401(k) Advisor

THE INSIDER'S GUIDE TO PLAN DESIGN, ADMINISTRATION, FUNDING, & COMPLIANCE

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BRIEFLY

2 DOCUMENT UPDATE
Restatement Period for Pre-Approved Plan Documents

3 LEGAL UPDATE
Offering Longevity Annuities in 401(k) Plans

4 Q&A
Top-Heavy: Part II

6 BENEFITS CORNER
- *IRS Updates Its Fix-It Guide*
- *ERISA Is 40 Years Old*
- *Updated DOL Guidance on Missing Participants*

10 REGULATORY AND JUDICIAL UPDATE

11 INDUSTRY INSIGHTS
Generation X Workers: Retirement Reality Bites Unless Answers Are Implemented

12 LAST WORD ON 401(k) PLANS
The Government and Chekhov's Gun

"Ban the Box" Laws Must Give Way to ERISA

Peter Gulia, Esq.

The states of California, Colorado, Connecticut, Hawaii, Massachusetts, Minnesota, New Jersey, and New Mexico have enacted a "ban the box" law that restrains when and how an employer may consider an employment applicant's or candidate's criminal background. And many cities and counties, including Atlanta, Boston, Chicago, Detroit, New York, Philadelphia, San Francisco, and Seattle, have similar laws. As employers refine procedures to comply with these state and local laws, an employer should consider other laws, including the Employee Retirement Income Security Act of 1974 (ERISA).

"Ban the box" laws typically include an exception for criminal background screening required by a federal or state law. Even if a state's law does not include such an exception, a federal statute often supersedes or preempts a state's law. At least a dozen federal statutes preclude employing someone in a specified job or task if he or she has been recently convicted of or imprisoned for any of a specified set of crimes. These restrictions affect banking, insurance, investment management, employee benefits, health care, child care, trucking, and aviation.

Among these federal statutes is ERISA, which supersedes a state's law that even "relates to" an employee

continued on page 7 ➤

DOL Issues Request for Information Regarding Brokerage Windows

John C. Hughes, Esq.

On August 20, 2014, the Department of Labor (DOL) issued a request for information (RFI) regarding the use of brokerage windows, brokerage accounts, and similar arrangements (collectively, Brokerage Windows) under self-directed defined contribution plans (which includes, and mostly affects, self-directed 401(k) plans).

Brokerage Windows generally allow plan participants to invest beyond a plan's designated investment alternatives (*i.e.*, menu of investments) selected by an employer and/or other plan fiduciary. These vehicles greatly expand the universe of available investments. Brokerage Windows are sometimes offered together with fiduciary chosen investment options under the plan, and sometimes, they are offered in lieu of fiduciary chosen investment options. Participants will often work with an investment consultant or broker of their choosing in utilizing Brokerage Windows.

The DOL previously communicated its intention to study Brokerage Windows. This was prompted in part following confusion associated with the "404a-5" regulations and associated

continued on page 8 ➤

Restatement Period for Pre-Approved Plan Documents

Charles D. Lockwood, Esq.

Under IRS procedures, pre-approved defined contribution plans (both prototype and volume submitter documents) must be completely restated every six years to comply with current qualification requirements. Beginning May 1, 2014, all pre-approved defined contribution plan documents, including 401(k) plans, must be restated to comply with the qualification requirements enacted under the Pension Protection Act of 2006 (PPA) as well as other legislation addressing qualified retirement plans, including the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act), the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA), and the Small Business Jobs Act of 2010 (SBJA). The restatement period applicable to pre-approved defined contribution plans expires April 30, 2016.

Review of Plan Design

The requirement to restate every pre-approved defined contribution plan by April 30, 2016, creates a new opportunity for employers to re-examine their plan design to ensure it continues to meet their retirement goals. As the needs of employers change, perhaps due to a change in employee demographics or a change in the financial situation of the employer, plan redesign can play a key role in addressing the employer's retirement and business goals. Employers may wish to re-examine the compliance testing of their plans to determine whether a safe harbor plan design could be a viable option. In addition, if the level of participation in an employer's 401(k) plan is lower than desired, the employer may want to consider adding an automatic contribution feature to bolster the participation levels under the plan.

Restatement of Safe Harbor 401(k) Plans

If an employer already has a safe harbor 401(k) plan, special consideration must be given to the restatement of the plan. The IRS has taken a position that safe harbor 401(k) plans may not be amended during the plan year to modify provisions of the plan, even where the amendment does not directly affect the safe harbor notices provided to participants. The IRS has allowed limited mid-year amendments to add provisions permitted by statute, such as Roth contributions and hardships distributions for primary beneficiaries, and certain nonsubstantive amendments, such as change in trustee. Safe harbor 401(k) plans also may be amended mid-year to prospectively eliminate the safe harbor contribution under the plan. For most other amendments, the IRS has stated that safe harbor 401(k) plans may not be amended during the plan year.

This raises an interesting challenge for the restatement of safe harbor 401(k) plans. Given the changes that have been made to most pre-approved plans as part of the PPA plan redesign, it will be very difficult to restate a safe harbor 401(k) plan from an EGTRRA document to a PPA document without making some modifications to the plan document. The IRS has not indicated whether a restatement from an EGTRRA document to a PPA document will violate the prohibition against mid-year amendments.

Until the IRS issues guidance in this area, it may be advisable to restate safe harbor 401(k) plans on a prospective basis. For example, if a safe harbor 401(k) plan is being restated in 2014, instead of using a 1/1/2014 effective date, the plan should use a 1/1/2015 effective date. Similarly, if restated in 2015, the plan should use a 1/1/2016

continued on page 8 ➤

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Offering Longevity Annuities in 401(k) Plans

Marcia S. Wagner, Esq.

