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Quarterly Update

Aon Hewitt Retirement Legal Consulting & Compliance

In this Issue

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Notes From Your Editor

A new year has arrived, bringing with it a new administration and some uncertainty regarding the future of retirement benefits. In this issue, Rick Jones, the leader of Aon Hewitt's National Retirement Practices, offers some interesting insights into how the provision of retirement benefits could evolve over the next four years.

As part of our response to the termination of the Internal Revenue Service's (IRS's) determination letter program for ongoing, individually designed plans, Aon Hewitt now offers a new solution for maintaining and documenting compliance with applicable requirements. Our new service, designed to fill the void left by the IRS's decision to cease issuing new determination letters on a plan's qualified status, is described more fully in this issue.

The start of each new year is also an opportunity to remind our readers of Aon Hewitt's Benefit Index® and the Real Deal—two programs that can help plan sponsors determine whether their benefit packages are competitive for their industries and assess how well their participants will be positioned for retirement.

We provide plan sponsors annually with useful information regarding plan limits and compliance deadlines, as well. This issue includes links to our recent 2017 publications in these areas. We hear a lot of positive feedback about these annual publications—and many people (including me) keep them posted at their desks for easy reference.

Further, as you're aware, plans that invest in shares of stock must continue to address unique issues related to that investment. In this issue, we describe the Department of Labor's recent guidance to plan fiduciaries regarding voting proxies and exercising shareholder rights with respect to shares of stock.

Finally, we have included a brief roundup of several new developments of interest. If you have any questions or need any assistance with the topics we've covered here, please contact the author of the article or Tom Meagher, our practice leader.

Regards,

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New Leaders in Washington—What's Next in Retirement Benefits?

by Rick Jones

America is watching the early moves of a new administration and a continued Republican-controlled Congress. Much has been said, predicted, and postulated regarding the future of health care in the United States, including repealing and replacing the Affordable Care Act. However, the new administration has said very little about retirement income policy.

Despite the uncertain environment, below are some predictions for the future of employer-sponsored retirement income plans.

Defined contribution benefits will continue to be the norm for most industries, but new options will emerge. We don't see anything reversing the significant trend over recent decades toward defined contribution retirement income programs. That said, the benefits community is poised and ready for new multiple employer models that produce more efficiencies, make broader expertise available, and ultimately provide better outcomes—including the prospects for more secure lifetime incomes. Congress has considered such models recently, including the Senate Finance Committee's 2016 deliberation on the Retirement Enhancement and Savings Act (RESA).

There are too many upsides associated with these models for Congress and the new administration to ignore, and we predict that many of them could become viable and available in the next four years. The financial services and benefits communities will have to work together with leaders in Washington to ensure the success of these new approaches. Aon Hewitt is, and will be, very actively involved in those conversations.

"The benefits community is poised and ready for new multiple employer models that produce more efficiencies, make broader expertise available, and ultimately provide better outcomes—including the prospects for more secure lifetime incomes."

The current pension financing environment and requirements will produce better-funded pension plans. Pension funded ratios in the private employer space have hovered around 80% for some time. Funded ratios will increase in the coming years as employers look to avoid, through larger contributions, the significant and increasing "underfunding tax" included in the PBGC premium structure, which will be exacerbated in 2018 by updated mortality tables. Furthermore, potential tax reform may trigger a spike in contributions as companies seek to accelerate tax-deductible contributions and interest payments into the current corporate tax regime, or contribute repatriated earnings should there be a loosening of related corporate tax rules.

Plan sponsors have taken advantage of the pension funding relief provisions included in federal budget acts and other legislation in recent years. This has included multiple rounds of interest rate "stabilization" that is being phased out through 2024. We anticipate that increased cash contributions, either required as funding relief wears away or strategically made to reduce risk or premiums, will produce stronger pension funded ratios.

In addition, economic policy at home and abroad will impact pension funding (and, more broadly, retirement planning). As noted repeatedly, economic policies could continue to impact interest rates as well as market and currency valuations. Finally, some believe the 30-year downward trend in interest rates has ended, and that higher yields are ahead of us. If this is true, funded ratios can improve even if equity returns are weak.

Pension settlements will continue without new limitations. Recent years have seen significant pension settlement transactions for private employers' defined benefit plans through annuity purchases with insurers and lump-sum distributions to participants. Aon Hewitt's calculations suggest that approximately 6% of total pension obligations in the single-employer space were settled between 2012 and 2016. Settlement activity will likely pick up steam. The stronger funded ratios mentioned above will support this trend.

