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Notes From Your Editor

Another quarter has passed and there is still uncertainty regarding the future of retirement benefits. On the regulatory front, the Department of Labor has delayed the applicability of the new fiduciary investment advice rules for at least 60 days while additional information is considered.

Many plan sponsors are freezing or terminating their defined benefit plans. In this issue we discuss actions that plan sponsors can take now to prepare for an eventual plan termination, even if the actual termination is not scheduled to occur any time soon (or at all). Also included is an article about actions that plan fiduciaries should be considering in order to protect themselves from liability. Again, advance planning and preparation can save a lot of problems in the long term.

Most sponsors of 401(k) plans designate a Qualified Default Investment Alternative (QDIA) to hold contributions for participants who haven't made any affirmative investment elections. However, other investments can also serve as default investments even if they don't satisfy the rules to be qualified as a QDIA. We discuss the use of a restrictive annuity for this purpose.

Claims procedures for disability benefits are changing as of January 1, 2018, and these can involve your pension and 401(k) plans to the extent that they provide disability benefits. It's a good idea to start reviewing your plans now to determine whether or not they require amendment. In addition, there have been several recent developments involving new substantiation guidelines relating to safe harbor hardship distributions from defined contribution plans, overpayments for Voluntary Correction Program submissions, final resolution of the Verizon annuity lift-out litigation, new requirements for plans covering employees in Puerto Rico, and the recent release of the IRS' operational compliance list to assist plan sponsors in keeping qualified plans in compliance with legal requirements.

If you have any questions or need any assistance with the topics covered, please contact the author of the article or Tom Meagher, our practice leader.

Regards,

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Is Your Pension Plan Ready for Termination?

by Paul Tschida

Your pension plan is frozen. Benefits stopped accruing years ago, but effort and costs certainly have not—especially those rampant Pension Benefit Guaranty Corporation (PBGC) premiums. You know the plan will eventually be terminated, but you keep putting off thinking about it because you've heard it's a lot of work and very expensive.

If this sounds familiar, you'll be happy to know that assessing if and when plan termination may be feasible is a straightforward (and valuable) exercise. You may be surprised to learn that termination is more realistic than you thought.

Is Plan Termination Feasible?
Terminating a pension plan typically requires significant outlays of time, effort, and money. A feasibility study assesses termination readiness from each of these perspectives and recommends actions that can be taken at an early point in time to facilitate the process. While a typical study looks at multiple angles, we focus here on the cost and compliance aspects.

Cost to Terminate
Upon plan termination, each participant's benefit may be paid as either a one-time lump sum from the plan (if the plan allows) or by an annuity purchased from an insurance company. Fluctuating market conditions drive the cost of both lump sums and annuities. While lump sums are generally less costly to the plan, participants cannot be compelled to take one. Lump sums also require design decisions such as whether they will be offered to retirees and whether any early retirement subsidy will be included.

The ultimate cost of plan termination therefore depends on various unknowns—the lump-sum design, the number of participants who receive one (the "lump-sum take rate"), and market conditions at distribution.

- **Lump-sum design.** Legal and actuarial experts can advise on the pros and cons of different approaches and their associated cost implications.
- **Lump-sum take rate.** We have amassed considerable prevalence data through assisting hundreds of plans with terminations and lump-sum windows. This data can help the actuary set a reasonable take rate assumption given the plan's design, demographics, and other factors.
- **Annuity purchase price.** Insurer pricing is driven not only by interest rates, but also by insurer capacity and competition—making cost estimating a complex exercise. Fortunately, our actuaries are able to utilize daily pricing guidance produced by Aon Hewitt's Institutional Annuities & Life Insurance Solutions team.

Code and ERISA Readiness
While cost is frequently the key impediment to plan termination, problems with the plan's provisions or operations can delay or derail a termination. For that reason, a feasibility study typically includes a high-level Internal Revenue Code (Code) and Employee Retirement Income Security Act of 1974 (ERISA) review.

- **Plan documentation.** Due diligence can help identify plan provisions that are not current with plan qualification requirements. In order to ensure a smooth plan termination process, it is advisable to undertake a review of the plan document in advance of the plan termination in order to ensure that all amendments have been timely adopted and that the plan qualification requirements are set forth in the current plan document. We have encountered plan terminations where the IRS discovered (during the determination letter on plan termination review process) that certain technical amendments had not been properly made in the past. Fixing this failure required unexpected effort and delayed the termination. Better to catch—and fix—issues in advance.
- **Plan operations.** Plan provisions may be perfect, but if they are not administered correctly the plan can still encounter difficulties and lose its qualified status. A review of plan operations can help uncover any lapses or deficiencies in controls before the plan sponsor gets too far down the path toward plan termination. Common pitfalls include benefit suspension notices not sent on time (or at all), required minimum distribution mistakes for participants over age 70½, miscalculated benefits, and insufficient or missing participant and beneficiary data and shortfalls in related searches.

