Aon Quarterly Update

First Quarter 2019

Retirement Legal Consulting & Compliance

In this Issue

Prior Issues

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Notes From Your Editors

We are pleased to announce that Susan Motter has joined our editorial staff as co-editor of the *Quarterly Update*. Susan brings a lot of experience to the team, and we are thrilled to have her on board.

This issue begins with an article about cybersecurity risks for retirement plans. We've developed a questionnaire to assist plan fiduciaries with evaluating whether an ERISA-covered plan is a good candidate for a cybersecurity risk assessment. Please see the article for more information and to obtain a copy of the questionnaire.

The retirement plan community is buzzing about recent lawsuits filed against plan sponsors and fiduciaries of pension plans challenging the actuarial equivalence factors used for converting benefits into optional forms and for early retirement reductions. While the IRS has provided specific factors to be used for some purposes such as calculating lump sums, plan sponsors aren't required to use those factors for the purposes described in the lawsuits. Since these lawsuits are at the initial filing stage, the merits of the claims have not yet been addressed. While we haven't seen any responses or defenses asserted by the plan sponsors or fiduciaries as we go to press, we will be following these cases closely in the coming weeks.

Plans covered under Section 403(b) of the Internal Revenue Code (relating to plans of certain tax-exempt organizations) have been getting more attention lately. In this issue we discuss how the proposed hardship regulations apply differently to these plans than to other defined contribution plans. We also cover the relief granted by the Internal Revenue Service for plan sponsors that may have misinterpreted the rules that apply to excluding part-time employees from participation. This should be very helpful to plan sponsors.

Each year we publish a Compliance Calendar that lists the significant compliance milestones and due dates that apply to qualified retirement and health and welfare plans having a calendar year plan year. Feedback on the calendar has been very positive as many plan sponsors rely upon it to make sure not to miss compliance deadlines. We have published an article about the Compliance Calendar that includes a link that can be followed to obtain a copy.

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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How Will Your Retirement Plan Respond to Cybersecurity Threats?

By Hitz Burton, Dick Hinman, and Tom Meagher

Retirement plans are attractive targets for cyber criminals. With the technology available today, cyber criminals may be able to gain access to plan participant information and use it to acquire plan assets, in many cases without the plan sponsor or fiduciary becoming aware until it is too late. In one instance, for example, cyber thieves were able to steal more than $2 million from a retirement plan by creating fraudulent plan loans. Additionally, cyber threats to plan administrative systems (successful or unsuccessful) may result in delays and inaccuracies involving administrative records and related services for retirement plans.

Retirement plans routinely store participants' personal information such as dates of birth, Social Security numbers, and home addresses—the type of information that may make a plan a likely target for identity theft by cyber criminals. A retirement plan's vulnerabilities, including cyber threats associated with email, may also compromise other plans (e.g., health and welfare plans) so a comprehensive review of the safeguards applicable to an employer's benefit plans is often desirable—and prudent. Moreover, from an Employee Retirement Income Security Act of 1974 (ERISA) standpoint, there is a growing concern that plan fiduciaries will be held accountable for a data breach involving the unauthorized disclosure of participant information and that such information may be considered a plan asset subject to ERISA's protections, including the need for prudent safeguards approved by the plan fiduciaries.

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From an ERISA standpoint, it is becoming more and more apparent that plan fiduciaries may be found to have a fiduciary duty to maintain adequate cybersecurity with respect to plan information. In November 2016, for example, the ERISA Advisory Council on Employee Welfare and Pension Benefit Plans published a report recommending that plans adopt cybersecurity risk management strategies. More recently, DOL field agents have asserted on audit that participant data is a "plan asset" subject to the same fiduciary protections under ERISA as plan investments, including ERISA's prudent person and exclusive benefit protections.

