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# Employee Benefits Update

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*Plan fee benchmarking*

# Key fiduciary considerations when reviewing plan fees

Are the services your plan receives reasonably priced? Knowing the answer is a vital fiduciary duty. ERISA expects more from plan fiduciaries than simply shopping around for plan providers offering rock bottom rates. Rather, the question turns on whether fees are reasonable in light of services provided. So, in addition to knowing how much the plan is paying, you must determine whether the level of service rendered is appropriate.

## Benchmarking in three steps

The benchmarking process itself — like all other substantive actions involving the plan — is subject to fiduciary standards. You'll need to use an objective and systematic process. The following three steps will help you benchmark your providers:

**1. Request information from your plan providers.** Information obtained when you originally chose the provider could be outdated. Request the latest general information available from your plan providers that describes their qualifications and all fees. Remember that any changes in plan fees are required to be disclosed to the plan in advance of the changes.

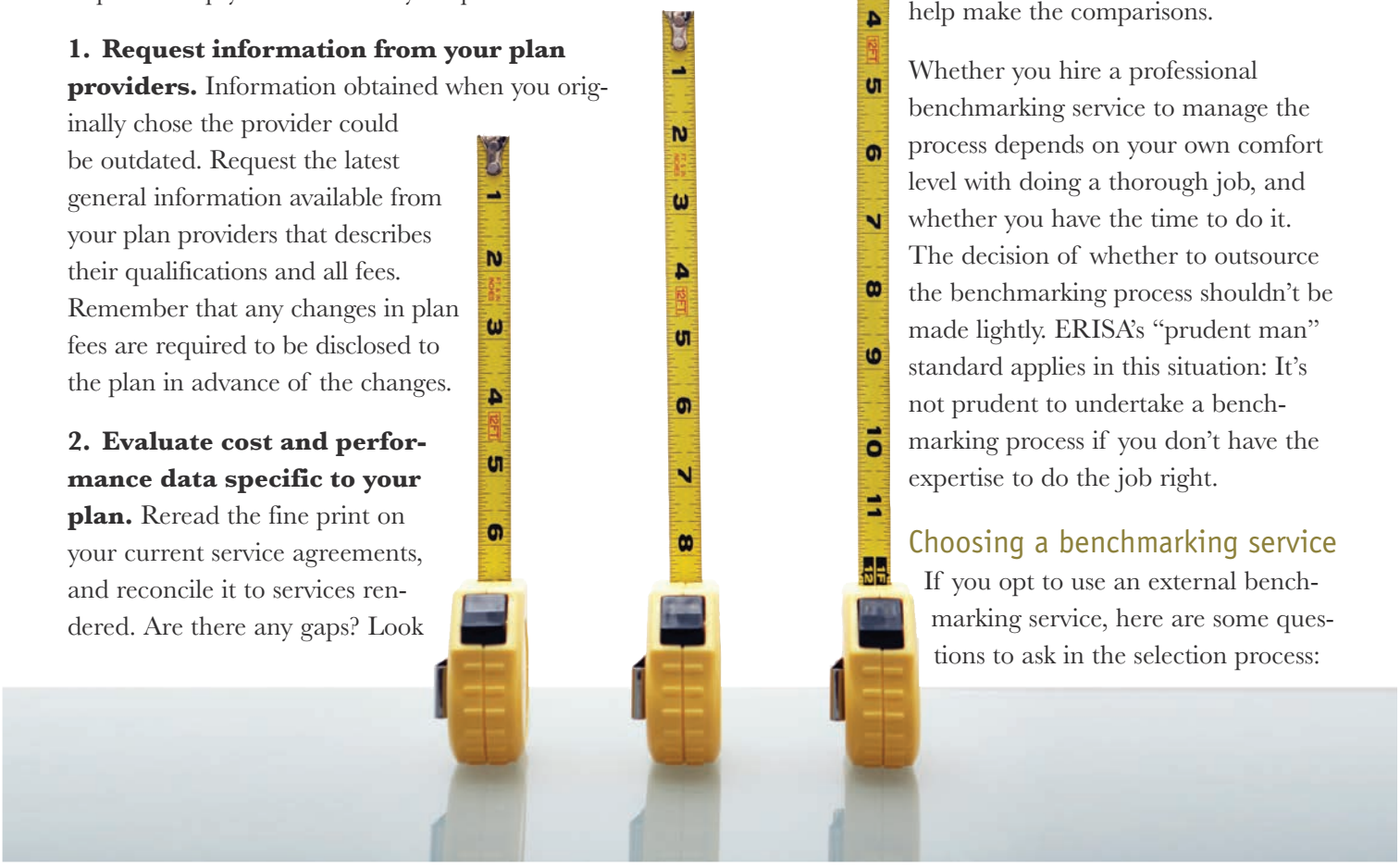
**2. Evaluate cost and performance data specific to your plan.** Reread the fine print on your current service agreements, and reconcile it to services rendered. Are there any gaps? Look for them in routine services and in contingencies. For example, how much liability does your administrator assume for any errors? What are the provider's backup capabilities in the event of some kind of disaster?

