401(k)/403(b) FIDUCIARY RESPONSIBILITIES

THE REST OF THE STORY

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Agenda

- Current Environment
- Update on Fee Disclosure Obligations
- Plan Operations Overview
- Roles and Responsibilities
- Documentation
- Common Administrative Mistakes
- Reporting and Disclosure
- Annual Audit Preparation
- Next Steps

Current Environment

Current Environment

- Regulators are increasing the scrutiny of Plan Sponsors in the operation and day to day management of their qualified retirement plans
  - **Internal Revenue Service**
    - In February 2012, the IRS issued an Interim Report on its 401(k) Compliance Check Questionnaire (sent to 1,200 plan sponsors), and from that has identified 3 major enforcement initiatives:
      - 401(k) Compliance: top errors found through checks (based on 2008 Forms 5500, more than 500,000 401(k) Plans cover 60 million citizens)
      - LESE projects ("**L**earn, **E**ducate, **S**elf-Correct, **E**nforce"): top-heavy requirements; 402(g) excesses
      - Targeted industries
  - **Department of Labor** has been extremely active
    - 2010: DOL closed 3,112 civil investigations, with total fines of $1.05 billion
    - 2011: DOL closed 3,472 civil investigations, with aggregate fines of $1.39 billion
    - 2012: DOL has hired nearly 100 additional investigators, increasing its enforcement staff to over 1,000 personnel

Source: EBSA Fact Sheets, 2010,2011; www.dol.gov

Current Environment

- Uptick in litigation, especially class actions regarding reasonableness of fees
  - Earlier cases favored plan sponsors who had appropriate processes
  - Recent case: Tussey v. ABB, Inc., ruling that plan fiduciaries were liable for $36.9 million for breaching their fiduciary duties

- Given this environment, the objective of our program is to help plan sponsors and fiduciaries understand and identify the potential risks of administering a qualified retirement plan, so that they develop a game plan to stay ahead of these risks and manage them effectively.

Fee Disclosure Update

Update on Fee Disclosure Obligations

- After several rounds of delays, fee disclosure is finally happening!
- **Key dates:**
  - July 1: Information from your vendors
  - August 30: 1st notice to your plan participants
  - November 14: 1st quarterly notice to your plan participants (for the quarter ending 9/30), showing the fees paid by each plan participant
- **Important Reminder:** Ensuring that your participants receive accurate and thorough disclosure information about investment fees, on time, is YOUR responsibility as a plan fiduciary, so be sure that you understand your obligations

Update on Fee Disclosure Obligations

- **Plan fiduciary obligations:**
  - **Review** information from your vendors
    - Analyze fee information
    - Draw on expertise of qualified experts
    - Consider an independent fee analysis/benchmarking study to provide input (and support) for your determination regarding the "reasonableness" of fees
  - **Review and approve** notices to your participants
  - **Prepare** to answer questions about your processes of selecting and monitoring investments and their related fees
  - **Review** the terms of your investment policy statement and the revenue sharing arrangements/ERISA budgets you have established with your vendors; revise/renegotiate them, as appropriate
  - **Document** your review of fee information, deliberations of relevant criteria, and determination about the reasonableness of fees to demonstrate your prudent, diligent process