Most ERISA plan fiduciaries who exercise discretion or control over plan investments have long since settled on the idea that regular periodic review of plan investments is essential to their prudent oversight of such assets. Likewise, fiduciaries may need to periodically assess their plans' cybersecurity safeguards and document that they have determined that such safeguards are appropriate in the current environment. As an initial first step in that analysis, fiduciaries should consider developing a baseline assessment of their plans' current cybersecurity safeguards. A baseline assessment, for example, would help fiduciaries understand the risks associated with whom (both inside and outside the employer) has access to participants' and beneficiaries' personal identifiable information, for how long, and under what conditions.

To help you evaluate whether your plan is a good candidate for an initial baseline assessment of its current cybersecurity protections, Aon has developed a very brief questionnaire. The questionnaire is designed to focus plan sponsors and fiduciaries on the various uses and disclosures of retirement plan data—both inside and outside the company—and help them determine if they should, at a minimum, evaluate the safeguards that are in place and intended to cover retirement plan data. Please contact **linda.lee.2@aon.com** to obtain a copy of the questionnaire or to schedule an appointment with a member of Aon's cybersecurity team.

New Litigation Challenges How Pension Plans Define Actuarial Equivalence

by Hitz Burton, Eric Keener, and Alan Parikh

A series of lawsuits seeking class-action status recently were filed against sponsors and fiduciaries of defined benefit pension plans challenging, among other things, the use of mortality tables created in the 1970s or 1980s to define actuarial equivalence for calculating optional payment forms or early retirement benefits. The complaints allege that the plan sponsors and fiduciaries breached their obligations under the Employee Retirement Income Security Act of 1974 (ERISA) by using old mortality tables (alone or in combination with low interest rates), or explicit plan-defined factors, that are no longer reasonable, resulting in an improper forfeiture of benefits. Below, we discuss further considerations regarding these calculations.

While Treasury Regulations require plans to use “reasonable” actuarial factors when converting an accrued benefit into optional payment forms or adjusting for early commencement, they have not mandated specific mortality tables or interest rates for these situations. This is in direct contrast to the applicable mortality table and interest rate used for lump sum and other benefit determinations defined in Section 417(e)(3) of the Internal Revenue Code (417(e) Factors). In addition to using reasonable actuarial factors, plan sponsors are required to provide participants with information about the relative value of the different optional forms of benefit offered under a plan. The relative value regulations recognize that different (non-417(e)) actuarial factors may be used to develop certain payment forms under the plan.

Because of this recent litigation and the uncertainty it presents, many plan sponsors and fiduciaries are evaluating possible responses. Among other considerations, plan sponsors and fiduciaries may wish to periodically review how their plans define actuarial equivalence and to confirm that the definition continues to be reasonable. For example, it may be prudent for plan sponsors and fiduciaries to compare optional annuity payment forms and early retirement benefits determined using plan factors to the results that would be obtained using the 417(e) Factors. Any resulting differences could then be evaluated.

It is important to note that, while the 417(e) Factors may be considered reasonable for benefit calculation purposes, there is no guidance stating that they are (or should be) the baseline for “reasonableness” determinations. The 417(e) Factors are based on a 50% male-50% female blend of life expectancies for a mixed blue-collar and white-collar population and the yields currently available on high-quality corporate bonds. For a plan with different demographics (e.g., a heavily male or female population), the use of the 417(e) Factors may produce benefits higher or lower than what factors based on the plan’s own demographics would produce. Similarly, a plan’s actuarial equivalence interest rate may be based on something other than high-quality corporate bonds (e.g., if the plan has a different investment strategy), and this may produce benefits higher or lower than what the 417(e) Factors would produce. It may be appropriate for sponsors and fiduciaries to consider these issues in assessing whether plan actuarial factors are reasonable. However, regardless of a plan’s circumstances, a periodic review of the plan’s existing assumptions for benefit calculation purposes may be advisable to confirm their continuing appropriateness. In addition, a review of the assumptions used for relative value disclosures may also be appropriate to ensure that these disclosures provide participants with sufficient information to support decisions regarding time and form of benefit commencement.