**3. Collect and assess comparative data.** For ERISA compliance, it's recommended that you send out requests for proposals to other vendors. However, if your plan is relatively small and your request form is long, you might find that not as many service providers will be willing to undergo the process as you would need to get enough data for a valid benchmark. That's where professional benchmarking services enter the picture. They generally have data that can help make the comparisons.

Whether you hire a professional benchmarking service to manage the process depends on your own comfort level with doing a thorough job, and whether you have the time to do it. The decision of whether to outsource the benchmarking process shouldn't be made lightly. ERISA's "prudent man" standard applies in this situation: It's not prudent to undertake a benchmarking process if you don't have the expertise to do the job right.

## Choosing a benchmarking service

If you opt to use an external benchmarking service, here are some questions to ask in the selection process:



- What are the technical qualifications of the principals of the firm, and how long have they been in business?
- How broad is the scope of the analysis — does it include all investment management as well as administrative service fees?
- How much of the firm's analysis focuses on individual fee components, as opposed to the overall fee structure by service category?
- Does the firm obtain fee data directly from the service providers, or through a third-party data provider?
- What quality control procedures are in place to ensure the data's accuracy?

When you have completed the benchmarking process, you may find that your current service providers are the best option. In some cases, you might conclude that, although the fees you're currently paying are competitive, they might not cover important services that another service provider includes in its standard service agreement.

Also, if you conclude that your current provider's fees are lacking, that doesn't necessarily mean you need to switch vendors. The benchmarking process opens the door to renegotiating your agreement with your current vendor.

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## Take the time

Given recent publicity and litigation around this topic, and increased ERISA fee disclosure requirements, the probability that you're dramatically overpaying plan fees is lower than it might have been in the past. Nevertheless, it's generally recommended that you benchmark your fees every two or three years. ◻

## Tips on helping preretirees prepare for retirement

A recent survey of retirees and workers approaching retirement has generated a set of recommendations for employers to help employees have a successful retirement. The *Current State of Retirement* report by the Transamerica Center for Retirement Studies gives several suggestions for ways employers can help current plan participants ease into retirement.

The report encourages employers to allow workers to phase in to retirement with flexible work arrangements and reduced hours. Another idea is for employers to extend retirement plan eligibility to part-time workers. In addition, offer preretirees access to financial counseling that includes retirement income strategies. Explain the need for a backup plan if the employee is forced into retirement sooner than expected.

Employees find it helpful when employers provide education about Medicare and Social Security claiming strategies to help them make informed decisions about when and how to apply to maximize the value of their benefits. Finally, encourage preretirees to participate in the selection, training and mentoring of the employee or employees who will assume their responsibilities when they retire.

# Why a nonqualified deferred comp plan may be right for you

What if a nonqualified deferred compensation plan (NQDCP) enabled your senior managers to replace a higher proportion of their current income when they retire? While NQDCPs often are perceived as only for top executives, they may also be right for your upper-level staff.

## Some considerations

The issue boils down to how much your senior managers are paid, and the extent of their willingness to set aside current income for future use. NQDCPs make sense when enough employees are prepared to defer more of their income than is allowed in a 401(k) plan. "Enough" requires an assessment of how motivational this program could be for prospective participants, weighed against administrative costs involved.