We are eager to see what the future holds for retirement income and broader benefits policy in the U.S. Our business is to help our clients to best anticipate future events, and this is no exception. We're glad to help!

2017 Limits for Benefit Plans

by Linda M. Lee

Employee benefit plans are subject to many dollar limits established annually by the Internal Revenue Service (IRS). There are limits on the amount of contributions that may be made to defined contribution plans, on the annual amount that can be paid from defined benefit plans, on the amount of compensation that can be used when calculating benefits, and many more. The limits are updated based upon price and wage inflation and changes in the law. As a result, the administration of qualified retirement plans must be adapted annually to accommodate the applicable limits.

Each year, Aon Hewitt publishes a report that summarizes the new limits and includes additional helpful tax information. Our clients have found this summary to be an extremely useful and easy-to-use reference document.

A copy of the 2017 benefit limits summary (including prior limits for years 2014–2016) can be downloaded **here.**

New Solution to Address End of IRS Determination Letter Program

by Tom Meagher and Meghan Lynch

When the Internal Revenue Service (IRS) announced that it was ending the determination letter program for individually designed plans (other than for new plans, terminating plans, and in other special circumstances), employers and plan fiduciaries became very concerned—and rightly so. No longer would employers be able to rely on a recent IRS review of the plan document to confirm that the plan terms were consistent with applicable statutory and regulatory requirements, or that design changes had not adversely impacted the plan's qualified status.

Employers and plan fiduciaries have been wrestling with how best to manage their plans in the post-determination letter environment. To help overcome this challenge, Aon Hewitt has developed a new plan qualification service to address the needs of employers and plan fiduciaries. The service is designed to fill the void left by the IRS when it decided to cease issuing determination letters for ongoing plans.

As employers and plan fiduciaries well know, plan qualification depends not only on the form of the plan document, but also on the administration of the plan. To respond to the needs of our clients, we are now offering a comprehensive review of a plan's qualified status—in terms of both the plan document and the administration of the plan. We have identified and dedicated a cross-functional team of professionals to perform these reviews that includes actuarial, defined contribution, administrative, nondiscrimination testing, and legal consulting specialists. Our team can review the plan and its administration to ensure that the plan is being administered in accordance with its terms (or, if it is not, to identify what actions should be taken to properly administer the plan).

Rather than rely on old determination letters or move forwardly blindly without assurance that their retirement plans are qualified, employers and plan fiduciaries can now rely on Aon Hewitt's National Compliance Practice to confirm that plan terms comply with qualification requirements. Moreover, cost-sensitive employers and fiduciaries will appreciate the fact that Aon Hewitt's qualification reviews are customizable—meaning employers and plan fiduciaries can limit the review to the most recent plan changes or to discrete aspects of plan administration.

In view of the end of the IRS determination letter program and the expected increase in regulatory examinations, employers and plan fiduciaries would be well advised to periodically review their plans' qualified status—from both a document and an administration standpoint. While such a review may not be needed each year, it is advisable to consider a review if it has been some time since the employer's last IRS determination letter (e.g., former Cycle "B" filers should consider such a review now). Pursuing such a document or administrative evaluation is also wise following any material changes to plan design, or following any significant statutory or regulatory changes.

Aon Hewitt is well positioned to provide a comprehensive evaluation of plan documents and plan operations. Our innovative solution provides clients with a thorough analysis of the plan's qualified status and a process to facilitate long-term compliance. A brief summary of Aon Hewitt's capabilities in this area is available **here.** Please contact your Aon Hewitt consultant with any questions.

Do Your Company's Benefits Measure Up? Ask Benefit Index®

by Mark Friedman

As a benefit manager or plan fiduciary, you are likely focusing a considerable amount of time on compliance issues. While this is necessary, plan sponsors also must make sure they are investing their energy on benefit programs that meet their organization's business needs.

> "Assessing the value and competitiveness of your company's benefit package can reveal whether you have the right programs in place."

An Aon Hewitt Benefit Index® benchmarking analysis quantifies the value of your company's benefits package and compares it to the value of benefits provided by your peer organizations in a simple, straightforward index. This valuable benchmarking analysis leverages Aon Hewitt's deep database of more than 1,000 participating organizations across a variety of industries, geographies, and types of employment. By comparing your organization's benefit program to subsets of this vast database, you can gain a wealth of insights and information. In addition to the quantitative analysis, Aon Hewitt maintains a web-based tool, Benefit SpecSelect™, which allows subscribing members to review benefit plan prevalence and specification details on demand.