While Treasury Regulations require plans to use "reasonable" actuarial factors when converting an accrued benefit into optional payment forms or adjusting for early commencement, they have not mandated specific mortality tables or interest rates for these situations.

While the recent litigation described above has raised several issues for plan sponsors and fiduciaries to consider, it is important to note that plan sponsors and fiduciaries may have valid defenses to a claim that plan factors are out-of-date. For example, a plan sponsor or fiduciary may have determined that the factors defined in their plan are not materially different from the 417(e) Factors, or that the assumptions used are more appropriate than the 417(e) Factors given the specific population covered by the plan. In response to fiduciary breach allegations, plan fiduciaries may be able to demonstrate that the process utilized to evaluate a plan’s actuarial factors was reasonable and prudent and that, as a result, no breach of an ERISA fiduciary duty occurred.

We will continue to monitor this litigation as it proceeds. Please contact your Aon consultant to discuss the implications of the above litigation or for assistance with reviewing the actuarial factors contained in your plans.

Application of Proposed Hardship Distribution Regulations to 403(b) Plans

by Dan Schwallie

In the **Fourth Quarter** issue of the *Quarterly Update*, we described recent proposed regulations affecting 401(k) plan hardship distributions and briefly noted that the proposed regulations are more restrictive as applied to 403(b) plans. This article describes the different rules applicable to hardship distributions from 403(b) plans.

> Sponsors of 403(b) plans should review the proposed regulations along with existing statutory and regulatory guidance to determine whether any modifications of their 403(b) plans' hardship distribution provisions and plan administration are needed or desired.

Essentially, the rules are different for 403(b) plans because the Bipartisan Budget Act of 2018 (BBA) and the Tax Cuts and Jobs Act (TCJA) did not amend Section 403(b) of the Internal Revenue Code (Code). BBA and TCJA expanded access for 401(k) plan hardship distributions to include income on elective deferrals among other changes. While Code Section 403(b)(11)(B) allows access to elective deferrals for hardship distributions, it expressly excludes income on such contributions. Because TCJA and BBA did not amend this statutory language, income attributable to 403(b) elective deferrals continues to be ineligible for hardship distributions.

In addition, BBA and TCJA expanded access for 401(k) plan hardship distributions to qualified nonelective contributions (QNECs) and qualified matching contributions (QMACs). For 403(b) plans invested in custodial accounts (rather than annuity contracts), Code Section 403(b)(7)(A)(ii) only allows access to elective deferrals for hardship distributions. TCJA and BBA did not amend this statutory language, so QNECs and QMACs in a 403(b) custodial account continue to be ineligible for hardship distributions even if later transferred to an annuity contract. As a result, many 403(b) plans limit hardship distributions to elective deferrals.

Sponsors of 403(b) plans should review the proposed regulations along with existing statutory and regulatory guidance to determine whether any modifications of their 403(b) plans' hardship distribution provisions and plan administration are needed or desired. Modifications to consider include changes to the safe harbor list of eligible expenses and the rules for determining whether a distribution is necessary to satisfy an immediate and heavy financial need (e.g., the six-month deferral suspension requirement and the requirement to first take a loan before taking a hardship distribution). In addition, sponsors may desire to weigh expanding the contribution sources from which hardship distributions are made from annuity contracts against the burden of tracking transfers to annuity contracts of amounts other than elective deferrals from custodial accounts. Aon's Retirement Legal Consulting & Compliance consultants can assist plan sponsors in assessing what changes to make and how best to communicate such changes.

Compliance Update for Plan Sponsors

by Linda M. Lee

Plan sponsors must keep their qualified retirement and health and welfare plans in compliance with all relevant legal obligations. Aon's annual Compliance Calendar provides plan sponsors and other interested parties with significant Internal Revenue Service (IRS), Department of Labor, and other regulatory agency due dates and deadlines for benefit-related compliance obligations. This calendar is designed to help plan sponsors maintain compliance with these due dates, thereby avoiding costly penalties for noncompliance due to missing these critical deadlines.

