employee benefits update

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THE NOT-SO-ABSOLUTE PRIVILEGE
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Is it time to review your plan's operations?

With the numerous U.S. Department of Labor (DOL) standards that plan fiduciaries must meet, a fiduciary's job seemingly never ends. Satisfying your fiduciary obligations in administering your retirement plan for the benefit of plan participants, however, need not be unduly onerous if you take an organized, methodical approach to the task. And the more methodical you are, the more evidence you'll have to show that you've met your duties in the event of a challenge.

Fiduciary vs. settlor functions

Fiduciary roles and actions are distinct from "settlor" functions. For starters, ERISA defines and regulates fiduciary duties, while state law generally governs settlor functions.

What's the difference? Settlor functions essentially pertain to plan design, including the decision to start, amend or terminate a plan. A settlor can design a plan to cover a particular set of employees (subject to ERISA rules) without incurring fiduciary responsibility. In contrast, fiduciary functions pertain to substantive actions. For example, when a fiduciary determines that a particular employee is ineligible to participate in the plan, he or she exercises control over a substantive plan action. ERISA considers this a fiduciary duty.

Key fiduciary tasks

As a plan fiduciary, how can you be sure to follow proper procedures regarding overall plan administration?

Remember, repeated or serious acts of noncompliance (including prohibited transactions) may be a violation of your fiduciary duties.

To start, maintain a comprehensive regulatory filing checklist to ensure that you file or issue to participants all required documents. Additional steps you should take include:

- Reviewing significant regulatory filings (such as Form 5500) before their submission,
- Assessing the performance of third-party administrators, recordkeepers, investment managers and consultants periodically (annually, if possible), and reviewing their agreements,
- Rebidding service provider contracts regularly (consider at least every three years) to ensure that fees and service capabilities are competitive,
- Consulting routinely with ERISA experts as to contemplated fiduciary actions,
- Staying current with legislative, regulatory and legal developments,

- Holding regular (no less frequently than annual) retirement plan committee meetings to review administrative performance and discuss any needed plan improvements, and
- Taking meeting minutes and sharing them with your board of directors.

Be sure to document committee meeting discussions and any decisions made. Perhaps most important, take decisive action to correct any administrative deficiencies.

Plan investment fiduciaries

Careful oversight of retirement plan investments — both the selection and suitability of the actual investment choices in participant-directed plans as well as their performance against relevant benchmarks — is a fiduciary function. This area can be rife with problems.

Some investment managers might insist they aren't fiduciaries. However, their status is based on their degree of influence over investment decisions, and the law doesn't require absolute control. Under ERISA, a person is a plan fiduciary to the extent that that person renders investment advice for a fee or other compensation, directly or indirectly, with respect to any money or other property of an ERISA plan, or has any authority or responsibility to do so.

In addition, DOL regulations state that a person is a fiduciary rendering investment advice if that person:

- Makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property to an ERISA plan,
- Regularly renders advice to the plan under an agreement that these services serve as the primary basis for investment decisions, or
- Structures his or her advice to address the plan's particular needs.

Other fiduciary duties should include holding regularly scheduled meetings with investment advisors to review investment market conditions and performance. Document these meetings, including any decisions or requests made at them. Have your plan's asset investment managers acknowledge their fiduciary status in their service agreements. While this doesn't diminish your own fiduciary duty, it demonstrates a desire to hold key plan service providers to the highest standard of accountability. And remember, your duty to monitor performance isn't suspended between meetings; responsibility is ongoing.

Maintain and monitor a comprehensive regulatory filing checklist to ensure you file or issue to participants all required documents.

Make it right

Retirement plans have many moving parts. By methodically reviewing your fiduciary duties as they relate to your plan's operations, you'll meet your fiduciary obligations. If you have any questions about ERISA's fiduciary obligations, contact your benefits specialist.

Upcoming compliance deadlines:

4/1 Initial required minimum distribution for participants who attained age 70½ in 2014 (applies to qualified plans where the participant is at least a 5% owner and to traditional IRA accounts)

4/15 Deadline for corrective distribution of 2014 excess deferral failures

4/15 Deadline for filing of 2014 individual and/or partnership tax returns and making contributions eligible for deductibility

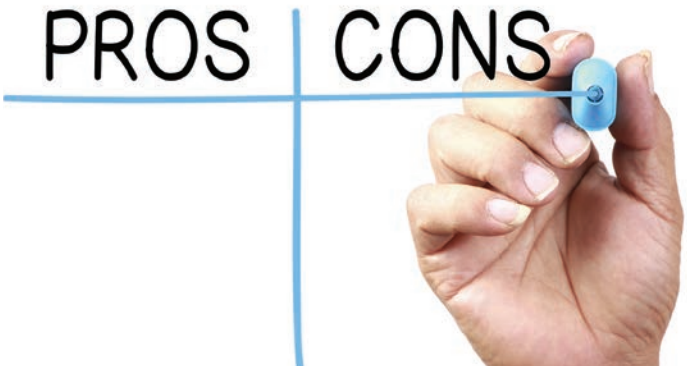
5/15 Deadline for filing 2014 Form 990, "Return of Organization Exempt From Income Tax"

Retirement plan loans: The pros and cons

According to the Employee Benefit Research Institute, more than one-fifth (or 21%) of all 401(k) plan participants eligible for loans have loans outstanding at any given time. Looking out for the best interests of your plan participants might involve discouraging them from borrowing against their savings, at least in the absence of a personal financial crisis.