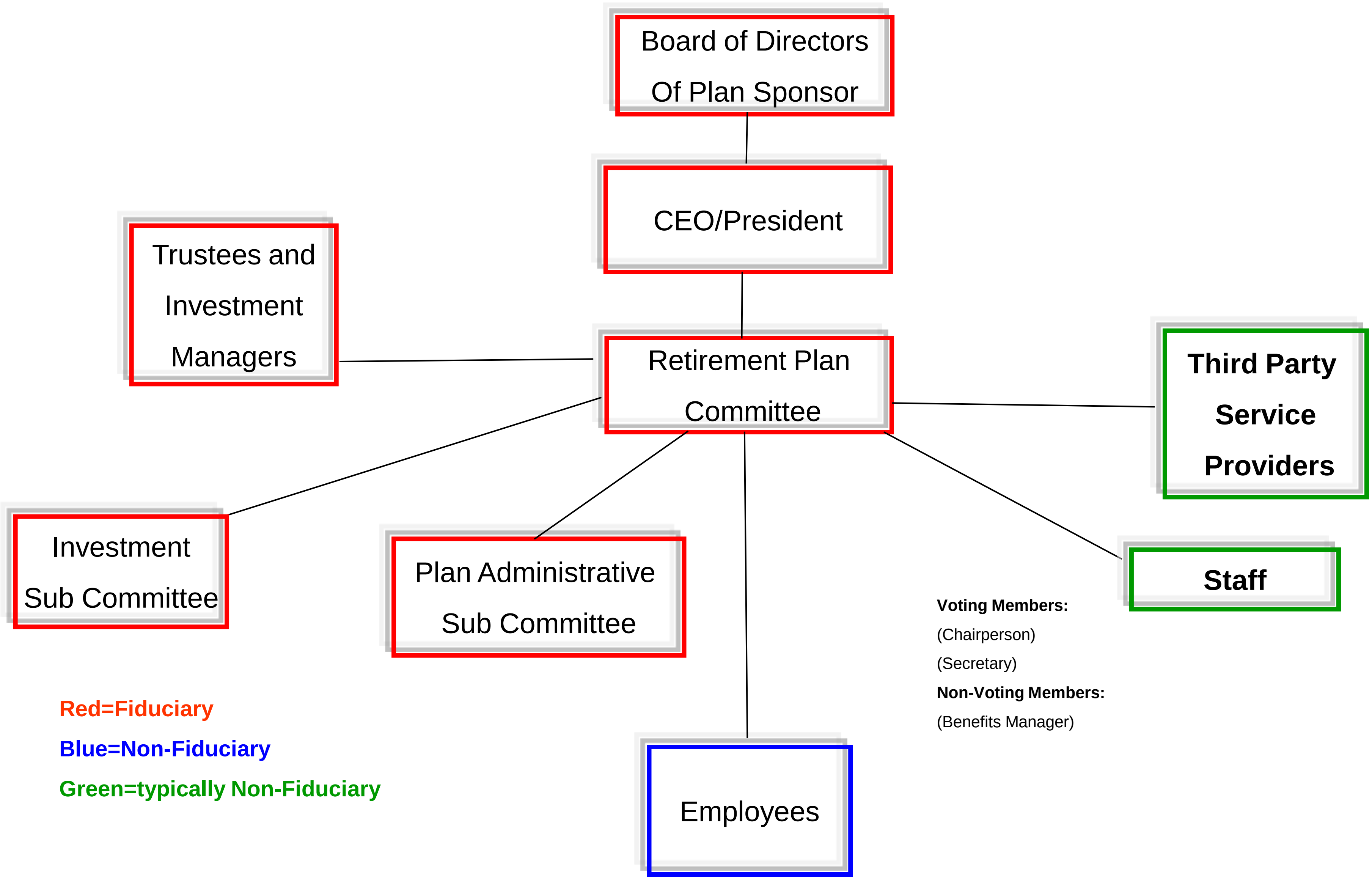
Plan Operations Overview

Plan Operations Overview

- The Employer/Plan Sponsor is responsible for the overall operation of the plan
  - Investment performance is critically important—but fiduciary responsibility does not end with implementing an investment policy statement and checking year-to-date numbers
  - It extends to overseeing and monitoring plan operations and administration
- Based on experience, clients have seen an uptick in audit activity and informal questionnaires and inquiries by both the DOL and IRS, most of which have short response time. Examples:
  - DOL notices of rejection on 5500s ("45 day letters")
  - DOL Audits (15 days to prepare)
  - DOL letters advising about need to correct late deposits or face penalties

Roles and Responsibilities

Roles & Responsibilities
Plan Governance Structure



Who is, and Who is not, a Plan Fiduciary?