Positioning the Plan for Termination
Even if termination is not presently affordable, actions can be taken now that may save money, mitigate ongoing fiduciary risk, and simplify the process later in the event a plan termination is pursued. Following are examples of actions to consider taking.

Data and Benefits Cleanup

- **Finalize frozen accrued benefits.** Special cases like breaks in service, QDRO splits, and transfers make this more time-consuming than one would expect. Additionally, it is helpful to inventory participants who are partially vested as they will need to be fully vested at plan termination.
- **Search for missing or deceased participants.** If you identify deceased retirees or beneficiaries, you will start saving money once you address any remaining payments. Effort is also reduced later when you terminate the plan.

- **Fill gaps in census data.** The insurer will require key elements such as participants' Social Security numbers and dates of birth. Dates and pay data must be displayed on a participant's Notice of Plan Benefits. The PBGC will ask for various data during the post-distribution audit.

Code and ERISA Considerations

- **Multiple plans.** If you sponsor more than one defined benefit plan that is to be terminated, consider merging the plans into one. While this may require some up-front effort, at termination you'll reap efficiencies—for example, only one determination letter filing, one of each PBGC filing, and one PBGC audit.
- **Add useful administrative provisions.** If needed, amend the plan to allow certain fees to be paid from the trust, lengthen the benefit election window to 180 days, and optimize the lump-sum stability period and lookback month. Also, adding a "deemed cashout" provision for participants who terminate prior to full vesting and a provision allowing excess assets to revert to the sponsor may be beneficial if plan termination will not occur for five or more years.
- **Consider eliminating any underutilized or redundant optional forms of benefit.** Plans with a multitude of joint and survivor optional forms may be able to eliminate one or more. Similarly, certain ancillary plan benefits may be considered for removal in order to facilitate the selection of an annuity contract to replicate the plan provisions.

Investment Strategy

- **De-risk the plan.** A "glide path" strategy systematically rebalances the plan's asset allocation as the funded level changes. This, coupled with a custom hedging strategy once the plan termination process ensues, helps to ensure that the plan does not take on unnecessary risk and minimizes the likelihood of a material change in funded status during plan termination. This is important, given the asymmetric nature of qualified pension risk in the U.S.; any underfunding must be redressed in full at termination, whereas any overfunding goes primarily to the IRS through excise and income taxes.
- **Address illiquid assets.** Even after all benefits have been distributed, a Form 5500 must continue to be filed each plan year until the trust asset value goes to $0. Assets not easily sold have proven troublesome in past plan terminations. An investment advisor can help identify potentially problematic assets and develop a plan for timely liquidation.

If you are interested in learning more about how to effectively position your plan for eventual termination, please contact your Aon Hewitt Retirement Consultant.

Avoid Overpaying User Fees for VCP Submissions

by Linda M. Lee

Plan sponsors be aware—the Internal Revenue Service (IRS) has recently noticed that many plan sponsors are submitting user fees that are higher than required under its Voluntary Correction Program (VCP). In response, the agency recently updated its website to provide clearer direction to avoid these common mistakes, and stressed the importance of using updated forms when making submissions to the IRS.

- Effective 2016, VCP user fees are no longer included in the revenue procedure for the Employee Plans Compliance Resolution System (EPCRS). Instead, refer to Appendix A.08 of Rev. Proc. 2017-4 to determine the correct VCP user fees for submissions made in 2017. It is important to note that the number of participants in a plan generally determines the user fees for 401(a) and 403(b) plans.
- In February 2016, the IRS actually lowered the user fees for many types of VCP submissions for 401(a) and 403(b) plans.
- Use only the 2016 version of Form 8951 (Rev. September 2016), Compliance Fee for Application for Voluntary Correction Program (VCP), to determine specific user fee amounts. The pre-2016 version of this form includes inaccurate information.

The instructions for Form 8951 indicate that if the full applicable user fee is not included with the submission, the submission may be returned without any action. And, while the instructions do not address overpayments, the Internal Revenue Manual affirms that overpaid user fees are refunded.

There are many situations that apply to determining the correct user fees. For questions and assistance with any VCP submissions you are required to make, please contact any member of the Aon Hewitt Retirement Legal Consulting & Compliance practice.

Fiduciary Investment Advice Rules—Where Are We Now?

by Elizabeth Groenewegen

Those who have followed the steps taken by the Department of Labor (DOL) regarding investment advice offered to retirement savers may recall that the revised legal standards (collectively, the "Rules") were due to become applicable on April 10, 2017. Since that time, a new administration has come to power and a number of developments involving the Rules have taken place.