Responding to concerns that participants may outlive their retirement plan savings, the IRS recently finalized regulations facilitating the use of longevity annuity contracts in defined contribution plans. A longevity annuity is a deferred annuity under which payments begin at an advanced age, such as age 80 or 85, and continue for the life of a plan participant. Retirees can now safely purchase such an annuity paying a guaranteed lifetime income commencing at an age later than normal retirement using proceeds from a portion of their 401(k) accounts. To enable this, the final regulations relax the required minimum distribution (RMD) rules of Internal Revenue Code Section 401(a)(9) and establish the conditions for plans offering longevity annuities to qualify for this more lenient treatment. The IRS hopes that this will make it easier for defined contribution plans to offer such annuities.

Background

Before the final regulations were issued, longevity annuities were a problematic investment option for a tax-qualified plan because of the RMD rules. These rules provide that the minimum distribution amount is calculated by dividing a participant's account balance by his or her life expectancy and that distribution of this amount must generally commence no later than April 1 following the year in which the participant attains age 70½. Previously, when a participant's account included a deferred annuity contract, the RMD rules required that the value of the annuity contract be included in the account balance when determining the amount to be distributed, which meant a larger distribution than otherwise would have been the case. Moreover, if the entire account were invested in the annuity, there would be nothing left to make required distributions.

In February 2012, in an effort to promote longevity annuities, the IRS proposed regulations allowing the exclusion of qualifying longevity annuity contracts (QLACs) from the RMD calculation if certain requirements are satisfied. As summarized below, final regulations were issued in July 2014 that are largely consistent with the proposed regulations. The final rules apply to annuity contracts purchased on or after July 2, 2014. Under a special rule, a noncompliant contract issued before this effective date may be exchanged on or after July 2, 2014, for a new contract that satisfies the QLAC requirements.

QLAC Requirements

In order to qualify as a QLAC, an annuity must be purchased from an insurance company and the contract (or a rider or certificate) must state when it is issued that it is intended to be a QLAC. A QLAC must also provide that distributions thereunder can commence no later than the first day of the month next following the participant's attainment of age 85. A QLAC is not permitted to provide a variable annuity, indexed annuity, or similar type of benefit, since its purpose is to provide a predictable stream of income. In addition, QLACs may not provide a commutation benefit (*i.e.*, a lump-sum distribution), cash surrender right, or other similar feature. However, a QLAC can be a participating annuity that pays dividends or an increasing annuity that provides for cost-of-living increases.

Aggregate premium payments for QLACs cannot exceed the lesser of $125,000 (the dollar limit), or 25 percent of the participant's account balance (the percentage limit). In applying the dollar limit, premium payments under all qualified plans, as well as under 403(a) plans, 403(b) plans, governmental 457(b) plans, and IRAs (except Roth IRAs) maintained on behalf of an individual are taken into account. The dollar limit will be adjusted for inflation in $10,000 increments.

The percentage limit generally applies on a plan-by-plan basis and is determined with respect to a participant's account balance, including the QLAC's value, as of the last plan valuation date before each premium payment. The account balance is adjusted for any contributions or distributions made after the valuation date. In the case of an IRA, however, the percentage limit is applied to the total of the balances of all IRAs that an individual holds and, within this limit, QLAC premiums paid from a particular IRA may exceed 25 percent of that IRA's account balance.

The regulations contain a correction procedure in the event that a participant inadvertently exceeds the dollar or percentage limits. Under this procedure, excess premiums can be returned to the "non-QLAC" portion of a participant's account by the end of the calendar year following the calendar year in which they were paid without disqualifying the annuity purchase.

Optional Features

Under the proposed regulations, a life annuity payable to a designated beneficiary was the only permissible death benefit a QLAC could provide. To address participants' aversion to the risk of losing premium payments, the final regulations create an exception to this rule by permitting QLACs to offer a return of premium feature payable in the event the participant dies either before or after the annuity starting date without recovering the participant's premium outlay. Accordingly, a QLAC may provide for a single-sum death benefit payable to a beneficiary in an amount equal to the excess of the total premiums paid for the QLAC

continued on page 9 ➤

Q&A

Top-Heavy: Part II

Jeffery Mandell, co-editor of 401(k) Advisor, *interviews James E. Turpin of the Turpin Consulting Group, Inc., regarding the top-heavy rules that affect all qualified retirement plans. This interview continues our top-heavy discussion reported in our July 2014 issue.*

James E. Turpin has provided actuarial, administrative, and consulting services for retirement plans for over 40 years and is a frequent author and lecturer on employee benefit and retirement plan issues. He is a member of the American Academy of Actuaries, a Fellow of the Conference of Consulting Actuaries, a member of the American Society of Pension Professionals and Actuaries, and an Enrolled Actuary. James can be reached at 505-888-7000 or JTandME@aol.com.

Q To recap our last discussion, what is a top-heavy plan and who are key employees?

A A top-heavy plan is a plan or plans in which more than 60 percent of the value of benefits or account balances are attributed to "key employees." There are three categories of employees who are deemed to be key employees, if at any time during the plan year they were:

1. an officer of the employer having annual compensation greater than $130,000 (with cost of living adjustments, this amount is $170,000 for 2014);
2. a 5 percent owner; or
3. a 1 percent owner with annual compensation in excess of $150,000.

Q Once you have identified the key employees, what is next?

