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PLAN CONSULTANT

SPRING 2020

Game Changer

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Measuring TPA Success

The Fiduciary Education Advantage

California's New Worker Classification Law

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The Coming Crisis

Some of the nation's largest multiemployer plans may not survive much longer.

With the ink barely dry on the fledgling SECURE Act, attention on Capitol Hill is turning to what may turn out to be the next major piece of retirement-related legislation: help for underfunded multiemployer pension plans. Lawmakers on both sides of the aisle agree that a solution to the funding problem is needed, but agreement on what that fix would look like has eluded them.

The House of Representatives has passed the "Butch Lewis Act," a bill that would create the Pension Rehabilitation Administration, a new federal agency that would issue Treasury bonds. The proceeds would fund a trust fund that would make 30-year loans to financially troubled multiemployer plans to pay benefits to retirees and participants. The bill would not raise PBGC premiums, and avoids reductions in retirees' and participants' benefits. (The hope is that with the loan proceeds funding current liabilities, the plans would get well financially from investment gains and employee contributions.) But its critics say that the bill would not do enough to help the most severely underfunded plans, meaning that at least some of the burden ultimately could fall on taxpayers.

The Senate bill would strengthen the PBGC, giving it more authority (and resources) to allow struggling plans to offload liabilities to the agency. It would increase the financial burden borne by unions and plan sponsors: Premiums would rise from $20 to $80 per participant, and a new variable premium would be imposed on underfunded plans. There would also be new withdrawal penalties and new rules for measuring liabilities and funding levels.

So the two chambers of Congress have come up with two very different solutions to the multiemployer plan funding crisis. No surprise there. Somewhere between the two proposals lies a workable plan to help those plans—without depending on taxpayers or healthy single-employer plans (an idea that has been floated) to pay for the solution. As the 2020 legislative calendar dwindles, here's hoping that members of Congress can find a way to meet somewhere in the middle.

Comments, questions, bright ideas? Email me at jortman@usaretirement.org.

JOHN ORTMAN
EDITOR-IN-CHIEF

Seeking SECURE-ity

WRESTLING WITH THE SECURE ACT? HERE ARE OUR PLANS TO HELP YOU GET YOUR ARMS AROUND IT.

As everyone knows by now, the SECURE Act is the most significant and complex new legislation since the Pension Protection Act of 2006. There's a lot to unpack there—and we're making a start in this issue of *Plan Consultant*:

- ASPPA President Missy Matrangola shares some observations about coping with the kind of change that the SECURE Act will create (see page 6).
- In his Regulatory/Legislative Update (see page 8), Brian Graff describes the long-term advocacy efforts by the American Retirement Association that played a key role in the development of the legislation and final push over the finish line.
- Our cover story on page 32, by Ted Godbout, provides an initial, 40,000-foot overview of the law, and includes first-take insights from Brian Graff and Jason Roberts.
- In his GAC Update (see page 64), ARA Chief Government Affairs Officer Will Hansen explains how you can play an important role as the SECURE Act's regulatory process moves forward.

That's just the beginning. Our Summer issue will take a deeper dive into the SECURE Act, featuring the insight of industry thought leaders that include Pete Swisher, Fred Reish, Bruce Ashton, John Markley, Dick Billings, Geoff Strunk and Blake Willis. The goal of the Summer "SECURE Act Issue" is two-fold: to help you make sense of how SECURE's rule changes and new provisions will affect your business, and to highlight opportunities for growth and new business in the law.

BY MIRIAM "MISSY" MATRANGOLA

How Secure Are You… in Your Future?

To help make your future secure, I challenge you: 'embrace the suck'!

As probably everyone in this country knows (unless they don't read yet), the Setting Each Community Up for Retirement Enhancement (SECURE) Act was signed into law late last year, bringing many changes to retirement plans and for those of us who work with them.

This is the largest reform to retirement plans since the Pension Protection Act of 2006. Whether you are an actuary, work for a recordkeeper or work for a retirement plan consultant (my choice to replace "TPA"), you will be affected. We don't yet know all the changes that this law will bring, but we do know that it will bring change.

I know the famous quote by Benjamin Franklin is, "in this world, nothing can be said to be certain except Death and Taxes." I would suggest that we amend that to Death, Taxes and Change! And in an industry that has seen much change over the past several years, such as fee disclosure, consolidation and fee compression, this change may not be welcomed by all.

Change is so often viewed as a negative rather than a positive. As Mary Shelley wrote in *Frankenstein*, "Nothing is so painful to the human mind as a great and sudden change." Here's an example: my husband is a corporate pilot. Several years ago, if an executive passenger wanted to leave early, he or she would call the pilot on the phone. Then a new CEO was hired. She only wanted to *text* the pilot if there was a change in schedule.

My husband had a flip phone, as he had resisted the change to the "new" cellphones and texting. Since a text message was the only option, he was forced kicking and screaming into changing. It was painful for him because he was resisting it.

I believe we have to try new and scary things if we want to grow. This quote from C. JoyBell C., author of *The Sun is Snowing*, says it perfectly: "The only way that we can live is if we grow. The only way that we can grow is if we change. The only way that we can change is if we learn. The only way we can learn is if we are exposed. And the only way that we can become exposed is if we throw ourselves out into the open. Do it. Throw yourself." Or, as speaker Mary Proctor Trane said: "Embrace the suck."

> I believe we have to try new and scary things if we want to grow."

Personally, I can attest that feeling your legs shake before going to speak to a large group is not the best feeling. But it is an awesome feeling afterwards to know that yes, you can do that!

So, if learning can help you with change, where can you learn? I think there are learning opportunities all around. Certainly, ASPPA and ARA can help you with that. We have webinars and conferences that offer information about technical topics, business information for firm leaders and sales and marketing topics. Upcoming conferences—ASPPA Te(K) Philadelphia in April, ASPPA Annual (in Chicago this year) and ASPPA Te(K) Cincinnati in November—will have sessions on the SECURE Act as well as technical sessions. ASPPA also offers the new Qualified 401(k) Administrator (QKA) program entirely online.

I am a big believer in understanding the trends in our industry and in other industries too. For that knowledge I believe in reading as much as I can and talking to anyone I meet, including in lines in the store. For retirement industry news and commentary, you can start with the ARA websites: ASPPA Net, NAPA Net and NTSA Net. And to understand what plan sponsors are thinking, it's good to review PSCA's annual survey on their new website, at psca.org. PC

Miriam "Missy" Matrangola, Esq., QKA, QPA, is the President of Atlantic Pension Services, Inc., an independent, non-producing TPA in Kennett Square, PA which she founded in 1992. She serves as ASPPA's President in 2020.

BY BRIAN H. GRAFF

Advocacy Never Rests

We need your continued involvement, engagement and support.

Most of you have been gearing up to understand and leverage the new opportunities for expanding plan adoption and narrowing the coverage gap afforded by passage of the SECURE Act. As you've seen and read over the years, we've been actively engaged in the framing and development of this legislation for more than half a decade, working with leadership in both the U.S. House and Senate through multiple sessions of Congress and across two very different administrations.

We were there working—with your support and assistance—as it passed the House by a remarkable, bipartisan 417-3 margin, and then, at a time when many advocates had declared things "over and done" for another session, continued to look for an opportunity to get it passed and to the President's desk for signature before the end of the year—and found it.

Of course, it's one thing to get legislation passed, and another to help make sure that the "details" of implementation make sense in the real world. And so, in late February, your Government Affairs team, aided by input from you and several informational webcasts we conducted following the SECURE Act's passage, met with the regulatory agencies and outlined for them in writing a list of priority items where clarification was needed and guidance requested.

It's a process—and make no mistake, effective advocacy is a process—that has only just started. A process that will, in all likelihood, require continued focus through the rest of 2020 and into 2021—when we will be dealing with a new Congress, and might be dealing with a new administration as well.

Between now and then we could also be dealing with a new fiduciary rule from the Labor Department and the ramifications of the Securities and Exchange Commission's Reg BI, as well as activities by state legislatures regarding fiduciary standards and state-run retirement plans for private sector workers—legislatures that often aren't aware of ERISA, much less its standards or implications for the nation's retirement policy.

Because of ASPPA you have a voice in our nation's capital and, increasingly, in state capitals as well. More importantly, you have the benefit of our ears—attuned with a sensitivity to not only your needs and perspective, but also to the real-world implications of changes in policy and procedures, as well as a deep concern about the implications for the retirement security of millions of working Americans.

> "Because of your support we are able to advocate for approaches that make sense, are workable, and maximize the positive impact and/or minimize the negative."

Because of your support we are able to not only listen for change and communicate the implications, but also to proactively advocate for approaches that make sense, that are workable, and that maximize the positive impact and/or minimize the negative.

When we say we couldn't do it without you, we mean it. We need your continued involvement, engagement and support. In fact, we depend on it. PC

Brian H. Graff, Esq., APM, is the Executive Director of ASPPA and the CEO of the American Retirement Association.

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Don't Mess with RMDs!

When dealing with Required Minimum Distributions, it's important to get everything right.

BY GARY BLACHMAN & SHALINA SCHAEFER

Editor's Note: This is the second of a two-part series on RMDs. Part 1, on plan sponsors' concerns with RMDs, was published in the Winter issue.

To reflect increased life expectancies and fortify retirement savings, the SECURE Act now pushes the age at which retirees must start drawing on their retirement plan savings from age 70½ to age 72.

The IRS requires plan participants to begin taking required minimum distributions (RMDs) from all employer sponsored retirement plan accounts funded with pre-tax contributions. The RMD rules also apply to IRA-based plans such as SEPs, SARSEPs and SIMPLE IRAs, and to inherited Roth IRAs when someone other than a spouse is a beneficiary.

RMDs are the government's way of recovering the taxes on your initial retirement plan contributions and

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> RMDs are the government's way of recovering the taxes on your initial retirement plan contributions and years of tax-deferred bliss.

years of tax-deferred bliss. Of course, most plan participants would prefer to leave these funds in their pre-tax accounts for as long as possible to avoid paying any taxes. Since RMDs can significantly wear away accumulated retirement savings, it is essential to minimize them if possible. However, RMDs and the withdrawal process are quite complicated.

HOW TO CALCULATE RMDs

From the government's perspective, the purpose of RMDs is to empty out your retirement accounts and recoup taxes by the time you die. For participants in qualified retirement plans and 403(b) plans, the SECURE Act now requires RMDs to begin by April 1 of the year following the later of the year of your retirement or the year in which you reach age 72. As a result, for distributions required to be made after Dec. 31, 2019 for individuals who reach age 70½ after that date, the age for the RMDs is now increased to age 72.

An individual who attained age 70½ during 2019 is subject to the pre-SECURE Act requirement and must take RMDs for 2019 and 2020. RMDs for certain 5% owners must now begin by April 1 of the year following the year in which they attain age 72, even if they have not retired. Since IRAs are not employment-based, RMDs from those accounts must begin as of April 1 of the year following the calendar year in which the owner attains age 72. After the initial RMD, the requisite RMD amount must be withdrawn by Dec. 31 of each following year.

Your RMD is calculated by dividing the balance in your tax-deferred accounts as of Dec. 31 of the immediately preceding calendar year by a life expectancy factor prescribed by certain IRS tables in IRS Publication 590-B. There are three life expectancy tables:

- The *Uniform Lifetime Table* is used to calculate RMDs during your lifetime unless your sole designated beneficiary is your spouse who is more than 10 years younger than you.
- The *Joint and Last Survivor Table* is used to calculate RMDs during your lifetime, but only if your sole designated beneficiary is your spouse who is more than 10 years younger than you. This table produces a lower RMD payment in recognition of the longer life expectancy of your spouse beneficiary.
- The *Single Life Expectancy Table* is used to calculate RMDs after your death with respect to your beneficiaries.

The RMD must be calculated separately for each IRA owned by an individual, but the total RMD amount can be withdrawn from one or more of the IRAs. This same aggregation rule applies to 403(b) contracts. However, RMDs from other types of retirement plans, such as 401(k) plans and 457(b) plans, must be taken separately from each of those accounts. Of course, the IRS does not limit an account owner from withdrawing more than the annual RMD and paying even more taxes!

PENALTY FOR NOT TAKING YOUR RMD

If you do not timely withdraw your RMDs, you will be subject to a severe tax penalty. Unfortunately, the IRS requires you to take your RMD even if you do not need the full amount each year to live on in retirement. If your total distributions during the year do not satisfy the RMD amount by the applicable deadline, you may be subject to a tax penalty of 50% of the amount you should have taken as an RMD. Plus, you must still pay income tax on the full amount that was supposed to be withdrawn. A taxpayer reports and pays the penalty tax by filing Form 5329, *Additional Taxes on Qualified Plans (including (IRAs) and Other Tax-Favored Accounts*, along with his or her federal income tax return for the year in which the full amount was not distributed. A taxpayer may also request a waiver of the penalty by attaching a reasonable cause statement to Form 5329. For example, the IRS may grant a waiver when the failure to take a distribution was due to a plan error. PC

Gary Blachman, Esq., is a partner with Ice Miller LLP in Chicago, where he is a member of the firm's national employee benefits and executive compensation group. His practice focuses on mergers, acquisitions, executive compensation and ERISA's fiduciary and legal compliance requirements.

Shalina Schaefer, Esq., is Of Counsel with Ice Miller LLP in Indianapolis, in the firm's national employee benefits and executive compensation group. She advises private and public employers in all aspects of the design and maintenance of health and retirement plans.

The Impact of California's New Worker Classification Law

How will the Golden State's new 'AB 5' law affect employee benefit plans?

BY NICHOLAS J. WHITE, SARAH KANTER & LINDSAY DOCTO

On Sept. 18, 2019, California Gov. Gavin Newsom signed Assembly Bill 5 ("AB 5") into law. In a dramatic departure from prior law, the new labor law codifies the "ABC Test" (explained below) adopted by the California Supreme Court in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles County*[1] for determining whether a worker is an employee or an independent contractor.

The new law creates a presumption in favor of employee status for the limited purposes of determining wage and hour claims and applying the California Labor Code and Unemployment Insurance Code, unless each prong of the ABC Test is satisfied. According to the California Legislature, the intent of AB 5 is to restore workplace rights and protections for workers who have been misclassified as independent contractors. The new law became effective on Jan. 1, 2020.

The media coverage has billed AB 5 as a drastic change in labor law – a real game changer – that will convert perhaps a million California independent contractors into employees for all purposes, including employee benefits. That, however, is an overreading of the new law.

It is true that AB 5 amounts to an important and significant change to the employee classification legal regime. However, since its scope is limited to wage and hour claims and the California Labor and Insurance codes, it has little direct impact on employer and consultant practices for determining employee status for purposes of eligibility to participate in employer-sponsored retirement and health and welfare plans, which are predominantly governed by federal law consisting of the Internal Revenue Code and ERISA.

Nevertheless, AB 5 does present some administrative challenges for California employers and the third-party administrators who assist them with their benefit programs, as discussed in this article.

The passage of AB 5 should be of interest to employers nationwide, not just California, since other states are contemplating following in California's footsteps. For example, there have been efforts in New Jersey that would classify all state workers as employees.[2] Furthermore, some analysts expect that other states, including New York, Washington, Oregon and Illinois, will adopt similar legislation.[3]

EMPLOYMENT CLASSIFICATION UNDER AB 5

Under AB 5, to classify a worker as an independent contractor (rather than an employee) for purposes of wage and hour claims, the California Labor Code and the Unemployment Insurance Code (subject to certain excepted classes of workers, as enumerated by AB 5), the three-prong ABC Test requires an employer to establish that a worker:

- **A.** is free from employer control over how the work is performed;
- **B.** performs work outside the usual course of the employer's business; and
- **C.** has an independently established business providing services of the same nature as the services that the worker is providing to the employer.

