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EMPLOYEE BENEFITS UPDATE

July 2015

Roundup of Recent Developments Affecting Retirement Plans

Executive Summary

In recent weeks, there have been a number of important new developments affecting tax-qualified retirement plans:

- The IRS announced it will be eliminating the staggered 5-year cycle currently used by individually-designed retirement plans to request determination letters, effective January 31, 2017. Thereafter, individualized determination letters will only be available at initial plan qualification, plan termination, and certain other limited circumstances that will be determined by Treasury and the IRS.
- Plans that let participants direct the investment of their accounts (like most 401(k) and 403(b) plans) now have an additional two months to provide annual fee disclosures.
- Plan sponsors must retain certain written records relating to participant hardship distributions and plan loans; electronic self-certifications will not be sufficient to meet most of these documentation requirements.
- The IRS has announced that qualified defined benefit pension plans will be prohibited from allowing retirees who are already in pay status to elect a lump-sum payment or other accelerated form of distribution in place of their annuity payments.
- Fiduciaries of defined contribution plans offering annuity distribution options should take certain steps for selecting, monitoring, and reviewing annuity providers and annuity contracts if they want to conform to "safe harbor" standards announced by the Department of Labor.

What You Should Do

- Sponsors of individually-designed retirement plans that fall into "Cycle E" (with EINs ending in "5" or "0") and "Cycle A" (with EINs ending in "1" or "6") should continue preparations to file on-cycle determination letter applications with the IRS by January 31, 2016 and January 31, 2017, respectively. Stay tuned for further guidance about when other determination letter applications will be accepted and what programs the IRS will develop to ease compliance with qualified plan documentation requirements, now that you will no longer be able to rely on the comfort of a determination letter for amendments made between initial adoption and plan termination.
- Sponsors of retirement plans with participant-directed investments should assess their policies and procedures for providing annual fee disclosures and determine how to time those disclosures, in light of the new 14-month period for doing so.
- All retirement plan sponsors should assess their current documentation practices for hardship distributions and plan loans to limit electronic participant self-certifications.
- Defined benefit plan sponsors interested in "de-risking" should avoid using temporary lump-sum payment windows for retirees who are already in pay status.
- Fiduciaries for defined contribution plans with annuity distribution options should review their current procedures for selecting, monitoring, and reviewing annuity providers and annuity contracts if they want to comply with "safe harbor" standards established by the Department of Labor.

Significant Changes to Determination Letter Program for Individually-Designed Plans

After months of speculation, on July 21, 2015 the IRS officially announced that it is eliminating the current program under which sponsors of individually-designed retirement plans can request a determination letter regarding the qualified status of their plans, once every five years (based on the last digit of their EINs). Citing its need to direct more efficiently its limited resources, the IRS announced that determination letter applications will be reviewed only for initial plan qualification, for qualification upon plan termination, and in certain other limited circumstances that will be announced periodically in published guidance.

Although IRS determination letters are not required in order for a plan to be tax-qualified, those employers who wish to have the added assurance that the written terms of their plan meet the tax-qualification standards of ERISA should submit determination letter applications to the extent they are still eligible to do so. Specifically, "Cycle E" employers with EINs ending in "5" or "0" are still permitted to submit determination letter applications until January 31, 2016, and "Cycle A" employers with EINs ending in "1" or "6" will still be permitted to submit determination letter applications as scheduled by January 31, 2017. However, after January 31, 2017, no further "on-cycle" applications will be permitted.

Eliminating the 5-year cycle will have other ramifications, including affecting when a plan needs to adopt interim amendments to comply with new changes in the law. For now, the IRS has stated that the remedial amendment period will be extended to at least December 31, 2017 while it considers approaches to these issues.

The IRS is also considering ways to make it easier for plan sponsors to comply with the complex documentation requirements associated with qualified plans, in light of the elimination of the determination letter process. Options being considered include:

- Providing model amendments;
- Permitting sponsors to forgo the adoption of certain plan provisions or amendments that are not relevant to their plan; and/or
- Expanding plan sponsors' options to document qualification requirements through incorporation by reference.