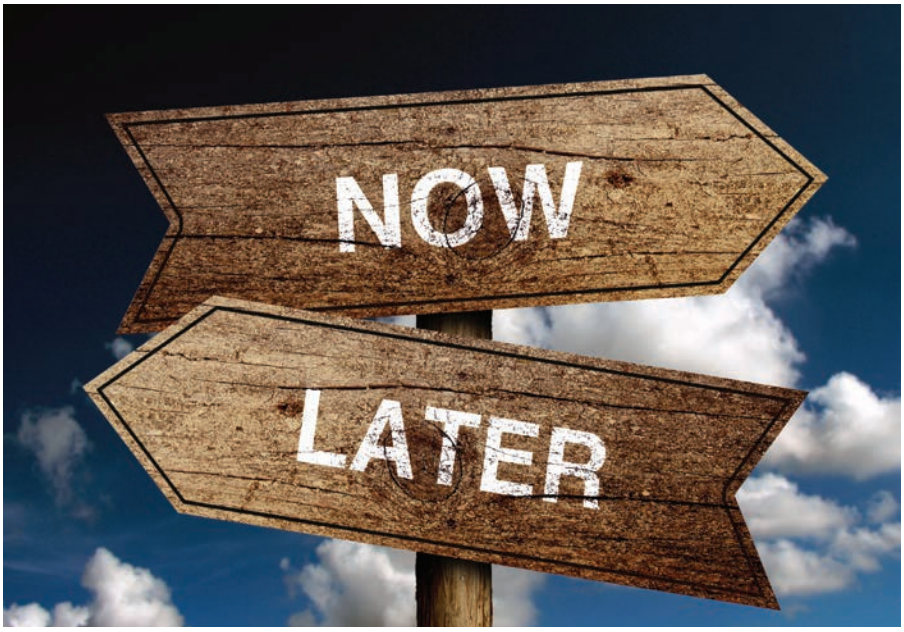
One catch for both parties to consider: Compensation deferred in an NQDCP isn't segregated from general corporate assets. Rather, it's a number on the balance sheet. If the company goes bust, NQDCP participants will be waiting in line along with other creditors to claim benefits, if any.

## Key features

So what are some NQDCP rules? Here are some key factors to consider with this type of plan:

**You decide who's eligible.** NQDCPs aren't subject to antidiscrimination rules, so you can limit participation to the highest earners. In practice, these plans aren't available to rank-and-file employees who don't fall within the definition of a select group of management or highly compensated employees.

**You can attach strings.** Employers can establish certain grounds under which employees must forfeit accumulated NQDCP funds. For example, if you terminate an employee for cause or an employee quits and goes to work for a competitor, the plan can specify that the employee must forfeit NQDCP funds. You can also establish vesting requirements, as you can in a qualified plan.




**You can grant flexibility.** These plans don't have to be used exclusively for retirement savings purposes. For example, employees can take "in-service distributions" for specified purposes — such as paying children's college tuition bills — if the distributions are set up properly through the plan.

**Corporate tax deduction deferred.** The company cannot expense compensation dollars that NQDCP participants squirrel away in the plan until the employee withdraws those funds. Any earnings on

deferred compensation are taxed to the corporation; however, they become deductible when paid to the participant.

**Stiff penalties for premature withdrawal.** If an employee opts to claim any accumulated funds before the normal retirement age (or other approved plan purpose), he or she can get hit by a 20% tax penalty, on top of a regular income tax hit, on the entire value of the deferred account — not just the amount of the withdrawal.

**Balance sheet implications.** Depending on whether, and the degree to which, the company earmarks dollars to nominally "fund" accruing benefits, the amount of accruing benefits may appear as a balance sheet liability. The degree of reserves set aside to cover the liability would counterbalance the balance sheet liability.

**Limited funding opportunity.** As noted, accumulated NQDCP benefits aren't sealed off in a distinct trust for the benefit of plan participants, as they are in qualified plans. However, a commonly used vehicle known as a "rabbi trust" offers limited protection. Dollars assigned to that trust are no longer subject to the employer's ability to alter the terms of the NQDCP, yet are still considered general corporate assets and subject to creditor claims in a bankruptcy.