If the employer cannot establish each prong of the test, a worker will be classified as an employee and eligible for a number of protections not afforded to independent contractors, including minimum wage, overtime compensation, paid sick days and family leave, as well as employer-paid state disability, unemployment and workers' compensation insurance.

Prior to AB 5, employers in California used the worker classification test established by the California Supreme Court in *S.G. Borello & Sons, Inc. v. Dept. of Industrial Relations*[4] (the "*Borello* test") to determine employee versus independent contractor status and, in some cases, additional multi-factor test(s), depending on the occupation of the worker. For workers who are exempt from AB 5 through statutory exclusions (AB 5 contains numerous exclusions which exempt many classifications of workers, from lawyers to commercial fishermen), the *Borello* test will still govern whether a worker is an independent contractor.

In addition, certain business-to-business contracting relationships are not subject to the ABC Test if certain conditions are met. AB 5 also provides that if a court rules that the ABC Test cannot be applied in a specific context, then the *Borello* test will be used to determine the employment status of the worker.

At the same time, the definition of "employee" for purposes of benefit plan eligibility is governed by less stringent common law tests under federal law. Therefore,

post-AB 5, a California worker could be deemed an employee for certain purposes (such as California wage and hour laws) but remain an independent contractor for others (such as eligibility for tax-qualified benefit plans). In modifying existing employee classification practices to comply with AB 5, employers and their advisors will need to be mindful of which legal regime applies, depending on the context, and consistently and reasonably apply such practices and procedures.

VARIOUS REGIMES FOR DETERMINING EMPLOYEE CLASSIFICATION

Notwithstanding the passage of AB 5, common law tests and guidance used for purposes of determining employee status under the tax code, and the test established by the U.S. Supreme Court in *Nationwide Mut. Ins. Co. v. Darden*[5] (the "*Darden* test," described below) under ERISA remain applicable for purposes of determining employee classification with respect to employer-sponsored benefit plans. Again, this is because AB 5 applies only for wage and hour claims and the California Labor and Unemployment Insurance codes, not for the purposes of ERISA or the Internal Revenue Code. Under the Code and ERISA, ERISA plans must operate pursuant to their written terms, and those terms require participants to be employees of the employer (as determined under the federal tax regime).

When it comes to federal tax and employee benefits matters, there is no presumption in favor of employee status, as there is in the case of the ABC Test. The federal tax common law tests and *Darden* test require that the determiner of fact, including a government agency, engage in a balancing of numerous factors to determine a worker's status, and no one factor is determinative. And, contrary to the operation of the ABC Test, there must be a reasonable basis for determining that a worker is an employee – it must make sense at an instinctive level.

Given the limited scope of AB 5, a California worker who qualifies as an employee under the ABC Test is not necessarily eligible to participate in an ERISA plan by virtue of his or her employee status under AB 5. Rather, for the purposes of ERISA plans, the employer must continue to determine employee status based on the *Darden* test, a multi-factor test that focuses on the issues of control and independence. While the *Darden* test shares two factors in common with AB 5 (*i.e.*, prongs A and B of the ABC Test), it also demands that the employer consider a number of other factors, including the location of the work, the hired party's discretion over when and how long to work, and the

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tax treatment of the hired party. Under the *Darden* test, no one factor is determinative – all factors must be assessed and weighed. If the worker qualifies as an independent contractor under the *Darden* test, the employer can legally exclude him or her from plan participation (on the basis that they are not an employee of the employer), regardless of the worker's classification in the context of AB 5.

For federal tax purposes, including tax withholding, and for purposes of determining the "employees" to whom an employer is required to make an offer of coverage under the Affordable Care Act, the common law test established by the federal tax courts, and supplemented by subsequent IRS guidance, still applies. In this context, factors such as behavioral control, financial control and the type of relationship between the employer and the worker are to be considered and balanced in making the determination as to whether a worker is classified as an employee or an independent contractor.

No matter what the analysis is, it is important that employers and their advisors operate consistently in applying their employee classification practices and procedures. In particular, California employers should be mindful of Code Section 530, which provides protection against certain retroactive taxes and penalties when a worker is reclassified as an employee during an audit. In order to be eligible to benefit from such protections, the employer must have:

- consistently treated similarly situated workers as independent contractors;
- complied with the Form 1099 reporting requirements; and
- had a reasonable basis for treating the workers as independent contractors.

Section 530 remains in effect and may continue to provide certain relief to employers in compliance with its requirements.

CONSEQUENCES OF MISCLASSIFICATION FOR PLAN PURPOSES

Covering a worker who is not an "employee" (as that term is defined under an employer-sponsored benefit plan) can subject a tax-qualified plan to disqualification. Such erroneous coverage also amounts to a violation of ERISA's exclusive benefit rule (assuming the plan is covered by ERISA and not just the Code). For retirement plans, there are implications here for compliance testing (*i.e.*, coverage, top-heavy and non-discrimination). Corrective contributions may have to be made to save the plan from tax disqualification and/or to cure a fiduciary breach.

With respect to health and welfare plans, allowing independent contractors to participate in an employer's health plan may cause the health plan to become a multiple employer welfare arrangement (MEWA), which would create additional compliance hurdles for any participating employers since self-funded MEWAs are prohibited in California.

For these reasons, employers cannot just take the easy way out and cover all of the workers classified as employees under the ABC Test in their qualified plans. That could be a disastrous approach to AB 5 compliance.

INDUSTRY CHALLENGES IN RESPONSE TO AB 5

Various interests have raised concerns about and challenges to implementing AB 5. For example, the California Truckers Association filed suit in November 2019, asserting that AB 5's application to the trucking industry is preempted by the Federal Aviation Administration Authorization Act. On Dec. 31, 2019, the U.S. Southern District Court of Los Angeles issued a temporary injunction, effectively blocking enforcement of AB 5 with respect to motor carriers while the case is being heard, ruling that the plaintiffs had demonstrated that they were likely to show that AB 5's application to motor carriers is preempted by federal law.

Freelance journalists are also challenging AB 5, on the basis that it violates the First and Fourteenth Amendments.

Uber and Postmates (along with some of their drivers) have filed a lawsuit in federal court which, among other things, argues that AB 5 is an "irrational and unconstitutional statute designed to target and stifle workers in the on-demand economy." The lawsuit asserts that AB 5 violates the Equal Protection and Due Process Clauses of the Fourteenth Amendment, the Ninth Amendment and the Contracts Clause of Article I, as well as similar provisions of the California Constitution. Separately, Uber, Lyft and DoorDash have pledged to jointly fund a ballot initiative, the Protect App-Based Drivers Services Act, to counter AB 5.

All of these challenges are intended to limit the scope of AB 5 by exempting certain industries from its application. However, even if one or more of them is successful, this would likely have little or no impact on an employer's obligation to continue to assess benefit plan eligibility under the Code and *Darden*.

FOOTNOTES

1. 232 Cal. Rptr. 3d 1 (2018).
2. Oncidi, Anthony, et al., "Adjusting To The 'New Normal' With AB 5 – A World Without Independent Contractors," THE NAT. L. REV. (Dec. 13, 2019), at https://www.natlawreview.com/article/adjusting-to-new-normal-ab-5-world-without-independent-contractors
3. De Silva, et al., "The California Senate has Voted to End the Gig Economy As We Know It," QUARTZ (SEPT. 11, 2019), at https://qz.com/1706754/california-senate-passes-ab5-to-turn-independent-contractors-into-employees/
4. 256 Cal. Rptr. 543 (2014) (en banc).
5. 503 U.S. 318 (1992).

> The intent of AB 5 is to restore workplace rights and protections for workers who have been misclassified as independent contractors. The new law became effective on Jan. 1, 2020.

KEY TAKEAWAYS

Notwithstanding the legal challenges being made to AB 5, employers with workers in California and their advisors should take affirmative steps to comply with the law and assess how it impacts their employment classification procedures. For example, employers should consider taking at least the following steps, in consultation with their advisors:

- Develop a clear understanding of AB 5 (and the ABC Test), and the scope of its application.
- Maintain a working knowledge of *Darden*, *Borello* and the IRS/tax courts' multi-factor tests.
- Establish and properly document practices and procedures related to employee classification.
- Apply the ABC Test to all existing workers classified as independent.
- After applying the ABC Test and determining that a worker is an employee, determine whether the individual would qualify as an employee under *Darden* (to determine whether that individual is eligible to participate in the employer's benefit plans).
- Cover *Darden* employees in employee benefits programs and specifically exclude all other independent contractors.
- Consistently carry out the processes and procedures developed, and have a "reasonable basis" for classifying the worker as an independent contractor (consider Code Section 530).
- Review employee benefit plan language to determine whether any updates need to be made, especially to provisions related to determining eligibility based on payroll, since under AB 5 a number of individuals may qualify as employees under applicable California law (and be on a company's payroll), but still not be eligible to participate in the company's benefit plans under *Darden*.
- Ensure that independent contractor agreements contain language necessary to document and provide support for the independent contractor classification pursuant to AB 5 and other applicable law.

As it currently stands, AB 5 does not change the determination of which workers are eligible to participate in employer-sponsored benefit plans. This is because the federal common law tests still apply for this purpose.

At the same time, it is important that employers and their advisors be mindful that new administrative procedures must be developed in determining and documenting which workers classify as employees for the purposes of AB 5, but remain independent contractors for the purposes of the common law tests applicable to employee benefit plans. Furthermore, any such procedures should be reasonable and applied consistently. PC

Nicholas J. White is a Director with Trucker Huss, APC, working out of both the San Francisco and Los Angeles offices. He is a Fellow of the American College of Employee Benefits Counsel, past Chair of both the IRS and DOL Subcommittees of ASPPA's Government Affairs Committee, and a past member of both the Executive Committee and the Board of Directors of the American Retirement Association. Nick is a frequent speaker and writer on a wide range of employee benefits topics.

Sarah Kanter is a senior associate with Trucker Huss, APC, in San Francisco who focuses her ERISA practice primarily on health and welfare plans.

Lindsay Docto is an associate with Trucker Huss, APC, in San Francisco.

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IRS: Uncashed Distribution Checks Includible in Gross Income

Withholding, reporting are still required for uncashed distribution checks.

BY JOHN IEKEL

In Rev. Rul. 2019-19 (IRB 2019-36, Sept. 3, 2019), the IRS determined that if an individual receives a distribution check from a qualified plan and does not cash the check, that individual cannot exclude the amount of the designated distribution from gross income and the employer remains subject to withholding and reporting obligations.

The revenue ruling presents a scenario in which the employer is the plan administrator of a qualified Section 401(a) retirement plan that does not include a qualified Roth contribution program under Section 402A(b). The plan must make a distribution of $900 to an individual in 2019. The individual:

- has no investment in the contract under Section 72 regarding the benefit;
- has a calendar-year taxable year; and

“The individual’s failure to cash the distribution check does not permit the individual to exclude the amount of the designated distribution from gross income under Section 402(a).”

- has never made a withholding election regarding the benefit under the plan.

The employer makes the required distribution, which is a designated distribution under Section 3405(e)(1), by withholding tax as required under Section 3405(d)(2) and mailing a check for the remainder to the individual.

Although the individual received the check in 2019, the individual does not cash it. The individual also does not make a rollover contribution regarding any portion of the designated distribution, and no other exception to income inclusion under Section 402(a) applied.

HOLDING

The IRS held that the individual’s failure to cash the distribution check does not permit the individual to exclude the amount of the designated distribution from gross income under Section 402(a). Says the IRS:

> “Section 402(a) provides that, except as otherwise provided in §402 (for example, a rollover under §402(c)(1)), any amount actually distributed to a distributee by an employees’ trust described in §401(a) which is exempt from tax under § 501(a) is taxable to the distributee, in the taxable year of the distributee in which distributed, under §72. Section 72 provides rules relating to inclusion in gross income of amounts received from qualified plans and certain other arrangements.
>
> “Under §402(a), the amount of the designated distribution is actually distributed from Plan X to Individual A in 2019. Because Individual A has no investment in the contract within the meaning of § 72 and no exception to §402(a) applies, the amount of the designated distribution is includible in her gross income in 2019. Individual A’s failure to cash the distribution check she received in 2019 does not permit her to exclude the amount of the designated distribution from her gross income in that year under §402(a).”

The IRS also held that the individual’s failure to cash the check does not alter employer’s obligations regarding withholding under Section 3405 and reporting under Section 6047(d).

According to the ruling, the Treasury Department and the IRS continue to analyze issues that arise in other situations involving uncashed checks from eligible retirement plans described in Section 402(c)(8)(B), including those involving missing individuals with benefits under those plans. PC

The Check is (Still) In the Mail

By Allison Wielobob

WHAT HAPPENS WHEN A QUALIFIED PLAN MAILS A DISTRIBUTION CHECK, but the check is not cashed? It’s a question that TPAs and their plan sponsor clients struggle with.

In Revenue Ruling 2019-19, the IRS determined that if an individual receives a distribution check from a qualified plan and does not cash it, the amount of the designated distribution is includible in gross income and the employer remains subject to withholding and reporting obligations.

The conclusions reached by IRS are not surprising. After all, Section 402(a) provides that amounts “actually distributed” from a qualified retirement plan are includible in income in the year distributed. The alternative of allowing individuals to delay recognition of a distribution by simply ignoring a distribution check would allow them to delay taxable income, a path that the IRS clearly does not want to go down. In effect, Section 402(a)’s “actual distribution” language effectively trumps constructive receipt for distributions from qualified plans under which earlier inclusion of income otherwise might be consistent.

Regardless, in practice, Section 402(a) generates confounding results for distributions made at or near the end of the tax year that cannot be deposited until the following year. Plan sponsors and service providers face reporting and withholding puzzlers, particularly when actual receipt is lacking due to death or an incorrect address – and, of course, there are many such situations.

We know that the IRS continues to analyze other situations involving uncashed checks, including situations involving missing participants. It’s a good bet that this Revenue Ruling will serve as a baseline for future IRS guidance – which would be welcome.

Allison Wielobob is the American Retirement Association’s General Counsel.

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Decisions, Decisions: Lump Sum or Annuity?

A pension doesn't always mean a monthly payout – some retirees receive their entire benefit when they separate from service.

BY DAVID J. KUPSTAS

When many people hear the word "pension," they think of a monthly check mailed to a retired employee after a long career as a factory worker, schoolteacher or firefighter. (Okay, it's 2020, so maybe a monthly direct deposit instead.)

Such a series of regular pension payments is commonly known as an annuity. Defined benefit plans will offer a variety of annuity options, usually paid monthly. These options will generally all have the same actuarial value so that a plan is indifferent as to which form of payment is chosen. Consider a traditional DB plan which offers Bob a straight life annuity (SLA) of $1,000 per month at age 65. Bob's plan also offers a life annuity with 10 years certain (10 C&C), a 50% joint and survivor annuity (50% J&S), and a 75% joint and survivor annuity (75% J&S).

Table 1 shows the benefit amounts assuming the plan's actuarial equivalence factors are 94 GAR mortality and 5.00 percent interest, and that Bob has a spouse age 62. Instead of an interest rate and mortality table, a plan could instead use a set of tabular factors for actuarial equivalence.

Of course, if the $1,000-per-month normal form of benefit were the 10 C&C, the 50% J&S, or the 75% J&S, an actuarial equivalent SLA would be something greater than $1,000. On average, the payment period for the SLA will be shorter than for the other forms, so the retiree would receive a higher benefit amount to make up for the expected shorter payment period.