Under the Rules, those offering investment recommendations to retirement plan savers (e.g., qualified plan participants and IRA holders) are uniformly held to a fiduciary standard regarding such advice. As such, the Rules require that advice be in the "best interest" of the recipient and generally prohibit an adviser from offering recommendations when its own financial interests may conflict with those of the recipient. The Rules have, however, created controversy. Those involved in promulgating the Rules (and their supporters) generally believed that the Rules would improve the quality of investment advice without unduly hampering the retirement savings advice market. Critics, on the other hand, generally contended that the Rules went beyond the scope of the DOL's jurisdiction and that they would result in severely limiting access to advice, particularly for middle and lower-income retirement savers.

Following the presidential election, President Trump directed his new administration to take a fresh look at the Rules. While this review was pending, the DOL proposed a 60-day delay in the applicability date.

On April 4, 2017, the DOL indicated that the Rules will not apply before June 9, 2017. The DOL also extended the applicability date of certain prohibited transaction exemptions for 60 days and noted that during a June 9, 2017, to December 31, 2017 transition period, fiduciaries intending to rely on the investment advice exemptions need adhere only to the new Impartial Conduct Standards (which involve providing advice in retirement investors' best interest, charging no more than reasonable compensation, and avoiding misleading statements) as conditions for the exemptive relief. Compliance with the remaining conditions in the exemptions will not be required before January 1, 2018.

While we are of the view that these rules generally will not significantly impact plan sponsors, plan sponsors should take ample time to address any impacts that the final Rules may have on their recordkeepers or other service providers. Aon Hewitt will continue to monitor these developments as they unfold.

Substantiation of Safe-Harbor Hardship Distributions

by David Alpert

A qualified 401(k) plan may permit eligible employees to receive hardship withdrawals of their elective deferrals if the withdrawal is made as the result of an immediate and heavy financial need and is necessary to satisfy that need. Internal Revenue Service (IRS) regulations provide for certain "safe harbor" reasons that are deemed to constitute an immediate and heavy financial need.

The IRS issued an internal memorandum on February 23, 2017, specifying the types of documentation its agents should review in determining if hardship withdrawals were properly made for a deemed need. The memorandum indicates that plans may obtain and rely on a summary of source documents (rather than the actual source documents) in support of a hardship withdrawal request. It also mandates that participants who "self-certify" that they have a deemed need must provide certain information.

Additionally, the memorandum provides that before making a hardship distribution, the plan must notify any such participant that:

- The distribution is taxable
- The distribution cannot exceed the amount of the need
- The distribution cannot be made from earnings on elective deferrals or from amounts attributable to qualified nonelective or qualified matching contributions
- The participant must preserve source documents and provide a copy to the plan upon request

A third-party administrator that receives a summary of source documents must provide the plan sponsor with an annual (or more frequent) report describing the hardship distributions made during the plan year.

Next Steps

Plan sponsors should assess internal and third-party administrator procedures for approving hardship distributions, and may wish to conduct a review to confirm that such procedures are being followed and that the summaries are complete and consistent with the underlying source documents.

Please contact any member of the Aon Hewitt Retirement Legal Consulting & Compliance practice for assistance with conducting a review.

Plan Fiduciaries—How to Mitigate Risk of Conflicts

by Hitz Burton

Since the Employee Retirement Income Security Act of 1974 (ERISA) became law, fiduciaries have been required to avoid conflicts of interest. Plaintiffs' attorneys are taking advantage of this idea as they continue to advance various theories of liability involving litigation over excessive fees charged to plan participants. In the last three years, more than 20 financial service firms have been sued regarding their use of proprietary investment funds and affiliated service providers in the 401(k) plans they sponsor. Among other allegations, these lawsuits typically allege that the investment fees associated with the proprietary investment funds are too high when compared to competing funds available in the marketplace.

An important first step for any fiduciary whose plan is using proprietary funds or affiliated service providers is to understand the precise nature of the actual or possible conflict and how best to respond. As always, plan governance and process matter—particularly where financial incentives may exist that favor the plan sponsor.

Typically, a fiduciary committee composed of three or five voting members that meets regularly, documents its deliberations and decisions thoughtfully, acts pursuant to a well-drafted investment policy statement, and utilizes independent expertise when necessary will be on solid ground when attempting to support its decisions. Committees dominated by a single individual or by a corporate executive making decisions in lieu of a committee can put plans at higher risk.

The importance of utilizing independent advisors cannot be overstated. Plan sponsors may have sophisticated internal expertise capable of addressing many plan-related fee and investment issues—but to the extent proprietary funds or affiliated service providers are involved, the utilization of an independent advisor could prove quite helpful in supporting the committee's ultimate decisions.