A The next step is determining the benefits or account balances that are included in the numerator and denominator of the fraction when calculating whether key employees have more than 60 percent of the total. For the current plan year, the determination is made at the end of the prior year except for the first plan year, which is determined at the end of the first year. For the denominator, you usually consider the account balances or accrued benefits for all participants at the end of the prior year. Plus, you add back distributions to former employees during that prior year and in-service distributions during the prior five years. In most cases, you do not include rollover accounts in the denominator or the numerator unless the rollover was from a related plan (typically another plan of the same employer).

The numerator is the portion of the denominator attributed to key employees. It is possible for a key employee to cease to being a key employee if his compensation declines below the thresholds for officers or 1 percent owners or the employee ceases to be an owner. Once you have determined the ratio of key employee accrued benefits and account balances to the total accrued benefits and account balances, the plan is top-heavy for the current year if, as of the determination date (end of the preceding year), this ratio is more than 60 percent.

Q What if the employer sponsors more than one plan?

A In that case, it may be necessary to aggregate those plans for determining top-heavy status. In simple terms, if a key employee benefits from more than one plan, you have to aggregate those plans together to calculate the top-heavy ratio. Further, even if the key employee does not benefit in all of the plans, if the plans have to be combined to pass coverage or nondiscrimination testing, then the plans are aggregated for top-heavy purposes. This is referred to as "required aggregation" and all of the plans that are part of the required aggregation group must comply with the minimum top-heavy requirements. There are unique circumstances where one plan will pass coverage and nondiscrimination testing and not be top-heavy but will have to be aggregated with another plan to allow the second plan to pass testing. Keep in mind that the first plan might not be considered part of an aggregation group with the second plan because it did not need to be combined with the second plan to pass testing.

It is possible when an employer sponsors more than one plan (where key employees do not benefit in all of the plans) and when it is not necessary to aggregate plans that cover key employees with plans that have no key employees to pass coverage and nondiscrimination testing, the plans that do not include a key employee would not have to be tested for being top-heavy. However, you might "permissively aggregate" the plans together, so that the combined plans might not be top-heavy. For example, Plan A covers 75 percent of the employees of the employer, including all of the key employees. Plan B covers the other 25 percent of the employees and no key employee. The top-heavy percentage for Plan A is 65 percent, but when you combine it with Plan A, the top-heavy percentage drops to 58 percent. With permissive aggregation, neither Plan A nor Plan B would be considered top-heavy.

Q What results once you have determined that a plan(s) is top-heavy?

A There are two general top-heavy requirements: minimum vesting and minimum benefits or contributions.

Q&A

For top-heavy plans, vesting must satisfy the top-heavy minimum vesting schedules that are either: (1) 20 percent after two years of service, increasing 20 percent per year to 100 percent at six years, or (2) a "cliff" approach that is zero percent until it is 100 percent after three years. Remember that a plan can be top-heavy and then cease to be top-heavy. This would allow it to revert to its normal vesting schedule when it ceases to be top-heavy. However, a participant's "vested percentage" before the change may not go down as a result of the change in status.

Q Tell me about minimum contributions.

A For a top-heavy defined contribution plan, the employer contribution for eligible non-key employees has to be the lesser of at least the highest contribution rate for any key employee or 3 percent. When determining the highest key employee employer-contribution rate, you include salary deferrals under IRC Section 401(k). So, even if the employer is not making a contribution this year, a minimum 3 percent contribution would be required for eligible non-key employees if at least one key employee contributed more than 3 percent as a salary deferral. A safe-harbor 401(k) plan for which the *only* employer contribution is either the 3 percent contribution to all participants or the safe-harbor employer match is deemed to satisfy the minimum top-heavy contribution requirement.

In a defined contribution plan, the employer contributions are often based only on compensation while an employee is a participant (for when an employee enters the plan mid-year). However, the minimum top-heavy contribution is based on full-year compensation. So, it is important to monitor the top-heavy contributions for employees who enter the plan other than on the first day of the plan year. In a top-heavy defined contribution plan, and if the plan is written this way, the minimum contribution only has to be provided to those participants who are still employed on the last day of the plan year regardless of the number of hours of service in that plan year.

Q What about defined benefit plans?

A For a defined benefit plan, the minimum benefit is an accrual equal to 2 percent of "average" compensation per year of service while the plan is top-heavy, not to exceed 20 percent. Average compensation for top-heavy is averaged over five years while the plan is top-heavy.

Unlike the defined contribution plan minimum contribution requirement, which is applied each year, the minimum top-heavy benefit in a defined benefit plan may have been earned in prior years. Consider a participant who is in a plan with a benefit that is 1 percent per year of service and has 5 years of service. The plan only became top-heavy in the current year. The participant would not have a 2 percent benefit in the current year since the existing benefit formula would have already provided the participant with a cumulative 5 percent benefit, more than the 2 percent minimum required for one year of top-heavy status. The participant might not see any additional benefit from the plan being top-heavy for several more years until the 2 percent per top-heavy year benefit exceeds the plan's normal benefit formula of 1 percent per year.

The top-heavy benefit is a life annuity commencing at normal retirement age. If the plan provides another form of payment as its normal form of annuity, the top-heavy benefit can be adjusted accordingly. For example, if the normal form is 10-year certain and life, the top-heavy benefit could be 1.80 percent instead of 2 percent.

Unlike the requirement for defined contribution plans, which only requires employment on the last day of the plan year to receive the top-heavy minimum contribution, the minimum top-heavy benefit in a defined benefit plan is provided to all participants who are credited with at least 1,000 hours of service during the plan year, even if the participant terminates employment during the plan year (again, if the plan is written that way).

Q Who reviews the top-heavy required benefits?