NOT ALL PENSIONS ARE PAID AS ANNUITIES

Now assume Bob's plan offers a lump sum payment along with the annuity forms. Using 94 GAR and 5.00 percent interest, the lump sum value of Bob's $1,000-per-month SLA at age 65 would be $141,529. So $141,529 is the amount he would receive if he chose the lump sum, right?

Table 1. Normal Retirement Annuity Benefits

Form of Benefit	Annuity Purchase Rate	Benefit Amount
SLA	$141.5291	$1,000.00
10 C&C	$147.8442	$957.29
50% J&S	$156.9058	$902.00
75% J&S	$164.5942	$859.87

An annuity purchase rate (APR) is the present value of $1.00 per month payable in that form of benefit. The amount payable under any form is equal to $1,000.00 divided by the APR for that form times the SLA APR.

> "Knowing that lump sums have been the less costly option, some plan sponsors will offer lump sum windows before or in conjunction with a plan termination."

Not so fast. The Code Section 417(e) regulations require lump sum payments to be at least as great as the amount determined using the "applicable mortality table" and "applicable interest rates." If these are not the regular plan AE factors, a "greater of" calculation must be done. Using October 2019 segment interest rates, Bob's lump sum payable at age 65 in 2020 is $179,897. Since this amount is higher than the $141,529 based on plan AE factors, Bob's lump sum would be $179,897.

In cash balance plans, the lump sum is simply the hypothetical account balance. Whipsaw rules, which often called for a lump sum higher than the hypothetical account balance, were abolished under PPA. Annuity amounts are derived by dividing the hypothetical account balance by the plan AE factors.

EARLY RETIREMENT EXAMPLE

If benefit commencement is available before normal retirement age, the payment is usually reduced so the plan does not incur actuarial losses due to the longer expected payment period. In our example, Bob's plan allows commencement at age 55 with at least 10 years of service. There is no reduction in payment amount for commencement at age 62 or later and a 4 percent reduction per year for commencement ages earlier than 62. Instead of a percentage reduction, the reduction could be based on interest and mortality.

Bob's colleague, Maria, is also entitled to an SLA of $1,000 at age 65. Maria is now age 55 and has 10 years of service. Maria could retire early and elect an SLA of $720 at age 55. This is her $1,000 age 65 benefit with no early retirement reduction from age 65 to 62 and a four percentage point reduction per year from age 62 to 55 (28 percent in all). Maria has a "subsidized early retirement benefit" since the amount is greater than what would result from applying any commonly used interest/mortality AE factors.

Table 2 shows the options available to Maria at age 55 using 94 GAR and 5.00 percent interest. Her spouse is 52 years old.

Table 2. Early Retirement Annuity Benefits

Form of Benefit	Annuity Purchase Rate	Benefit Amount
SLA	$174.8887	$720.00
10 C&C	$176.8858	$711.87
50% J&S	$187.0458	$673.20
75% J&S	$193.1243	$652.01

The amount payable under any form is equal to $720.00 divided by the APR for that form times the SLA APR.

The amount payable under any form is equal to $720.00 divided by the APR for that form times the SLA APR

Now, what lump sum is Maria entitled to? Per the Section 417(e) regulations, the lump sum cannot be less than the present value of the normal retirement benefit. That would be the greater of (1) and (2) in Table 3, or $125,587. One might argue that the lump sum could be (3) or (4). These are present values of the subsidized ER benefit based on plan AE factors and 417(e) rates, respectively.

Which of these amounts Maria is entitled to will depend on the terms of the plan. She is entitled to at least $125,587, the present value of the normal retirement SLA, or Max{1,2}. If the plan says to consider the ER SLA, then Maria would be entitled to $161,187, or Max{Max{1,2},Max{3,4}}. If the plan is silent about whether to base the lump sum on the ER benefit, then likely the interpretation should be to disregard the ER benefit in lump sum calculations.

Because of the subsidized annuity, the lump sum based on the ER benefit is much greater than the lump sum based on the normal retirement benefit. Again, a plan does not have to reflect an ER subsidy in its lump sum calculations. An early retiree may feel this is not fair. However, that's the rule. One of the purposes of the relative value disclosure rules is to let participants know that the value of a lump sum might be significantly less than the actuarial value of a subsidized early retirement SLA. A lump sum payout dangled in front of an early retiree can be very tempting. A disclosure pointing out the relatively low value of that lump sum may make that option less appealing.

ANNUITIES VS. LUMP SUMS UPON PLAN TERMINATION

When a DB plan terminates, the benefits must generally be settled either through lump sum payouts or the purchase of an annuity contract from an insurer. In recent years, it has generally been cheaper for a plan to settle a given benefit with lump sum payments rather than an annuity purchase.

Knowing that lump sums have been the less costly option, some plan sponsors will offer lump sum windows before or in conjunction with a plan termination, hoping as many participants as possible will elect the lump sum. While this may be an effective cost-reducing strategy, plan sponsors should know that an insurer might charge more for annuity benefits if lump sums have been offered recently. The thinking is that less healthy participants will gravitate toward the lump sums, leaving behind the healthier participants – who are more expensive for an insurer to provide lifetime benefits for.

If a lump sum option is newly granted as part of a plan termination, it must be decided whether the lump sum feature will be temporary or permanent. An insurer might charge more for annuity contracts with a lump sum feature than for contracts without one, since there would be uncertainty about future interest rates, future lump sum rules, and the timing of payouts. PC

David J. Kupstas, FSA, MSPA, EA, is Chief Actuary at Actuarial Consulting Group, Inc. in Midlothian, VA. He has more than 25 years of experience as a TPA for small and mid-size plans of all types.

Table 3. Lump Sum Amounts Based on Normal Retirement and Early Retirement Benefits

Lump Sum Description	SLA Amount	Age SLA Commences	APR at Age 55	Lump Sum at Age 55
1 PV of NRB (Plan AE)	$1,000.00	65	$86.8866	$86,887
2 PV of NRB (417(e))	$1,000.00	65	$125.5873	$125,587
3 PV of ERB (Plan AE)	$720.00	55	$174.8887	$125,920
4 PV of ERB (417(e))	$720.00	55	$223.8710	$161,187

PV = Present Value
NRB = Normal Retirement Benefit
ERB = Early Retirement Benefit
AE = Actuarial Equivalence
APR = Annuity Purchase Rate

The Plan AE APR of the NRB is the age 65 APR discounted for 10 years at 5.00 percent interest (no mortality discount).

SCOTUS Reins In 'Actual Knowledge' Standard

Only one of the three ERISA cases heard by the Supreme Court in this term, *Intel v. Sulyma*, was decided.

BY NEVIN E. ADAMS, JD

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In a unanimous ruling, the nation's highest court said you don't need more than a dictionary to know the meaning of "actual knowledge" when it comes to participant awareness regarding 401(k) disclosures.

The decision came in a case involving Intel's 401(k) over its decision to invest its custom target-date funds in alternative assets (including hedge funds), and exactly when a participant became aware of a decision that he claimed was a breach of fiduciary duty.

The original lawsuit, filed in November 2015 in the U.S. District Court for the Northern District of California by former Intel employee Christopher Sulyma, had charged that Intel's investment committee boosted the $6.66 billion profit-sharing plan's allocation for hedge funds in the firm's target-date portfolios from $50 million to $680 million, while at the same time the allocation for hedge funds in the diversified global fund rose from $582 million to $1.665 billion, and to private equity investments from $83 million to $810 million, between 2009 and 2014.

The suit claimed that participants were not made fully aware of the risks, fees and expenses associated with the hedge fund and private equity investments, or of the underperformance of the company's target-date and global diversified funds compared to their peers, and that as a result participants "suffered hundreds of millions of dollars in losses during the six years preceding the filing of this Complaint as compared to what they would have earned if invested in asset allocation models consistent with prevailing standards for investment experts and prudent fiduciaries."

JUDGE 'MEANT'S

The Intel defendants were granted summary judgment based on their argument that the claims were filed after ERISA's three-year statute of limitations (measured from when the plaintiff had actual knowledge of the underlying facts constituting his claim). The defendants had presented evidence that "during his brief tenure with Intel, respondent regularly accessed the website for those materials," clicking on more than 1,000 web pages within that site. (It was undisputed that Sulyma "accessed some of th[e] information" that disclosed the disputed investment decisions on the websites.)

Upon appeal, the 9th Circuit reversed and remanded the decision

> "The ruling will make it harder for plan fiduciaries to claim that effective notice has been provided by the series of disclosures that are designed to communicate plan specifics."

of the lower court, noting that if (as claimed) "Sulyma in fact never looked at the documents Intel provided, he cannot have had 'actual knowledge of the breach.'" The 9th Circuit acknowledged that their view of actual knowledge conflicted with the 6th Circuit's reasoning in *Brown v. Owens Corning Investment Review Committee*, where the court held that, "[w]hen a plan participant is given specific instructions on how to access plan documents, their failure to read the documents will not shield them from having actual knowledge of the documents' terms"—but "respectfully" disagreed with that analysis. "As we have previously recognized, 'plan participants who have been provided with [summary plan descriptions] are charged with constructive knowledge of the contents of the document,' not actual knowledge," and that "under our interpretation of ERISA, such knowledge is insufficient."

READING 'READING'

The Supreme Court lined up solidly behind the position of the 9th Circuit. In a unanimous decision by Justice Samuel Alito, the court held that "a plaintiff does not necessarily have 'actual knowledge' under §1113(2) of the information contained in disclosures that he receives but does not read or cannot recall reading. To meet §1113(2)'s 'actual knowledge' requirement, the plaintiff must in fact have become aware of that information."

The Intel defendants had argued that that reading substantially diminishes protection for plan fiduciaries. Justice Alito acknowledged that concern but dismissed it, writing: "if policy considerations suggest that the current scheme should be altered, Congress must be the one to do it." He also cautioned that by the same token, "petitioners' interpretation would greatly reduce §1113(1)'s value for beneficiaries, given the disclosure regime that petitioners themselves emphasize. Choosing between these alternatives is a task for Congress, and we must assume that the language of §1113(2) reflects Congress's choice."

Alito also noted another argument put forward by the Intel defendants: that once a plaintiff receives a disclosure, they have the knowledge that §1113(2) requires because he effectively holds it in his hand. "In other words, he has the requisite knowledge because he could acquire it with reasonable effort"—but that he noted, "turns §1113(2) into what it is plainly not: a constructive-knowledge requirement."

MAKING THE CASE

Justice Alito did provide fiduciaries with leeway for mounting a legal defense in the future, noting that the ruling "does not foreclose any of the 'usual ways' to prove actual knowledge at any stage in the litigation," and that "Plaintiffs who recall reading particular disclosures will be bound by oath to say so in their depositions." Moreover, he not only explained that "actual knowledge can also be proved through "inference from circumstantial evidence," but also laid out a path for success for future defendants, noting that "this opinion does not preclude defendants from contending that evidence of 'willful blindness' supports a finding of 'actual knowledge.'"

Noting that "We must enforce plain and unambiguous statutory language" in ERISA "according to its terms," Alito confirmed that, "Although ERISA does not define the phrase 'actual knowledge,' its meaning is plain. Dictionaries are hardly necessary to confirm the point, but they do. When Congress passed ERISA, the word 'actual' meant what it means today: 'existing in fact or reality.'"

WHAT THIS MEANS

There's little question that the ruling will make it harder for plan fiduciaries to claim that effective notice has been provided by the series of disclosures, mandated and otherwise, that are purportedly designed to not only communicate plan specifics, but to establish a point of reference from which the statute of limitations may objectively be established.

It's not that the disclosures are less essential to the process—but it may well mean that employers will feel the need to obtain more specific validation that the disclosures were, in fact, viewed and read. That said, keep an eye out for more assertions of "willful blindness"—and a surge in those ubiquitous pop-ups that lawyers love in various online service agreements. You know, the ones that assert you've read something… that you almost never have. PC

ERISA's Fiduciary Standard for Investment Portfolios

What are the legal responsibilities associated with a model investment portfolio?

BY MARCIA S. WAGNER

In 1979, the Department of Labor issued final regulations for fiduciary responsibility regarding investment of assets under ERISA's "prudence" rule. The DOL indicated that generally the relative riskiness of a specific investment or investments does not render such investment or investment course of action either per se prudent or per se imprudent; and, in accordance with modern portfolio theory, the prudence of an investment should not be judged without regard to the role that the proposed investment or investment course of action plays within the overall portfolio.

PRUDENCE

The universe of permissible investments under the prudence rule is not limited to those permissible at common law. The preamble to the regulations indicates that the DOL does not view compliance with the regulations as the exclusive means by which a plan fiduciary can satisfy the prudence requirement. Rather, the prudence regulation is a safe harbor, with the DOL expressing no opinion as to the status of activities undertaken or performed that do not comply with the regulations.

Additionally, the required activities to satisfy the prudence requirement take into account the nature of the plan. The rule's preamble states that "it would not seem necessary for a fiduciary of a plan with assets of $50,000, to employ, in all respects, the same investment management techniques as would a fiduciary of a plan with assets of $50,000,000."

It is also important for a plan fiduciary to understand the nature of the investments that a plan is making. If it is a complex financial product that the plan fiduciary does not understand, the fiduciary should either forego the investment or make sure that it has guidance from an advisor who understands the product.

Specifically, the regulations provide that the prudence requirement is satisfied if the fiduciary has given appropriate consideration to those facts and circumstances that, given the scope of the fiduciary's duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action, including the role that the investment or investment course of action plays in that portion of the plan's investment portfolio with respect to which the fiduciary has investment duties. The regulations define "appropriate consideration" to include, without limitation, a determination by the fiduciary that the particular investment or investment course of action is reasonably designed, as part

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> The maintenance of an IPS is consistent with a plan fiduciary's obligations under ERISA, including the duties of prudence and diversification.

of the portfolio, to further the purposes of the plan, taking into consideration the risk of loss and opportunity for gain associated with the investment or investment course of action. (Risk refers to any and all types of risk associated with a particular investment or investment course of action.)

DIVERSIFICATION

A fiduciary should also consider the composition of the fund with respect to diversification, the liquidity and current returns of the portfolio relative to the anticipated cash flow requirements, and the projected return of the plan relative to the funding objectives of the plan.

Under ERISA, fiduciaries have a duty to diversify investments so as to minimize the risk of large losses, unless it is clearly prudent not to do so, a duty which the Restatement (Third) of Trusts characterizes as "the central feature of prudence." The legislative history of ERISA makes it clear that the phrase "clearly prudent" is not intended to impose a more stringent standard of prudence than is normally associated with plan investments. Instead, "by using this term, it is intended that in an action for plan losses based on the diversification requirement, the [DOL's] initial burden will be to demonstrate that there has been a failure to diversify. The [fiduciary] then is to have the burden of demonstrating that the failure to diversify was prudent."

Despite ERISA's diversification requirement, ERISA provides no further guidance as to the proper allocation of assets or what constitutes large losses. Furthermore, the requirement to diversify cannot be stated as a fixed percentage. However, factors that courts take into account, based upon ERISA's legislative history, include:

- the purpose of the plan;
- the amount of the plan assets;
- financial and industrial conditions;
- the type of investment, whether mortgages, bonds, shares of stock or otherwise;
- distribution as to geographic location;
- distribution as to industry; and
- the dates of maturity.

The establishment of written investment guidelines such as an Investment Policy Statement (IPS) is extremely helpful for plan fiduciaries in developing practical steps to adhere to ERISA's duties of prudence and diversification. An IPS is a written statement designed to further the purposes of the plan, providing guidelines for the plan's investments, as well as a course of action for a plan's investment fiduciaries when, for example, a fund performs poorly or changes its composition. While not legally required under ERISA, the DOL encourages plan fiduciaries to establish an IPS for a plan, and has stated that the maintenance of an IPS is consistent with a plan fiduciary's obligations under ERISA, including the duties of prudence and diversification.