For a number of years, "outside assistance" meant hiring an investment consultant to provide access to market-based benchmarking data. That data was then used by plans to demonstrate that recordkeeping and mutual fund expenses were "reasonable" since they were in line with the expenses paid by similar plans. Recent litigation, however, appears to be placing a greater burden of proof on fiduciaries, suggesting that investment committees need to:

- Understand sometimes subtle differences in various mutual fund asset classes
- Demonstrate that their decisions are independent of the interests of the plan sponsor and are for the benefit of plan participants
- Better understand how to utilize the purchasing power of their plan for the exclusive benefit of plan participants

Given the inherent conflict-of-interest risk associated with proprietary investment funds and affiliated service providers, plan fiduciaries would be wise to develop a strong fiduciary record to support that the decisions they make are in the best interest of plan participants.

Plan sponsors and ERISA fiduciaries seeking additional protection may wish to consider the appointment of an independent investment fiduciary—this may be a role that is limited to discrete transactions, or may involve a continuing role with the committee. Over the years, ERISA fiduciaries have utilized independent fiduciaries in a number of areas posing heightened risks, from the forced liquidation of an employer stock fund and an annuity lift-out transaction involving a defined benefit pension plan, to responsibility for ongoing monitoring of employer stock in a defined contribution plan's employer stock fund.

If you are an ERISA fiduciary with concerns about how to respond to possible conflict-of-interest issues or a prohibited transaction involving an ERISA retirement plan, an Aon Hewitt Retirement and Investment consultant can help you evaluate the actual or possible risks presented and discuss strategies to mitigate such risk.

Supreme Court Ends Verizon Annuity Lift-Out Litigation

by Hitz Burton

On March 27, 2017, the U.S. Supreme Court declined to review claims brought by Verizon pension plan participants who had sued Verizon, alleging that they were harmed as the result of Verizon purchasing annuity contracts for other participants. The decision relates to Verizon's 2012 transfer of approximately $7.4 billion in pension liabilities covering approximately 41,000 retirees currently receiving pension payments. We believe that this action by the Court will likely end litigation regarding this matter.

While these annuity purchase transactions can be quite attractive for employers that are looking to limit their pension liabilities and reduce premiums paid to the Pension Benefit Guaranty Corporation (PBGC),

care must be taken in structuring them. Verizon's transaction was challenged by two groups of retirees—retirees for whom annuity contracts were purchased and participants for whom annuity contracts were not purchased. Among other claims brought, the participants who remained covered by the Verizon pension plan alleged that they had been harmed because Verizon had breached its fiduciary duties and depleted plan assets when it paid expenses related to the annuity transaction. An earlier lawsuit on behalf of the participants for whom annuity contracts had been purchased was also decided in Verizon's favor.

In deciding not to permit the Verizon participants who remained in the plan to appeal further, the Court let stand the lower appellate court's decision indicating that the group had not suffered "concrete harm" as a result of the Verizon annuity transaction—the remaining participants' right to payment was not shown to be at risk by reason of the annuity transaction; thus, the plaintiffs had not suffered an injury the Court could then address.

Among other important results, this litigation should be encouraging for clients considering an annuity purchase, and it lends support to the following principles:

- The need to pay careful attention to plan governance requirements
- The importance of timely amendments to plan documents and summary plan descriptions (SPDs) to specifically provide for the purchase of an annuity contract for current participants or retirees
- Recognition that settlor decisions to annuitize retiree benefits are not fiduciary decisions and therefore are not subject to the fiduciary requirements of the Employee Retirement Income Security Act of 1974
- Confirmation that there is no requirement to obtain consent from retirees prior to transferring the legal responsibility for payment to an insurer
- Confirmation that retirees have no legal right to continue to be participants covered by an employer-sponsored retirement plan or to have their pension benefits covered by PBGC protections when a plan sponsor amends the plan to purchase an annuity covering their accrued benefits

To read our prior articles on this subject, please click on these links:

Claims Brought by Verizon Plaintiffs Rejected Again

Challenges to Transfer of Pension Liabilities Rejected by Appellate Court

If you are considering an annuity purchase for your defined benefit pension plan, we should discuss additional steps you may wish to consider, including developing and documenting a thorough fiduciary process and adding protective language to your relevant plan documents and SPDs. While no process or plan language can act as a guarantee against claims being brought, a rigorous and robust fiduciary process and updates to your plan documentation—in advance of taking action—may preclude certain claims from being successful and will go a long way to completing a successful annuity purchase transaction.

Aon Hewitt is well positioned to provide assistance with plan and SPD amendments, along with plan governance considerations. Our Retirement Legal Consulting & Compliance consultants have model language available and can quickly and easily help. We can also provide assistance with documenting your decision-making process to further protect you in the event of litigation.