- "Fiduciary" is a functional definition—not based on title
- A person is a fiduciary to the extent he or she:
  - Exercises discretionary authority or discretionary control over management of the plan or disposition of its assets
    - Selecting and monitoring investment options
  - Renders investment advice for a fee with respect to plan assets; or
  - Has any discretionary authority or responsibility for the administration of the plan
    - Selecting and monitoring service providers
    - Making decisions about how benefit claims should be handled

Roles and Responsibilities
Fiduciary Roles

- **Trustee** - An organization or group of individuals who hold the plan assets in trust
  - Responsible for administering the plan per the plan document
  - May be limited if “directed” trustee role
- **Plan Sponsor** - Operating through its Board of Directors or other governing body
- **Retirement Plan Committee** - Can be 1 committee that oversees both plan investments and plan operations, or there can be multiple sub-committees, with one primarily focused on investment performance and the other on administrative matters
- **Plan Administrator** – Operates all activities of retirement plan. Duties may include:
  - Providing complete and accurate employee data
  - Maintaining participant records
  - Advising participants and beneficiaries of their rights and distribution options
  - Ruling on claims, benefits and distribution of benefits

Note: Duties may be delegated and outsourced to the vendor, but delegation does not relieve the fiduciary from liability—you still have an ongoing obligation to monitor

Roles and Responsibilities
Non-Fiduciary Roles

- Not a fiduciary if you perform ministerial, nondiscretionary functions involved with plan operations
- Daily HR and Payroll contacts – An employee of the Plan Sponsor that works directly with the vendor on general administrative duties
- Service providers – Plan recordkeepers, actuaries, accountants, lawyers, consultants
- Plan sponsor – When establishing, amending, freezing or terminating plan in its role as “settlor” of the plan

Roles and Responsibilities
Overview of Fiduciary Duties

- **Duty of loyalty**
  - Act solely in the interests of plan participants, for the exclusive purpose of providing benefits to them and defraying reasonable expenses
- **Duty of prudence**
  - Act with the care, skill, and diligence that a reasonable person, who is familiar with these matters, would use under the same circumstances.
  - If one does not have expertise (i.e., with investments), seek out experts
- **Duty of diversification**
  - Diversify plan investments, in order to protect against the risk of large investment losses and to defray reasonable expenses (no guarantee of results)
- **Duty to avoid self-dealing/prohibited transactions**
- **Duty to follow plan terms**

Documentation

Documentation
Key Plan Documents

Operating a plan according to the written terms of the plan documents is one of a fiduciary's core duties, is at the heart of most administrative errors, and is the focus of most plan audits since retirement plan documents memorialize tax-qualification requirements.

Plan document

– If prototype, volume-submitter, or other pre-approved plan, this includes both the "base" plan and an adoption agreement
– **Must be current and must be signed** – up to date with recent plan changes
  – *This is the legal and fiduciary responsibility of the plan sponsor (even if vendor provides products)*
– Prior plan documents are helpful to create an audit trail
– Should be reviewed annually with your plan advisors and recordkeepers
– **NOTE:** Plan administration & calculations manuals are NOT substitute for plan
- If your vendor relies only on plan administration and calculation manual, you should review it to be sure that it is consistent with plan terms and updated to reflect plan amendments

Documentation
Key Plan Documents

- **Trust agreement**
  - May not be a stand-alone document (instead, may be incorporated into plan)
  - May need a "Master Trust" if there are multiple classes of assets (i.e., life insurance policies + mutual funds)
- **Summary plan description (SPD) and summaries of material modifications (SMMs)**
- **IRS approval letter/determination letter**

– Get a copy and understand its scope (individual determination letters expire)

– If your plan deviates from the pre-approved plan, consider getting an individual letter

- **Service agreements**

– Identify services to be provided, extent to which fiduciary duties have been delegated, measurable standards of performance, and limits on liability/indemnification rights

- **ERISA fidelity bond**

– 10% of plan assets (maximum required amount is $500,000 unless plan holds company stock, in which case $1,000,000 bond is required; higher bonding is permissible)

– Key terms required by regulations – i.e., discovery period of at least 1 year after bond is terminated

Documentation
Key Plan Documents

- **Required notices**
  – Periodic notices
    - Notices of amendment
    - Blackout notices when investment options change, plans merge
  – Regular notices
    - Safe harbor status
    - Qualified default investment alternative (“QDIA”)
    - Auto enrollment features
    - Fee disclosure notices (starting 2012), including quarterly statements
    - Summary Annual Report/Annual Funding Notice
- **Annual reports**
  – Form 5500, including all attachments, schedules, audit reports, and management letters
  – For government audits, need returns for at least 3 years