Benefit Index should be part of any plan design project. It can be used as both a tool for educating senior management on the current state of the benefit program and as a communication tool for sharing results with the broader employee group. Benefit Index can also be used to improve your understanding of current benefit trends, model future benefit plan changes, and coordinate benefits after a merger or acquisition transaction. Given the myriad of changes to benefit regulations and health care programs that may be coming, keeping up with evolving trends will be important to maintain a competitive new hire benefits package.

If you are interested in reviewing the competitiveness of your company's benefits or subscribing to Benefit SpecSelect, please contact **Mark Friedman**, or **Debbie Hildenbrand**.

Are Your Employees Prepared for Retirement?

by Grace Lattyak and Melissa Hollister

Are your employees financially prepared for retirement? Do they know how much they should be saving to be prepared? At what age will they be able to retire with adequate retirement resources? Produced by the Aon Hewitt Retirement & Investment group, the *Real Deal* is a triennial retirement income adequacy study that provides a framework for answering these questions. The study defines retirement preparedness for over two million employees of large companies, analyzes retirement risks, measures employer and employee actions to help improve retirement outcomes, and provides answers to critical questions as employees and employers prepare for a financially secure retirement.

According to this robust study, to maintain their preretirement standard of living, workers who participate in their employers' benefit plans for their entire careers typically need to accumulate retirement assets and benefits (in addition to Social Security) worth about 11 times their pay. When the study compares projected resources to needs, roughly two out of five workers are expected to be on track to retire with reasonably adequate retirement income.

The other three out of five workers must save more, retire later, or face a significantly reduced standard of living in retirement. What percentage of your workforce is on track to save enough for retirement?

For many, a method to achieve adequate retirement income is to delay retirement. The *Real Deal* found 68 to be the median age at which full-career contributors are projected to have sufficient resources to maintain their standard of living. However, 16% of the population is still not expected to be able to retire by age 75. Will your workforce and business be favorably or adversely impacted if your employees retire later than they do today?

To learn whether your retirement program is adequate for your employees and what the resulting workforce implications might be, contact **Grace Lattyak**.

To learn more about the study, visit the *Real Deal* **here.**

Updated DOL Guidance on Exercising Shareholder Rights by Plan Fiduciaries

by Tom Meagher

On December 29, 2016, the Department of Labor (DOL) issued Interpretive Bulletin 2016-1 addressing the conduct of plan fiduciaries in voting proxies and exercising shareholder rights with respect to shares of stock held by retirement plans. The bulletin was issued in order to clarify possible misunderstandings relating to fiduciaries' responsibilities.

In issuing the interpretive bulletin, the DOL reiterated that a fiduciary's obligation to manage plan assets prudently should include actions with respect to voting proxies, establishing statements of investment policy, and engaging as a shareholder with company management. Key parts of the bulletin include:

- **Proxy voting.** The responsibility for voting proxies lies exclusively with the plan trustee unless the trustee is subject to the direction of a named fiduciary or investment responsibility has been delegated to an investment manager. The bulletin indicates that the responsible fiduciary should consider factors, both financial and nonfinancial, that may affect the value of the plan's investment. A named fiduciary's duty to monitor investments (and investment managers) necessitates that accurate records of proxy voting be maintained to enable the named fiduciary to review both the proxy voting procedure and specific actions taken.
- **Investment policy statement.** The bulletin serves as an important reminder that plan documents, investment policy statements, and investment manager agreements should be consistent and clearly identify the parties' responsibilities—including those related to actions surrounding proxy voting. Investment policy statements should provide guidelines or general instructions concerning various types or categories of investments. These categories may include proxy voting, policies concerning economically targeted investments, and requirements that investments incorporate environmental, social or governance (ESG) factors. In all cases, the actions taken must be consistent with ERISA's fiduciary obligations.
- **Shareholder engagement.** Investment policies may propose that plan fiduciaries monitor or attempt to influence the management of corporations in which the plan owns stock. However, the fiduciary should reasonably conclude that doing so is likely to enhance the value of the plan's investment after taking into account the costs involved. Shareholder engagement issues may include, among others, governance structures, board composition, executive compensation, transparency and accountability of corporate decision-making, climate change preparedness and sustainability, practices to address environment or social factors with an impact on shareholder value, and responsiveness to shareholders.

With the change in administrations, it appears that the DOL wanted to clarify that plan fiduciaries may consider a number of financial and nonfinancial issues and factors when evaluating current and future plan investments. Any such investment decisions must be consistent with the instruments governing the plans, prudent, and in the best interests of participants and beneficiaries.