Under trust law, a trustee has a continuing duty to monitor trust investments and remove imprudent ones that is separate and apart from a trustee's duty to exercise prudence in selecting investments at the outset. A trustee cannot assume that if investments are legal and proper for retention at the beginning of the trust, or when purchased, they will remain so indefinitely.

While "nothing in ERISA requires every fiduciary to scour the market and find the cheapest possible fund" and the cost of an investment is only one of the factors that a fiduciary responsible for investments should take into account, pursuant to the Restatement (Third) of Trusts, which the U.S. Supreme Court has indicated is appropriate to take into account a fiduciary's investment responsibilities, a trustee is to incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the trusteeship.

The Restatement further instructs that "cost conscious management is fundamental to prudence in the investment function and should be applied not only in making investments but also in monitoring and reviewing investments." Similarly, the Uniform Prudent Investors Act, which the Supreme Court has also cited with approval, states that "wasting beneficiaries' money is imprudent. In devising and implementing strategies for the investment and management of trust assets, trustees are obliged to minimize costs." PC

Marcia Wagner, Esq., the founder of The Wagner Law Group, has practiced employee benefits law for over 33 years. She has written 16 books and hundreds of articles, is a highly sought-after speaker, and has been a guest on Fox, CNN, Bloomberg and NBC.

THE FIDUCIARY

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EDUCATION ADVANTAGE

Here's your next key differentiator: a focused fiduciary education solution that mentors advisors.

By Thomas E. Clark Jr. & David J. Witz

Historically, recordkeepers and third-party administrators have led the industry in innovation, technology and plan design. Many advisors can directly attribute their success to the partnerships they built with those vendors who invested time and capital in them to hone their retirement planning skills.

Yet, there remains an army of advisors with exceptional relationship-building skills but minimal technical knowledge of ERISA at a time when the DOL, the courts and the industry are demanding a higher degree of fiduciary sophistication. With such demands at the highest level since the inception of ERISA, vendors should be asking themselves, "How has our fiduciary mentoring role changed, and what must we do to adapt to this new environment?"

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Vendors have had a primary role in the development of advisor expertise for good reason: It has helped vendors develop loyal distribution channels among advisors. However, today's market environment imposes a different level of fiduciary education that requires vendors to determine what support they want to deliver, how they want to deliver that support and to whom they want to deliver it.

While the need for fiduciary education is not subject to debate, the method of delivery and the type and length of content are. Clearly, the educational needs of the elite advisor are different than those of the "occasionalist" advisor. And, of course, advisors' needs differ from those of their staff, their plan sponsor clients, and the participants the advisor serves – all of which emphasize the importance of answering the key questions: how, what, and who?

MANY ADVISORS CAN DIRECTLY ATTRIBUTE THEIR SUCCESS TO THE PARTNERSHIPS THEY BUILT WITH THOSE VENDORS WHO INVESTED TIME AND CAPITAL IN THEM TO HONE THEIR RETIREMENT PLANNING SKILLS.

THE ONLINE SOLUTION

Historically, education was delivered face-to-face. But as technology evolved, webinars came into vogue. Today, online solutions answer the "how" question. Online learning is the fastest growing educational distribution channel for three reasons:

1. Boomers are being replaced with tech-savvy Millennials;
2. technology is the most efficient means to educate, train and mentor; and
3. leveraging technology is less expensive than hiring more people to meet the growing need.

As for what support to provide and to whom the vendor wants to provide it, it depends on the expertise of the vendor, but it goes without saying the more holistic the deliverable, the more appreciative the advisor – and in turn, the more likely a vendor is to develop loyalty with that advisor.

An online education solution can accommodate all demands cost effectively and efficiently. So, the "what" question is highly dependent on the "whom." If the "who" is advisors, then the focus covers a broad range of topics, including marketing ideas, technical issues and fiduciary obligations. For vendor or advisor staff, the focus is compliance and support.

On the other hand, the educational focus for plan sponsor fiduciaries is their role and responsibilities, delivered in a manner that simplifies complex topics. And for participants, the educational focus is on successful outcomes.

The adoption of any new deliverable is subject to a cost/benefit analysis. While we know there is a demand for holistic education solutions, obviously a more robust solution that covers every student population is more costly than one that focuses on one specific segment. Of course, this is where a vendor can separate itself from the competition by being an early adopter of a comprehensive educational platform, a decision that involves both time and money. The cost for technology is predictable, but the cost for developing effective content is much more difficult to quantify. What is clear is that there is a lack of content that effectively addresses each segment. Furthermore, since some of the education is literally customized to the vendor's processes, an off-the-shelf solution will probably not meet all the vendor's needs. Therein lies the challenge – to write, record, edit, and distribute custom scripts that the vendor, its distribution channel and its clients will value, and that effectively reduce labor costs while increasing productivity and margin.

IS IT WORTH IT?

A focused fiduciary mentoring solution has no basis in statute or regulation. In fact, there are no preparatory requirements dictated by law before a person accepts

VENDORS HAVE HAD A PRIMARY ROLE IN THE DEVELOPMENT OF ADVISOR EXPERTISE FOR GOOD REASON: IT HAS HELPED VENDORS DEVELOP LOYAL DISTRIBUTION CHANNELS AMONG ADVISORS.

either a functional or a formally appointed fiduciary role. However, every fiduciary is held to a fiduciary standard – the highest known to law – and is personally liable for his or her conduct as a fiduciary.

Unfortunately, it is not hard to find examples of fiduciary education that has been imposed on fiduciaries by class action plaintiffs, the DOL, or the courts in settlement agreements. These include:

- **2006 –** ADC Telecommunication agreed to provide fiduciary training on an annual basis during a 3-year period.[1]
- **2016 –** Fifth Third Bancorp agreed to fiduciary training for Committee members at least twice annually.[2]
- **2018 –** BB&T entered into an agreement requiring plan fiduciaries to participate in ERISA fiduciary duty training.[3]
- **2019 –** MIT agreed to provide annual fiduciary training on prudent practices, loyal practices and proper decisionmaking in the exclusive best interest of plan participants during a 3-year settlement period.[4]
- **2019 –** SEI's settlement included a provision to ensure that all Investment Committee members would participate in fiduciary training for the next 3 years.[5]

These examples are just the tip of the iceberg. As early as November 2002, the DOL expressed its view on fiduciary education in its "Report of the Working Group on Fiduciary Evaluation and Training", observing, "[M]any fiduciaries of small plans are unaware that they are cloaked in fiduciary status and ignorant of the duties such status requires." According to the report, "the need for education of ERISA fiduciaries is pronounced, whether a fiduciary is involved with plans of large or small employers."

That is not the only time the DOL is on record regarding its concern that fiduciaries lack the requisite education to fulfill their duties prudently. In fact, in an informal discussion on May 5, 2010 between private sector representatives of the Joint Committee on Employee Benefits (JCEB) and DOL staff, the DOL expressed its concern. The JCEB representatives asked:

> "In recent years, the DOL has taken steps to foster best practices of fiduciaries, including participation in fiduciary training programs. One of the more significant ways in which this has been done is through *mandatory fiduciary training conditions in enforcement action settlement agreements.* Sometimes those agreements require that the specific fiduciary training programs utilized to satisfy the settlement agreement's terms must be satisfactory to the DOL. Are there any general guidelines regarding the elements that the DOL believes should be included in fiduciary training programs?" (Emphasis added)

DOL staff responded:

> "Staff believes that there may be many worthwhile and suitable fiduciary training programs available. *Where the Department has required training as part of its settlements*, the fiduciaries are able to identify such programs subject to the Department's approval on a facts and circumstances basis." (Emphasis added)

In the aftermath of that meeting with the JCEB, it was reported in the *Tax Management Compensation Planning Journal* in 2013 that the DOL was, in fact, inquiring into fiduciary training during its examinations. Furthermore, both authors of this article are personally aware of the DOL imposing educational requirements against advisors as well as requiring advisors to provide fiduciary education to the fiduciaries of the plans they serve.

It is important to emphasize that there are no existing requirements that you obtain a designation, be trained by an attorney or be trained in person. While all of those options demonstrate exceptional effort, none of them is required. In fact, a self-study approach is an acceptable approach if the materials are aligned with the requirements of ERISA and there is evidence of the education.

Also, it should go without saying that neither the DOL nor the courts have imposed marketing- or sales-centric education. Nonetheless, sales and marketing workshops are as important to a vendor's organic growth as ERISA education is to a plan sponsor's risk mitigation strategy.

PURVEYORS OF EDUCATION

Recordkeepers and TPAs are the best distribution channels for fiduciary education and for supporting advisors ranging from occasionalist to elite. Establishing a robust education solution to train advisors, their staff, their clients and plan participants is emerging as a "new normal." Becoming a fiduciary education hub for all client segments is not only a differentiator, it is solving a problem that can be tied directly to client persistence and new engagements.

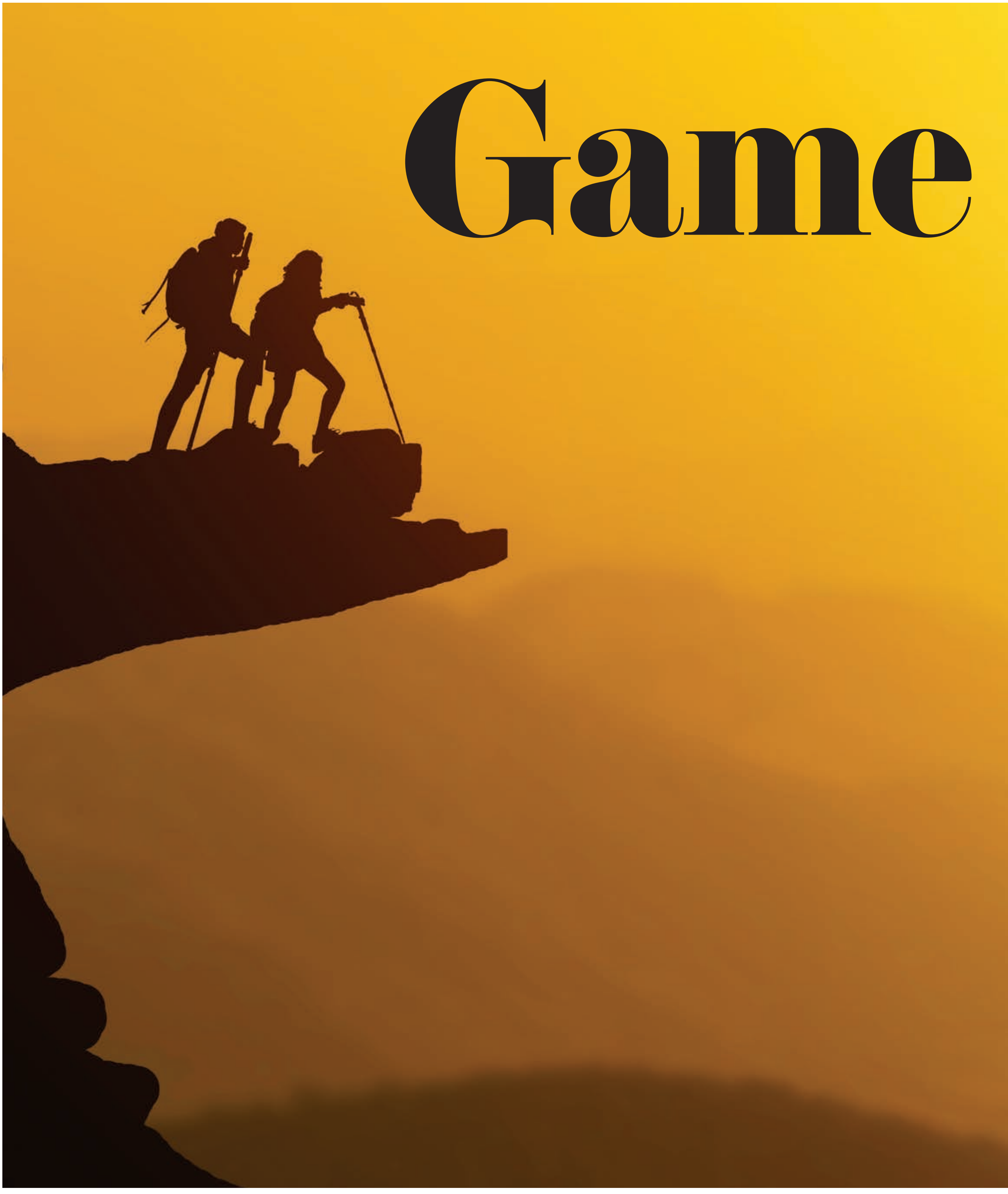
The keys to success in the endeavor to become an education solution are technology and customization. If the effort is not technology-driven, it is difficult to deliver an efficient and scalable solution that is customizable. Today there is a bright light focused on fiduciary education – and it is the vendors who are best positioned to deliver a solution. PC

Thomas E. Clark Jr., is a nationally known ERISA attorney. He a partner and the COO of The Wagner Groups.

David J. Witz is the CEO of Fiduciary Risk Assessment LLC and PlanTools LLC, and the COO of Catapult HQ, Inc. He is co-chair of ASPPA's Plan Consultant committee.

FOOTNOTES

11. Notice of Class Action Settlement No. 03-2989 ADM/FLN (Aug. 3, 2006).
2. Stipulation of Settlement Civil Action No. 1:08-CV-538-SSB (March 15, 2016).
3. Plaintiff's Memorandum In Support of Motion for Preliminary Approval of Class Settlement, Case No. 1:15-cv-732-CCE-JEP (Nov. 30, 2018).
4. Class Action Settlement Agreement, Case No. 1:16-cv-11620-NMG (Oct. 28, 2019).
5. Class Action Settlement Agreement, Case No. 2:18-cv-04205-NIQA (July 26, 2019).



Game

Changer

The SECURE Act is already having a major impact on the retirement industry. Are you prepared?

By Ted Godbout

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President Trump signed the Setting Every Community Up for Retirement Enhancement (SECURE) Act into law on Dec. 20, 2019. It is arguably the most significant retirement policy legislation since the Pension Protection Act (PPA) in 2006—and was a top priority of the American Retirement Association, which, over the course of the past two years, was actively involved in shaping and refining the legislation.

The SECURE Act passed in the U.S. House of Representatives by a 417-3 margin in May 2019, but then languished in the Senate before finally being attached to the $1.4 trillion "Further Consolidated Appropriations Act, 2020" (H.R. 1865), "must-pass" spending legislation to fund the government and prevent a shutdown. The House of Representatives approved H.R. 1865 on Dec. 17, followed by the Senate on Dec. 19.

The SECURE Act's unexpected resurrection resulted in some potential problems. Of particular concern are the law's effective dates, unaltered despite the late passage, with a number of provisions effective on the date of enactment, and numerous others effective on Jan. 1, 2020. While the legislation includes a provision providing for a remedial plan amendment period until the 2022 plan year (2024 plan year for certain governmental plans), or a later date if the Treasury Department provides one, for any plan amendment required under the SECURE Act and its accompanying regulations, in many cases plans will be expected to comply operationally with the provisions regardless.

"The Setting Every Community Up for Retirement Enhancement (SECURE) Act was a top priority of the American Retirement Association, which, over the course of the past two years, was actively involved in shaping and refining the legislation."

Snapshot

One of the major premises underlying the legislation is that, while workplace retirement plans provide an effective way for employees to save for retirement, not all employees have access to a plan, and, of those who do, some do not participate. To address those gaps, Congress believed it was necessary to provide:

- new incentives for employers to adopt retirement plans (including ways to reduce the costs associated with having a plan);
- new incentives for workers to contribute to workplace plans; and
- other measures to boost retirement income security.

