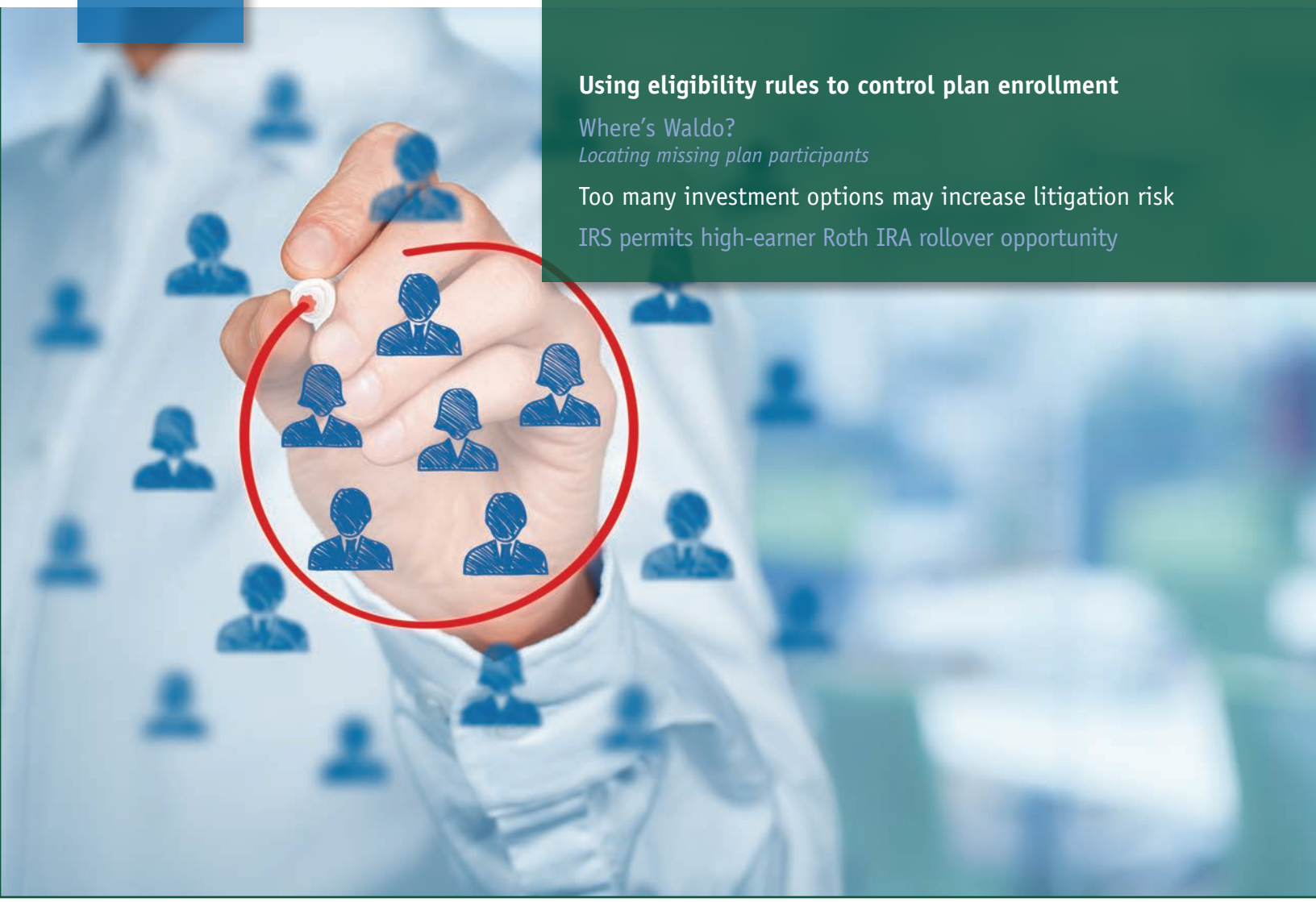
YEAR END
2016

Employee Benefits Update



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Using eligibility rules to control plan enrollment

Plan sponsors have more flexibility than they may realize when it comes to setting eligibility rules for 401(k) plan participants. Even though ERISA sets many rules for eligibility, plan sponsors have leeway to meet the demands of the employment market. Here are some thoughts for plan sponsors to consider when determining plan enrollment.

When to be generous

ERISA doesn't dictate how generous you can be regarding enrollment. So if you want to make all new hires eligible to participate and receive fully vested employer matches from day one, you won't encounter any legal difficulties. There are, however, sound reasons you might not want to take that approach.

Generally, in a tight labor market prospective employees expect competitive 401(k) benefits. For sponsors, turnover is lower and plans aren't urgently trying to minimize 401(k) expenses. In this scenario, plan sponsors may want to be more liberal with eligibility requirements.