Following is an overview of the topics addressed by the 2019 Compliance Calendar:

- Timing of participant communications and notices (e.g., summaries of material modifications, pension benefit statements, and summaries of benefits and coverage);
- Changes to health plan reporting obligations;
- Plan contribution due dates; and
- Filing dates for IRS forms (e.g., Forms W-2 and 1099-R).

The Aon 2019 Compliance Calendar helps promote timely disclosure and compliance with related filing obligations. Download your complimentary copy of the 2019 Compliance Calendar **here.**

Relief from 403(b) “Once-In-Always-In” Rule for Part-Time Employees

by Dan Schwallie

Nondiscrimination and participation rules for elective deferrals made to 403(b) plans differ from the rules for other defined contribution plans and frequently have been misinterpreted by plan sponsors. Internal Revenue Service (IRS) Notice 2018-95 provides transition relief for plan sponsors who have not operated their plans in accordance with a specific provision of the rules surrounding the exclusion of part-time employees from participation. Specifically, the notice addresses the "once-in-always-in" (OIAI) condition for excluding part-time employees from making elective deferrals under a 403(b) plan.

Elective deferrals under 403(b) plans are subject to a universal availability rule requiring these plans to allow all employees to make elective deferrals if any employee has the right to do so, with certain limited exceptions. A part-time employee may be excluded from participation unless that part-time employee works at least 1,000 hours in any year (or if the employee was reasonably expected to work at least 1,000 hours in the first year of employment). Some employers interpreted the part-time employee exclusion rule to mean that a part-time employee could be excluded from making elective deferrals for any particular year if the employee did not work 1,000 hours in the preceding year. In other words, some employers thought part-time employees could pop in and out of eligibility to make elective deferrals, depending on how many hours the employees worked in the preceding year.

Final Treasury Regulations related to 403(b) plans, issued in 2007 and generally effective for taxable years beginning after December 31, 2008, provided that a part-time employee (i.e., an employee who normally works fewer than 20 hours per week) can be excluded from making elective deferrals if the following conditions are satisfied:

- **First-year Exclusion Condition.** The employer must reasonably expect the employee to work fewer than 1,000 hours during the employee’s first year of employment.
- **Preceding-year Exclusion Condition**. For each exclusion year ending after the end of the first-year exclusion, the employee must have actually worked fewer than 1,000 hours in the preceding 12-month period.

In 2015, the IRS issued a Listing of Required Modifications (LRM) that surprised many employers. The LRM specifically highlighted the OIAI condition regarding the exclusion of part-time employees from participating in 403(b) plans. Under this condition, the employee may be excluded if and only if, in the employee’s first year of employment, the employee meets the first-year exclusion condition, and, in each year ending after the first year of employment, the employee meets the preceding-year exclusion condition. The effect of the OIAI exclusion condition is that if an employee fails to satisfy either of the exclusion conditions—whether in the first year of employment or for any subsequent year, the employee cannot be excluded from making elective deferrals in the future. Commenters requested transition relief, arguing that many employers were not aware of the rule until it was highlighted by the 2015 LRM.

In response, the Treasury Department and the IRS issued Notice 2018-95 providing transition relief during a “relief period,” as well as a fresh-start opportunity when the relief period ends. The relief period starts with taxable years beginning after December 31, 2008, and ends for all employees on the last day of the last exclusion year that ends before December 31, 2019. A plan will not be treated as failing the part-time employee exclusion rule merely because the plan did not provide an employee with an opportunity during the relief period to make elective deferrals for each year after the year in which the employee worked at least 1,000 hours. The notice also provides an optional fresh-start opportunity whereby the part-time employee rule is applied as if it first became effective January 1, 2018.

> Some employers interpreted the part–time employee exclusion rule to mean that a part–time employee could be excluded from making elective deferrals for any particular year if the employee did not work 1,000 hours in the preceding year.