2017 Compliance Calendar

by Linda M. Lee

The Aon Hewitt Compliance Calendar is an annual publication that alerts plan sponsors and other interested parties of some of the more significant Internal Revenue Service (IRS), Department of Labor, and other regulatory agency due dates and deadlines for benefit-related compliance obligations.

A few of the topics addressed by the 2017 Compliance Calendar include:

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

The 2017 Compliance Calendar also helps promote discussions between plan sponsors and their consultants that will ensure timely disclosures and compliance with related filing obligations. Download your complimentary copy of the **2017 Compliance Calendar** now.

Quarterly Roundup of Other New Developments

by Jan Raines and Bridget Steinhart

Potential retirement program opportunities gleaned from Form 5500 data. Department of Labor Form 5500 database information was recently analyzed by a media group to assess the prevalence of certain reported data and to identify possible "red flags." The group found numerous examples of disclosures related to corrective distributions and plan terminations, among other matters. Corrective distributions to highly compensated participants are a regular occurrence in many plans, but can suggest opportunities for re-strategizing total rewards and benefits budgets as they relate to plan design components.

Opportunities might include changing employer contributions, taking a fresh look at participant communication strategies used to address the importance of plan participation and appropriate deferral levels, or implementing a "top hat" deferred compensation plan to support the highly paid group's retirement objectives. For plan terminations, the findings present an opportunity for active retirement plans to implement or maintain a periodic search for missing participants and to explore solutions such as rolling over lost participants' balances to individual retirement accounts (as permissible).

Women tend to be under-saved and underprepared for retirement. While retirement readiness is a concern for both men and women, women are currently more likely to lack sufficient savings to manage their financial needs in retirement, according to survey results issued by Aon Hewitt this year (see the article earlier in this issue). According to the survey data, 401(k) plan participation for both genders is the same at 79%, but women are not saving as much toward their retirement needs as men (83% of women have a savings gap, as compared to 74% of men). Longer lifespans and other factors mean that women, on average, will need to work a full year longer than men, retiring at age 69 in order to meet their financial needs in retirement. When determining participant education strategies for 2017, it may be beneficial to explore providing communications targeted to women and other at-risk groups.

IRS offers correction methods for using the wrong definition of compensation. The Internal Revenue Service (IRS) recently explained that one of the most common errors submitted through its Voluntary Compliance Program (VCP) is the use of an incorrect definition of compensation when administering the plan. In a helpful move for plan sponsors, the IRS has indicated that such errors may be eligible for correction using a method (if certain requirements are met) that does not require making corrective distributions or contributions. In many cases, the errors occur as a result of the inclusion or exclusion of bonuses, overtime, or commissions. Often the plan sponsor's payroll system is not in sync with the definition of compensation defined in the plan document—or there is one definition for purposes of plan contributions and a different definition for purposes of nondiscrimination testing.

The IRS now permits plan sponsors to correct certain errors by retroactively amending the definition of compensation to match the compensation that was actually used, as long as it can be documented that the definition of compensation used matched participants' expectations. For example, if the plan document states that bonuses won't be included but participant communications indicate that bonuses are included—and contributions were calculated based upon a definition of compensation that included bonuses—the IRS may agree that it makes sense to correct the failure by amending the plan to include bonuses, instead of making a corrective distribution of the amounts attributable to the bonuses.

Each VCP application is reviewed and evaluated based on the submitted facts to determine which is more appropriate—a retroactive amendment or the more traditional correction method of making corrective contributions or distributions, adjusted for earnings. It is important for sponsors to perform periodic reviews of plan operations in conjunction with the plan document—particularly in the area of plan compensation—to ensure that there are no operational failures, and if errors are identified, to make corrections as soon as possible.

Supreme Court to hear "church plan" lawsuits. The U.S. Supreme Court will review three cases for Christian-affiliated hospital systems to determine if their defined benefit plans are considered "church plans" under the Employee Retirement Income Security Act of 1974 (ERISA). Church plans that have not elected to be subject to ERISA are exempt from ERISA requirements (e.g., minimum funding and reporting requirements) and certain requirements of the Internal Revenue Code, which plaintiffs claim puts their pension plans at risk. According to the appeals court, the plans in question are not church plans, since they were not initially established by a church, and would be subject to ERISA.

As noted in Aon Hewitt's December 2016 white paper, entitled, **"What's at Stake for Health Care Organizations with Church Pension Plans,"** hospitals that have treated their pension plans as church plans will want to understand the changes in contributions and administrative practices that would be required if these plans were subject to ERISA. While there have been dozens of suits filed and only a few settlements reached, none thus far have required that the plan fully comply with ERISA.

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