And even if the employment market isn't tight, some businesses have higher turnover rates than others. If you routinely experience high turnover, allowing new hires to join the plan right off the bat may lead to needless administrative effort, possible errors and higher administrative costs. You could wind up having to distribute many small 401(k) balances to participants who left within a year, or maintain those legacy accounts until former participants request a rollover.

Limits on limits

Many plan sponsors find a happy medium somewhere between immediate enrollment and highly restricted or delayed enrollment. ERISA restricts your ability to limit eligibility in multiple ways:

Age restriction. You don't have to enroll employees below the age of 21, but you cannot have an age requirement over such age. This may or may not have an impact, depending on your workforce demographics. Many plans either have no age requirement or use age 18 as the minimum age.

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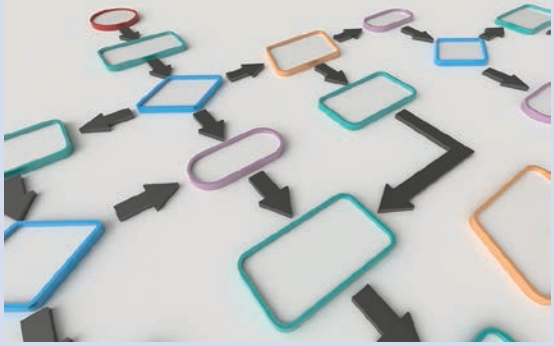
Delayed gratification. You can require employees to wait up to 18 months to enter the plan. This is accomplished by requiring employees to work at least 1,000 hours over the course of a 12-month period to gain eligibility. The plan then provides that, once eligibility is met, entry into the plan is the next semiannual entry date. For example, suppose your plan is a calendar year plan. You hire Jane on July 2, 2016, and she completes one year of service and the 1,000 hour requirement by July 2, 2017. She would enter the plan as of January 1, 2018.

Category-based standard. Plan sponsors can assign different standards for exempt vs. nonexempt employees. For example, you could set more generous eligibility rules for exempt employees than nonexempt employees. You might want to do so if the labor market

Vesting and matching contributions

If you're focusing on limiting the hard cost of your 401(k) plan related to matching contributions, flexibility with vesting rules can help. For example, you can allow new employees to enroll and begin making their own contributions promptly, but postpone the date at which they become entitled to take ownership of matching contributions.



You have two formulas to choose from if you wish to postpone the date when employees are fully entitled to keep the matching contributions:

1. Cliff vesting formula. Using this formula, employees aren't vested in any matching contributions until they've completed three years of service. That is, they go from zero to 100% vested when they've been in the plan for three years.

2. Graded vesting formula. Using this formula, a participant's vesting status increases in 20% increments, after the participant's second year in the plan. Thus, the participant is 40% vested after three years, 60% after four years, 80% after five years and 100% after six years in the plan.

You can be more liberal with either of the vesting formulas, but not more restrictive. Also, keep in mind that, if you sponsor a safe harbor plan, participants are automatically 100% vested in employer contributions. In addition, if you sponsor a Qualified Automatic Contribution Arrangement, participants must be vested in employer matching contributions in two years.

Whenever considering plan design options, it's important to work with experienced consultants who can advise you on the options available, as well as what may work best for your company given your objectives and employee demographics.

is tight for the types of jobs your exempt employees hold, but not your nonexempt employees.

However, your ability to establish these job classification distinctions is limited by your need to satisfy IRS coverage tests. These tests are designed to prevent discrimination against lower-paid workers. For example, the percentage of participating nonhighly compensated employees (NHCEs) cannot be less than 70% of the participation rate of highly compensated employees (HCEs). In addition, the average benefits received by NHCEs must equal at least 70% of benefits received by HCEs. The average benefits test also features a more subjective nondiscriminatory classification component.

You can also create different eligibility rules for union and nonunion jobs, and those distinctions, like the delayed eligibility timing tactic, aren't subject to the minimum coverage tests.

Make the choice

Restricting 401(k) plan participation eligibility isn't for everyone. And be aware that, if new employees don't get on the 401(k) bandwagon early, they might be less inclined to participate later when they're eligible. This could lead to problems with other discrimination tests, namely those comparing deferral rates of NHCEs to HCEs. Still, for some employers, a restrictive eligibility strategy may prove useful. ◻

Where's Waldo?

Locating missing plan participants

It's not uncommon for previously active employed plan participants to fall off the radar screen. They include retirees and former employees that move away without informing you. Before you or your plan administrator realizes it, they become "lost" participants. Here's what you need to know about these participants.

DOL considerations

What if participants have vested benefits? You can't just wait for them to reappear and present themselves to you. Rather, the burden — and fiduciary duty — is on you to make a good faith effort to track them down to ensure they receive or have access to those benefits.