An employer with an individually designed 403(b) plan has until March 31, 2020 to amend the plan, if needed, to reflect that the OIAI condition of the part-time employee rule was not applied during the relief period. Amendments to pre-approved 403(b) plan documents are not required. For periods after the relief period ends, both pre-approved and individually designed plan documents that provide for the part-time employee exclusion must expressly include language that, once an employee has worked 1,000 hours in a year, the employee must be eligible to make elective deferrals each year thereafter. Aon’s Retirement Legal Consulting & Compliance consultants can assist employers with understanding how the transition relief may apply and what amendments may be needed by March 31, 2020.

Quarterly Roundup of Other New Developments

by Teresa Kruse, Jan Raines, and Bridget Steinhart

Managing Retirement Plan Outflows
Plan participants take loans from their retirement plans for many reasons, such as buying a house or a car, paying off credit cards, or paying for a vacation. Unfortunately, the downside of taking a plan loan is a potential reduction in retirement savings and possible tax implications if the loan is not timely repaid. When a participant with a loan changes or loses a job, full repayment of the outstanding balance of the loan may become due and payable. If the participant is unable to repay the loan, the plan sponsor will treat the loan as a taxable distribution to the participant and a 10% additional tax penalty may also apply. Corporate actions such as mergers or acquisitions can also adversely affect plan participants with loans and cause a loan to be payable in full long before anticipated by the participant. This outflow of retirement savings is detrimental to participants' retirement security.

There are many ways plan sponsors can combat the outflow of retirement funds:

- **Education Is Key.** Review the financial education programs offered through your retirement plan provider to confirm loan and debt-management education is included. Make this topic a priority.
- **Provide Alternatives.** Offer emergency savings accounts or short-term emergency loans as part of the benefit package. Payments can be made through payroll deduction.
- **Review Plan Design.** Assess your plan design to determine whether you can reduce circumstances where participants take out loans, such as reducing the number of loans that participants can take or increasing the wait time between loans.
- **Understand Impact of M&A Transactions**. Understand how corporate transactions can affect your retirement plan and participants with loans. If the transaction will result in termination of the retirement plan, educate participants regarding their options.

Aon consultants can help identify ways to structure your defined contribution plan to maximize your employees' retirement savings and tax advantages.

New Tactics Deployed by Plaintiffs' Attorneys (or Forewarned is Forearmed)
Plaintiffs' attorneys have been trying new tactics in Employee Retirement Income Security Act of 1974 (ERISA) litigation such as:

- **Demanding a Jury Trial.** Defendant plan sponsors and fiduciaries have long argued, and courts have traditionally agreed, that there is no statutory or constitutional right to a jury trial in ERISA cases. Instead, these cases are decided by judges in courts of equity, which only provide for equitable remedies for a fiduciary breach (such as the cessation of a practice that specifically violates ERISA or any provision of a plan subject to ERISA). Several plan sponsors and fiduciaries are potentially facing jury trials for alleged breaches based on a new legal theory that an attempt to hold the plan's fiduciaries personally liable for losses by the plan may be the type of claim that should be brought before a jury. If this new legal theory holds, it may change how cases are presented in the future. *Cassell v. Vanderbilt Univ., No. 3:16-cv-02086 (M.D. Tenn. report and recommendation filed 10/22/2018); Moitoso v. FMR LLC, No. 1:18-cv-12122-WGY (D. Mass., amended demand for jury trial filed 1/15/2019); Cunningham v. Cornell Univ., No. 1:16-cv-06525-PKC (S.D.N.Y. def.'s letter to judge filed 9/21/2018).*
- **Questioning Which Party Has the Burden of Proof.** Putnam Investments LLC intends to petition the U.S. Supreme Court to review a court's decision regarding its 401(k) plan. Specifically, Putnam is asking the Supreme Court to address which party—plaintiffs or defendants—have the burden of proving (or disproving) that a plan loss is due to fiduciary misconduct. *Brotherston v. Putnam Invs., LLC, No. 17-01711 (1st Cir. mot. to stay mandate 10/24/18).*
- **Initiating Fee Litigation Against Smaller Plans.** Fee litigation against retirement plans is moving down-market. The most recent example is a lawsuit against Kaleida Heath's 401(k) and 403(b) retirement plans, which have $81.4 million and $444.8 million in assets, respectively, as of December 31, 2017 (as reported on Form 5500). *Lutz v. Kaleida Health, No. 1:18-cv-01112-EAW (W.D.N.Y. complaint filed 10/10/2018).*