New Disability Claims Procedure Rules

by Dave Alpert

On December 19, 2016, the U.S. Department of Labor (DOL) issued final regulations governing claims procedures for benefit plans subject to the Employee Retirement Income Security Act of 1974 (ERISA) that provide disability benefits. Disability benefits can be paid from either a retirement plan (both pension and 401(k)) or a health and welfare plan, and the new rules apply to both. These rules generally apply to claims for disability benefits filed on and after January 1, 2018.

Definition of Disability Benefit. A benefit is considered a disability benefit if the plan conditions its availability upon a showing of disability. If the plan must make a determination of disability in order to decide a claim, the claim is subject to the disability claims procedure rules whether the plan as a whole is a pension plan or a welfare plan. However, if the benefit claim is conditioned on a finding of disability made by a party other than the plan (such as by the Social Security Administration or the employer's long-term disability plan), then it is not considered a disability claim for purposes of the claims procedure rules.

Key Changes. The new rules make the following substantive changes regarding disability claims procedures. Such changes, to the extent applicable, should be included in the appropriate plan documents to ensure compliance.

- **Conflicts of Interest.** New criteria apply that are designed to avoid conflicts of interest and ensure the independence and impartiality of the individuals involved with the claims review process (e.g., a claims adjudicator, medical expert, or vocational expert).

Decisions with respect to any such reviewing individual regarding hiring, compensation, promotion, and termination, for example, cannot be based on the likelihood that the individual will support a claim denial.

- **Adverse Benefit Determination Notices.** Certain additional information must be included in an adverse benefit determination notice, including (i) a discussion of the reason(s) for the determination; (ii) the plan rules or similar criteria that were relied upon in making the adverse determination or a statement that they do not exist; (iii) the right of the claimant to receive, on request, a copy of all relevant documents and information (for initial determinations); and (iv) a description of any contractual limitations period, and the expiration date of such period, that may apply to the claimant's right to bring a civil action under ERISA section 502(a) (for appeals).
- **New Information.** While an appeal is pending, the plan must automatically send to the claimant, as soon as possible before an adverse benefit determination notice, any new or additional evidence or rationale considered or generated by the plan.
- **Strict Compliance.** Under ERISA section 502(a), claimants may seek court review of a claim if the plan fails to strictly comply with the new rules (the claim is deemed denied, with no deference to be given by the court to the plan decision), unless the failure is minor, nonprejudicial to the claimant, and beyond the plan's control.
- **Coverage Rescissions.** An adverse benefit determination includes a retroactive cancelation or discontinuance of disability benefit coverage (even if there is no adverse effect on any particular benefit at that time) that is other than for nonpayment of required premiums or contributions.
- **Culturally and Linguistically Appropriate Notices.** Adverse benefit determination notices must be provided in a culturally and linguistically appropriate manner.

Next Steps

Employers sponsoring any pension or welfare plan that is subject to ERISA (or that otherwise voluntarily follows ERISA rules regarding claims procedures), that conditions benefits upon a showing of disability, should review their plan documents to determine if any amendments are necessary to address the new disability claims procedure rules. Any required amendments to qualified retirement plans (including defined benefit and defined contribution plans) should be timely adopted in accordance with guidance established by the Internal Revenue Service. In addition, responsible plan fiduciaries should ensure that the plan (and its service providers) operationally comply with the new rules.

The Aon Hewitt Retirement Legal Consulting & Compliance group can assist with reviewing and modifying the relevant provisions of plan documents, SPDs, claims procedures, notices, and other documents.

Restricted Annuity Can Be DC Plan Default Investment

by Dan Schwallie

Recent guidance from the U.S. Department of Labor (DOL) concludes that an annuity investment with liquidity and transferability restrictions, although not a qualified default investment alternative in a defined contribution plan (QDIA), may be a default investment alternative if it is prudently selected, the investment otherwise satisfies the requirements to be a qualified default investment alternative, and appropriate notice and disclosure are provided regarding the restrictions. This guidance may further the development and availability of lifetime income products and features in defined contribution plans, which could reduce the risks of outliving retirement account balances, market volatility near and during retirement, and participant cognitive decline with respect to retirement portfolio management.

On December 22, 2016, the DOL responded to an information request regarding a custom target-date fund (TDF) proposed as a default investment alternative (DOL Information Letter, December 22, 2016). This TDF satisfied all the requirements for a QDIA, except for certain liquidity and transferability restrictions attributable to an annuity component. The QDIA regulations require that a participant must be able to transfer assets invested in a QDIA in whole or in part to any other investment alternative available under the plan, consistent with the frequency with which participants can invest in the QDIA, but not less frequently than once in three months.