Documentation
Key Plan Documents

- **Plan records**
  - **Payroll records** – tracking withholding of employee contributions
  - **Deposit registers/remittance reports** – tracking transmittal and deposit of contributions
  - **Information regarding company contributions**
    - Calculations – to conform to plan terms
    - Allocation records – especially important if plan terms provide for contributions to be funded every payroll period, monthly or quarterly
  - **Service records** – tracking calculations of service for eligibility to enter the plan, receive a company contribution (i.e., 1000 hours), and vesting credit
  - **Loan reports**
    - Administrative policies/procedures
    - Reports from recordkeeper showing loans made, outstanding balance, and default reports
    - Instructions authorizing deemed distributions
  - **Distribution records**

Documentation Best Practices

Documentation
Best Practices

Although not required, the following documents are considered "best practices" for plan sponsors, and are often requested by DOL and IRS auditors:

- **Investment policy statement**
  - Articulates Committee goals for plan assets, including asset allocation strategies, benchmarks for evaluation, and standards for when funds will be replaced
  - Should be sufficiently tailored to plan while still preserving some flexibility to avoid giving a "roadmap" to potential plaintiffs
  - At least annually, Committee should review and update, as appropriate
- **Committee charter/bylaws**
  - Details delegation of authority and responsibilities of Retirement Plan Committee (and any subcommittees), including right to amend plan; membership (including resignation/removal); meeting protocols (quorum, voting); indemnification rights; and how charter can be amended
- **Committee minutes**
  - Memorialize experts consulted, deliberations, and decisions made, to establish "paper trail" that plan fiduciaries have acted with prudence, diligence and loyalty

Documentation Best Practices

- **Fiduciary liability insurance**
  - Covers amounts above and beyond the required ERISA fidelity bond, because most D&O policies specifically exclude coverage for fiduciary liability
  - Should be reviewed and renewed annually
- **Document retention policy**
  - Articulates document retention policy for retirement plan records, which is often different (and longer) than most other corporate records
  - General recommendation: retain records for at least 7 years, but keep all records, indefinitely, that are necessary to support benefit calculations

Common Administrative Mistakes

Common Administrative Mistakes

Mistake	Explanation	Corrective Actions
Late deposits of 401(k) deferrals	Deferrals should be deposited as soon as the amounts can be reasonably segregated from the employer's general assets—generally a day or two after paychecks, based on past deposit history—and no later than the 15th day of the month following payday	Coordinate with payroll to determine date contributions should have been deposited; deposit late contributions plus earnings, using DOL correction procedures, and either submit corrective DOL filing or pay excise taxes Report on Form 5500 Set up procedures to avoid delays in future; monitor payroll and deposit reports
Wrong definition of compensation	The definition of compensation in the plan does not match the payroll system, resulting in missed or erroneous salary deferrals and employer matching and other contributions, improper classification of HCEs, and erroneous testing results Common example – problems with bonus pay	Make corrective contributions or distributions using IRS procedures Perform annual review of compensation definitions to ensure that plan terms and payroll systems conform – being wary of the fact that plans may have multiple definitions of compensation that are used for different purposes (if so, consider simplifying)
Improper exclusion of eligible employees from plan or certain contributions	Employees who should have been eligible to be in the plan were not given an opportunity to make elective deferrals or to receive employer contributions. (Often affects eligible part-time employees, non-deferring employees who begin or terminate participation during a plan year, or rehired employees)	Make corrective contributions using IRS procedures Monitor census information and apply participation requirements appropriately, especially if there are service requirements in order to receive an allocation of contributions (e.g. 1 year of service, 1,000 hours during the plan year, or being employed on the last day of the plan year)
Unexecuted, or out-of-date plan document	Plan documents must be updated periodically to reflect new changes in the law, and they must be updated to reflect any changes in design All plan documents must be dated and signed	Adopt amendment for missing law changes; submit to IRS as necessary Put a tickler on your calendar to check with plan vendor each year to determine if there are any plan amendments that must be signed before year-end