Offering loans

For starters, plans aren't obligated to have a loan provision in their plan documents — although an estimated 87% of plan sponsors do. So the definitive way to discourage loans would be to amend your plan and no longer offer them. However, this may backfire for two reasons: It may stop employees from joining the plan and current plan members may not continue to contribute because of the inability to access their retirement funds in a perceived emergency.



Alternatively, plans can offer loans, but limit them to specific, nonfrivolous purposes. For example, ERISA allows for hardship withdrawals using the following safe-harbor definition of hardship:

- All deductible medical expenses incurred or anticipated to be incurred by the employee, the employee's spouse or dependent,
- Purchase (excluding mortgage payments) of an employee's principal residence,
- Tuition and related educational fees for the next 12 months for postsecondary education for the employee, spouse, children or dependents,
- Payment to prevent eviction from the employee's primary residence or foreclosure on the mortgage on the employee's primary residence,
- Funeral expenses of parents, spouse, children or dependents, and
- Certain expenses relating to the repair of damage to the employee's principal residence that would qualify for the casualty deduction.

Plans can use these same criteria — or any others — when defining loan purposes in their plan document.

Borrowing limits

Although ERISA gives plans the freedom to establish their own loan purpose criteria, it prescribes the maximum dollar amount of plan loans. Specifically, participants may borrow the lesser of $50,000 or 50% of the participant's vested plan assets.

Plans can create an exception to the 50% limit for loans up to $10,000. However, some plans may choose to require a separate security for this loan type. If the participant previously took out another loan, the $50,000 limit is lowered by the highest outstanding loan balance during the one-year period ending on the day before the new loan.

Plans can also set a minimum loan amount, to discourage borrowing simply to cover routine expenses. Doing this may also reduce the plan's administrative expenses related to plan loans.

Prior to 2010, plan loans were covered by the Truth in Lending Act (the federal law mandating disclosure of a variety of loan facts). One such required disclosure included the total amount of interest the borrower would pay if the loan weren't paid off until the end of its term. Plan sponsors can still provide this information so that prospective borrowers understand the loan's total cost.

Communicating with participants

When talking with participants about plan loans, sponsors should do more than just ensure that the purpose of the loans meets the plan document requirements. Each participant should understand the pros and the cons of borrowing against plan assets. For example, explain to participants that plan loans may result in:

Impeding the ability to save. The loan payments will reduce cash otherwise available for retirement saving.

Forfeiting potential investment gains. When plan investments are performing reasonably well, dollars used for loan repayment won't be earning those returns on a favorable tax-deferred basis.

Taxing inefficiency. Loan payments are made with after-tax dollars, and when these payments are taken from the plan on distribution, they are taxed again.

Plan loan documentation: Not a casual affair

Plan sponsors and administrators need to properly document approved participant plan loans to prevent the loan from being treated as a taxable distribution. For example, the loan must be a legally enforceable agreement. Make sure the loan document, whether on paper or electronic, is dated, states the loan amount and binds the participant to a repayment schedule.

In addition, the plan loan documentation must:

- Secure the loan with the borrower's account balance,
- Provide an interest rate and repayment schedule similar to what a participant would receive from a financial institution,
- Base payments on a level, amortizing schedule payable no less frequently than quarterly, and
- Require repayment of the loan within five years, unless the participant uses the loan to purchase a principal residence.

Putting retirement capital at risk. If a participant defaults on the loan, the collateral — the participant's remaining retirement savings in the plan — will be liquidated to repay the loan. Also, the IRS considers the liquidated savings a distribution. That means the amount of the forced distribution is subject to income tax — and, if the participant is under age 59½, the IRS also assesses a 10% premature withdrawal penalty.

Limiting job mobility. If the borrower changes jobs, he or she might be required to repay the balance within a relatively short period of time. If the participant can't raise the cash to pay it off, it'll be considered a default, and the participant will lose retirement savings and be subject to tax consequences.

Going backward financially. The point of having a retirement plan is to prepare for retirement. Using it to add more debt defeats its purpose.

Making the decision

In certain circumstances plan loans can be a good choice. However, they're not always cost effective — for both the participant and the plan. Be sure to discuss the pros and cons of plan loans with your participants.