The proposed TDF provided in-plan access to an investment with a guaranteed rate of return, guaranteed lifetime income at retirement, and a glide path that increases allocations to the annuity component along with fixed income funds as a participant ages. The information request specifically asked whether the Employee Retirement Income Security Act of 1974 (ERISA) prohibits a plan fiduciary from selecting this TDF as a default investment alternative for a participant-directed account plan.

The DOL noted that the QDIA standards are not intended to be the exclusive means by which a fiduciary can select a default investment and still satisfy ERISA's fiduciary duties. The DOL concluded that a plan fiduciary could prudently select an investment with lifetime income elections as a default investment if the investment complies with all the QDIA requirements other than the liquidity and transferability requirements, even though the specific fiduciary relief of the QDIA regulations would not apply. Thus, for the TDF, plan fiduciaries are not immune from liability for losses as they would be if the investment option qualified as a QDIA.

Whether the selection of such an investment as a default investment alternative satisfies the general ERISA fiduciary duties would depend upon all the relevant facts and circumstances. The DOL noted that the relevant facts and circumstances for the TDF would include, among other considerations, the nature and duration of liquidity restrictions, the level of guarantees of principal and minimum interest rates, any opportunities for guaranteed minimum interest rates to be supplemented with additional credited amounts, the expected lifetime income to be provided in retirement, and the fees and investment expenses.

The plan fiduciary should also consider what additional notice should be provided to participants regarding the liquidity and transferability restrictions, and consider using additional educational materials regarding the features of the investment alternative.

Aon Hewitt Retirement and Investment consultants are available to assist plan sponsors in evaluating whether a default investment alternative that includes annuity or other lifetime income features should be part of their participant-directed defined contribution plans.

IRS Releases Operational Compliance List—Next Steps

by Tom Meagher and Meghan Lynch

Plan sponsors have been wrestling with how best to confirm that their retirement plans remain qualified in the absence of the Internal Revenue Service's (IRS's) determination letter program. On February 27, 2017, plan sponsors received some helpful guidance when the IRS released its first Operational Compliance List. The Operational Compliance List is intended to be issued annually by the IRS in order to identify changes in the operational qualification requirements that are effective during a calendar year.

While the applicability of operational compliance requirements varies by plan, it is important for plan sponsors to note the newly issued requirements and to confirm whether they are applicable to their plans. If the operational requirements do apply, plan sponsors need to take steps to confirm that the plan is being administered consistent with such requirements.

> "In order to be qualified, a plan must comply operationally with each relevant qualification requirement."

For 2017, the Operational Compliance List includes the following items for consideration by plan sponsors:

- Proposed regulations regarding qualified nonelective contributions (QNECs) and qualified matching contributions (QMACs) in defined contribution plans (permitting nonforfeitability requirements to be satisfied at the time of allocation to participant accounts)
- Extension of temporary nondiscrimination relief for closed defined benefit pension plans (extending prior relief to plan years beginning before 2018)
- Final regulations regarding partial annuity distribution options for defined benefit pension plans
- Final regulations regarding hybrid plans (regarding market rate of return and other cash balance/hybrid plan requirements)
- Application of benefit restrictions for certain defined benefit plans (relating to eligible cooperative plans or eligible charity plans)

In order to be qualified, a plan must comply operationally with each relevant qualification requirement—even if the requirement is not included on the Operational Compliance List. While compliance with the Operational Compliance List each year is helpful, full operational compliance ultimately is dependent upon the plan terms and can be established only through a review of the plan's administration and related operations.

Aon Hewitt has developed a new service to partner with our clients to fill the void left by the discontinuance of the IRS determination letter program. Even if a plan sponsor relies on an outside law firm to review its plan document, the plan's administrative operations are the area most susceptible to noncompliance and will most often require the involvement of actuaries and defined contribution and administrative specialists to identify operational issues. Please click on these links to review articles in prior issues of the *Aon Hewitt Retirement Legal Consulting & Compliance Quarterly Update:*

New Solution to Address End of IRS Determination Letter Program

No Ongoing Determination Letter Program—What's Next?

If you are interested in determining whether your plans continue to satisfy Code requirements, please contact the authors of this article or your Aon Hewitt client contact.

