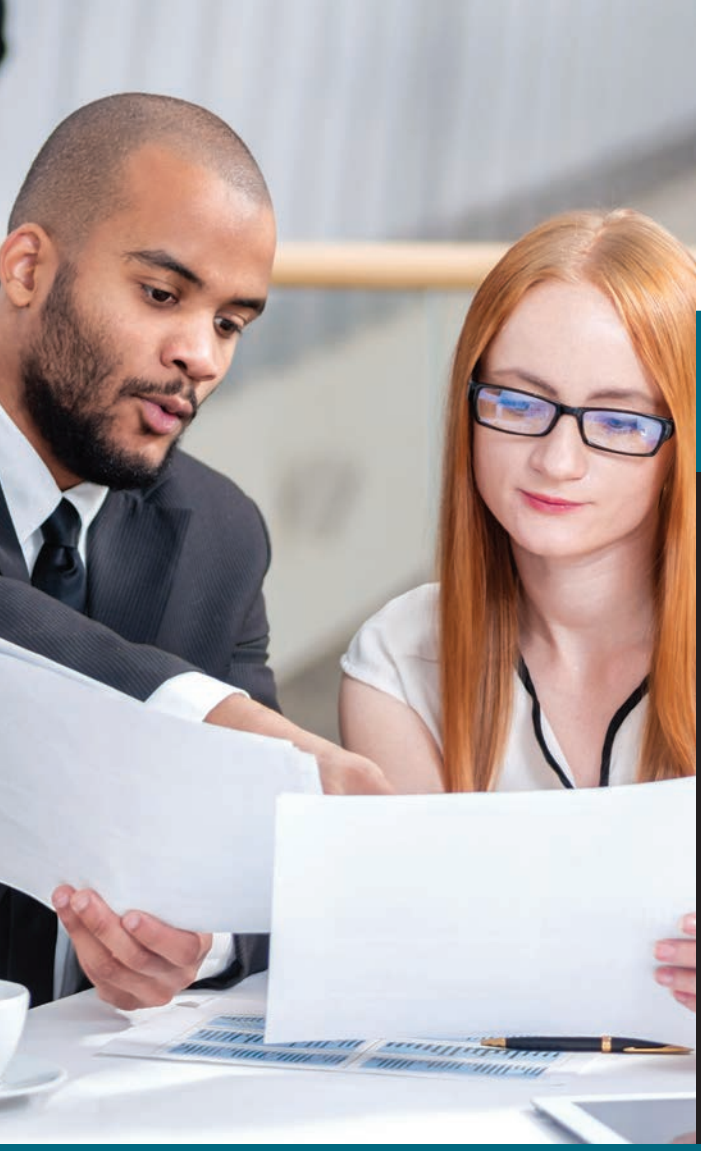

employee benefits update

year end 2015

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Determination letter limbo

IRS MAKES CHANGES TO DETERMINATION LETTER PROGRAM

Sponsors of individually designed qualified retirement plans will need to adjust to the idea of operating without the IRS's official blessings when changing the plan document to comply with new laws and regulations. The changes won't affect plan sponsors who have adopted standardized preapproved plans, as many small plan sponsors do. Earlier this year, the IRS laid out its plans to scale back its plan determination letter program. Here's what you need to know.

"Off-cycle" submissions

The IRS established a system of rolling five-year reporting periods. Each sponsor of a non-preapproved standard plan was assigned to one of the periods based on the plan sponsor's employer identification number. Sponsors could seek a determination letter for remedial plan amendments (such as an amendment remedying a plan provision that might have been noncompliant) only once during its assigned five-year period.

Now, as of July 21, 2015, the IRS will no longer accept determination letter applications that are submitted "off-cycle." An off-cycle application is one that is filed "other than during the last 12-month period of a plan's remedial amendment cycle, that is, the 12-month period ending on January 31 of the last year of the cycle."

Although the IRS is scaling back its determination letter program, it's not cutting back on its regulatory compliance enforcement efforts, including plan audits.

