Benefit Plan Compliance

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ERISA Overview and Statistics Nationally

- Approximately 81,000 plan audits performed annually
- Approximately 6,300 auditing firms performing audits
- 126,000,000 participants are covered by a benefit plan, roughly 39% of the American population is a benefit plan participant
- 7.5 trillion dollars of assets are maintained within benefit plans

Purpose of Benefit Plans

- Defined contribution plans
  - 401(k), 403(b), employee stock ownership, and profit sharing plans
    - Intend to provide a tax deferred savings plan to assist in employee's future retirement goals
    - Benefits are not guaranteed and participation is optional
- Defined benefit plans
  - Pension
  - Health and welfare plan (Insurance)
    - Promises a specific benefit:
      - Monthly retirement income
      - Promised medical coverage

Defined Contribution vs. Benefit

- At risk benefit vs. guaranteed benefit
- Employee control assets vs. employer controlled
- Portability of future benefits
- Defined benefit plans are typically much more expensive for plan sponsors and are gradually being phased out in most industries
- Defined benefit plan exposure
  - Future liabilities dependent on asset performance
  - Annual contributions dependent on asset performance

Client Risks

- Fiduciary risk for lack of prudence in selecting plan auditor
- Potential rejection of form 5500 filing due to deficient audit work
- Civil monetary penalties for failure to follow fiduciary obligations
- Loss of tax exempt status for benefit plan, resulting in taxes being owed

Essential Elements of a Plan

- Written plan document
  - Must describe benefit structure and operations
- Plan assets must be held in a trust fund
  - Typically under custodianship of broker or insurance company
- A record keeping system to track plan activities
  - Defined contribution plan are usually administered by 3rd party record keeper, while defined benefit are done in house
- Documents provided to employees, participants, and government regarding plan information.

Fiduciary of Plans

- The plan sponsor (employer) is the fiduciary, but elects a representative
- Named Fiduciary
  - Specifically named
- Functional Fiduciary
  - Based on job functions performed
- Functions of Fiduciaries
  - Day to day operations
  - High level

Responsibility of Fiduciaries

- Appropriate implementation of the Plan documents
  - The Plan document is the governing body regarding plan operations and compliance
    - Most plan documents have received confirmation regarding their tax exempt status
- Following investment and other formal policies established by the Plan Trustees
- Accurately maintain records regarding transactions of plan
  - Can be outsourced to 3rd parties, but fiduciary still should maintain some form of oversight

Duties of Fiduciaries

- Act solely in the interest of participants/beneficiaries
- Act under ERISA standards of conduct
- Ensure that only reasonable fees are paid by the Plan
- Monitor plan operations and supervise service providers
  - Plan fiduciary is responsible for all actions taken by 3rd parties
- Avoid prohibited transactions and transactions with disqualified persons
  - Borrowing money from plan
  - Selling property to plan
  - Using as security for financing arrangements

Why Does it Matter

- Plan sponsors and Fiduciaries are responsible for safe guarding participants future assets needed for retirement
  - Future quality of life is dependent on these assets and benefits
- 1% in excess fees over the lifetime of the average American worker reduces participants retirement assets by 28%
  - Source: DOL, EBSA website

Not Meeting Fiduciary Responsibilities

- Personal criminal liability, including imprisonment
- Personal DOL civil liability for monies lost
- Personal liability under ERISA
- Civil liability of Plan sponsors
- Loss of Plan's tax exempt status

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Investment Options

- Fiduciaries are required to offer a wide variety of investment options for participants to invest in (Defined Contribution)
  - Participant must be given the opportunity to choose investments
  - Must offer a minimum of 3 different investment that allow for diversification
  - Participants must be provided with sufficient information to make informed decisions regarding investment elections
  - Participants must be allowed to change investment at least quarterly
- Maintain compliance with developed investment policy (Defined Benefit)
  - Plans should have an investment policy (internally developed or outsourced)

Plan Fees

- Plan sponsors and Fiduciaries must understand fees
  - What fees are paid
  - What those fees are for
  - Are they reasonable
  - How are they calculated

Tips for Fiduciaries

- Hire good reputable vendors
  - Document why they were chosen
- Offer quality investment options or policy
  - Provide adequate diversification with investments
  - Investment policy should be clear and appropriate, establish benchmarks and processes for changing managers
- Make sure fees are reasonable and appropriate
- Hire a good auditor
- When in doubt ask for help

Operational Errors and Risks

- Operational errors are errors made in course of carrying out the plan in accordance with the plan document.
- There has been in an increase in the enforcement of regulations by governmental agencies such as the Department of Labor (DOL) and Internal Revenue Service (IRS)
- Failure by the plan sponsor to follow these regulations can be costly due to penalties and excise tax that may be assessed. There are costs associated from an administrative standpoint to correct these errors as well

Common Operational Errors (Defined Contribution Plans)

- Improper application of the definition of compensation
- Employer matching contributions weren't made to all eligible employees
- Eligible employees were not given an opportunity to make deferrals
- Delayed remittance on participant contributions
- Improper fidelity bond coverage
- Non-conforming participant loans
- Disallowed distributions were made (hardships)

Improper Definition of Compensation

- What types of employee wages/earnings are eligible?
  - Plan document should be clear on eligible compensation and election methods
  - Examples of compensation other than regular compensation
    - Bonuses, on-call time, hazard pay, commissions, etc.
  - You can exclude certain types of compensation within the adoption agreement
  - Some forms of compensation can require “special salary reduction agreements”
    - Require secondary request for bonuses
    - Use default deferral rate in lieu of notification from employee
- Correction methods
  - Plan sponsor contributes additional monies to cover negative impact on employee
  - For over payments, distribute excess contributions and forfeit match