Among the key changes, the SECURE Act allows two or more unrelated employers to join a pooled employer plan, creating an economy of scale that lowers both employer and plan participant cost. It also significantly bumps up the tax credit for new plans from the current cap of $500 to $5,000, and small employers (those with 100 employees or fewer) that implement an automatic enrollment feature in their retirement plan design are eligible for an additional $500 credit (see box on page 41).

Other key provisions of the SECURE Act:

- ease the multiple employer plan rules—basically creating the much-anticipated framework for so-called "open" MEPs.
- increase the auto enrollment safe harbor cap from 10% to 15% of pay;
- simplify safe harbor 401(k) rules;
- allow plans adopting by the filing due date to be treated as in effect as of close of year (see sidebar on page 36);
- allow long-term part-time workers to participate in 401(k) plans;
- expand the fiduciary safe harbor for selection of a lifetime income provider;
- provide portability of lifetime income options and require disclosures regarding lifetime income;
- lower the eligibility age for in-service distributions from DB, money purchase or 457(b) plan from 62 to 59½, on a voluntary basis, effective for plan years after Dec. 31, 2019; and
- modify the nondiscrimination rules to protect longer service participants in frozen DB plans.

Those provisions are discussed in greater depth below. Two other provisions, which modify the treatment of custodial accounts upon termination of 403(b) plans and eliminate the so-called "stretch IRA," are not discussed in this article.

The legislation also includes a few provisions that are designed to raise revenue to offset the tax revenue "lost" to the federal government by virtue of the provisions listed above, including significant increases in the penalties for late filing of retirement plan returns and notices (see page 43).

In total, the legislation includes 30 provisions, many of which are designed to make it easier for small- and mid-sized businesses to provide a retirement plan.

MEPs, PEPs and PPPs

One of the centerpiece provisions of the SECURE Act eases previous rules that had restricted multiple employer plans (MEPs) to employers with a common interest or relationship. Under the legislation, two or more unrelated employers will now be able to join a pooled employer plan (PEP). Easing the MEP rules had been debated for the past several years by policymakers who believe the changes will help expand access to retirement plans, particularly for smaller employers, by producing economies of scale for plans (and providers who support smaller programs), and in the process, lower both employer and plan participant costs, both by the aggregation of assets and by the reduction in audit and Form 5500 filing requirements.

Before the SECURE Act, a single MEP could (and still can) provide economies of scale that result in lower administrative costs and expense ratios than apply to a group of separate plans covering the employees of different employers. But the concern that a violation by one or more employers—the proverbial "one bad apple"—participating in the MEP might jeopardize the tax-favored status of the plan or create liability for other employers was strongly believed to discourage the use of MEPs.

By eliminating the commonality requirement and the "one bad apple" rule, as well as requiring only a single plan document and streamlining the audit and Form 5500 reporting requirements, a pooled plan provider (PPP)—which could include, for example, a recordkeeper, third-party administrator, insurance company, bank, broker-dealer or RIA—can now market a PEP to employers, paving the way for an expansion of these plans.

In general, the legislation specifies that the designated PPP must be a named fiduciary, must be responsible as the ERISA Section 3(16) plan administrator and must register with the DOL and IRS. It also increases the ERISA bond limits to $1 million. In addition, each adopting employer will maintain responsibility for selection and monitoring of the PPP or any other named fiduciary.

This provision is effective for plan years beginning after Dec. 31, 2020. It is anticipated that the Labor and Treasury Departments will issue guidance fleshing out the details of the employer and PPP responsibilities, as well as the one bad apple rule and the new reporting requirements.

Increasing the Auto-Enrollment Safe Harbor Cap

To address concerns that the existing 10% cap set in place by the PPA ultimately may be imposing a ceiling on participant contributions, the SECURE Act modifies the automatic enrollment safe harbor to raise the automatic escalation cap.

That well-intentioned but potentially restrictive cap initially reflected a concern that too high a default rate may be in excess of what some employees prefer, which may cause them to opt out and not contribute at all, thus undercutting the purpose of the safe harbor. This concern is likely eased, however, for automatic increases for years after default contributions have begun. Under the new provision, the 10%

RETROACTIVE DEDUCTION FOR ADOPTING A 401(k) PLAN

By Brian H. Graff

Let's say you are a plan advisor or TPA with experience in cash balance, age-weighted profit-sharing or similarly designed retirement plans—and your client's accountant calls in April with a problem.

Your shared client (with just a 401(k) plan) had a banner year and they are getting clobbered with a giant tax bill. She asks you: "Is there anything you can do to help?"

Prior to the SECURE Act's passage, your response would have been "not much."

That situation is about to change, thanks to a provision in the SECURE Act that was developed by the American Retirement Association Government Affairs Committee. Section 201 of the Act provides that if an employer adopts a qualified retirement plan, such as a cash balance or profit-sharing plan, after the close of the taxable year but before the filing date (including extensions) for the employer's tax return, the employer can elect to treat the plan as being adopted in the prior tax year.

In other words, if the employer adopts the plan prior to the extended filing date for the employer's tax return, it can retroactively count the employer's contribution to such plan as a deduction on that return. In the case of a partnership or LLC, that would be Sept. 15.

However—and importantly for C corporations—even though they technically have until Oct. 15 to file their extended return, they will actually need to adopt the plan by Sept. 15 in order for the plan contribution (due by Sept. 15) to count as a deduction for the prior year. This new provision is effective for plans adopted with respect to taxable years beginning after Dec. 31, 2019.

It should be noted that the retroactive deduction for the adoption of a new plan only applies to the employer contributions to the plan. As such, a standalone 401(k) plan and the accompanying employee deferrals would not qualify. They continue to be only deductible in the year in which they are made.

Now let's flash forward to April 2021. The accountant with a different shared client calls with the same problem—a giant unexpected tax bill. But this time your response is entirely different—you can help immediately, with the adoption of a new plan, like a cash balance or age-weighted profit-sharing plan, funded with employer contributions, that will retroactively reduce that tax bill. That is instant tax relief for your client.

Some consultants are suggesting that this could reduce the sales cycle for these plans from 18 months to as little as 18 days. And there are estimates that interest in these plans will rise by 20% because of the instant tax relief they can now provide. That's good news for both the employer client and its employees, who will now benefit from a plan providing much higher contributions than a typical 401(k) plan. We call that a pension win-win!

Brian H. Graff is the Executive Director of ASPPA and CEO of the American Retirement Association.

limitation on the default rate under an automatic enrollment safe harbor plan is increased to 15% after the first year that an employee's deemed election applies. The provision applies to plan years beginning after Dec. 31, 2019.

Simplifying the Safe Harbor 401(k) Rules

Congress made two key changes to the rules for nonelective contribution 401(k) safe harbor plans, believing that more flexible rules, combined with employee protections, will better facilitate the adoption of such plans. The SECURE Act eliminates the safe harbor notice requirement for nonelective contributions, but maintains the requirement to allow employees to make or change an election at least once per year.

Notice that SECURE did not repeal the annual notice requirement for eligible automatic contribution arrangements (EACAs), and thus a qualified automatic contribution arrangement (QACA) with a nonelective safe harbor contribution would still need the EACA notice if the plan wanted to include a permissive withdrawal provision.

The new law also permits plan sponsors to switch to a safe harbor 401(k) plan with nonelective contributions at any time before the 30th day before the close of the plan year. An amendment after that time would be allowed if it provides a nonelective contribution of at least 4% of compensation (rather than 3%) for all eligible employees, and if the plan is amended no later than the close of following plan year. This provision applies for plan years beginning after Dec. 31, 2019.

Part-Time Participants

From its inception, ERISA has allowed employers to exclude from participation workers based on certain age and/or service requirements, in the case of the latter, specifically those with fewer than 1,000 hours of service in any given plan year. However, that service requirement has effectively barred many part-time and/or part-year workers from being able to participate in the plans offered by their employers, even if their employment relationship extends over a period of years. To provide a means for long-term part-time employees to save for retirement, the SECURE Act creates a significant new mandate for plan sponsors.

Except in the case of collectively bargained plans, the legislation requires employers maintaining a 401(k) plan to have a dual-eligibility requirement under

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"The SECURE Act includes three specific provisions that attempt to expand access to lifetime income options, while removing, or at least buffering, some of the traditional concerns about these options."

which an employee must complete either a one-year-of-service requirement (with the 1,000-hour rule) or three consecutive years of service where the employee completes more than 500 hours of service. In the case of employees who are eligible solely by reason of the latter new rule, the employer may elect to exclude such employees from testing under the nondiscrimination and coverage rules, as well as from the application of the top-heavy rules.

This provision applies to plan years beginning after Dec. 31, 2020, except that for determining whether the three-consecutive-year period has been met, 12-month periods beginning before Jan. 1, 2021, shall not be considered. The practical impact is that 2024 appears to be the earliest a part-time employee could actually participate under the three-year rule, but plan sponsors (and their recordkeepers) will need to retain records beginning in 2021 to comply with the three-year component. It seems nearly certain that there will be many questions about how these new rules will work.

OPPORTUNITIES CREATED IN THE

By Jason C. Roberts

Sweeping reforms set forth in the SECURE Act are already leading large financial institutions, including banks, broker-dealers and retirement plan-focused investment advisers, to commit to entering the Pooled Employer Plan (PEP) market—including buying or building the components of a Pooled Plan Provider (PPP).

But for many recordkeepers and TPAs, the biggest opportunities are yet to come, we believe. There are hundreds of small and mid-sized broker-dealers, regional banks and independent RIAs that have built successful plan advisory practices but don't have the resources to invest in building PPPs from scratch. At the same time, these firms are beginning to evaluate how to efficiently compete in the new multiple employer plan (MEP) market, including through the use of PEPs.

There are significant opportunities for TPAs and recordkeepers that can present "plug-and-play" options and allow retirement advisory firms to embed their services into scalable solutions for small business owners. Let's take a closer look at some initial suggestions.

SEEK THE 'GATEKEEPERS'

TPAs and recordkeepers looking to forge relationships with retirement advisory firms will be well served by reaching out to their "gatekeepers"—particularly the plan specialists—to better understand their needs. Being able to align your solutions with those needs will go a long way in securing an invitation to the due diligence phase.

Be prepared to illustrate how partnering with your TPA and/or recordkeeper will facilitate the plan specialists' goals, help save time and better manage the risks they are dealing with today. Describe how your proposal allows specialists to do what they do best while leaving room for those who may have less experience serving plans, but have established individual relationships with small business owners—likely by playing a role in educating and advising participants.

ROLE OF INVESTMENT COMMITTEES

It appears that advisory firms with internal investment committees are well positioned and more inclined to participate in a structure in which the "home office" serves as the 3(38) investment manager for the entire PEP. In other words, this arrangement would make their advisors distributors of the firm-sponsored PEP while playing an educational or advisory role with participants.

On the other hand, although nearly all advisory firms impose general restrictions on investments their advisors can recommend (e.g., by maintaining policies prohibiting advisors from recommending leveraged, illiquid or alternative investments to certain types of clients), many smaller and mid-sized firms do not have internal investment committees. These firms are more likely to allow their plan specialists to perform 3(38) functions—as many do today—but in the context of one or more PEPs endorsed by the firm.

DUE DILIGENCE CONCERNS

Once you are prepared to speak to the needs of your potential distribution partners, the next step will be proactively mitigating due diligence concerns. Put yourself in their shoes. Try to imagine how, given the same resources, you would manage the risk attendant to growing a segment of clientele you haven't traditionally considered to be profitable enough to focus on as standalone prospects—i.e., small businesses.

What are the questions you would ask a prospective joint venture partner? Proactively ask and answer those questions in writing. Offer to meet with the firms' stakeholders, and be prepared to bring along internal or outside ERISA counsel who can help map out an implementation plan that aligns with their existing duties under the securities laws and regulations.

THE VALUE PROPOSITION FOR 'RETAIL' ADVISORS

Only about 5-10% of financial advisors focus primarily, if not exclusively, on serving retirement plans. The rest include numerous "retail" advisors whose predominant focus is on their wealth management clients, many of whom are small business owners. In some cases, they also advise on those businesses' 401(k) plans.

The PEP/PPP structure will allow these retail advisors to initiate conversations they may have avoided in the past in order to convert wealth management clients into participating employers in a PEP. Indeed, many successful retail-focused advisors have shied away from prospecting plan business from their business owner clients. Realizing they don't have the expertise to play a meaningful role supporting technical plan governance requirements, they are less inclined to compete for their clients' plans. For many, this reluctance has led to client attrition—another firm comes in to advise the plan and positions its advisors to develop individual advisory relationships with the company's executives.

The PEP structure eliminates most, if not all, of those barriers, since participating employers will be able to delegate those technical duties to the PPP. Consequently, we anticipate that retail advisors will readily embrace the concept of recommending PEPs to their business owner clients—particularly those where plan-level investments are managed by their firm (or an affiliated team)—not simply to deepen the relationship with their business owner clients, but as a way to defend against competing advisors.

CONCLUSION

Whether you serve as a subcontractor to the PPP or make your PPP available in a "white label" scenario, being able to articulate the benefits of your proposal in plain English will be critical to securing distribution partners. The plan advisors may be the specialists, but don't overlook the opportunity to serve their retail counterparts.

Jason C. Roberts, Esq. is the founder and CEO of the Pension Resource Institute and Managing Partner of the Retirement Law Group.

Expanded Fiduciary Safe Harbor for Selection of Lifetime Income Provider

For the past several years, the subject of how to help workers better manage the decumulation of their retirement savings throughout their retirement and expanding access to annuity income solutions in DC plans has been a major focus among policymakers. While not necessarily presented as a package of reforms, the SECURE Act includes three specific provisions that attempt to expand access to lifetime income options, while removing, or at least buffering, some of the traditional concerns about these options. Not surprisingly, some industry stakeholders cheered the inclusion of these provisions, while others were less enthused.

Perhaps the most significant of the three is the expanded fiduciary safe harbor for the selection of a lifetime income provider. There are in-plan options available in the marketplace now, of course. However, industry surveys indicate that only about half of DC plans currently provide an option for participants to establish a systematic series of periodic payments, much less an annuity or other in-plan retirement income option—and that's

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following the 2008 safe harbor regulation from the Labor Department regarding the selection of annuity providers under DC plans, not to mention a further attempt to close that comfort gap in 2015 (see FAB 2015-02).

To date, those steps don't seem to have been very effective—but to the extent that what's holding back adoption is a concern that 20 years down the road, a retiree who finds him- or herself ill-served by a provider will sue the plan sponsor fiduciary who selected them, the new safe harbor is intended to address that concern.

Under the legislation, fiduciaries are afforded an optional safe harbor to satisfy the prudence requirement with respect to the selection of insurers for a guaranteed retirement income contract. As part of this, they are protected from liability for any losses that may result to a participant or beneficiary due to an insurer's inability in the future to satisfy its financial obligations under the terms of the contract.

The expanded lifetime income provider safe harbor requires that the plan fiduciary consider the annuity provider's financial capability and its ability to fulfill obligations under the plan. Among other requirements, for the preceding seven years the provider must have:

- been licensed by the state insurance commissioner to offer guaranteed retirement income contracts;
- filed audited financial statements in accordance with state laws; and
- maintained reserves that satisfy all the statutory requirements of all states where the annuity provider does business.

While these criteria are applicable at the time of selection, the plan fiduciary must periodically review the criteria. The plan fiduciary also must consider cost, i.e., fees and commissions—although there is no requirement to select the lowest cost.

This provision became effective on Dec. 20, 2019, the date of enactment.

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SECURE ACT'S SMALL PLAN START-UP TAX CREDIT

By Brian H. Graff

Surveys of small business owners have consistently shown cost to be a significant impediment to the adoption of a retirement plan for employees. The SECURE Act includes a provision that could really make a difference.