Common Administrative Mistakes

Mistake	Explanation	Corrective Actions
Elective Deferrals Exceeding Plan Percentage Limits or IRS Dollar Limit ($17,000 for 2012)	Elective deferrals are made above plan limits, typically caused by failure to monitor the limits for each employee, or employees who transfer between divisions within the same employer	Distribute excess deferrals, per IRS procedures. Work with payroll to ensure that payroll systems have embedded appropriate plan limits and IRS dollars limits (although 401(a)(17) compensation limit does not need to apply)
Plan fails nondiscrimination testing	Plan administrator may inappropriately classify HCEs (failing to look at prior year compensation, consider attribution rules relative to ownership when identifying 5% owners, or complying with plan document terms regarding top-paid election and current vs. prior year testing)	Distribute excess contributions, or make qualified nonelective contribution, to correct testing failures, per IRS procedures Depending on the timing of the corrective action, there may be potential liability for excise taxes Consider safe harbor plan design to avoid testing requirements Monitor census information to ensure it is accurate and comprehensive (including all affiliates)
Participant loans do not conform to terms of plan	Plan administrator may inappropriately make loans (without restrictions in plan document), or fail to provide vendor with instructions to default loans that have not been repaid	Modify or correct plan terms, if possible, per IRS procedures Review and follow plan provisions regarding loans, amounts, terms, and repayment provisions Review default reports from plan vendor and provide appropriate instructions
Hardship distributions not made properly	Plan administrator may inappropriately process hardship distributions that do not conform to the restrictions in the plan documents (e.g., requirement that all other resources, including plan loans, be exhausted before hardship distributions are permissible; or 6 month suspension from resuming elective deferrals)	Correct impermissible distribution, per IRS procedures Implement procedures to ensure that future plan operations follow plan terms

Common Administrative Mistakes

Mistake	Explanation	Corrective Actions
Top heavy plan but required minimum contributions not made	If a defined contribution plan is top-heavy, employer must contribute 3% of compensation for all non-key employees who are employed on the last day of the year. "Non-key" employees are not necessarily the same group as "non-highly compensated employees" used for other nondiscrimination testing purposes.	Make corrective top-heavy contribution, per IRS procedures Have vendor perform top-heavy test annually (with plan administrator verifying census information for determination of "key employees")
Failure to file Form 5500 (or related audit)	Every qualified retirement plan (regardless of size) must file a Form 5500 no later than 7 months after the end of the plan's fiscal year (although limited extensions are permissible); failure to file a complete Form 5500 can expose the plan administrator to penalties of up to $1,100 per day	File accurate and complete Form 5500; if one was previously filed, be sure to file an amended return; keep records in the event of inquiry or audit Put reminders on calendar regarding due dates for audits, filing deadlines, and extension requests
Failure to operate the plan according to its terms	A plan's failure to be operated according to any of its written terms can result in disqualification of the plan as a whole, plus personal fiduciary liability or plan fiduciaries	Correct administrative/operational errors from past; going forward, revise plan administrative processes—or plan terms—to ensure future conformity Review plan administration or calculation manual that may be used by plan vendors, to ensure they conform with the plan terms and have been updated for any plan amendments
Failure to consider impact of changes in corporate structure	Due to aggregation rules, changes in corporate ownership (through merger or otherwise) can impact nondiscrimination testing results	Implement corrective actions, as appropriate per IRS procedures Inform plan vendors about changes in ownership structure to assess impact on plan design and nondiscrimination testing, and availability of any transitional grace periods

Common Administrative Mistakes
Corrective Actions

- **Key Principles to Remember**
  - Promptly identify errors (on own, by vendors or 3rd party auditors)
  - Implement appropriate, reasonable corrective action consistent with plan terms and fiduciary duties, which restores the plan and participants to the positions they would have enjoyed had the errors not occurred
  - Revise plan operations and systems to ensure errors do not occur in the future
    - For testing violations, consider periodic modeling or sample tests during partial year
  - Keep an adequate paper/audit trail