A Whether it is a minimum contribution or a minimum benefit, the plan is only required to provide such contribution or benefit to non-key employees. However, many plans (some on purpose, some by mistake), are written to provide the same top-heavy benefit to both key employees and non-key employees.

Q Often you will find an employer that sponsors both a defined contribution and a defined benefit plan. Is it necessary to provide the minimum top-heavy contribution and benefit in both plans?

A No, there are several ways to "allocate" top-heavy minimums between plans. There are four safe-harbor ways to do this when a non-key employee participates in both a defined contribution and a defined benefit plan sponsored by his employer.

1. Since the 2 percent benefit in the defined benefit plan is generally considered more valuable than the 3 percent contribution to the defined contribution plan, providing the 2 percent benefit will satisfy the top-heavy requirement for both plans.

continued on page 9 ➤

BENEFITS CORNER

Submissions by William F. Brown

IRS Updates Its Fix-It Guide

To help plan sponsors and administrators with regulatory issues, the IRS has posted many different forms of guidance on its Web site, including "Fix-It Guides" for various types of plans. It recently posted an updated version of its Fix-It Guide for 401(k) plans, which is available at *http://www.irs.gov/pub/irs-tege/401k_mistakes.pdf*. The guide contains 52 pages of detailed information, but the first page has a chart listing 12 common mistakes involving 401(k) plans with three additional columns headed Find the Mistake, Fix the Mistake, and Avoid the Mistake. The 12 mistakes range from failing to update the plan document to failing to file one or more Form 5500-series returns. Other mistakes include various errors regarding contributions, failure to follow various rules, and failure to timely deposit participant deferrals. Each mistake has a link that shifts the reader to a more detailed discussion of the topic. Even if a plan administrator is absolutely convinced that it is operating the plan in accordance with all the rules, review of at least the first page chart could suggest areas for improvement. The rest of us, meaning virtually everyone working with 401(k) plans, will benefit from even a cursory review of the new guide.

ERISA Is 40 Years Old

Many different sources noted that September 2, 2014 marked the 40th anniversary of the day President Gerald Ford signed the Employee Retirement Income Security Act of 1974. Several commentators marked the anniversary of this much-maligned and oft-amended legislation with a variety of suggestions for improvements and criticisms of its structure and impact. It is also important to note the context of this historic effort to regulate private retirement savings.

Consider the political situation at the time. Gerald Ford assumed the Presidency less than a month before signing ERISA into law; it is reportedly the first legislation he signed. Six days later, he pardoned his disgraced predecessor, Richard Nixon, and eight days after that, he introduced a conditional amnesty program for draft dodgers who fled abroad to avoid the Vietnam War.

The first major event that gave rise to the pension reform effort was the 1963 shutdown of the Studebaker Corporation, an automobile manufacturer with a woefully underfunded pension plan. When the dust settled, Studebaker changed the plan to pay full pensions to approximately 3,600 employees who had reached the retirement age of 60. Another 4,000 workers between the ages of 40 and 59 received lump-sum payments equivalent to about 15 percent of the actuarial value of their pension benefits, and another 2,900 employees received nothing at all. This event was the first significant demonstration that the defined benefit promises of American manufacturers might not be realistic. In response, President Kennedy named a committee to examine private sector pension plans, and several influential Congressmen began developing legislation.

Another key development was the revelation that George Barasch, a leader of the Teamsters union, had sole control over two union benefit funds holding millions of dollars. In hearings before a Senate investigative committee looking into misuse and diversion of employee benefits, Barasch invoked his Fifth Amendment right against self-incrimination over 150 times.

Despite these developments, various legislative proposals failed to gain enactment in the face of business and union objections. The final impetus was a television program broadcast on September 12, 1972, by NBC. Entitled *Pensions: The Broken Promise*, the hour-long program relied on congressional reports to highlight the onerous vesting requirements of many pension plans and show the consequences of poorly funded plans. This prompted new congressional hearings and growing public support for pension reform. The ultimate result was ERISA, a bipartisan effort to pull together several pieces of legislation amid many compromises fostered by business and labor interests.

Updated DOL Guidance on Missing Participants

For various reasons, some participants fail to apprise plan administrators of their current address, causing the administrator to lose track of them. The IRS and the DOL have long expected administrators to attempt to track down such participants. This is particularly the case when the plan sponsor has decided to terminate the plan. On August 14, 2014, the DOL issued Field Assistance Bulletin No. 2014-01 to provide updated guidance regarding the fiduciary duties when a terminating defined contribution plan has missing participants. This FAB replaces FAB 2004-02 and will be useful for administrators of ongoing plans too.

One of the key changes in FAB 2014-01 is elimination of references to the letter-forwarding services of the IRS and Social Security Administration, which have been discontinued.The FAB notes that "Internet search technologies" have expanded and improved. The FAB also incorporates suggestions from the 2013 ERISA Advisory Council.

Although the decision to terminate a plan is a settlor function, the distribution of plan assets to participants is a fiduciary task, and the fiduciary "must act prudently and solely in the interest of the plan's participants and beneficiaries." Consistent with these obligations, the fiduciary must make "reasonable efforts" to locate missing participants or beneficiaries. The FAB notes that

some search steps “involve so little cost and such high potential for success” that the fiduciary “should always take them” before abandoning the search, “regardless of the size of the participant’s account.” “At a minimum,” the fiduciary should “take all of the following steps before abandoning efforts” to find a missing participant: (1) use certified mail to send notice of termination and distribution paperwork; (2) check the records of a related plan, such as a group health insurance plan, and other employer records; (3) try to identify and contact any individual that the missing participant has designated as a beneficiary; and (4) use free electronic search tools, such as Internet search engines, public record databases, obituaries, and social media. The FAB notes that there is no requirement that fiduciaries must do these “in any particular order.”