Congress previously tried to address this concern by providing a tax credit to offset the start-up costs of establishing/administering the plan for the first three years to small businesses with no more than 100 employees and at least one non-highly compensated employee (NHCE), and previously without a plan. However, this credit was capped at $500 or 50% of the year's start-up costs, whichever was lower. While there has been some utilization of this credit, small business retirement plan coverage continues to lag behind larger businesses, and surveys continue to suggest cost as a significant reason. Some have pointed out that the current credit does not begin to offset those early start-up costs.

Enter the SECURE Act, which dramatically expands this tax credit to cover potentially more than half of the cost of a new small business retirement plan. Under SECURE, the amount of the tax credit is now capped at $250 times the number of NHCEs eligible to participate in the plan up to a $5,000 annual maximum (but never less than $500), though, as we saw with prior law, the credit is still limited to 50% of the start-up costs. Additionally, if the new plan automatically enrolls employees into the plan on a uniform basis (but at no minimum rate), the employer will get an additional annual credit for start-up costs of $500 per year.

For example, consider the case of a small business with 15 NHCEs that wants to establish a safe harbor 401(k) plan for its employees and is willing to do automatic enrollment. The provider quotes an out-of-pocket cost to the employer of $1,500 per year. In that case, the tax credit available to this employer will be $750 plus $500, or $1,250, which is almost the entire cost.

And all of this was effective Jan. 1, 2020.

These new credits could have a meaningful impact on small plan adoption and coverage. Obviously time will tell, but this is definitely a good message for small business owners who were previously reluctant to offer a retirement plan to their employees.

Brian H. Graff is the Executive Director of ASPPA and CEO of the American Retirement Association.

Portability of Lifetime Income Options

The second of the lifetime income provisions in the SECURE Act seeks to help preserve retirement income and prevent pre-retirement "leakage" by both encouraging the addition and utilization of lifetime income options (such as annuities).

Specifically, these investments frequently include a surrender charge, and if a participant held one of these as an investment in an employer-sponsored retirement plan and, for example, wanted to rebalance their account, that might trigger a charge or fee. Moreover, restrictions on in-service distributions may have prevented the employee from avoiding such a charge and from preserving the investment, through a distribution or rollover of the existing investment. And, should a plan sponsor choose to change providers, e.g., moving from one that provides a lifetime income option to one that doesn't support that feature, the operational challenges at a participant level can be significant.

To alleviate this issue, if a lifetime income investment is no longer authorized to be held as an investment option under the plan, the SECURE Act will now permit qualified DC plans, 403(b) plans or governmental 457(b) plans to make a direct trustee-to-trustee transfer to another employer-sponsored retirement plan or IRA of lifetime income investments or distributions of a lifetime income investment in the form of a qualified plan distribution annuity. Those distributions would have to be made within the 90-day period ending on the date when the lifetime income investment is no longer authorized to be held as an investment option under the plan. This provision is effective for plan years beginning after Dec. 31, 2019.

Lifetime Income Disclosures

The third of the lifetime income provisions requires that benefit statements provided to DC plan participants include a lifetime income disclosure at least once during any 12-month period. That disclosure must illustrate the monthly payments the participant would receive if the total account balance were used to provide lifetime income streams, including a qualified joint and survivor annuity for the participant and the participant's surviving spouse and a single life annuity.

There has been some concern expressed over the years that showing participants an estimate of a future value might be viewed as a promise of that benefit, certainly by the plaintiffs' bar. To alleviate litigation fears, the SECURE Act specifies that plan fiduciaries, plan sponsors or other related persons will have no liability under ERISA solely by providing lifetime income stream equivalents that are derived in accordance with the provision and include the explanations contained in the model disclosure. The provision—which directs the Labor Department to craft the particulars of the calculation—applies to pension benefit statements furnished more than 12 months after the DOL issues interim final rules, the model disclosures and corresponding assumptions.

Nondiscrimination Relief to Protect Longer-Service DB Plan Participants

When a defined benefit pension plan is closed to new hires, that tends to result in a disproportionate number of more highly compensated individuals as participants in the plan, and that, in turn, has a negative impact on the plan's ability to pass the required nondiscrimination tests. The IRS had been providing temporary, limited relief for the past several years (going back to plans that were closed by an amendment adopted before Dec. 13, 2013), and it had announced in Notice 2019-60 that it was providing additional temporary relief for closed DB plans through 2020.

Now the SECURE Act provides codified relief with respect to benefits, rights and features for a closed class of participants, and to benefit accruals for a closed class, under a DB plan that meets the applicable requirements. The legislation also treats a closed or frozen DB plan as meeting the minimum participation requirements if the plan met the requirements as of the effective date of the plan amendment by which the plan was closed or frozen. More specifically, a DB plan will not fail nondiscrimination testing if:

- the Section 401(a)(4) testing for the year the plan closed and the following two successive plan years passed; and
- any amendment that modifies the closed class or the

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benefits, rights and features does not discriminate significantly in favor of highly compensated employees.

The provision is effective on the date of enactment, without regard to when the plans are modified, but plan sponsors and advisors will want to review their specific circumstances carefully, as the requirements of this provision are beyond the scope of this article.

Big Increase in Penalties for Late Plan Returns, Notices

While there was a lot of good news for retirement plans and those who work with them in the SECURE Act, there are a few nuggets of "coal" in the law as well.

One such provision that retirement plan advisors, administrators and sponsors should be mindful of is a significant increase in the penalties for late filing of retirement plan returns and related notices. The provision was added to help offset the underlying "cost" (in the form of lost tax revenue) of the legislation. These changes apply to returns, statements and required notices provided after Dec. 31, 2019.

Form 5500

Section 403 of the SECURE Act includes a tenfold increase in the penalty for a failure to file Form 5500 from $25 for each day the failure continues to a maximum penalty of $15,000 to $250 per day up to a maximum of $150,000.

Registration Statements

The legislation also includes tenfold increases in the failure to file a registration statement and notification of changes. In this case, the penalty for a failure to file a registration statement as required will increase from $1 for each participant with respect to whom the failure applies, multiplied by the number of days during which the failure continues, to $10 per participant per day. In addition, the maximum penalty for this type of failure is increased from $5,000 with respect to any plan year to $50,000.

Administrators of plans subject to ERISA's vesting requirements are required to file a registration statement with the IRS with respect to any plan participant who separated from service during the year and has a deferred vested benefit under the plan.

Similarly, a failure to file a required "notification of change" will result in a penalty of $10 per day (up from $1), not to exceed $10,000 for any failure (up from $1,000). Here, plan administrators are required to notify the IRS if certain information in a registration changes, such as any change in the name of the plan or the plan administrator, the termination of the plan, or the merger, consolidation or division of a plan.

Withholding Notices

Failure to provide a required withholding notice was also increased tenfold, resulting in a penalty of $100 for each failure (up from $10), not to exceed $50,000 for all failures during any calendar year (up from $5,000).

Withholding requirements apply to distributions from tax-favored employer-sponsored retirement plans and IRAs, but, except in the case of certain distributions, payees may generally elect not to have withholding apply. To that end, a plan administrator or IRA custodian is required to provide payees with notices of the right to elect no withholding.

Distributions for Qualified Disasters

In addition to the SECURE Act provisions, the $1.4 trillion appropriations act includes a provision affecting disaster-related plan withdrawals.

The legislation provides temporary tax relief to areas affected by certain qualified major disasters, including relief from the 10% early withdrawal penalty for qualified disaster relief distributions up to $100,000 from a qualified retirement plan, a 403(b) plan or an IRA. In addition, income attributable to a qualified disaster distribution may be included in income ratably over three years, and the amount of a qualified disaster distribution may be recontributed to an eligible retirement plan within three years.

Additionally, individuals who took a hardship distribution from a retirement plan for a first-time home purchase in the disaster area whose transaction was terminated due to the disaster can recontribute the amount back to the retirement plan without penalty. The loan limits on retirement plans subject to this relief can be increased from $50,000 to $100,000 and retirement plan loan repayment periods can be extended accordingly.

In general, the relief applies to individuals who suffered losses in a qualified disaster area beginning after 2017 and ending 60 days after the date of enactment, but additional rules apply to specific effective dates, including those related to a "qualified disaster distribution." The California wildfires were excluded because they were covered in other legislation. PC

Data Driven Success

Developing a key strategic plan and relevant metrics that effectively measure progress toward important goals sets your business up for optimal results and success.

By Amanda Iverson

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Closely held business owners are often pulled in many directions.

While servicing clients is a high priority, it can be difficult for an owner to find the time and tools to efficiently monitor the health of the business.

When TPA business owners want to evaluate the health of the business, well-intended owners often jump right to the corporate financial statements. While accurate financial statements are very important (and admittedly I am a numbers nerd and love talking financials), Stephen Covey's guidance, "begin with the end in mind" (from his book, *The 7 Habits of Highly Effective People*) is a better approach for beginning the analysis of a business's overall direction and health. To paraphrase Covey, one must begin with a clear vision of his or her desired destination.

How does one do this? A company can benefit greatly from the development of a strategic plan. A well designed strategic plan will generate a map to drive the organization to meet its desired business goals. Subsequent to the development of a strategic plan, various relevant business metrics provide leaders with the tools to analyze the results of business efforts, provide focus and identify areas of concern.

Designing a Strategic Plan

A strategic plan should incorporate goals and expectations related to the practice's key business areas. Combined with a thorough analysis to track those goals, this will provide a roadmap to the desired profits and success. While every strategy discussed below may not be feasible for every practice, this article is intended to provide TPA business leaders with practical strategies and tools that can be incorporated into the business to assist with practice management and improve the firm's evaluation of and progress toward ultimate success.

A strategic plan does not need to be overly complicated, but some business leaders may find it necessary to hire an external consultant to facilitate its development. Ultimately, the business leader will have to decide which factors are the most important keys to future prosperity. When developing the organization's goals associated with the strategic plan, the considerations should include the following.

- The corporate "why" and overall mission of the organization
- Company vision for the next three to five years and beyond
- Business growth goals
- Greatest prior successes and "challenge areas" that need to be emulated or addressed
- Industry changes that may affect the organization and require the company to rethink service models and offerings
- Current marketing efforts' effectiveness and any changes needed
- Company's client retention and service goals
- Consideration of practice areas that require additional or modified focus, improvement or elimination
- Technology improvements, innovations and investments that will require priority in order for the organization to adapt, evolve and change over the next decade
- Employee considerations to handle the company's goals
- Unusual/non-reoccurring revenues (or expenses) that need to be considered, and how they might affect future goals
- Additional resources needed to satisfy goals

> When establishing revenue and growth goals, one should evaluate client satisfaction and plan retention trends.

The drafting of the strategic plan also does not need to be overly complex. A strategic plan template could be as simple as the one provided below.

Using the Strategic Plan in Combination with Metrics

The strategic plan should be used as a dynamic roadmap to steer future business decisions. Thus, leaders must regularly revisit their plan and evaluate progress toward its corporate goals. Additionally, it's important to share the plan with the entire corporate team, so that staff members understand the direction of the firm.

Once a firm has well-defined goals, business metrics can pave the way for analyzing business efforts and identifying both successes and problem areas. These metrics can include all aspects of the business:

Strategic Plan Template

GOALS (BROAD PRIMARY OUTCOMES)	OBJECTIVES (SPECIFIC/MEASURABLE STEPS)	TACTICS (INITIATIVES)	LEADER RESPONSIBLE	TIMELINE 2020	TIMELINE 2021	TIMELINE 2022	COMMENTS
Financial Goal							
Goal							
Clients / Sales / Marketing Goal							
Goal							
Employees (Human Capital) Goal							
Goal							
Additional Area Goal							
Goal							

- Human capital metrics help leaders plan and evaluate staffing needs, retention issues and performance results.
- Client service metrics can also help in evaluating employee performance, as well as identify which service areas are excellent and which are cause for concern.
- Metrics around sales and marketing goals help leaders evaluate if current business development efforts are providing the desired effects and whether they are aggressive enough to meet strategic goals.
- Metrics surrounding financial statements help the business owner understand and plan for financial changes to prevent surprise financial hardships.

Metrics should also provide the guidance needed to determine whether there is a need to modify the strategic plan and/or efforts to achieve the goals within the plan.

Metrics surrounding human capital can develop employee expectations and evaluate employee performance, as well as identify hiring needs. Common employee metrics include:

- staffing retention trends;
- ratio of team members to plans;
- revenue per employee;
- billings per employee; and
- utilization per employee.

With those types of metrics, consistency is key. By continually monitoring their selected metrices and thereby having comparative figures, leaders can use this data to better manage the business expectations.

Compensation structures and methodology should also be evaluated when considering human capital metrics. This will ensure that the firm has consistent "equal pay for equal work" practices in place.

Excellent client service should be a goal of any practice. Client retention and service impact the company's reputation. Additionally, it is usually more expensive to add a new client than it is to keep a satisfied client. For these and many other reasons, business leaders should always incorporate client service metrics into their analysis. They can provide both clients and employees with turnaround expectations and then use metrics (such as expected and then actual average turnaround time from the receipt of client data to the delivery of the service offerings) to evaluate progress toward meeting those expectations.

Relevant business metrics provide leaders with the tools to analyze the results of business efforts, provide focus and identify areas of concern.

Many industry-specific workflow programs are designed to help business leaders evaluate average turnaround times. Some programs incorporate internal turnaround expectations into the workflow process as well, to help with the calculation and evaluation of these turnaround metrics. If turnaround results are not consistent with expectations, leaders may be able to identify why (e.g., training issues, data request issues, technology problems, etc.) and address what's causing poor service before it becomes a bigger problem.

Growth and new business are key components of a healthy, thriving business. The addition of new business is necessary to make up for inevitable client losses and to grow the practice into a larger business. And of course, when developing marketing and sales goals, it is helpful to evaluate your previous successes or failures.

Data that will assist in both planning and evaluating growth include plan count changes (both in terms of number of plans and plan revenue), net growth by service area/plan type, and client acquisition cost trends. Also important is the ratio of plan wins compared to proposals created (both by plan type and referral source), and win rate statistics when firms present the proposals as compared to win rates when the opportunity to present a proposal is not available.

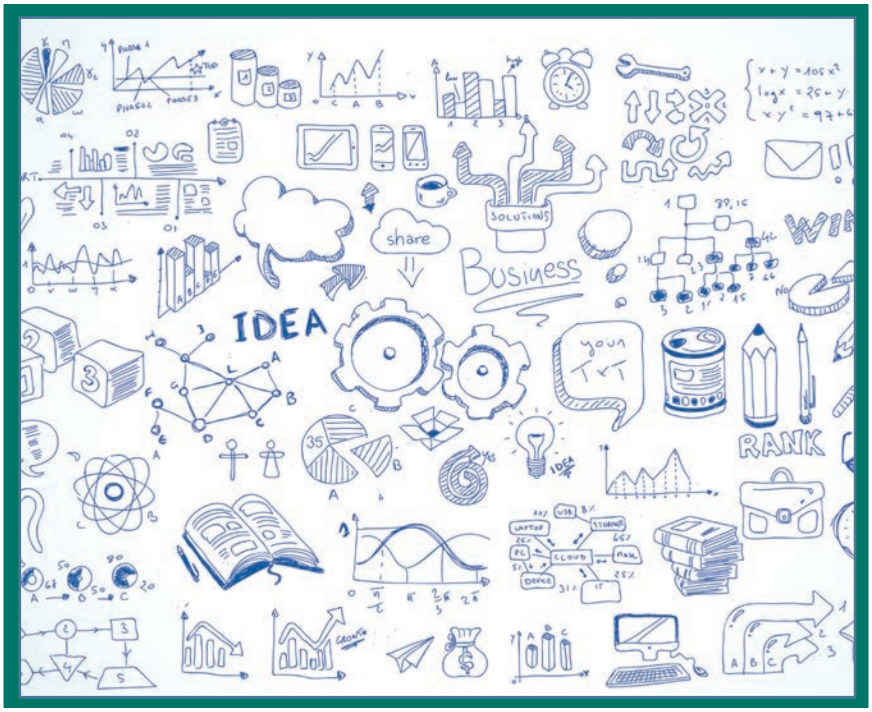
Metrics like those may identify the need to modify marketing and sales plans or change future approaches and efforts. For example, a firm may identify very low win rates with one referral source, while another referral source has much more promising win rates. This knowledge helps leaders be better equipped to know where to focus more of the firm's sales efforts.