Common Administrative Violations
Corrective Actions

- Both DOL and IRS have **voluntary correction procedures** that can be used, depending on the type and scope of the mistake (based on a variety of factors)
  - Some permit self-correction (without filing); others require formal corrective action
    - DOL's Voluntary Fiduciary Correction Program ("VFCP")
    - DOL's Delinquent Filer Voluntary Compliance Program ("DFVCP")
    - IRS's Employee Plans Compliance Resolution System
      - Self-Correction Program ("SCP")
      - Voluntary Correction Program ("VCP")
      - Audit Closing Agreement Program ("Audit CAP")
  - Employers fund costs of correction
    - Key is making employees "whole" – restoring plan and benefits to what they would have been, if the error had not occurred
    - This includes adjustments for earnings, despite market volatility in recent years
    - Penalty taxes may be assessed as well
- **Remember: Fines and enforcement are escalating: $1B in 2010; $1.4B in 2011; $???B in 2012**

Source: EBSA Fact Sheets, 2010, 2011; www.dol.gov

Common Administrative Mistakes
Why Correct – What's at Risk?

- Restoration of plan benefits
- Monetary (civil) penalties for wide range of violations – including, but not limited to:
  - 20% for breach of fiduciary duty
  - Daily penalties for failure to provide information
- Penalty excise taxes (prohibited transactions) – including, but not limited to:
  - 15% of amount involved
  - 100% if prohibited transaction not corrected or "unwound"
- Personal liability for breach of fiduciary duties
  - For your own fiduciary conduct
  - For the conduct of your co-fiduciaries, if you have knowledge of their breach and you fail to stop or remedy any breach of which you aware

Your best strategy to avoid penalties and liability as a plan fiduciary is to do the right thing and avoid errors in the first place!

Reporting and Disclosure

Reporting and Disclosure

- Fiduciary duties include obligations to report information to the government, and disclose information to plan participants
  - Fiduciary duties require accurate content, and timely and thorough reporting to all of the right parties
- **Government Reporting Obligations**
  - Annual Form 5500 and attachments, including audit report
  - Electronic filing, through EFAST
  - Follow up inquiries/Notice of Rejection provided more quickly than in past (which create exposure to significant penalties of $1100/day, assessed on plan administrator)
    - Late deposit of contributions
    - Missing or incomplete schedules or audits

Reporting and Disclosure

- Periodic notices to Participants:
  - – Distribute SPDs and/or SMMs
  - – Participant statements – at least annually (quarterly for defined contribution plans with participant investment direction)
  - – 404(c) notice, often satisfied through SPD
  - – Distribution notices (including benefit election and consent forms, information on tax treatment and rollover options)
  - – Notices of plan amendments, blackout options as needed
- Annual Notices:
  - – Summary annual report (annual funding notice for DB plans)
  - – Safe harbor notice
  - – QDIA
  - – Auto enrollment
  - – Fee disclosure notices
    - - Special considerations with multiple vendors

Annual Audit Preparation

Annual Audit Preparation Basics

- **Plans with more than 100 employees at the beginning of the plan year are required to have an audit annually by an independent accountant**
  - If the plan has between 80-120 participants at the beginning of the plan year, the plan may elect to continue filing as a small plan, without the audit
- **Audits examine the plan's financial statements, records and operations**
  - Auditors can rely on certified trust statements from plan trustees/custodians
  - Review of operations include sampling – more rigorous in recent years
  - Goal: To receive an opinion that financial statements are represented fairly and in conformity with generally accepted accounting principles
- **Audit reports are filed as part of the Form 5500 and are available online**
  - Missing audits can trigger Notice of Rejection and threat of asserted penalties of up to $1,100 per day
  - Disclaimer audit opinions are also likely to trigger investigation

Annual Audit Preparation
Vendor Data for your Accountant

The following reports are generally provided to your accountant

- Certified financial summary
- Notes to financial report
- SAS 70/SSAE 16
- Loan transaction report
- Loan investment report
- Distribution report
- Plan census and valuation report, showing participant activity
- Nondiscrimination testing
- Copies of any plan amendments adopted during the year
- Documentation regarding any self-correction of plan errors identified during the year

Next Steps

Checklist of Next Steps

√ **1. Identify appropriate fiduciaries overseeing plan administration**

– Committee charter/bylaws with delegation of authority

– Minutes and periodic reports to Board of Directors or Compensation Committee

√ **2. Inventory all plan documents – be sure you have the most current, completed and executed versions**