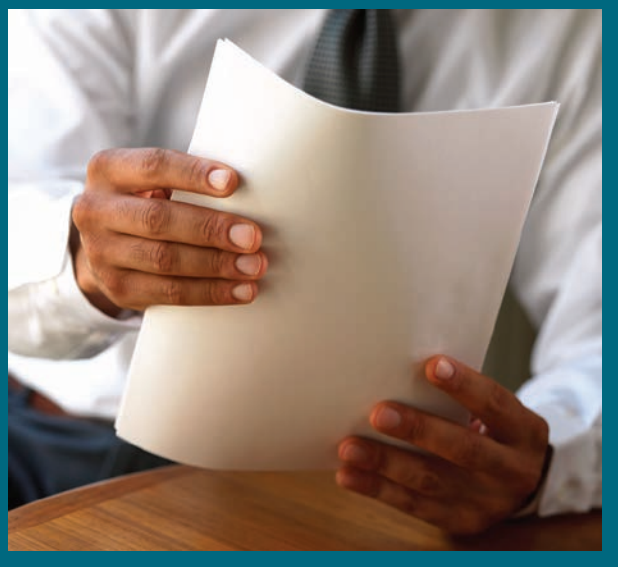
The timing question will become moot beginning in 2017, however, when the five-year remedial amendment cycle program will disappear entirely. At that time, the IRS will no longer issue determination letters for remedial amendments to sponsors of nonstandard plans. Plans covered by the "A" five-year cycle, however, get a small break: These plans will be able to submit determination letters between February 1, 2016, and January 31, 2017.

Master and prototype, volume submitter plan document guidance updated

The IRS has updated some guidance on requesting preapprovals for master and prototype and volume submitter plan documents. The new guidance modifies and updates previous positions.

Most notably, under the new guidance, the IRS will now issue preapproval letters for many kinds of Employee Stock Ownership Plans (ESOPs) and defined benefit plans containing cash balance features.

Among other requirements for preapproval letters, cash balance plans must provide that, at all times, prior accrued benefits (and other enumerated benefits) are protected. If the cash balance plan was the subject of a conversion amendment, the plan must comply with the IRS minimum vesting standards and regulations for plan conversion amendments. And if it contains any structure of principal credits that increase with age, service or other measure during a participant's employment, those plan provisions must be definitely determinable, operationally nondiscriminatory, and at all times in compliance with the "133⅓ percent rule" and enabling regulations.



Surviving determination letter categories

Determination letters will still be issued to all nonstandard plans, however, when a new plan is formed (the "initial determination letter") or is terminated. The IRS times these determination letter requests to the underlying events, not to a five-year cycle.

The IRS gave itself the freedom to make exceptions under "certain other limited circumstances that will be determined by the Treasury and the IRS." The agencies also can seek public suggestions on appropriate circumstances to grant an exception.

Avoiding penalties

Why the changes to the determination letter program? The IRS is trying to more efficiently direct its limited resources because of budget cuts while at the same time Congress has enacted new laws that have stretched the agency's legal staff thin.

Although the IRS is scaling back its determination letter program, it's not cutting back on its regulatory compliance enforcement efforts, including plan audits. In the absence of remedial determination letters, audited plans determined to have compliance deficiencies could be subject to greater penalties than might otherwise have been the case. As a result, third parties that audit qualified plans might begin seeking formal assurances from the plan sponsor that its plan is compliant.

Keeping up to date

Plan sponsors should keep a close watch for additional IRS guidance on the issues left unresolved by the IRS determination letter announcement. Moving ahead without formal approval from the IRS for remedial amendments may be tricky.

Upcoming compliance deadlines:

12/31 Deadline for making required minimum distributions for 2015

12/31 Deadline for making corrective distribution for failed 2014 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)

1/31* 2015 Forms 1099 due to participants

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

** Because January 31, 2016, falls on a Sunday, the deadline for delivering Forms 1099 will occur on the next business day: February 1, 2016.*

Tibble case puts focus on fiduciaries' ongoing duties

Earlier this year, the U.S. Supreme Court clarified the ongoing duty of retirement plan fiduciaries to monitor plan investments. *Tibble v. Edison International* has been percolating through the federal court system since 2007. The case focuses on the timing of lawsuits against plan fiduciaries for breaches of their fiduciary duty.