When establishing revenue and growth goals, one should evaluate client satisfaction and plan retention trends. Client surveys help to evaluate current client service and satisfaction. While new plan trends are important, it is just as vital to evaluate plan loss trends. Leaders should analyze plan losses and the reasons for those losses. What percentage of losses are due to service complaints, fee issues, or plan terminations? Are client retention issues isolated or concentrated to an internal service team? Is the firm focused on a certain business service line or referral source that is no longer fruitful?

Client retention rates, lead generation analysis and the evaluation of marketing goals are important in understanding where the firm is headed and evaluating whether future goals will be met.

Financial Statement Development and Analysis

It is imperative to pay attention to and understand the firm's financial statements and related information. Accurate



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and timely financial statements are important. A thorough financial review is critical, and will provide an important measure of the company's success. Use of various metrics (to anticipate financial targets and then evaluate whether those targets will be met) is helpful in planning for and evaluating a company's business health.

And of course, traditional financial metrics, such as profit margin analysis, growth trends, cash flow trends and expense trends, are helpful for proper business management as well.

To create projected budget financial goals, it may be easiest to start with a review of the previous period's financial results. However, one should not rely on prior-period financial data and expect those same results in the current and future periods. Leaders must consider whether there were additional revenues (or expenses) that will not reoccur. Examples of potential non-reoccurring revenue may include document restatement, consulting or plan termination work.

Businesses must also consider how regulatory changes will affect their workflow and staffing requirements, incoming cashflow and revenue cycles. For example, the passage of the SECURE Act may affect the timing of new plan implementation, which could change a TPA's cashflow timing.

Business owners should also consider when they create budgets and expectations for the subsequent year. Leaders should create reasonable revenue goals for the organization based upon historical data, strategic goals and industry or corporate changes. Leaders must also evaluate whether particular expense outputs need to be increased (such as an investment in technology) to meet evolving business demands. The firm should use trends in growth, profit and cashflow to direct future strategic business decisions and purchases.

Practices Looking to Sell

An owner may want to sell his or her firm in the near future and therefore may not believe the suggestions offered above are important to the practice. However, to be "sales ready," it is important to have a solid handle on the corporate financial position. Buyers will require potential sellers to provide extensive financial information, often covering a three- to five-year period. Acquiring firms will also likely request data on revenue by source; new business lines by source; plan breakout by type, size and revenue; plan losses statistics; referral source information; and various growth trends. Additionally, buyers may request human capital information, such as employee retention rates and compensation practices and methodologies. A firm that is proactive and has a developed strategic plan, related metrics and reliable financial statements will have a much easier path to sale.

Conclusion

No matter the business life cycle of the practice, from startup to growth to mature or somewhere in between, developing a key strategic plan and relevant metrics that effectively measure important goals sets the business up for optimal results and success. Companies that develop goals, expectations and evaluation tools whereby challenges can be identified and corrected early on often have the best chance for strong success.

While every business identifies success differently, having productive and engaged employees, satisfied clients, valuable referral sources and profitable, predictable financial statements makes for a healthy and successful business. PC

Amanda R. Iverson, CPA, MBA, PHR, SHRM-CP, APM, is a partner at Pinnacle Plan Design LLC and the firm's COO. She is a member of ASPPA's Leadership Council and the Annual Conference Planning Committee.

Foreign Registration Issues for TPAs

Doing business in multiple states? You need to 'foreign qualify.'

BY TIMOTHY J. TERVEER, JR.

As a retirement plan professional, sometimes it can feel like you're expected to be an expert in all aspects of business law. One area of confusion for many business owners involves the rules and laws regarding conducting business in multiple states. In today's increasingly digital economy, many retirement professionals have facets of their business that involve dealings in other states, such as out-of-state clients, remote employees and independent contractors. By law, if your company does plan to conduct business in a state other than its state of incorporation (or LLC formation), then you may need to register your business in those states. The process is called foreign qualification.

DOMESTIC COMPANIES AND FOREIGN COMPANIES

Regardless of entity type (corporation or LLC), a company can only be domiciled in one state. Each company's "domestic" state is typically the state in which it was formed. (There may be reasons to change where you are domiciled later in the company's life, but that's an article for another day.) If a company wants to do business in any other state, it would be considered a "foreign" company. Each state has the power to prohibit foreign companies from doing business within their borders unless they are in compliance with their specific conditions.

FOREIGN QUALIFICATION

Foreign qualification is the process by which a statutory business entity receives authority to do business in a state other than its formation (domestic) state. This process is typically referred to as registration. It's treated in much the same way as your domestic registration was. In most states, you provide many of your organization's initial documents (articles of incorporation, bylaws, operating agreements) along with an application to the Secretary of State's office. Once they have qualified your business, typically you must comply with a few other requirements such as maintaining a registered agent in their state, filing an annual report and paying a fee.

HOW DO I KNOW IF I NEED TO PREPARE A FOREIGN QUALIFICATION APPLICATION?

Many TPAs and other business owners will have aspects of their business that may require foreign qualification because they are "doing business." The rule itself is very simple: If you are doing business in a state, you must follow that state's business registration rules. The definition of "doing business" is where things become very complicated, and laws will vary from state to state. In fact, many state laws list only the activities that don't constitute "doing business" – leaving courts to decide what does constitute doing business on a case-by-case basis.

Here are a few common examples relating to retirement plan professionals:

- Your firm was founded and has operated in South Dakota since inception. Earlier this year, one of your business partners decided to relocate in the winter to Texas, and has leased a small office in downtown Houston.
- Your company operates and is domiciled in New York State. However, you find yourself meeting with a few of your larger clients at their offices in Connecticut.
- You found a great employee, but she lives in California and you operate from Florida. You decide that her talent is so valuable that you will allow her to work remotely from her home.
- In order to secure a major municipal agency, they require

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you to register for a license to conduct business in their city.

If you are uncertain whether your specific facts and circumstance meet the requirement for foreign qualification, you should check with your legal counsel for guidance.

WHY IS FOREIGN QUALIFICATION IMPORTANT?

Though the process of registering your business in multiple states may seem burdensome, failure to do so can result in unfavorable consequences. A corporation or other business entity is subject to fines and penalties for failure to foreign qualify when required to do so. Moreover, your company could be barred from bringing a lawsuit within that state, such as a suit for breach of contract, because it is not recognized by that state. And in certain circumstances, the state where you should have filed actually becomes your company's registered agent, authorizing that state to receive legal notices on behalf of your company in the event it is served notice by a plaintiff that you are being sued.

Another potential pitfall exists as a result of the 2018 U.S. Supreme Court decision in *South Dakota v. Wayfair Inc.* In this decision, the Court upheld that states may charge tax on purchases from out-of-state sellers, even if the seller does not have a physical presence there. With 50 states come 50 different laws regarding what services are subject to sale tax. Depending on the provisions each state has and the services your company provides, you may have a nexus in the state and may need to foreign qualify because of the sales volume you have in a state you never enter. This Supreme Court decision has emboldened states to pursue sources of revenue that were previously disallowed.

CONCLUSION

Foreign qualification is a necessary regulation by the states to protect their citizens and domestic businesses. While we don't have to like the complexity and varied approach each state has for foreign qualification, it is nonetheless our duty as professionals to apply our specific facts and circumstances to our business and qualify where necessary. PC

Tim Terveer, CPA, is the managing partner of Kramer & Associates, LLC, a CPA firm specializing in providing tax and accounting services to small and mid-sized professional service firms.

Q&A: Administrative Committees

Why form an Administrative Committee for your plan? Answers to these six questions will help answer that one.

BY THOMAS R. BICK

Fiduciaries of a retirement plan have significant obligations as they manage plan assets and oversee day-to-day operations. ERISA requires all named fiduciaries to perform proper due diligence in every task. One very good way to address these fiduciary obligations is to create an Administrative Committee. A structured group of dedicated individuals will go far in "doing the right thing" for plan participants.

Let's take a look at some common questions regarding Administrative Committees.

ARE ALL COMMITTEE MEMBERS CONSIDERED FIDUCIARIES?

Almost certainly. A person is a fiduciary to the extent they have any discretionary authority or responsibility in the administration or management of a plan or exercise any discretionary authority or control with respect to the management or disposition of plan assets. Under this definition, committee members will be functioning as fiduciaries for purposes of ERISA.

WHAT LIABILITIES DO COMMITTEE MEMBERS HAVE?

Section 409(a) of ERISA stipulates that all Committee members are personally liable for any act or omission during their tenure that violates fiduciary rules. However, section 409(b) also provides that a fiduciary shall not be liable with respect to a breach if it occurred prior to becoming a fiduciary.[1]

But members are not completely off the hook for prior actions. Each member has a duty to review investments, procedures, etc. If one becomes aware of any prior mistakes or problems, corrective action must be taken.[2] Similarly, a member is not liable for any fiduciary breach after ceasing to be a fiduciary. But any resigning fiduciary must ensure that someone else remains to take over said fiduciary duties. If one becomes aware of a breach and their only remedy is to resign, this could be considered a fiduciary breach.

WHAT IS A COMMITTEE MEMBER'S 'PRIME DIRECTIVE'?

Actually, you should think of having two "prime directives."

Under ERISA, each fiduciary has a duty of loyalty to the participants. Every action taken must be for the *exclusive* benefit of participants and beneficiaries. A committee member who constantly asks, "Does this action exclusively benefit participants?" will be a long way down the road to doing a good job. If actions benefit anyone else, the committee and its members could be running afoul of the prohibited transaction or conflict-of-interest rules. ERISA does not prohibit a fiduciary from also acting as a nonfiduciary in making company business decisions that are in the company's favor. One can still can act as a company officer, employee or agent. But one must be careful that one's actions don't run counter to this first "prime directive."

The second "prime directive" is that a named fiduciary is required to exercise care, skill, prudence and diligence and conform to the "highest standards" as mandated by ERISA. Every fiduciary, and therefore every committee member, must have familiarity and expertise regarding the issue in question. If a fiduciary fails to have requisite expertise, outside expert assistance must be sought. Every fiduciary would be well served to remember a phrase contained within a 1982 court case involving a retirement plan committee sued by a plan participant. One judge wrote about the Administrative Committee, "a pure heart and an empty head are not good enough."[3]

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> A structured group of dedicated individuals will go far in 'doing the right thing' for plan participants."

CAN FIDUCIARY RESPONSIBILITIES BE OUTSOURCED?

Most owners find running their own company to be a full-time job. Finding time to form and moderate a committee and oversee the plan can be a daunting task. Fortunately, fiduciary responsibility can be allocated among different named fiduciaries. ERISA provides some fiduciary relief of direct liability for duties delegated to another fiduciary.[4] But—and this is a big "but"—this doesn't insulate the delegating fiduciary from liability if it's an improper delegation. A common situation would be when a plan sponsor hires a service provider for "3(16) fiduciary services." All too often the service provider's "3(16) Agreement" actually precludes them from being a fiduciary; they just want to perform ministerial administrative tasks, like discrimination testing. A plan sponsor must actually read, and understand, all plan contracts.

If a plan fiduciary or a committee wishes to delegate fiduciary responsibility, federal regulations require the service provider in question to state, in writing, that they accept and serve in a fiduciary capacity under ERISA. The common types of outsourced fiduciaries are:

- §402(a) (often regarded as the highest-level fiduciary);
- §3(16) (administrative fiduciary);
- §3(38) (investment fiduciary);
- §3(21) (investment co-fiduciary)

Therefore, it is not only critical that each respective fiduciary overtly accept the tasks being delegated, but also that each fiduciary in question be an expert capable of serving in that capacity.

WHAT IF A COMMITTEE MEMBER DISCOVERS SOMETHING WRONG?

ERISA §405(a) imposes liability for knowing and concealing a breach of fiduciary duty, even if it is by a co-fiduciary. Trust law imposes a requirement of "duty of loyalty" on plan fiduciaries to both monitor and remedy any wrongs of which they become aware. It's clear and simple: If one becomes aware of a problem, effective corrective steps must be taken!

HOW IS A PLAN ADMINISTRATIVE COMMITTEE RUN?

When creating an Administrative Committee, it is critically important to document the committee's authority, duties and obligations, and to document, with as much specificity as reasonable, how it will exercise its authority. A committee's internal workings are rarely set out in the plan document. Accordingly, it's wise to incorporate all delegated authority within a formal written charter or by-laws. This document specifies who will be the actual committee members, and their terms and their ongoing training, as well as the specific duties delegated to the committee.

The next step is to establish what is called "procedural prudence." Broadly speaking, this means setting up the protocol for selecting and monitoring investments, making sure the plan is being run in accordance with the terms of the plan document and applicable regulations. Then schedule regular committee meetings to conduct formal reviews and discuss relevant actions.

Committees should always consider inviting key company personnel who can contribute to the discussions. They should also require each service provider to send a representative, in person or via conference call, to report on key aspects of their services and duties. For example, investment professionals would provide reports on how plan assets are performing, recordkeepers on plan account activity, administrative firms on plan compliance, etc.

Above all else, the most important thing any Administrative Committee can do is keep accurate records of all meetings, documenting the elements of each review and the decision process for actions taken. When the Department of Labor or a participant's attorney come calling, if you don't have meticulous records, you will be treated as if the meeting never occurred. And who remembers what was said or done two or three years after the fact? PC

Thomas R. Bick, QPA, ERPA, RF, APA, APR, is the Director of Fiduciary Compliance at Fiduciary Wise. His 35 years of experience include COO of a regional CEFEX-certified TPA firm and a qualified plan consultant for several national financial and accounting firms.

FOOTNOTES

[1] 29 U.S.C. §1109(b).

[2] *Barker v. American Mobil Power Corp.* (64 F.3d 1397. 9th Cir. 1995).

[3] *Donovan v. Cunningham* (716 F.2d 1455, 1467).

[4] 29 U.S.C. §1105(c)(1).

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Learning Management Systems Are Coming of Age

A customized LMS solution can help your firm increase revenues and capture more market share. Here's how to get started.

BY THOMAS E. CLARK JR. & DAVID J. WITZ

Online education is flourishing worldwide. The growth and popularity of online universities like the University of Phoenix have drawn mainline universities like Harvard, Yale, Princeton, Penn State and many others into the fold. Team-Treehouse, an independent firm providing technology education, has more than 50,000 current students learning to code.

And online education is now a growing trend in the retirement industry. Underlying this trend are five reasons:

1. **Convenience** – students access education on their own time schedule 24/7.
2. **Efficient** – instructors share their knowledge with an unlimited number of students without additional effort.
3. **Cost Effective** – online education minimizes labor and operating cost.
4. **Appeal** – it is the preferred training method by the largest segment of the workforce.
5. **Differentiator** – online education is an emerging market that offers a competitive advantage.

However, not all Learning Management Systems (LMS) are the same. In fact, the differences will have a major impact on your competitive position now and in the future. For example, any off-the-shelf LMS solution is a competitive advantage in the early adoption stage, but there are custom solutions that better position your company for long-term success.