These most recent tactics by plaintiffs' attorneys potentially affect retirement plans of all sizes and underscore the importance of sound governance processes, including fiduciary training, regular investment fund and plan expense reviews, and appropriate documentation of the fiduciaries' work in their areas of responsibility. Aon consultants are available to help review governance processes, provide fiduciary training, provide for appropriate recordkeeping of actions taken and develop an annual fiduciary checklist.

Retirement Plan Litigation Update

Retirement plan litigation has been prevalent over the past decade affecting corporate plan sponsors, plan fiduciaries, financial institutions that are also plan sponsors, and universities sponsoring 403(b) plans. Defined contribution plan cases generally fall into the following three areas: inappropriate or imprudent investment choices, excessive fees, and self-dealing. Recently, several cases involving financial institutions and universities have been dismissed (in full or in part) or settled, including:

- Financial Institutions
  - *Sims v. BB&T*—Case settled for $24 million
  - *Rozo v. Principal*—Case settled for $3 million
  - *Pease v. Jackson National*—Case settled for $4.5 million
  - *Bekker v. Neuberger Berman Grp.*—Case partially dismissed
- Universities
  - *Daugherty v. Univ. of Chicago*—Case settled for $6.5 million
  - *Davis v. Wash. Univ.*—Case fully dismissed

Plan sponsors seeking to reduce their litigation risk liability use a variety of strategies including increasing the number of passive funds in their plans and implementing better fee transparency. *Sims v. BB&T Corp., No. 1:15-cv-00732-CCE-JEP (M.D.N.C Dec. 13, 2018); Rozo v. Principal Life Ins. Co., No. 4:14-cv-00463-JAJ (S.D. Iowa Sept. 12, 2018); Pease v. Jackson Nat'l Life Ins. Co., No. 1:17-cv-00284-JTN-ESC (W.D. Mich. Nov. 1, 2018); Bekker v. Neuberger Berman Grp. LLC, No. 1:16-cv-06123-LTS-BCM, 2018 BL 351830 (S.D.N.Y. Sept. 27, 2018); Daugherty v. Univ. of Chicago, No. 1:2017-cv-03736 (N.D. Ill. Sept. 12, 2018); Davis v. Wash. Univ. in St. Louis, No. 4:17-cv-01641 (E.D. Mo. Sept. 28, 2018).*

Please see the applicable Disclosures and Disclaimers on page 8.

Recent Publications

Retirement Plan Benefits for Reducing Student Loan Debt: Are Mortgages Next?
By Daniel Schwallie
Journal of Pension Planning & Compliance (First Quarter 2019)

A recent IRS private letter ruling opens the door to plan designs that provide retirement benefits for employees who pay down their student loan debt, but also raises some unanswered questions.

Click **here** to read the article.

Special Coverage and Nondiscrimination Testing Rules for 403(b) Plans
By Daniel Schwallie
Journal of Pension Planning & Compliance (First Quarter 2019)

Coverage and nondiscrimination testing of 403(b) plans sponsored by 501(c)(3) tax-exempt organizations involves special rules for determining controlled groups, testing elective deferrals, and testing when non-403(b) plans are included in a controlled group.

Click **here** to read the article.

Preapproved Plan Pros and Cons
By Daniel Schwallie
Benefits Quarterly (First Quarter 2019)

An IRS preapproved plan document can be a cost-effective document solution with the ability to rely on an IRS opinion letter. However, a preapproved plan has limited flexibility for plan design compared with an individually drafted document and is also not available for all plan types.

Click **here** to read the article.

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