Case background

In 1999, Edison's 401(k) plan added three retail-priced mutual funds and in 2002 added three more. In 2007, plan participants sued plan fiduciaries "to recover damages for alleged losses suffered by the plan from alleged breaches of [the fiduciaries'] fiduciary duties."

ERISA sets a six-year time limit on filing a fiduciary breach complaint. Under the law, the clock starts "the date of the last action which constitutes part of the breach or violation, or, in the case of an omission, the latest date on which the fiduciary could have cured the breach or violation."

Both the district court in California and the U.S. Court of Appeals for the Ninth Circuit found that the plan's initial investments in 1999 — eight years before the initiation of the lawsuit — constituted the "last action." They reasoned that the addition of the three funds in 2002 didn't amount to a change in the program, so there was no call to reset the six-year limitation to that date.

U.S. Supreme Court ruling

A unanimous U.S. Supreme Court held that the Ninth Circuit had erred because it failed to consider "the contours of the alleged breach of fiduciary duty." The nature of the fiduciary duty in this circumstance, the court held, is "derived from the common law of trusts," which means that "a trustee has a continuing duty — separate and apart from the duty to exercise prudence in selecting investments at the outset — to monitor, and remove imprudent, trust investments."

Thus, because the trustees' duty was ongoing, no deadline was reached for the plaintiffs to file their lawsuit. As long as the alleged breach of the continuing duty of prudence occurs within six years of the suit, the claim falls within the statute of limitations.

The Supreme Court's ruling didn't address whether plan fiduciaries at Edison had failed to act as prudent

fiduciaries, merely that they were still on the hook despite the interval between the time certain plan investments were made and the date that a class action suit was launched. The Court sent the case back to the Ninth Circuit to determine whether Edison's fiduciaries shouldn't have allowed the 401(k) plan to use mutual funds, whose fee structure was the same as that offered to "retail" (individual) investors, instead of cheaper institutionally priced funds.

Basic issue remains unresolved

The appeals court will have to consider the underlying question: Did the fiduciaries violate their duties in allowing the 401(k) plan to invest in retail-priced funds? Although the *Tibble* case is about plan fees, that's only one of the many things plan fiduciaries need to consider, of course. Other critical areas of ongoing focus include:

Investment performance. Certain types of investments are volatile and positive results can never be guaranteed. But ongoing monitoring requires comparing their performance to other funds with similar investment strategies that might be doing better, even if they're losing money. Having an independent investment expert provide regular performance monitoring and benchmarking will be important in supporting investment decisions. According to the U.S. Department of Labor, the duty to act prudently is one of a fiduciary's central responsibilities under ERISA. It requires expertise in a variety of areas, such as investments. A fiduciary lacking investment expertise should hire someone with that professional knowledge to carry out investment functions. Going it alone without such expertise can lead to poor investment decisions.

ERISA Section 404(c). This provision requires plans to provide a "broad range" of investments. The range of investments must, among other things, offer at least three investment choices that are diversified and have different risk and return characteristics.

Qualified default investment alternatives (QDIAs). The QDIA rules are specific about acceptable default investments. Fiduciaries need to make sure their QDIAs maintain those characteristics over time.

Potentially bad investment choices. While meeting Section 404(c) requirements is an explicit fiduciary responsibility that plan sponsors must monitor, a conservative approach alone isn't enough. Keep an eye on any particular fund that, if participants unwisely invested too heavily in, could get them in financial trouble.

Being a prudent fiduciary by keeping track of plan investments and operations on an ongoing basis doesn't guarantee everything will always go according to plan.

Investment manager competence. Fiduciaries must monitor who's managing each of the fund's investments. Funds may periodically switch managers. When this occurs, conduct due diligence on any replacement manager.

Being a prudent fiduciary by keeping track of plan investments and operations on an ongoing basis doesn't guarantee everything will always go according to plan. Congress understood that when it enacted ERISA, and courts will take this into consideration when considering possible violations.

Timing matters

At a minimum, fiduciaries must demonstrate through their actions — and, equally important, the documentation of their actions — that they gave careful thought to the plan participants' best interest. And as the U.S. Supreme Court made clear in *Tibble*, fiduciaries' duty to do so can never be put on hold.