In fact, the Department of Labor (DOL) has announced that, when it conducts routine plan audits, it'll pay close attention to how you handle (or plan to handle) locating lost participants. The DOL's primary concern is that people who are entitled to benefits receive them.

Steps to take

The DOL's 2014 field assistance bulletin (FAB) 2014-01 outlines and updates its expectations of plan sponsors with respect to keeping tabs on participants of terminated plans. Plan sponsors can charge missing participant accounts "reasonable expense for efforts to find them." Even though the FAB was written to outline steps required in the event of a plan termination, for now it serves as the best guidance on what to do if your plan is still up and running.

Under the FAB, to locate missing participants, plan sponsors are encouraged to:

1. Use certified mail. Certified mail provides an easy way to locate participants to distribute benefits at little cost.

2. Check related plan and employer records. If the retirement plan administrator lacks a current address for a former participant, the employer or another of the employer's benefit plans may have more current information. If these other potential sources decline to provide an address due to privacy concerns, ask them to contact the individual and relay the retirement plan administrator's message.

3. Check with a designated plan beneficiary. It might be possible to find the missing participant by way of a spouse or child who, presumably, would want to be helpful.

4. Use free electronic search tools. These include Internet search engines, public record databases, obituaries and social media.

What if these steps fail to locate the participant? According to the FAB, the fiduciary's required efforts might not stop there, depending on the facts and circumstances.

Additional measures

In deciding which additional measures to take and expenses to incur, plan fiduciaries can consider the size of a participant's account balance. A fiduciary couldn't be faulted for abandoning the search if the added cost would approach the size of the lost participant's account balance.

Otherwise, additional search resources that might be tapped include:

- Commercial locator services,
- Credit reporting agencies,
- Information brokers,
- Investigation databases, and
- Analogous services that may involve charges.

When all reasonable efforts to find missing participants come up short in the case of a plan termination, sponsors have some choices of how to distribute the funds.

For example, you can roll funds into an IRA in the missing participant's name, assuming an IRA custodian can be found that is willing to receive them. The choice of such a custodian, as well as how the funds are invested, "requires the exercise of fiduciary judgment," but the DOL has a safe harbor rule that automatically satisfies fiduciary standards.

Finally, in the plan termination context, if you cannot find a willing IRA custodian to receive missing participant funds, you can open an interest-bearing federally insured bank account in the name of the missing participant or beneficiary. Also, in the past, plans would transfer the account balance to a state unclaimed property fund; however, the IRS frowns on this now, with so many more options to locate missing participants.

Tax consequences

It's not just the DOL who has an interest in lost participants. The IRS is also interested in the fate of these individuals, but from a different perspective: When retirees hit age 70½, they must begin receiving their taxable required minimum distributions (RMDs). The IRS doesn't want lost participants to avoid paying those taxes because they haven't received the RMDs.

The consequences for retirees who don't receive and pay taxes on those RMDs are severe: an excise tax equal to 50% of the distribution they should have received. Retirees who are aware of this penalty will take steps to avoid it, including keeping you informed about where they live. Not all retirees are that savvy, however.

Follow the blueprint

The DOL's guidance in this FAB provides a blueprint of the procedures you must follow when faced with a missing participant scenario when a plan is terminated. However, as noted, for now the guidance is the best available for ongoing plans as well. Consult with your benefits specialist to make sure you have the proper steps in place. In case of a plan audit, being able to show the auditor you have such procedures in place should be satisfactory. ◻

Compliance Alert

Upcoming compliance deadlines:

12/15 Extended deadline to distribute the Summary Annual Report for plans that filed Form 5500 by October 15 (calendar year plans)

12/30* Deadline for making required minimum distributions for 2016

12/30* Deadline for making corrective distribution for failed 2015 actual deferral percentage (ADP) and actual contribution percentage (ACP) tests with 10% excise tax penalty, as well as for making a qualified nonelective contribution (QNEC)

12/30* Prospective amendment to add or remove safe harbor status (for 2017 plan year)

12/30* Prospective amendment to add automatic enrollment (EACA and QACA only) (for 2017 plan year) (must give participants notice at least 30 days prior to effective date)

1/31 2016 Forms 1099 due to participants

Blackout notice: 30 to 60 days before the last day participant may make a change

** The original due date of December 31, 2016, falls on a Saturday. The IRS historically hasn't extended due dates for required disclosures, contributions or distributions.*

Too many investment options may increase litigation risk

Giving plan participants a wide range of investment options is a good thing — but only to a point. That's one of multiple allegations in recent class action lawsuits filed against several prominent universities. The litigation, in the early stages as of this writing, offers a cautionary note for plan sponsors who offer a high number of investment options. While 401(k) plan sponsors are more than familiar with these types of claims, this is the first time nonprofit organizations have been targeted.