If all of these steps fail, the fiduciary must “consider if additional search steps are appropriate” based on consideration of the size of the missing participant’s account balance and the cost of further efforts. The FAB admonishes that “other more expensive approaches may be required when the account balance is large enough to justify additional plan expense and other efforts have failed.” Additional efforts can include “Internet search tools, commercial locator services, credit reporting agencies, information brokers, investigative database and analogous services that may involve charges.”

The FAB recognizes that sometimes all reasonable search efforts will fail to locate a missing participant. If so, the fiduciary must select “an appropriate distribution option.” The FAB stresses that the preferred distribution option is a direct rollover distribution to an IRA for the benefit of the missing participant. It also notes that the selection of the IRA “requires the exercise of fiduciary judgment” and that it has published a “safe harbor regulation” [29 C.F.R. § 2550.404a-2] for fiduciaries to satisfy “their fiduciary responsibilities.”

If the fiduciary cannot find an IRA provider to accept the direct rollover distribution for a missing participant, or there is “some other compelling reason” not to do so, then the fiduciary has two other options: (1) it can open an “interest-bearing federally insured bank account” in the name of the missing participant or beneficiary, or (2) it can transfer the account balance to a state unclaimed property fund. Before doing so, however, the fiduciary “must prudently conclude” that such distribution is “appropriate despite the potential considerable adverse tax consequences to the participant.” Finally, the FAB expressly states that a fiduciary “should not use” the option of applying “100% income tax withholding” for a missing participant. This technique transfers the missing participant’s benefits to the IRS, but the DOL believes that this option “is not in the best interest of participants and beneficiaries and would violate ERISA’s fiduciary requirements.” ❖

➤ **“Ban the Box”**

continued from page 1

benefit plan. Except for plans maintained by a governmental employer or a church, ERISA governs most employee benefit plans, including plans for health coverage, disability benefits, death benefits (life insurance), and pension or retirement benefits. So ERISA governs most 401(k) retirement plans.

Because ERISA, with few exceptions, supersedes a state’s civil laws other than those that regulate banking, insurance, or securities, a state or local law cannot prohibit an employer from screening an applicant’s or candidate’s criminal background if the job includes employee benefits administration or investment management.

ERISA makes it a federal crime for a person convicted during the past 13 years of any of a long list of federal and state crimes (including several regulatory crimes), or imprisoned during the past 13 years because of such a conviction, to serve as an administrator, fiduciary, officer, trustee, custodian, counsel, agent, employee, or representative of an employee benefit plan. Likewise, such a person must not serve in any capacity that involves making decisions for an employee benefit plan or any custody or control of any plan’s asset. Further, even without such a role or responsibility, a person recently convicted of or imprisoned for any of the specified crimes must not serve as a consultant, advisor, or service provider to an employee benefit plan. ERISA makes it a federal crime for a person—not just a fiduciary, but any person—to “permit” the service of a disqualified person in a precluded role.

Perhaps worse, a fiduciary that permits a disqualified person to serve in a precluded role might have acted imprudently and so might have breached a fiduciary responsibility to an employee benefit plan. (A claimant could argue that it is inherently imprudent to disobey an explicit statutory command.) A breaching fiduciary is personally liable for a loss or harm that results from the fiduciary’s breach of its responsibility. Those consequences can be harsh if the loss or expense is uninsured. (See “Am I Indemnified? Are We Insured?” in *401(k) Advisor*’s September 2014 issue.)

Understanding this, an employer, whether a plan sponsor or a service provider, should design and use an appropriate criminal background check when hiring (or promoting) an employee, if getting the job would make the employee a fiduciary of an employee benefit plan or would involve some other precluded role. To do this, an employer might get help from an employee benefits lawyer. Sorting out which jobs include an employee benefits function might be difficult for someone who lacks practical experience with employee benefit plans’ operations.

An employee benefits lawyer can evaluate job descriptions and employee benefit plans' documents to look for jobs that include employee benefits administration or investment management. Also, an employer might want help in designing its procedures so it can defend against a complaint that the employer considered more information than was necessary or appropriate. ❖

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➤ DOL Issues Request

continued from page 1

guidance. The 404a-5 regulations generally require plan fiduciaries to make certain disclosures regarding plan fees, expenses, and investments to plan participants. Prior to the issuance of the 404a-5 regulations (effective in 2012), there were generalized areas of concern and questions surrounding the use of Brokerage Windows and the potential effect on fiduciaries and the fulfillment of their duties. Some of the 404a-5 guidance significantly affected the treatment of, and disclosure requirements relating to, Brokerage Windows under the 404a-5 regulations.

The RFI is intended to assist the DOL in "determining whether, and to what extent, regulatory standards or other guidance concerning the use of brokerage windows by plans are necessary to protect participants' retirement savings."

The RFI states that the DOL has considered several pros and cons relative to Brokerage Windows. In general, some argue that offering more options is beneficial, primarily for sophisticated investors, while others argue that Brokerage Windows present undue risks for most participants because they present too many options and too little guidance. The RFI poses 39 questions (many containing several subquestions). The questions generally seek information about the types of Brokerage Windows in use, the circumstances under which they are used by different plans and different populations of participants, the conditions associated with the use of Brokerage Windows, how Brokerage Windows are selected and monitored, and the costs associated with using Brokerage Windows.