Incorrect Application of Employer (ER) Match

- **Causes of operation errors concerning matching contributions**
  - Failure to define eligible participants
    - Issues when counting hours of service, or plan entry dates
  - Incorrect definition of compensation
    - What basis do we use for calculating the ER contribution
  - Timing of employer matching contributions
    - Is the ER calculation done on an annual basis, quarterly, specific payroll period
    - If done annually or quarterly, true up contributions may be necessary
    - Keep a close eye on highly compensated employees. Could cause issues depending on frequency of the matching contribution
- **Correction methods**
  - Apply reasonable corrective actions, with the intent to make participants whole. Self correction (SCP) is available if completed before the end of the 2^{nd} subsequent plan year date. If after 2^{nd} year, voluntary corrective program (VCP) is required

Eligible Employees and Missed Deferrals

- Be sure you understand your plan requirements for eligibility
  - Age, service term, and allowable enrollment dates
- Actively monitor the plan census for oversights
- Consider auto enrollment features and affirmative support of enrollment dismissal
  - Obtain tangible support that employee was notified of plan and provided enrollment information
  - Do not rely solely on 3rd parties
  - We recommend annual correspondence with non-participating eligible employees
- Correction methods
  - Qualitative non-elective contributions, typically 50% of missed withholding + ER contributions of 100% of calculated match

Delayed Remittance of Contributions

- **What are the requirements?**
  - Earliest date that deferrals can be segregated from general assets
  - Must not exceed 15th business day of following month
    - The 15th day rule is not a safe harbor, merely a maximum deadline
  - DOL is looking at consistency and reasonableness
- **Issues**
  - In extreme cases failure to timely remit contributions can result in disqualification of plan
  - Potential for prohibited transaction to occur
- **Correction methods**
  - Determine all payrolls that were effected and calculate lost earnings. Normally resolved with a SCP, but may warrant a VCP resulting in fees
  - Highly recommended to remit plan contributions in conjunction with payroll

Fidelity Bond Coverage

- ERISA fidelity bond and fiduciary liability coverage are not the same
  - One protects the plan, the other protects the fiduciary
- ERISA bonds are only allowed to be purchased by approved vendors
  - List can be obtained from fiscal.treasury.gov
  - Most household name insurers are approved vendors
- Must maintain a minimum coverage of 10% of plan assets or $500,000, whichever is less
  - Recommended to purchase the $500,000 policy or include an auto escalation policy
  - Premium is normally negligible for lower bond amounts vs $500,000 policy

Non-Conforming Participant Loans

- Loans must be legally enforceable and properly documented
- Amount and Terms of borrowing
  - Must bear a reasonable rate of interest
  - Terms must not exceed 60 months, unless for purchase of primary residence
  - Must not exceed $50,000 or 50% of vested account balance
- Vested Balance?
  - Determine borrowing base from vested account balance not total account balance
  - Review vesting schedule in plan documents to verify what percentage in ER contributions participant is allowed to borrow against
  - Do not rely solely on 3rd party to determine maximum allowed loan
- Correction methods
  - Repayment of excess or adjust amortization to allowable terms

Disallowable Distributions (Hardships)

- Determine what types of distributions are allowable under the plan
  - Are in-service and/or hardship distributions allowed?
    - Hardships for emergencies
    - In-service for any reason
- Acceptable hardships (immediate and heavy)
  - Generally related to health, primary residence issues, and higher education costs
- Are all other resources exhausted?
  - If a plan loan is available, a hardship should not be available
  - External lending capabilities available to participant
- Must suspend plan deferrals for 6 months
  - Most common finding when examining subsequent activity on employee receiving hardship distributions

Recommended Internal Controls

- Continued monitoring of plan is best practice for detecting operational errors
  - Annual review of employee census
    - Pay specific attention to those not participating and new hires
  - Internal inspection of TPA vs. Payroll deferral rates
    - Many plans allow participants to change deferral rates electronically and notifications are provided to plan sponsors afterwards
    - Human error can occur
    - DO NOT rely on employees to notify plan sponsors of errors
    - Per DOL: fewer than 10% of plan participants examine their personal 401k account on an annual basis
  - Annual inspection of outstanding loans
    - Verify payments are proper and frequent
    - Review for multiple loans and loan thresholds

Errors in Defined Benefit Plans (Pension)

- Highest risk area is the calculation and payment of benefits
  - Improper definition of compensation
  - Improper calculation of benefits
    - Wrong length of service
    - Improper income time periods (Example: Highest paid 5 years)
      - Highest paid period isn't always the last portion of employment
    - Wrong benefit calculation used, especially those plans with tiered membership levels
- In most cases 3rd parties are performing the benefit calculation
  - Verify that the information on the calculation is accurate
  - Annual census data is critical for future calculations

Internal Controls Relied on by 3rd Party Service Providers

- For Plan sponsors that rely heavily on 3rd parties for plan operations, internal controls are still relevant.
- Most service providers are receiving SOC-1 report (internal control audits)
  - Review these annually and look for deficiencies
  - Determine what is your responsibility
  - Review "complementary user controls"
    - Example: "verify data sent to (Service Provider) is complete and accurate"
    - Example: "provide all benefit plan change information and validate information is complete and accurate"
    - Example: "restricting access to data outputs and report generation"
- Service providers are only as good as the information they receive
  - Garbage in – Garbage out

Summary

- Operation errors can often times be self corrected without penalty
  - Actively monitor you plan, do not rely on TPA, Custodian, or even Plan Auditor
- Seek guidance when unsure of how to handle certain situations
- Review the plan document annually
- Don’t forget about plan compliance when developing payroll internal controls and procedures
- Seek out fiduciary training and continuing professional education
- When in doubt, give their money back
- Do not be afraid to consult prior to performing a transaction

Questions or Comments?

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