We expect to receive additional IRS guidance on this point in the future. We also expect the IRS to continue its opinion and advisory letter programs for pre-approved plans (such as the volume submitter and prototype plans sponsored by many recordkeepers, banks, and investment houses). As a result of these changes, employers may re-evaluate whether they want to consider giving up the flexibility of an individually-designed plan for the comfort of relying on the IRS opinion or advisory letter issued to a pre-approved plan, but this approach will not work for everyone. For now, all sponsors of individually-designed plans should stay tuned for further developments as the IRS refines its guidance in light of this massive overhaul of the determination letter program.

New Flexibility for the Timing of Annual Fee Disclosures

Several years ago, the DOL introduced regulations that require plans with participant-directed investments, a category that includes most 401(k), 403(b) and profit-sharing plans, to disclose to participants certain plan and investment-related information, including details about fees and expenses. These "fee disclosure" regulations require that information be provided (i) on or before the date the participant can first direct his or her plan investments, and (ii) "at least annually thereafter." As a general rule, the regulations have been interpreted to mean that the disclosures must be furnished at least once in any 12-month period, or no later than one year exactly (e.g., 365 days) after the prior annual notice was provided. As a practical matter, complying with this yearly requirement has proved challenging for many plan sponsors, causing disclosures at a time that does not align with other plan communications.

To address these concerns, effective June 17, 2015, the DOL issued a final rule amending its prior regulations to interpret the phrase "at least annually thereafter" to mean that the disclosure must be furnished at least once in any 14-month period, instead of once in every 12-month period. Extending the deadline for the annual fee disclosures gives employers additional flexibility to determine the timing of their disclosures, align them with other plan communications if desired, and standardize the timing from year to year. Employers should take this opportunity to review their policies and procedures and assess what, if any, changes they would like to make in light of their increased flexibility.

Retaining Documentation for Hardship Distributions and Plan Loans

In a recent newsletter, the IRS cautioned employers who sponsor retirement plans about the proper retention of documentation for hardship distributions and plan loans, undermining the efficacy of some electronic self-certification programs offered by a number of recordkeepers.

The IRS newsletter reminds plan sponsors that they must retain the following records for each hardship distribution or plan loan, either in paper or electronic format:

Hardship Distributions

- Documentation of the hardship request, review and approval;
- Financial information and documentation that substantiates the employee's immediate and heavy financial need;
- Documentation to support that the hardship distribution was properly made in accordance with the applicable plan provisions and the Internal Revenue Code; and
- Proof of the actual distribution made and related Forms 1099-R.

Loans

- Evidence of the loan application, review and approval process;
- An executed plan loan note;
- If applicable, documentation verifying that the loan proceeds were used to purchase or construct a primary residence;
- Evidence of loan repayments; and
- Evidence of collection activities associated with loans in default and the related Forms 1099-R, if applicable.

The IRS was painstakingly clear that these records must be retained by the plan sponsor – it is not sufficient for plan participants to keep their own records because they could leave the company or lose the records, thereby rendering the documents inaccessible to the IRS in an audit.

Perhaps the most significant aspect of the IRS' guidance for employers is the clarification that a participant's electronic self-certification is not sufficient documentation of:

- The nature of a participant's hardship for a hardship distribution; or
- A participant's eligibility for a loan with an extended repayment period for the purchase or construction of a residence.

Although many plan recordkeepers allow participant electronic self-certifications in these scenarios, the IRS maintains that this practice is impermissible. For hardship distributions, self-certification can be used for the limited purpose of showing that a distribution was the only way to alleviate a hardship, but not to show the nature of the hardship. For plan loans, plan sponsors cannot rely on a participant's self-certification that he or she is eligible for an extended repayment period loan for the purchase or construction of a residence, but must instead obtain documentation of the home purchase before the loan is approved.

While some recordkeepers are disputing the IRS position, employers should review their policies and procedures, as well as their service agreements and plan administration manuals with their recordkeepers, with a critical eye toward any electronic participant self-certifications, and should assess whether they, along with their recordkeepers, are collecting and retaining all of the necessary documentation.

Elimination of Lump-Sum Payment Windows for Retirees in Pay Status under Qualified Defined Benefit Plans

In recent years, "de-risking" strategies for pension plans have become more common as many employers look to reduce their exposure to market volatility and accounting considerations that can have a significant financial impact on their plan funding liabilities. One common de-risking strategy has been to open a temporary lump-sum payment window during which participants and their spouses can effectively cash out their pensions by electing to receive their future plan benefits in a lump sum instead of in a series of annuity payments. This practice has long been accepted for deferred vested participants, but whether it could be offered to participants or beneficiaries who had already begun receiving payments was an open question.