Responses are to be submitted to the DOL on or before November 19, 2014. The RFI contains details about how to submit comments, including how to submit comments electronically. The comments will be made available to the public. It will be interesting to see how the industry responds and how the DOL interprets and applies the information it receives. ❖

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➤ Document Update

continued from page 2

effective date to ensure that the plan is not amended during the current plan year. Hopefully, the IRS will issue guidance on this issue before restatements are being processed in 2016 to clarify how the expiration of the restatement cycle on April 30, 2016, affects this strategy.

Interim Amendments

Now that the IRS has approved PPA pre-approved documents, the next concern is whether additional amendments must be adopted to supplement the approved document. Due to the timing of the review process, pre-approved plans had to be submitted to the IRS by April 2, 2012. The final approved documents do not contain provisions addressing qualification changes that were implemented after the submission of the plan documents.

The most significant new provision affecting pre-approved plans may be the recent Supreme Court ruling on same sex marriage. Under the *United States v. Windsor* case and subsequent guidance from the IRS and DOL, qualified retirement plans must now provide ERISA-mandated spousal benefits to spouses in a same-sex marriage. Since the Supreme Court case was issued after the deadline for making modifications to pre-approved plans, the *Windsor* case was generally not considered in PPA pre-approved documents. However, the IRS has indicated that as long as the provisions under a plan are not inconsistent with the current guidance on the recognition of same-sex marriage, the plan does not need to be amended, unless the employer wishes to reflect the *Windsor* decision under the plan terms or wishes to apply the ruling prior to June 26, 2013 (the date of the *Windsor* decision). Most pre-approved plan documents do not specifically address the definition of spouse as it applies to same-sex marriages. If that is the case, no amendment would be required to the existing pre-approved document. However, if a plan contains language that is inconsistent with the holding in the *Windsor* case, a separate amendment would need to be adopted by December 31, 2014, to reflect the requirements of *Windsor*.

Other provisions that that may need to be addressed in separate interim amendments include the modifications to the in-plan Roth conversion rules as implemented under the American Taxpayer Relief Act of 2012 (ATRA) and the recent guidance on the mid-year elimination of safe harbor 401(k) contributions.

Other Document Types

In addition to the restatement of pre-approved defined contribution plans, the IRS has issued guidance with respect to the submission of other plan types.

In Announcement 2014-4, the IRS announced an extension, to February 2, 2015, of the deadline for the submission of applications for pre-approved PPA defined benefit plans. This extension is intended to allow pre-approved defined benefit plans to include cash balance provisions for the first time. If the IRS does not extend the

submission date again (which is a possibility) and continues to follow its regular procedures for restating plan documents, the restatement period for employers with pre-approved defined benefit plans will probably run from May 1, 2017, to April 30, 2019.

In Revenue Procedure 2014-28, the IRS also extended the deadline for submitting pre-approved 403(b) plans until April 30, 2015. The IRS is opening a new program that will allow for pre-approved prototype and volume submitter 403(b) plans. Again, following the IRS general timeline for plan restatements, if the submission deadline is not delayed (which again is a possibility), the restatement period for employers to adopt a pre-approved 403(b) period would not begin until sometime in 2017 or 2018. The IRS has also announced that it will not establish a determination letter program for individually designed 403(b) plans.

Conclusion

While pre-approved plans provide an easier, less expensive option for employers to maintain a qualified retirement plan, employers must make sure they are properly restating the documents within the required restatement period. Failure to restate a pre-approved document will cause the plan to lose its qualified status and would require a separate submission to the IRS (and a user fee) to correct the failure. ❖

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➤ **Legal Update**

continued from page 3

over the total payments made to the participant under the QLAC as of the participant's death. If the QLAC will provide a life annuity to a surviving spouse, it may contain a similar benefit after the deaths of both participant and spouse. The return of premium must be completed no later than the end of the calendar year following the calendar year in which the participant dies, or in which the surviving spouse dies, whichever is applicable.

Where a surviving spouse is the sole beneficiary, a life annuity payable to the spouse cannot exceed 100 percent of the payment the participant was receiving under the QLAC. However, where a participant dies prior to his or her annuity starting date, this payment may be increased to the extent necessary to satisfy the pre-retirement survivor annuity requirements. If there are beneficiaries in addition to the spouse, satisfaction of the minimum distribution incidental death benefit requirement limits a life annuity payable to a designated beneficiary.

As was the case under the proposed regulations, the final regulations also require annual reporting to the IRS by QLAC issuers.

Implications for Plan Sponsors

Making longevity annuities available to 401(k) plan participants will help them manage their retirement assets, but selecting a QLAC is a fiduciary act that will expose the plan sponsor to the risk of fiduciary liability. Accordingly, plan sponsors that decide to offer QLACs are advised to engage in an objective, thorough, and analytical process to evaluate QLAC features and pricing and select the QLAC issuer. A plan sponsor is advised to review the safe harbor established by the Department of Labor for selecting annuity providers and to monitor additional guidance expected from the Department. ❖

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➤ **Q&A**

continued from page 5

2. Similarly, if the defined contribution plan provides a 5 percent contribution instead of the minimum 3 percent contribution, that will satisfy the top-heavy requirements for both plans.
3. It is also possible to use a floor offset approach, where the 2 percent minimum benefit in the defined benefit is offset by the actuarial equivalent of the account balance in the defined contribution plan.
4. Finally, the plan can apply an analysis that demonstrates the contribution to the defined contribution plan plus the accrued benefit in the defined benefit plan are comparable to the minimum benefit requirement for the defined benefit plan. In other words, the contribution when converted to a comparable benefit might provide a 1.25 percent benefit and the defined benefit plan normal benefit might be 0.75 percent. Thus, the combination of the contribution and the benefit are comparable to a 2 percent benefit in the defined benefit plan.