**Investment features.** In some NQDCPs, the company establishes a formula that determines how deferred earnings will grow, such as pegging the rate to the yield on a 10-year Treasury bond, or a stock market index, like the S&P 500. Other plans actually set aside the deferred compensation and allow participants to select from a menu of mutual funds — mirroring the investment options in the company's 401(k) plan.

## Change in control

Executive compensation plans typically feature change-in-control protections for covered executives, locking in certain pay features to secure promised benefits if the company is sold. NQDCPs typically have similar provisions.

However, these provisions can be troublesome to prospective purchasers of the company, knowing that their hands will be tied. A "double-trigger" change-in-control provision can alleviate that concern, providing, for example, that accrued benefits are guaranteed only for employees who leave within 18 months of the acquisition. That motivates the acquirer to give employees a chance to prove themselves before deciding whether to terminate them.

## Is it right for you?

NQDCPs are worth considering for employers seeking ways to give highly paid employees additional tools to save for retirement on a tax-deferred basis. Ask your benefits consultant or attorney about them. Because these plans are subject to strict regulations, it's important to make sure that both your written plan and the operation of the plan comply with the regulations. ◻

## Compliance Alert

Upcoming compliance deadlines:

**4/1** Initial required minimum distribution for participants who attained age 70½ in 2015 (applies to qualified plans where the participant is at least a 5% owner and to IRA accounts)

**4/15** Deadline for corrective distribution of 2015 excess deferral failures

**4/18*** Deadline for filing of 2015 individual and/or partnership tax returns and making contributions eligible for deductibility

**5/15** Deadline for filing 2015 Form 990, "Return of Organization Exempt From Income Tax"

** The due date is April 18, because of the Emancipation Day holiday in the District of Columbia.*

# Assessing the legal risks of brokerage windows

Why limit plan participants' investments to a handful of managed funds when they can have an unlimited selection using a "brokerage window"? The answer might depend on your appetite for legal risk.

## Brokerage windows explained

Brokerage windows allow participants to establish an account that gives them access to virtually any investment under the sun — whether it be a "safe" blue chip stock, or some exotic leveraged commodity-based exchange-traded fund (ETF).

Brokerage windows are traditionally added to retirement plans at the request of senior executives who have considerable investment experience with their personal portfolios. Those participants typically believe they can do a better job on their own, or working with their own investment advisor, than when limited to standard 401(k) plan core options like target date funds.

Plans with brokerage accounts are generally professional services organizations (law firms and doctor groups) where the executives want greater diversity than the core menu of funds.

## Available to all

If a highly compensated employee has access to a brokerage window in the 401(k) plan, all plan participants must be given this option as well, although rank-and-file employees rarely select this option. Lower-paid workers generally don't understand brokerage windows and typically don't select it as an option. The U.S. Department of Labor (DOL) is concerned that brokerage accounts aren't monitored by plan committees.

Designated investment alternatives (DIAs) are the standard investment choices in a 401(k) plan. They're subject to extensive performance and related reporting requirements. Investments available through a brokerage window aren't subject to these same requirements — although the DOL has shown interest in regulating this area.

For example, in Field Assistance Bulletin 2012-02, the DOL indicated that some investments available through a brokerage window might be covered by DIA requirements, based on the number of plan participants who chose them. The DOL subsequently revised this bulletin, backing off that assertion. Yet the relevant section of the revised document, Q-39, didn't leave plan sponsors off the hook entirely.

## Still on the hook

ERISA regulations absolve plan sponsors of responsibility for the performance of certain DIA categories identified in those regulations, so long as the process for selecting the investments was prudent. The same principle applies to a sponsor's decision to offer a brokerage window.

The DOL acknowledged that brokerage accounts aren't DIAs, and therefore not subject to the same disclosure requirements. Yet its answer to Q-39 hints at its

underlying fiduciary concern and the possible path of future regulation. According to the DOL, a plan fiduciary's failure to designate investment alternatives, such as by offering a brokerage option to avoid investment disclosures under the regulation, raises questions under ERISA's general statutory fiduciary duties of prudence and loyalty.