Offering choices

Targeting seven universities, including New York University, Duke, Yale and MIT, the lawsuits suggest there are at least two problems when offering too many fund choices:

1. Overwhelming participants, and

2. Incurring excessive costs.

Another possible problem: Fiduciaries may not have the ability to monitor the performance of so many funds.

"Defendant provided a dizzying array of duplicative funds," according to the complaint in *Sacerdote v. New York University*. According to the complaint, NYU offered more than 70 investment options for participants.

To put that number into perspective, the complaint cited a survey that determined the average number of funds in defined contribution plans, excluding target date options, is 15. The plaintiffs contend that this lower number of options "provides choice of investment style while maintaining a larger pool of assets in each investment style and avoiding confusion."

Spinning heads

According to the suit, studies indicate that people have less confidence and end up making no decision when presented with too many choices. Thus, according to the plaintiffs, plan fiduciaries aren't serving the best interests of plan participants as required under ERISA by offering a large number of options.

Be aware, however, that the complaint didn't offer any statistical evidence that participants had made inappropriate investment choices. The organizational culture at many universities gives great deference to employees' confidence in their ability to make complex decisions.

Whether that confidence is appropriate under ERISA is to be determined. Each plan sponsor will need to provide evidence that it took the demographics of its own employee population into account in determining whether the number of plan investments is overwhelming.

Purchasing power

As for the cost issue, the evidence may be easier to assess. The suit faults NYU on two fronts: using three record keepers and too many funds. The complaints allege that these failures cost tens of millions of dollars in retirement funds. As is not uncommon with nonprofit organizations that sponsor 403(b) plans, their retirement programs consist of multiple recordkeepers with different investment options. Employees can choose among all offered recordkeepers to invest their funds.

The plaintiffs contend that using a single recordkeeper provides clear benefits. For example, using a single recordkeeper can enhance purchasing power and allow sponsors to negotiate lower, transparent participant investment fees.

The complaint makes the same argument with respect to the number of investment options: The plaintiffs assert that plan sponsors can "dramatically reduce participant-borne costs while improving employees' retirement readiness by reducing the number of investment options, utilizing

an 'open architecture' investment menu, and packaging the options within a tiered structure."

The plaintiffs also criticized the plan's inclusion of many actively managed stock funds, whose costs are typically much higher than passive index funds. "To the extent managers show any sustained ability to beat the market, the outperformance is nearly always dwarfed by mutual fund expenses," states the complaint.

Reviewing options

These cases are in the early stages. However, take notice: No matter how well you've chosen your investment options, if your plan includes dozens of options, this could signal a breach of your fiduciary duty. Review your investment options now to avoid the possibility of dealing with this issue later in court. ◻

IRS permits high-earner Roth IRA rollover opportunity

As highly compensated employee (HCE) 401(k) plan participants approach retirement, you might draw their attention to a potentially useful tax-efficient IRA rollover technique. The IRS has specific rules about how participants can allocate accumulated 401(k) plan assets based on pretax and after-tax employee contributions between standard IRAs and Roth IRAs. (This article doesn't address opportunities involving Roth 401(k) plans.)

High-earner dilemma

In 2016, the top pretax contribution that participants can make to a 401(k) is $18,000 ($24,000 for those 50 and older). Plans that permit after-tax contributions (about half do) allow participants to contribute a total of $53,000 ($35,000 above the $18,000 pretax contribution limit). While some highly compensated supersavers may have significant accumulations of after-tax contributions in their 401(k) accounts, the IRS income caps block the highest paid HCEs from opening a Roth IRA.

However, under IRS rules, these participants can roll dollars representing their after-tax 401(k) contributions directly into a new Roth IRA when they retire or no longer work for the company. Thus, they'll ultimately be able to withdraw the dollars representing the original after-tax contributions — and subsequent earnings on those dollars — tax-free.

IRS guidance

Participants can contribute rollover dollars to conventional and Roth IRAs on a pro-rata basis. For example, suppose a retiring participant had $1 million in his 401(k) plan account, $600,000 of which represents contributions. Suppose further that 70% of that $600,000 represents pretax contributions, and 30% is from after-tax contributions. IRS guidance clarifies that the participant can roll $700,000 (70%) into a conventional IRA, and $300,000 (30%) into a Roth IRA. Although the portion of the $300,000 rolled into the Roth that represents earnings on those after-tax contributions (40% of the $300,000, or $120,000) will be taxable for the year of the rollover, subsequent growth on the Roth will be tax-free when withdrawn.

The IRS rules allow the retiree to delay taxation on the earnings attributable to the after-tax contributions ($120,000) until the money is distributed by contributing that amount to a conventional IRA, and the remaining $180,000 to the Roth. Partial rollovers can also be made, and the same principles apply. ◻

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 & Co. 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 & Co. 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 150 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 more than 125 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 & Co. 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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