On July 9, 2015, the IRS issued Notice 2015-49, announcing that qualified defined benefit pension plans will be prohibited from using temporary lump-sum payment windows to allow retirees who are already in pay status to elect to receive a lump-sum payment or other accelerated form of distribution in place of their annuity payments. This restriction is narrow and only applies with respect to retirees who have already begun to receive benefits; plan sponsors will still be permitted to provide temporary lump-sum payment windows for vested deferred participants who are not yet in pay status. With limited exceptions for lump-sum payment windows that were already open or authorized as of July 9, 2015, the change is intended to be effective immediately.

For now, employers who are interested in pursuing de-risking strategies should steer clear of temporary lump-sum payment windows for retirees who are already in pay status. We will keep you informed of any additional details when regulations formally implementing this change are actually issued.

Clarification of Safe Harbor for Defined Contribution Plan Annuity Distribution Options

In 2008, the Department of Labor issued regulations establishing "safe harbor" conditions for the selection and monitoring of annuity providers for benefit distributions under defined contribution plans. However, employers continued to remain unclear about the scope of their fiduciary obligations with respect to annuity selection. Therefore, in an effort to provide more clarity and certainty to plan fiduciaries, the DOL has issued Field Assistance Bulletin 2015-02, which provides further guidance on a fiduciary's duty to act prudently in selecting, monitoring, and reviewing annuity providers and annuity contracts for benefit distributions under defined contribution retirement plans.

Under the safe harbor, a plan fiduciary's duty of prudence will be deemed fulfilled if the fiduciary:

- Engages in an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities;
- Appropriately considers information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract;
- Appropriately considers the cost (including fees and commissions) of the annuity contract in relation to the benefits and administrative services to be provided under the contract;
- Appropriately concludes that, "at the time of selection", the annuity provider is financially able to make all future payments under the annuity contract and the cost of the annuity contract is reasonable in relation to the benefits and services to be provided under the contract; and
- If necessary, consults with an appropriate expert or experts.

The safe harbor also provides that plan fiduciaries must periodically review an annuity provider who has been selected to offer annuities that participants may later choose as a distribution option to assess the annuity provider's financial ability to make all future payments and the reasonableness of the cost of the contract.

To clear up confusion about the scope of a fiduciary's duty "at the time of selection", and in performing a periodic review and monitoring of any selected annuity provider, the new DOL guidance confirms that a fiduciary's selection and monitoring of an annuity provider will be judged based on the information available at the time of the selection, and at each periodic review, and not in light of subsequent events. The frequency of periodic reviews necessary to comply with the safe harbor depends on the facts and circumstances, but a review is not required each time a participant or beneficiary elects an annuity from the provider as a distribution option. However, certain "red flags," like a major insurance rating service downgrading the financial health rating of the provider, or several annuitants submitting complaints about a pattern of untimely payments, should trigger a reexamination of the provider, even between otherwise periodic reviews. A plan fiduciary's duty to monitor an annuity provider ends when annuities from that provider are no longer offered as a distribution option under the plan.

Importantly, employers should note that this guidance is limited to the selection and monitoring of annuity providers for benefit distributions from defined contribution plans. Annuity providers and contracts that are offered as investment options under defined contribution plans are not covered, but the DOL indicated that it is considering guidance on fiduciary selection and monitoring for these annuities as well.

This is not the last guidance that we expect to receive regarding the selection of annuity providers, as it is part of the DOL's overall emphasis on encouraging plan sponsors to offer lifetime income distribution options under plans, so stay tuned for further developments in this area.

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If you have any questions about how these new developments impact your tax-qualified retirement plans, or about your retirement plans in general, please let us know.

ISLER DARE, P.C.
1945 Old Gallows Road, Suite 650
Vienna, Virginia 22182
703-748-2690

Andrea I. O'Brien
aobrien@islerdare.com

Vi D. Nguyen
vnguyen@islerdare.com

Matthew M. Craig
mcraig@islerdare.com