Give employees more bang for their buck

HOW TO USE DEFAULT DEFERRAL RATES AND AUTO-ESCALATION CLAUSES

According to a Plan Sponsor Council of America survey, only 46% of defined contribution plans automatically enroll participants. The most common default deferral rate for those that do is 3%. Are you telling your employees that they can afford to retire by saving just 3% of their salary each year? Some participants may think so.

Avoiding advice?

Studies by the Employee Benefit Research Institute suggest that, when plans default participants into a 3% deferral rate, participants stay at that level. This happens even when the participants were willing to defer more (typically 6%) to get the maximum employer match before the plan established its auto-enrollment feature. A slim majority (55%) of plans with a default participation feature automatically boost deferral rates annually, typically by one percentage point.

Employees often are less resistant to higher default rates than many plan sponsors believe.

A Towers Watson survey of large employers found that fewer than 22% gave employees a specific suggestion of what a reasonable retirement savings rate might be. Of those that did, 39% suggested a figure of at least 10%.

For many participants, depending on the age at which they began saving for retirement, 15% might be more in order — although trying to default

participants in at that rate likely would backfire. Yet employees often are less resistant to higher default rates than many plan sponsors believe. Doubling the auto-deferral rate from 3% to 6% seldom creates a participant backlash. In fact, a majority of employees in a OneAmerica online survey said they would appreciate being nudged into higher deferral levels through an auto-escalation feature.

What does it cost?

Company budgetary considerations sometimes can draw a veto to proposals to boost auto-enroll and auto-escalation default numbers. Naturally if you match, for example, 50 cents on the dollar up to a 6% deferral level, moving the default deferral from 3% to 6% will increase your plan's cost.

But offering a 33% match up to a 9% deferral rate would cost you the same 3% of pay for each participant going for the maximum match, and those participants would then be saving at a 12% of pay rate with the match added in. That's three points higher than the prior combined rate.

Also, the 33% match capped at 9%, in the case of some participants, might wind up costing you less, but still inspire employees to increase deferrals. For example, while it may not prompt a participant to increase his or her deferral all the way up to the 9% ceiling, that participant may choose to increase it instead to 7% or 8%.

With the 33% match, the participant would still wind up with a higher total deferral (9.31% and 10.64%, respectively). However, your cost would actually drop from the original 3% of payroll amount, to 2.33% and 2.66%, respectively.

The end game

Encouraging participants to do more for themselves by deploying more aggressive plan designs can deliver better results for everyone. Contact your benefits advisor to see if you and your employees can profit from increased deferral rates and auto-escalation provisions.

Is a customized TDF right for you?

Some investment managers who haven't broken into the ranks of the largest target date fund (TDF) providers are using a "one-size-doesn't-fit-all" argument to promote customized TDFs. And the argument has merit.

There's regulatory support for plan sponsors to at least think about the option. When in 2013 the U.S. Department of Labor published a series of suggested questions sponsors should ponder when considering TDF options, one asked whether a custom or nonproprietary TDF would be a better fit for their plan.

When would a customized TDF be appropriate? Generally, retirement plans with unusual demographics might benefit from customization. One possible scenario: Suppose your plan has a high concentration of older participants, and average account balances for that group are well below ideal levels. It may make sense to go with a custom TDF with a glide path that maintains a higher-than-standard equity allocation as the nominal retirement date draws near. Why? These participants need to take on a little more risk to achieve higher returns to get their retirement savings on track.

However, don't end the analysis yet. If many older participants also accrued benefits from a frozen defined benefit (DB) pension plan, they might do better with a more conservative glide path because they wouldn't want to sustain the anxiety that typically accompanies the volatility inherent in equity portfolios. But the opposite argument could be made: Older participants, knowing they had a base guaranteed benefit from the frozen DB pension plan, may not be troubled by turbulent 401(k) plan assets with a higher-than-standard equity allocation. Debating these issues could lead to the conclusion that customization isn't needed.

A helpful tool is the DOL's Target Date Retirement Funds Tips published in February 2013. In considering whether a customized TDF is appropriate for your participants, the Tips will provide you some guidelines that will be important as you make your decision.

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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