Remember that when you have two plans, the plans must specify in writing how the combined plans will pass top-heavy. Depending on demographics and the plan design, the plan's default option (say a 5 percent contribution to the defined contribution plan) may not be the best option.

Also, with the first two top-heavy safe-harbor options be wary of the differences in the contribution and benefit requirements. For example, the defined contribution plan might provide a 5 percent contribution to cover the

continued on page 12 ➤

REGULATORY & JUDICIAL UPDATE

Item	Statement	Status
Fiduciaries held to higher standard in proving plan loss was not caused by procedural imprudence.	***Tatum, et al. v. RJR Pension Investment Committee*, CA-4, No. 13-1360, 8-4-14** The Fourth Circuit Court of Appeals has held that courts must ascertain whether another fiduciary acting prudently would have made the same decision when determining whether fiduciaries that breached duties of procedural prudence in divesting a plan of company stock were liable for causing the resultant loss. Accordingly, a lower court erred in focusing on whether a prudent fiduciary could have made the same decision. Plan fiduciaries were determined to have breached their duties under ERISA by, following a corporate spin-off, liquidating company stock funds held in the plan on an arbitrary timeline without conducting a thorough investigation, resulting in a substantial loss to plan participants. The fiduciaries failed to engage a prudent decisionmaking process and not only acted contrary to the express terms of the plan but reflected no consideration of the purposes of the plan, which was to provide long-term retirement savings. Moreover, the record indicated that the divestment was driven by fear of liability more than the best interests of the plan participants. However, the trial court further determined that the fiduciaries met their burden of proof by establishing that the procedural breaches did not cause the loss allegedly sustained by the plan. According to the trial court, the decision by the fiduciaries to eliminate the company stock fund was "one which a reasonable and prudent fiduciary could have made" after a thorough investigation of the issues. Initially, the appeals court affirmed the holding of the trial court that the plan fiduciaries did not engage any process by which they could investigate, analyze, or consider the circumstances regarding the company stock and whether it was appropriate to divest. The extent of the procedural imprudence appeared to the court to be "unprecedented" in an ERISA case. The court also agreed with the trial court that the fiduciaries bore the burden of establishing that their imprudent decisionmaking process did not cause the plan's loss. However, the court disagreed with the trial court on the standard to be used in determining whether the procedural imprudence of the fiduciaries actually caused the plan's loss. The Fourth Circuit initially explained that even if a fiduciary failed to act prudently by not conducting an appropriate investigation before making a decision, it will be insulated from liability if a hypothetical prudent fiduciary would have made the same decision anyway. Thus, the court noted, if a hypothetical prudent fiduciary would have made the same divestment decision, the decision would be viewed as "objectively prudent" and the fiduciary would not be subject to liability. The trial court, however, concluded that the evidence did not compel a decision to maintain the company stock fund in the plan, and that a prudent fiduciary could have inferred that the decision to sell was prudent. Rejecting the relaxed standard applied by the trial court, the appeals court stressed that it would "diminish ERISA's enforcement provision to an empty shell" if a breaching fiduciary was allowed to escape liability by showing nothing more than the "mere possibility that a prudent fiduciary 'could have' made the same decision." On remand, the trial court was instructed to review all relevant evidence, including the timing of the divestment, in redetermining whether the plan fiduciaries met their burden of proving by a preponderance of the evidence that a prudent fiduciary would have made the same divestment decision. ❖	**A fiduciary that failed to act prudently by not conducting an appropriate investigation before making a decision may not establish objective prudence sufficient to avoid liability unless a prudent fiduciary would have made the same decision.**

Generation X Workers: Retirement Reality Bites Unless Answers Are Implemented

Transamerica Center for Retirement Studies, August 2014

"Who wants to be a millionaire? Generation X workers estimate they will need to save $1,000,000 (median) for retirement. Thirty-one percent of Generation X workers believe that they will need to save $2,000,000 or more.

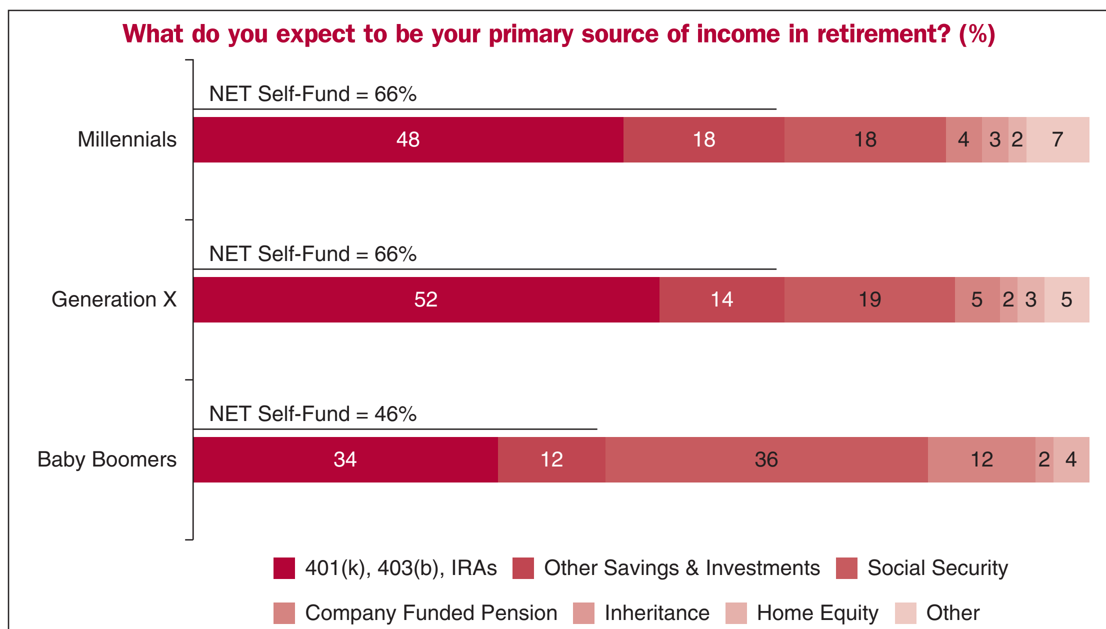
Half of Generation X workers (51 percent) who provided an estimate of their retirement savings needs indicate they guessed what that number should be. Approximately one in five (21 percent) have estimated this goal based on his/her current living expenses. Just 12 percent used a retirement calculator or completed a worksheet.