### How's your appetite?

Regardless of possible future DOL regulation, fiduciaries' duties when offering a brokerage window option are serious. If offering one harms enough participants such that doing so could be deemed a failure to safeguard plan participants' interests, you may want to think twice. ◻

# DOL stresses plan auditor experience

Generally, plans with at least 100 participants must provide an audit report when filing IRS Form 5500. A recent analysis of private audits of Forms 5500 conducted by the U.S. Department of Labor (DOL) suggests the importance of ensuring that your plan's audit is conducted by a well-qualified auditing firm. Although a majority (61%) of the sample either provided flawless audits or those with only "minor deficiencies," the DOL considered 39% to be an unacceptably high proportion of audits with an "unacceptable" amount of errors.

The study, conducted by the Office of the Chief Accountant within the DOL's Employee Benefits Security Administration, reviewed 400 audited Forms 5500 out of some 81,162 audit reports submitted for 2011 plan years.

A large number (7,730) of CPA firms audited the forms submitted that year. Half of those firms, however, audited only one or two Forms 5500. Those firms accounted for a larger proportion of the auditing errors. The error rate for auditors that had audited only one or two plans that year was higher than for those that conducted more. In addition, the DOL is petitioning the American Institute of Certified Public Accountants (AICPA) to make improvements to its Peer Review process, as many of the deficient audits were performed by firms that received "clean" peer review reports. (Under the Peer Review requirements, firms that audit benefit plans are required to have the workpapers for at least one benefit plan selected for review.)

Also, the study reviewed the difference between "limited-scope" and "full-scope" audits. Limited-scope audits are less costly than full-scope audits, and don't involve testing of investment data. They're allowed under ERISA if this data is supplied to the plan administrator by a bank or similar financial institution.


The DOL believes that plan auditors weren't as focused on all relevant audit areas when they were subject to a limited-scope audit. According to the DOL, the most prevalent deficiencies were contributions, planning and supervision, internal controls, participant data, investments, party-in-interest transactions, and benefit payments. With the exception of investments, these deficiencies are tested under both limited-scope and full-scope audits. ◻

# The solution for skyrocketing audit fees

Finding ways to cut costs while maintaining quality seems to be at the top of every executives to do list. As the person responsible for your organization's employee benefit plan audit, we can help you not only reduce your audit costs but also provide a higher level of service.

Pension auditors must sift through enormous amounts of financial data in accordance with the requirements of numerous laws, regulations and professional standards. If they don't know what they're doing, they can easily get lost in the numbers, run up large fees and fail to provide an accurate assessment of a plan's financial status.

## Pension audit specialists

Insero & Company specializes in pension plan audits. Our professionals have extensive experience in this area and to ensure that our audits meet the highest standards of quality, our firm is a member of the American Institute of Certified Public Accountants (AICPA) Employee Benefit Plan Audit Quality Center and is registered with the Public Company Accounting Oversight Board (PCAOB).

Insero & Company is the independent registered public accounting firm for many companies that file a form 11-K with the Securities and Exchange Commission. We currently perform audits for more than 100 plans ranging in size from 100 to 60,000 participants, and from $1 million to more than $10 billion in assets.

## Big firm capabilities, small firm attentiveness

As our many satisfied clients will testify, we offer the comprehensive benefit services of a large national firm, but at less cost and with a higher level of service. With close to 100 accountants, professional consultants and support staff, our firm is large enough to bring robust resources to bear on almost every client need, yet small enough to provide the personal attention and relationship-based service that is important to our clients.

The culture of Insero & Company is hands-on and proactive, shaped by the old-fashioned notion of doing what is in the best interest of the client. In addition to pension and corporate audits, we provide a full range of tax, accounting and consulting services, including internal audit/Sarbanes-Oxley services, outsourced accounting and wealth management.

## Go with the experts

We would welcome the opportunity to discuss your audit or other needs and put our expertise to work for you. Please contact Vince Leo at 585-697-9683 or Mike Giess at 585-697-9639 and let us know how we can be of service.

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