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Retirement PLAN news

RECENT developments

DOL proposed fiduciary definition

On April 14, 2015, the U.S. Department of Labor (DOL) issued its long-awaited proposed definition of "fiduciary." When finalized, the new definition will have a major impact on who is considered to be a fiduciary.

Historically, a 401(k) plan sponsor is a plan fiduciary. As such, the sponsor makes sure that investments made available to participants are prudent and looks out for participants' best interest.

Since trillions of dollars of retirement savings end up in traditional IRAs, the DOL is seeking to have the same fiduciary protection participants are used to having in their qualified plans apply when individuals roll their money into IRAs. To that end, the individual who advises a participant to roll his or her money from an employer's qualified plan to an IRA could be deemed to be a fiduciary.

The proposed regulation strives to ensure that those providing participants with investment advice for a fee are acting in the participants' best interest, not providing "conflicted advice." A comment period will run until July 4, 2015.

IRS updates elective deferral failure correction methods

On April 2, 2015, the IRS updated its Employee Plans Compliance Resolution System (EPCRS) regarding corrections involving elective deferral failures in 401(k) plans. The guidance was issued in response to comments the IRS received that said the existing elective deferral correction rules overcompensate participants (especially in situations where failures last for short periods) and that participants have the opportunity to increase elective deferral contributions in later periods. The IRS also received feedback indicating that high costs related to correcting elective deferral failures in automatic arrangements were discouraging employers from adopting automatic enrollment features. Revenue Procedure 2015-28 introduces new correction methods that significantly reduce the cost of corrections related to deferral failures.

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Retirement distribution advice

It is common practice for financial services firms to contact 401(k) participants who are nearing retirement to discuss rolling over their 401(k) nest egg into an individual retirement account (IRA).

Several different regulatory agencies, including the Financial Industry Regulatory Authority (FINRA), the Government Accountability Office (GAO), the Department of Labor (DOL), and the Securities and Exchange Commission (SEC), are focusing attention on this practice.

FINRA Notice 13-45

FINRA is making it a priority to examine these practices. Notice 13-45 reminds broker-dealer firms of their obligations when making recommendations about rolling over retirement plan assets and marketing IRAs and associated services. The Notice focuses on the recommendations firms make to participants in 401(k) and other employer-sponsored retirement plans who are terminating employment and contemplating how to invest their plan assets.

Broker-dealers may no longer just urge participants to make an IRA rollover, even if the securities in the IRA would be suitable. Broker-dealer recommendations must be based on an evaluation of the pros and cons of the following four options:

- Keeping the assets in the old employer's plan,
- Rolling the assets into the new current employer's plan,
- Rolling the assets into an IRA product that the firm is authorized to sell, or
- Taking a taxable distribution.

Suitability standards

When a firm recommends that an individual sell his or her 401(k) assets and roll the cash into an IRA, the recommendation to sell plan-held securities is subject to FINRA Rule 2111. The rule establishes a suitability standard that requires a broker-dealer and its associated personnel to have a reasonable basis for determining whether a recommended securities transaction or investment strategy is suitable for the individual. Rollover suitability obligations extend not only to the pros and cons of the plan maintaining the distribution-eligible account, but they also apply to the new current employer's plan (if any) when a participant changes jobs.

In Notice 13-45, FINRA recommends that certain suitability factors be considered when a firm recommends rolling assets into an IRA rather than keeping the assets in a prior employer's plan or rolling them into a new employer's plan. Following are highlights of some of the factors:

Investment options. IRAs may provide an investor with a broader range of investments than an employer's plan. However, FINRA also points out that an investor who is satisfied with low-cost institutional funds that are available in some plans may not value having a broader range of investment options.

Fees and expenses. Both IRAs and plans typically have investment-related expenses and plan or account fees. Plan fees typically include administrative fees, such as recordkeeping, compliance, or trustee fees. IRA fees may include custodial fees, sales loads, or commissions.

Services. Retirement plans and IRAs may offer different types of services.

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Hardships and loans

The April 2, 2015, edition of the IRS newsletter for plan sponsors (*Employer Plan News*) contained an important reminder: Plan sponsors that permit hardship distributions or participant loans should review their current practices to ensure they are operating in compliance with IRS requirements.

Hardship distributions. The IRS makes it clear that a plan sponsor is obligated to retain the following paperwork:

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

Failure to have these records available is a plan qualification failure. It is not sufficient for the participant to retain his or her own hardship distribution records; the plan sponsor must retain documentation that demonstrates the nature of a hardship. The IRS noted that while participants are permitted to "self-certify" that they have a financial hardship, self-certification — filed electronically or on paper — is not enough to prove the nature of a hardship request.

Example: John requests a hardship distribution to pay a hospital for unreimbursed medical expenses. He certifies that he has no other means of satisfying the hardship besides taking a distribution from his 401(k) account. However, John does not submit any hospital bills to the plan sponsor and simply signs a form indicating he is using the funds to pay unreimbursed medical expenses. If the plan sponsor approves John's request without obtaining and retaining supporting documentation that reflects the amount John owes to the hospital, the plan sponsor is not in compliance with the IRS's documentation and retention requirements.

Participant loans. The IRS requires plan sponsors to retain similar documentation with respect to participant loans, including the following:

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

During audits, the IRS has found that some plan sponsors permit participants to self-certify their own loan eligibility. When a participant requests a loan in excess of five years for the purchase or construction of a primary residence, the plan sponsor is required to obtain documentation of the purchase prior to approving the loan.