New Puerto Rico Tax Law Changes Impact Retirement Plans

by Tom Meagher and Hitz Burton

On February 8, 2017, the Puerto Rico legislature amended its Internal Revenue Code to foster the development and improvement of retirement plans under its tax laws. In enacting the new legislation, Puerto Rico noted that the changes were needed to halt the mass exodus of the Puerto Rican professional class, safeguard the professionals' futures, and facilitate more retirement plan sponsorship by private employers. These new developments will be important to employers that sponsor Puerto Rico-only retirement plans or "dual-qualified" plans covering Puerto Rico employees (intended to satisfy both U.S. and Puerto Rico tax laws). Of particular importance to plan sponsors is the fact that the tax law changes were made effective immediately upon enactment and may complicate dual-qualified plan administration. Key changes include:

- **Annual Defined Contribution Limits.** The annual limits for defined contributions plans were amended. The annual contributions of the employer and participant, and other additions with respect to a participant (not including rollover contributions from another qualified retirement plan), cannot exceed the lesser of $75,000 or 25% of net income.
- **Employer Plan Deductions.** In the case of defined contribution plans, while the employer deduction continues to be limited to 25% of plan participant compensation, the tax law change increases the deductible amount to the extent that contributions to a defined contribution plan do not exceed the individual annual limits ($75,000 or 25% of net income), not including rollover contributions.
- **Safe Harbor ADP Nondiscrimination Testing.** The actual deferral percentage (ADP) nondiscrimination rules will not apply to retirement plans with fewer than 100 participants whose businesses generate less than $10 million per year in gross income, so long as the employer provides a benefit to all eligible employees of not less than 3% of compensation.
- **Highly Compensated Employees.** Highly compensated employees now include any employee who: (i) holds more than 5% of the voting stock or of the total value of all classes of stock in the participating employer; (ii) holds more than 5% of the capital or interest in the gains of the employer (for entities other than corporations); or (iii) received more than $150,000 in compensation from the employer in the preceding tax year.

There are other provisions that were introduced or amended by the Act, including new rules relating to beneficiary designations of married participants where the retirement plan is qualified in Puerto Rico and subject to ERISA and rules relating to retirement plan trust assets' exemption from the estate and inheritance provisions of the Puerto Rico Civil Code.

Employers with retirement plans covering Puerto Rico employees should review their plan terms and related administration right away as these changes became effective immediately. Additional guidance clarifying how these new rules will be applied should be forthcoming.

Quarterly Roundup

by Jan Raines and Bridget Steinhart

Fiduciaries Prevail in Another Stable Value Fund Complaint. Certain plan participants brought an action against CVS Health Corporation and its benefits committee, alleging a breach of fiduciary duty related to permitting plan investments in a stable value fund that underperformed its peers in the time frame addressed. But for the second time, the defendants prevailed in convincing the U.S. District Court to dismiss the lawsuit.

The original complaint and the amended complaint were each dismissed because the plaintiffs were unable to provide sufficient facts to support their allegations of imprudence on the part of stable value fund manager Galliard Capital Management, Inc. The court commented that no failure was demonstrated with respect to the plan's guidelines and investment objectives, and that fiduciaries can be expected neither to predict the future nor to be exposed for avoiding risks that, in hindsight, do not come to fruition.

The case is noteworthy for its underscoring of the importance of having strong plan governance in place, such as the prudently developed investment guidelines that CVS Health Corporation followed in managing the stable value fund.

Who Has the Burden of Proof? The burden of proof for a claim for benefits under the Employee Retirement Income Security Act of 1974 (ERISA) traditionally rests on the shoulders of the plan participant bringing the claim (the plaintiff). However, the Ninth Circuit Court of

Appeals recently determined that when plan eligibility information is in the exclusive control of the defendants, the defendants have the burden of proving that a plaintiff is not entitled to benefits.

In this case, plaintiff Bruce Barton worked for American District Telegraph Company (ADT) or its affiliates at various times between 1967 and 1986. ADT was subsequently acquired. When Barton applied for pension benefits in 2010 at age 65, he was advised that plan records failed to indicate that he'd earned a vested benefit. Barton appealed to the pension plan's committee, providing pay stubs, W2s, and Social Security statements reflecting FICA withholding for some of the periods in question. The committee had no hours of service records from the affiliates and advised Barton that the information provided did not establish that he'd earned 10 years of continuous service credit. His claim was denied, since no plan records indicated that he was either eligible to participate in the plan or eligible for benefits.

Barton sued for his pension benefits but was not successful. He subsequently appealed. The majority of the appellate court found in Barton's favor, and indicated that it had previously shifted the burden of proving hours worked to the defendant in cases where the defendant had not maintained required records. However, the court specified that the burden remains with the plaintiff when the plaintiff has equal or better access to evidence supporting his or her claim, such as in a disability case.

Collateralizing or Self-Dealing? TIAA Faces Complaint Regarding Loan Practices. A complaint filed in February 2017 alleges that the Teachers Investment and Annuity Association (TIAA) engages in participant loan practices that violate ERISA's duties of prudence and loyalty, resulting in ill-gotten gains in excess of $50 million annually across TIAA's recordkeeping clients.