Achieving retirement readiness is more than just saving enough; it involves planning for both the expected and, moreover, the unexpected. One of the most important secrets to attaining retirement readiness is having a well-defined written strategy about retirement income needs, costs and expenses, and risk factors. The majority of Generation X workers (61 percent) have a retirement strategy, but only 14 percent have a written plan (the other 47 percent have a plan but it is not written down).

A worker's retirement strategy must consider a broad range of factors that could impact his/her retirement savings, ability to generate income in retirement, and protection of savings. Most Generation X workers with a strategy have factored in total retirement savings and income needs (56 percent), ongoing living expenses (56 percent), and a retirement budget (50 percent). However, fewer than half of these Generation X workers have considered health care costs, government benefits, investment returns, tax planning, and contingency plans. Only 22 percent of Generation X workers have factored pursuing their retirement dreams into their strategies.

Almost two-thirds (65 percent) of Generation X workers agree that they don't know as much as they should about retirement investing. When asked what would motivate them to learn more about saving and investing for retirement, 51 percent of Generation X workers would like it to be made easier to understand. Thirty-eight percent want larger tax breaks. A small but startling minority (10 percent) say nothing—they're just not interested."

The full text of this presentation can be downloaded at: *https://www.transamericacenter.org/docs/default-source/resources/center-research/tcrs2014_sr_generation_x.pdf.* ❖



The Government and Chekhov's Gun

Martin J. Burke, Esq.

If you say in the first chapter that there is a rifle hanging on the wall, in the second or third chapter, it absolutely must go off. If it's not going to be fired, it shouldn't be hanging there.

—Anton Chekhov

One of the most well-known rules of drama goes by the name of "Chekhov's Gun." The rule, plainly stated, says that if an author goes through the machinations to describe an object or idea, that object or idea should play some part in the story as a whole. The Internal Revenue Service and the Department of Labor often give us a peek at their metaphorical regulatory guns, but often those guns never fire.

With the release of their 2014–2015 priority guidance plan, the IRS has given us a whole rack full of regulatory efforts they intend on releasing in the coming year. Some of the highlights of the list of guidance the IRS is planning to issue relate to the levels of substantiation needed for hardship distributions, regulations relating to the testing of "closed" defined benefit plans, and new rules and regulations relating to ESOPs.

One of the most anticipated pieces of planned guidance will be related to the ability to make certain mid-year changes to safe harbor plans. Currently, the IRS position is that only very limited amendments can be made to safe harbor retirement plans during the plan year. Even if these amendments would have no effect or even allow more participants into the plan, the IRS looks at these amendments very unfavorably. Of course, the very restrictive views the IRS takes concerning mid-year safe harbor amendments will negatively affect the calendar year safe harbor plan sponsors who want to wait until the last minute to restate their retirement plans on their six-year restatement cycle. Even if the plan sponsor is not changing anything substantial with their retirement plans, the language changes in a restatement might be enough for the IRS to have issues with a restatement as a mid-year amendment. Thus, safe harbor plan sponsors will only have until a reasonable period before the close of the 2015 year instead of the ability to wait until April 30, 2016, to complete their restatement.

The IRS's establishment of priority guidance gives us a good look at their future, and if everything remains on schedule, the IRS's "Chekov's Gun" will deliver what it promises. Generally, the IRS has been fairly consistent in timely issuing the guidance on its priority guidance list. Unfortunately, the DOL has really drawn out their process for issuing regulations that have the ability to change the landscape of the retirement industry.

The most obvious case of violating the rule of Chekhov's Gun is the DOL's continued delays in releasing new fiduciary regulations relating to ERISA-covered retirement plans. After first being introduced to severe industry criticism, the DOL withdrew its first attempt at fiduciary regulations in 2010. Since that date, the regulations were going to be re-released "soon" for at least three years. The latest of these delays moved the target for the release of the regulations from August of 2014 to January of 2015.

Of course, the rules of drama don't follow the twists and turns of reality. The DOL may never release its fiduciary regulations. However, the additional tension that builds from the long period of time in which the regulatory gun was never fired could be the only appropriate run-up to a potentially industry changing BANG! ❖

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➤ Q&A

continued from page 9

top-heavy status for both plans. A participant terminates employment before year end but after being credited with 1,000 hours and thus is not entitled to the 5 percent top-heavy contribution in the defined contribution plan. However, the participant has satisfied the requirement for a top-heavy benefit in the defined benefit plan. You have to be sure that the plans have still satisfied the top-heavy requirement for both plans in this situation.

The above is just a brief summary of the top-heavy requirements. Numerous conditions and nuances to determining top-heavy status represent pitfalls for the unwary. So, it is wise to be cautious when evaluating a plan's top-heavy status. ❖

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