the basic plan document.

M&P plans come in two categories:

- A standardized plan is designed to satisfy the qualification requirements solely based on its terms. An employer who adopts a standardized preapproved plan can rely on the opinion letter issued to the preapproved plan sponsor as if it were its own determination letter.
- A nonstandardized plan provides plan design choices and elective provisions that don't ensure compliance with the nondiscrimination testing requirements.

Making the filing

Plan sponsors choosing to adopt any of the new M&P plans must do so by April 30, 2016. The IRS will also accept individual determination letter applications through April 30, 2016 — the end of the six-year restatement cycle for preapproved defined contribution plans. However, an adopting employer of an M&P plan — whether standardized or nonstandardized — can no longer use Form 5307 to apply for a determination letter. Adopting an M&P plan can save plan sponsors significant time and expense vs. seeking approval of a unique plan document.