Demystifying plan audits

IRS RELEASES UPDATED GUIDANCE

To clarify its plan audit process, the IRS recently updated the guidance it offers to plan sponsors. Even though the guidance is fairly general, it's helpful for all plan administrators and sponsors to review. Let's take a look at some common questions regarding plan audits.

Who gets audited?

The IRS chooses plans for audit in one of four ways:

1. As part of a special IRS initiative focusing on a specific issue,
2. On a tip-off,
3. After discovering questionable or unusual items on a plan's return, or
4. By random selection.

The IRS says audits aren't merely a game of "gotcha." The purpose is to develop corrective strategies and help plan sponsors execute these strategies.

How can you prepare?

If you're notified that the IRS wants to audit your plan, the examiner generally will give you a list of documents to review before the site visit. Similarly, after the on-site examination, the IRS may ask you to produce additional documents.

Remember: You don't have to go it alone. As with a tax audit, it's in your best interest to be represented by a plan expert. Make sure that you authorize this person to act on your behalf in writing, using the required IRS form (Form 2848, "Power of Attorney and Declaration of Representative"), and that he or she is licensed to practice before the IRS.

What does the IRS look for?

The IRS will likely examine one of 10 plan operational areas. Questions to ask about your plan include:

1. Are all eligible employees properly participating?
2. Is the plan properly crediting service and vesting in the plan?
3. Do plan contributions, benefits, rights or features improperly favor highly compensated employees and thus discriminate against non-highly compensated employees?
4. Have minimum contributions and benefits and accelerated vesting been provided to meet top-heavy requirements?
5. Are all contributions and benefits within applicable limits?
6. Are contributions correct and made timely, and are deductions within applicable limits?
7. Has the plan correctly calculated, properly made, and timely and accurately reported distributions?
8. Is the trust operating for the exclusive benefit of participants and according to fiduciary standards?
9. Do the plan document and trust meet current tax law?
10. Did the plan timely and accurately file federal returns and reports?

The IRS plan audit can cover any of these topics. Now is the time to review your plan to make sure it complies with the questions above.

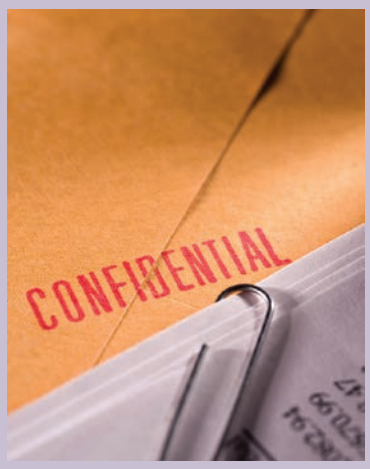
If you receive a notice of an IRS plan audit, have the requested documents available on the examiner's arrival. If you need additional time to gather the requested data, contact the IRS as soon as possible to request an extension of time.

Prepare now

At the conclusion of a plan examination, the examiner can instruct you to make operational changes to the plan, dictate a remedy to an alleged problem, or, in the worst-case scenario, disqualify your plan. Remember that you can appeal any IRS findings.

The not-so-absolute privilege

ERISA and attorney-client privilege



The attorney-client privilege protects communications between a lawyer and a client from disclosure in a legal proceeding. But in the realm of ERISA law, it's not so absolute.

Legally, plan fiduciaries must protect the best interests of plan beneficiaries. But what happens when a plan fiduciary communicates with an attorney about an ERISA-covered retirement plan?

In this situation, the so-called "fiduciary exception" to the attorney-client privilege may come into play. Generally, a person or entity acting in the capacity of an ERISA fiduciary cannot assert the attorney-client privilege against plan beneficiaries on matters of plan administration. This means that such communication may be seen by plan participants (the beneficiaries), their attorneys or even the U.S. Department of Labor.

However, courts have created exceptions to the exception. In these situations, the attorney-client privilege *will* apply to protect the communication. Specifically, communications involving the plan's start-up, amendment or termination aren't considered fiduciary functions and are, thus, protected under the privilege. In addition, communications related to defending fiduciaries in adversarial proceedings fall under the privilege. This may include communications regarding a fiduciary's personal defense against a claim of breach of fiduciary duty.

When determining whether the attorney-client privilege or the fiduciary exception applies in a given situation, courts will try to determine whether the interests of the fiduciaries and plan participants have diverged. If so, the communications with an attorney generally are shielded from discovery. To help determine this, courts consider:

- Whether plan participants have retained an attorney,
- The prospect of litigation, and
- Whether the fiduciary and the attorney have discussed potential litigation and if the fiduciary paid the attorney out of personal rather than plan funds.

Legal actions involving fiduciaries and the attorney-client privilege can be complicated. Remember that the attorney-client privilege may protect less than you think.