– Plan and trust documents

– IRS approval/determination letter

– Vendor/service agreements

– SPDs, SMMs

– Summary Annual Reports and other required notices

– Investment policy statement

– ERISA bond and fiduciary liability insurance coverage

Checklist of Next Steps

√ **3. Review your plan document: Be sure it says what you think it does, and that your plan operations and payroll systems match your plan**

- **Eligibility**
  - Classification of workers: any exclusions?
  - Age & service requirements for each type of contribution
  - Entry dates: Be sure someone is responsible for timely contacting newly-eligible individuals
- **Definition(s) of compensation**
  - Know what is included & excluded under your plan
  - Check to be sure it conforms to your payroll system, at least annually
  - Know whether different definitions are used for different purposes (contributions vs. testing)
  - Implement a system of “checks and balances”—i.e., automatic limitations in place so that deferrals and employer contributions do not exceed their respective limits

Checklist of Next Steps

- **Contributions**
  - Different types of contributions (pre-tax; after-tax; Roth; rollover; auto enrollment; matching; discretionary; performance)
  - Separate contributions or elections on different type of pay (i.e., bonuses?)
  - Amounts/limits on contributions: Percentage of pay; dollar limits
  - Frequency of funding: By payroll period; monthly; quarterly; annual; true-up reconciliation at year-end
- **Vesting calculations**
  - Actual hours, equivalencies, elapsed time methods used?
  - Treatment of rehired employees
- **Distribution rights**
  - When and how benefits are paid
  - Suspensions for hardship distributions (and recommencement when hardships are over)

Checklist of Next Steps

√ 4. Review informal plan documents against plan terms

- Review SPDs, benefit summaries, statements in employee handbooks, plan administration manuals to be sure they conform to plan terms

√ 5. File Complete Form 5500 on time

-Coordinate audit and timely requests for extensions, as needed

-Promptly amend if schedules or audit are missing, or if subsequent filings identify errors in prior returns

√ 6. Provide all required materials and notices, to all the right people, on time

-Provide all required enrollment materials, SPDs, and notices to current and former participants in a timely manner

-Comply with limitations on electronic methods for disclosure

Checklist of Next Steps

√ **7. Communicate with your plan providers/TPA**

– **Know what your service agreement does (and does not) cover**
  - Plan documentation, amendments & SPDs
  - Required notices – safe harbor, QDIA, auto enrollment, fee disclosures
  - Census data
  - Identification of HCEs
  - Confirmation, calculation and monitoring of contributions
  - Distribution elections and consents; tax reporting
  - QDRO determinations

– **Required testing**
  - Minimum coverage
  - Nondiscrimination testing (ADP; ACP; benefits rights and features; non-standard definitions of compensation)
  - Top-heavy testing

– **Recordkeeping for participant accounts**

– **Keep them informed about changes in your business**

Checklist of Next Steps

√ **8. Keep up with ongoing plan oversight and maintenance**

- Put ticklers on calendar to annually renew bond, fiduciary liability insurance, and check with plan vendor to see if any amendments to plan need to be executed
- Accurate census and compensation records
- Calculation & confirmation of contributions (including deferrals, matching and other employer contributions)
- Reconciliation of contribution, payroll, and remittance records
- Loan & distribution reports

√ **9. Fix mistakes thoroughly and promptly**

Goal: ***Have exam-ready processes and records in place!***

Questions

Questions?

Additional Resources

- "Meeting Your Fiduciary Responsibilities"; US Department of Labor – Employee Benefit Security Administration
  – **http://www.dol.gov/ebsa/pdf/meetingyourfiduciaryresponsibilities.pdf**

- "Understanding Retirement Plan Fees and Expenses"; US Department of Labor – Employee Benefit Security Administration
  – **http://www.dol.gov/ebsa/pdf/undrstndgrtrmnt.pdf**

- “A Plan Sponsor’s Responsibilities”; Internal Revenue Service
  – **http://www.irs.gov/retirement/sponsor/article/0,,id=132528,00.html**

  ▪ "401(k) Plan Fix-It Guide"; Internal Revenue Service
  – **http://www.irs.gov/pub/irs-tege/401k_mistakes.pdf**

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•Our discussion of these concepts is intended to convey our general understanding of the applicable principles, but is not intended as legal or tax advice for a particular situation or client.

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