Plaintiffs' attorneys described the typical participant loan practice wherein a participant's own investments are reduced by the amount borrowed, but a loan account is established in the borrower's plan account in order to account for principal and interest payments. Interest rates are fixed, and reinvested loan payments replenish the borrower's account over time.

However, according to the complaint, TIAA's loan practices instead require a participant to transfer 110% of the desired loan amount to TIAA's own traditional annuity account, a TIAA general account that pays a fixed interest rate to investors. Although the traditional annuity account currently credits investors with 3% interest, it is reasonable to assume that this proprietary fund earns more in gains than it pays. The TIAA loan process then provides that loan proceeds are distributed to the borrower from that proprietary account, and loan repayments are made to that same account.

Plaintiff Melissa Haley currently has two outstanding loans in the Washington University Retirement Savings Plan, both established with variable rates (currently bearing rates of 4.44% and 4.17%), despite the fact that the plan's loan policy calls for a fixed market rate of interest determined at the time the loan is made. In addition to noncompliance with the loan policy, the crux of the allegations is that TIAA keeps for itself the difference on the spread between the 3% crediting rate earned by participants as loan repayments are made and the actual interest rates charged to the borrower.

Since this action is still in the early pleadings stage (and the court has not yet evaluated the merits of the plaintiffs' claims), we can anticipate that TIAA may have one or more defenses to the plaintiffs' allegations and may ultimately prevail once it has an opportunity to fully respond. We will continue to monitor this matter.

Another Claim Regarding Excessive 401(k) Fees. A complaint filed in December 2016 alleges that fiduciaries responsible for a 401(k) plan with assets in excess of $1 billion breached their fiduciary duties "in the management, operation and administration" of the plan. Similar to other complaints and lawsuits, this complaint alleges that, among other matters, fiduciaries failed to ensure that the plan's fees were reasonable, and that the service provider received "kickbacks" from revenue sharing but did not disclose that information.

In addressing the fee issue, the complaint cites a BrightScope rating (an independent service that rates 401(k) plans) as further proof that the plan did not stack up to its competitors, noting that "sixteen years of additional work was required by the plan sponsor's employees to reach the same level of savings as peer plan participants." In addressing both the fees and the revenue sharing issue, the complaint indicates that recordkeeping costs were not charged on a per-participant basis but rather were based on plan assets, even though the actual cost of recordkeeping is "the same for a participant with $1,000 in his account as for a participant with $50,000."

As other cases have shown, it is the fiduciaries' responsibility to ensure that fees are reasonable for the services provided and disclosures to participants are appropriate. Utilizing an independent resource to perform this analysis is key. Since this action is still in the early pleadings stage (and the court has not yet evaluated the merits of the plaintiffs' claims), we can anticipate that the defendant may have one or more defenses to the plaintiffs' allegations and may ultimately prevail once it has an opportunity to fully respond.

Good News for Sponsors of Safe-Harbor 401(k) Plans. In January 2017, the IRS issued proposed regulations that amend the definitions of QNECs (qualified nonelective contributions) and QMACs (qualified matching contributions). QNECs and QMACs are contributions made to a plan to satisfy nondiscrimination rules under 401(k) and 401(m) (ADP/ACP tests).

Previously, QNECs and QMACs must have been 100% vested when they were "first contributed to the plan" and were generally not available for withdrawal prior to a participant's severance of employment. Because the IRS defines safe-harbor matching and safe-harbor nonelective contributions in the same manner as QNECs and QMACs, these safe-harbor contributions were treated similarly. As a result, forfeitures could not be used to "fund" safe-harbor contributions since forfeitures were, by definition, amounts of participant accounts that were not 100% vested when contributed to the plan, and therefore were not considered "nonforfeitable."

These regulations—which have been a long time coming—change the definition of QNECs and QMACs, including safe-harbor contributions, to nonforfeitable status when allocated to participants' accounts, which opens the door for plan sponsors to use prior forfeitures held in the plan to reduce future employer contributions (including safe-harbor contributions).

The proposed regulations will become effective for years beginning on or after the date the final regulations are published, but may be relied on now—subject to confirmation that they are not subject to the Trump administration's freeze on new regulatory guidance.

Before using forfeitures in this manner, plan sponsors should confirm whether their plan document needs to be amended to address this change.

Recent Publications

Hardship Withdrawals Create Hardships for Plan Sponsors
Dan Schwallie
Journal of Pension Planning & Compliance 42 (Spring 2017)

Many plan sponsors and third-party administrators limit hardship distributions to safe harbor reasons so as to avoid a "facts and circumstances" review of a hardship request, but the safe harbor rules to avoid such review include more than simply restricting hardship distributions to the safe harbor reasons.

Click here to read the article.

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