In reviewing the responses to the 401(k) questionnaire sent to employers in 2010, the IRS discovered that instead of an administrator overseeing the actual operation of the plan, it has, in many cases, been relegated to a computerized investment platform with no procedure in place to actually ensure that the hardship distribution is for an allowable reason or for a proper amount. The IRS also discovered that there is often minimal oversight regarding plan loan repayments being made according to the amortization schedule.

Retirement distribution advice

(Continued from page 1)

Investors should consider the services they will receive when choosing whether to leave their assets in their employer's plan or move them to an IRA.

Penalty-free withdrawals. The law permits individuals who terminate employment between ages 55 and 59½ to take withdrawals from an employer retirement plan (such as a 401(k)) free of IRS early distribution penalties. IRA distributions are generally not penalty free until age 59½. The availability of funds could impact an investor's decision about where to invest his or her plan assets.

Creditor protection. Retirement plan assets generally have unlimited protection from creditors under federal law, whereas IRA assets are only protected in bankruptcy proceedings. State laws vary on the protection of IRA assets.

Required minimum distributions (RMDs). IRA owners must begin taking RMDs when they reach age 70½. Retirement plans can be designed to delay the timing of RMDs for individuals who continue working beyond age 70½ and who do not own more than 5% of the company sponsoring the plan. Therefore, leaving assets in a plan may be an advantage for certain individuals.

Employer stock. Rolling over stock that has significantly appreciated from a retirement plan into an IRA can have negative tax consequences. Net unrealized appreciation (NUA) is a special tax treatment that is only available for distributions of employer securities from an employer's qualified plan. If the employer securities are rolled into an IRA, the NUA is lost. FINRA reminds investors that it can be risky for participants in a retirement plan to invest too much of their account in employer stock.

Conflicts of interest

FINRA is urging broker-dealers to review their policies to prevent potential conflicts of interest that could impair the judgment of a registered representative or other person who advises investors on the subject of retirement assets. Representatives who recommend rolling plan assets into IRAs may earn commissions or other fees as a result, which means there is an economic incentive for the representatives to encourage the rollover option.

EPCRS revised

On March 27, 2015, the IRS published Revenue Procedure 2015-27. The new guidance revises certain correction methods under the Employee Plans Compliance Resolution System (EPCRS) and makes changes to Revenue Procedure 2013-12, the current version of EPCRS.

The revisions provide plan sponsors with greater flexibility in fixing overpayment errors and reduce compliance fees associated with correcting certain operational failures regarding participant loans and required minimum distributions (RMDs). This article highlights the major revisions in Rev. Proc. 2015-27. Although the effective date is July 1, 2015, plan sponsors are permitted to apply these provisions on or after March 27, 2015.

Overpayment corrections

An overpayment occurs when a payment made to a participant or beneficiary exceeds the amount that should have been made payable under the terms of the plan or based on certain regulatory limitations. Prior to this guidance, overpayment failures were typically corrected by requesting that a participant or beneficiary return the overpayment to the plan. The IRS recognized that it may be financially difficult for some participants and beneficiaries to repay the plan, especially in situations where errors have occurred over lengthy periods of time (e.g., in a stream of pension payments) and involve substantial amounts of interest.

Under Rev. Proc. 2015-27, the IRS is stating that when an overpayment failure results from a benefit calculation error, an appropriate correction method may include having the employer or another person contribute the amount of the overpayment (with appropriate interest) to the plan in lieu of seeking repayment from plan participants and beneficiaries. Another example of an acceptable new correction is for a plan sponsor to retroactively adopt an amendment to conform the plan document to plan operations.

Example: Steve is 80% vested in his employer match. Steve terminates and inadvertently receives a lump-sum distribution of 100% of his employer match. The nonvested amount Steve receives is an overpayment. Rev. Proc. 2015-27 permits the employer to contribute the amount of overpayment to the plan instead of trying to recoup the amount from Steve.

Reduced compliance fee for RMD failures

When an RMD is not distributed from an employer's qualified plan, the plan could be subject to disqualification. EPCRS contains procedures for correcting these types of failures. The correction involves filing a submission under the Voluntary Correction Program (VC Program) and paying a compliance fee based on the number of participants in the plan.

Prior to Rev. Proc. 2015-27, if the only failure is missed RMDs for 50 or fewer participants, the fee was $500, regardless of the actual number of participants in the plan. Rev. Proc. 2015-27 extends the number of missed RMDs covered by the $500 fee from 50 or fewer participants to 150 or fewer participants. The Rev. Proc. also introduces a higher level of correction for missed RMDs: from 151 to 300 participants for a fee of $1,500. If more than 300 participants fail to receive RMDs, the general fee schedule, which is based on the number of participants in the plan, is utilized.

Reduced compliance fee for loan failures

Changes have also been made that improve the method of determining compliance fees for plans with a relatively small number of participant loans that fail to satisfy the requirements of Internal Revenue Code Section 72(p). Such failures include issuing participant loans in excess of the maximum amount available, setting up loans that are not in compliance with the maximum repayment schedule, and failing to make repayments in accordance with the terms of a loan.

When these types of failures occur, the IRS requires a VC Program submission, which includes a compliance fee. Prior to Rev. Proc. 2015-27, the fee was based on the number of participants in the plan. The fee is now based on the number of participants with loan failures. If the VC Program submission involves a loan failure and the failure does not affect more than 25% of the plan sponsor's participants in any year in which the failure occurs, and the loan failure is the only failure described in the submission, then the compliance fee will be:

Number of participants with loan failures	Compliance fee
13 or fewer	$300
14 to 50	$600
51 to 100	$1,000
101 to 150	$2,000
Over 150	$3,000

The fees in this schedule are significantly lower than the general compliance fee schedule and provide considerable relief to plan sponsors that are correcting loan failures.