Of course, even the customizable LMS solutions have different features and capabilities that will impact current and future success – especially if you intend to leverage your in-house expertise as a value proposition. If that is your intent (and it should be) then you will need an LMS solution that gives you pricing and reporting capabilities – that is, the ability to sell your content at any price or give it away and deliver detailed reports that keep you informed of all student activity.

Your LMS should also include four key features:

1. **Brandable** – it must be your "university" or "academy."
2. **Customizable** – it must permit you to customize the content and update that content as changes occur.
3. **Interactive** – it must enable you to communicate with your clients/students.
4. **Gamification** – it must be fun, create competition, and potentially offer rewards.

Let's take a closer look at each of these features.

BRANDING

Full control is needed of the LMS API that resides on your server, which is dedicated to distributing your knowledge. It must be accessible through your website and appear completely and seamlessly integrated with your deliverables. Of course, that also means prominently displaying your logo, color scheme and any custom messaging.

CUSTOMIZABLE

Customization is a much broader topic in the LMS world than it would seem on the surface. The features of LMS customization that are "must haves" include the ability to:

1. Offer workshops for any audience, e.g., staff, fiduciaries, participants
2. Assign different workshops to different audiences
3. Populate a workshop with content developed by internal or external resources
4. Download reports that track all activity
5. Develop quizzes to test retention and offer your subscribers Certificates of Completion as proof
6. Link ancillary documents or other resources to a specific workshop
7. Engage in on-demand Q&As with students and store historical dialogue for any student to read
8. Have reusable seats to manage costs
9. Incorporate gamification using badges, points and incentives, e.g., a $10 Starbucks gift card
10. Price the service from $0 to what the market will bear

INTERACTIVE

It goes without saying that ERISA is not an easy subject to master. In fact, even the masters struggle to maintain competency on a topic that is evolving constantly. This highlights the need to have interactive capabilities that permit students to ask questions of the instructor and see the instructor's response in real time. All Q&A responses should be stored and be accessible to other students and the instructor to reference. Another advantage of a Q&A function is that it gives the instructor a touch point with the client and the ability to identify other opportunities.

GAMIFICATION

Your LMS solution must be gamified. Gamification is designed to inspire competition, self-achievement and recognition. At a minimum your gamification should offer badges and points which permit a student to self-assess their progress versus their peers. If possible, you want an LMS solution that will accommodate the addition of real monetary awards as well. For example, if you complete all workshops within a certain period of time you receive a $25 dollar gift card to Starbucks.

CONCLUSION

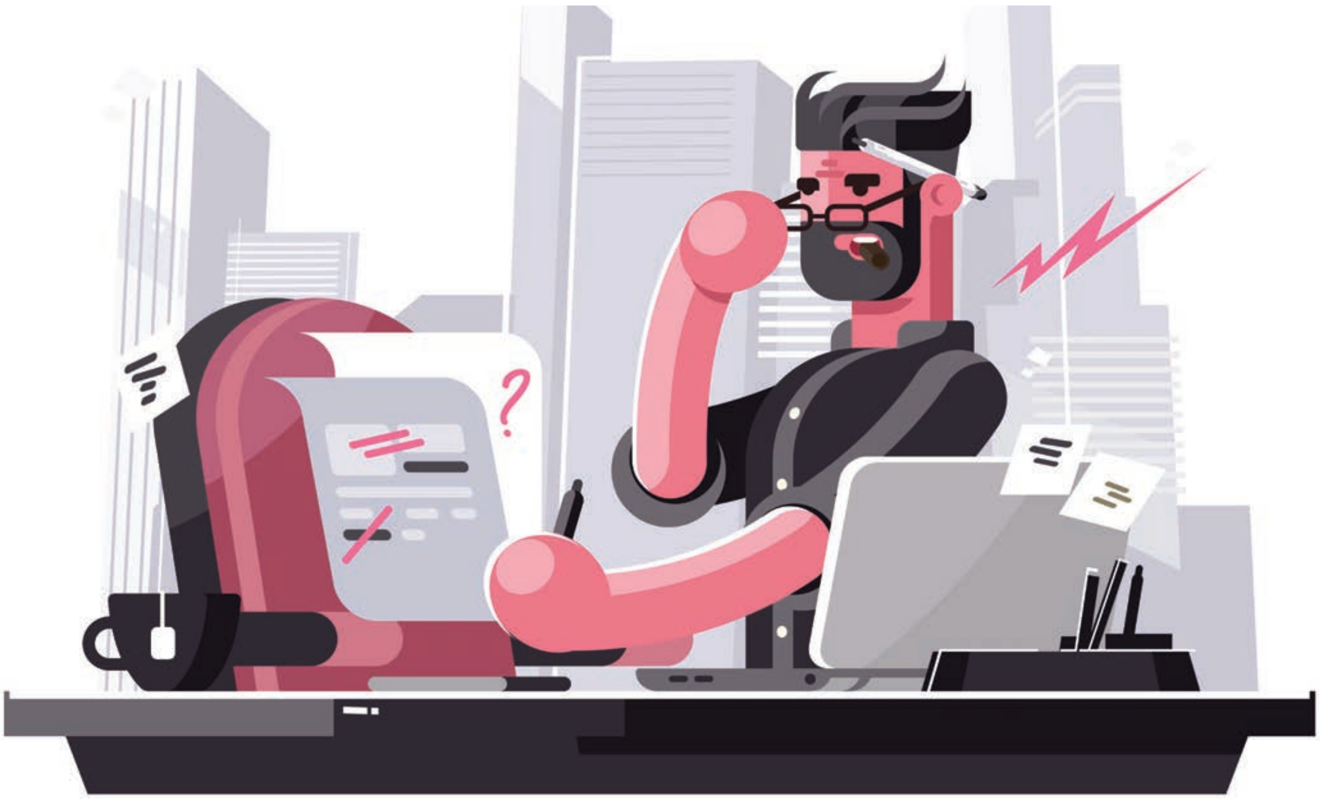
Fiduciary education is not a statutory or regulatory requirement. In fact, the only time education could arguably become a requirement is if it is part of your service agreement, in which case it becomes a contractual obligation subject to an assessment of fee reasonableness under ERISA Section 408(b)(2) when paying with plan assets. However, we have seen both DOL guidance and judicial settlements that include continuing education requirements for fiduciaries. While they have not made fiduciary education a broad requirement applicable to all retirement plans, this trend sends a strong message to all vendors and plan fiduciaries that they should document their education activities to demonstrate a culture of fiduciary prudence.

We work in a complex industry that requires a commitment to continuing education for the professionals who serve retirement plans, their staff, clients (advisors and plan sponsors) and participants. Though education is not a requirement, it is a necessity – and those vendors which have the budget to establish an LMS solution are best positioned to increase revenues and capture more market share.

Clearly, now is the time to monetize your knowledge. Now is the time to transfer your best marketing ideas and most prolific analogies that convert complex topics into understandable concepts accessible via your customized corporate LMS video library. PC

Thomas E. Clark Jr., is a nationally known ERISA attorney. He a partner and COO of The Wagner Group.

David J. Witz is the CEO of Fiduciary Risk Assessment LLC and PlanTools LLC, and COO of Catapult HQ, Inc. He is co-chair of ASPPA's Plan Consultant committee.



Lapses of Professionalism: Does Intent Matter?

An innocent mistake can create almost as much trouble for a benefit plan professional as an intentional mistake would.

BY LAUREN BLOOM

Employee benefit plan professionals usually want to serve their employers and clients well. They are normally people of strong integrity who strive to deliver high-quality work to their principals. Typically they are dedicated, diligent experts who recognize that poor behavior or work on their part will reflect badly not only on their own reputations, but on the reputations of their peers and chosen profession.

Also typically, however, they are very busy people. They frequently work long hours, often travel extensively, and may have to juggle the potentially conflicting demands of multiple clients. They sometimes have to deal with employers and clients who are financially unsophisticated, unresponsive, impatient, intransigent or, in the most difficult cases, aggressively litigious. In addition, they may have to rely on other professionals – attorneys, accountants, investment advisors and others – who are uncooperative, discourteous, incompetent, competitive or downright obnoxious. They may be asked to work with outdated, incomplete or inaccurate plan information, or to alter their findings or recommendations to better accommodate a principal's financial needs, personnel objectives or prior representations to regulators. They may even be asked to cover up or lie for a professional colleague, a client or employer, or some other individual associated with a benefit plan.

Perhaps most importantly, employee benefit plan professionals are human. No matter how carefully they work, they may still fall prey to human error, or may be compromised if they fail to appropriately manage someone

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else's mistake. They may be tempted to cut corners when deciding how much time and effort to devote to a particular project. They may inflate their bills or timesheets, create work products that shade or distort the truth, cover up their own mistakes or those of a friend or colleague, or help a plan sponsor evade its legal obligations. Whether deliberately or accidentally, even the best employee benefit plan professional can suffer a lapse of professionalism.

When such a lapse occurs, a number of questions may arise. What went wrong? Why did it happen? Was someone harmed? Did the injured individual(s) contribute to the lapse? Was someone else involved? How bad was the harm, if any? Was the employee benefit plan professional's lapse intentional or inadvertent? And does it even matter?

The answer to the last question may depend on the context in which the employee benefit plan professional's lapse is being examined. Let's imagine, for example, a benefit plan actuary named Leslie who has agreed to calculate the present dollar value of the well-funded employee benefit plan of 2BSold Inc., a company that is about to be acquired by Tightfisted Co.

Leslie's completed analysis overstates the value of 2BSold Inc.'s plan by approximately $25 million. The acquisition is consummated using Leslie's analysis as a factor in 2BSold, Inc.'s purchase price, so Tightfisted Co. has to acquire 2BSold Inc. for $25 million more than the company is worth. Leslie's report is inaccurate, but does it matter if the inaccuracy was accidental or intentional?

Some more facts might be helpful. Let's imagine that Leslie worked as an advisor to the seller, 2BSold Inc.'s owners, and that Leslie conspired with them to deliberately overvalue the plan, effectively helping the owners to defraud Tightfisted Co. and "steal" $25 million. In the unlikely event that criminal charges were brought against 2BSold's former owners, Leslie's intent would be very relevant because, as we've learned from various recent high-profile trials, prosecutors are usually required to prove criminal intent to get a conviction. Leslie might be charged as an accessory to the crime but would likely be found guilty only if prosecutors could prove that she intentionally overvalued the plan.

Next, imagine the more probable situation where Tightfisted Co. discovered the erroneous valuation and filed a civil lawsuit to recover the overpayment. There, Leslie's intent would be less important (especially because the sellers would likely have primary responsibility for refunding the overpayment). If the judge found that Leslie intentionally overvalued the plan, that finding might support a claim for punitive damages against Leslie and the sellers. But for the purposes of the buyers' primary claim to recover the overpayment, it wouldn't matter if Leslie's overvaluation was intentional or merely negligent (i.e., unintentional). Either way, Leslie would likely have to hire a defense attorney and settle in for a long, expensive lawsuit.

What if Leslie's professional organization received a complaint against Leslie (likely from the buyers or another actuary who could recognize Leslie's mistake) about the overvaluation? Leslie's intent would likely be very relevant to how the complaint would likely be resolved. An innocent, unintentional mistake might well result in a minor penalty if any, especially if this was the first complaint the organization had received about Leslie. If, on the other hand, the organization concluded that Leslie intentionally overvalued the plan, Leslie might expect public reprimand, suspension or even expulsion from membership.

These three situations demonstrate that, when a professional lapse may have occurred, the professional's intent is relevant, but not necessarily dispositive. An innocent mistake can create almost as much trouble for the employee benefit plan professional as an intentional mistake would. Still, no employee benefit plan professional should intentionally act unethically. The profession provides its members with clear guidance on conduct, practice and qualification. The wise employee benefit plan professional will refer regularly to that guidance, and will devote adequate attention to preventing professionalism lapses, whether intentional or not. PC

> "Perhaps most importantly, employee benefit plan professionals are human.

Lauren Bloom is an attorney who speaks, writes and consults on business ethics and litigation risk management.

Participant Education: Making the Right Choices

The right mix of tools and technologies can boost both participation rates and a plan sponsor's perception of its plan's value.

BY MICHAEL BILLINGS, CARRIE RIDLER, DAN MORAN & KERRY LOCKART

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Interacting with plan participants influences the way we provide service, ensure understanding and engage active participation in plans. Whether participants require a benefits calculation or need to file a death claim, we appreciate the direct role we fill as plan administrator and recordkeeper. Participant education is our best resource to make sure participants have all the tools they need to be completely satisfied with the plan.

Serving as a recordkeeper for hundreds of plans gives our organization direct insight into some of the most effective participant educational methods and practices. For one thing, not all plan participants have the same educational needs. Furthermore, they understand the information presented with varying levels of interest and comprehension.

We've found that using a variety of participant education tools and technologies – from onsite enrollment meetings and online video guides to contribution calculators and printed worksheets – encourages higher participation rates and improves participants' satisfaction with the plan.

Participants who feel empowered to make smart choices generally have more confidence in the decisions they make, often increasing their contribution amounts. And when participants understand what's available and how contributions benefit them, plan sponsors are more satisfied with their plan metrics and the value of the retirement plan.

STICK WITH PAPER OR GO DIGITAL?

There are several appealing options available to deliver plan participant education materials. Before choosing

> Using a variety of participant education tools and technologies encourages higher participation rates and improves participants' satisfaction with the plan."

the program and delivery method that works best for a particular organization, consider the participant population and any obstacles they may encounter during the educational program.

The best approach to participant education incorporates some flexibility when deciding on the appropriate distribution method and frequency to meet the participation goals of the plan sponsor. This will help tailor the educational program to the participants.

When evaluating participant education methods, consider these questions:

- Are there any technology obstacles? Do all eligible participants have consistent and direct access to a computer if only digital training is offered? Limited access to digital materials may adversely affect participation rates and deferral percentages.
- Are there work-day considerations when scheduling enrollment meetings? For instance, pulling all eligible employees into onsite enrollment meetings may adversely affect production output and cost the company money. Online resources are available 24 hours a day, 7 days a week and can be made available to eligible employees who may be unable to attend an onsite enrollment meeting.
- Do participants require materials delivered in another language? It may be easier to use translated print-format worksheets and factsheets in several languages than creating multiple translations of video segments.
- Do all participants reside in the same geographic location? Or do they need to travel to participate in an onsite educational program? Distribution of printed materials may be more cost-effective when all the participants are in the same location at the same time. Holding multiple meetings at separate locations can increase printing and shipping costs beyond what you planned.

An online digital participant education program can be delivered to participants 24 hours a day no matter where they are. Furthermore, participant education can occur throughout the calendar year instead of being limited to onsite meetings during open enrollment. Digital participant education can also offer insights into who is using the online tools and how the tools affect contribution rates.

We've had good results with the online video education offerings that are available to all plan participants when they visit our online portal. Nearly all new enrollees use these tools to determine their retirement needs and risk profile and then select their contributions.

MATCH THE SPONSOR'S GOALS FOR THE PLAN

Successful deployment of an appropriate participant education program begins with understanding what the plan sponsor wants to accomplish.

Was the plan designed to help recruit and retain the best employees available? The absence of a well-designed 401(k) plan can be an obstacle for well-qualified potential employees. When faced with a choice of employers, potential employees may choose a business that offers a 401(k) plan over one that doesn't.

Do the business owners consider employees to be members of their extended family? If so, these paternal plan sponsors may have designed the plan to ensure that treasured employees have the right resources to provide for their own families, even into retirement.

On the other hand, other plan sponsors may be perfectly satisfied with lower participation rates. (Keep in mind that plans with higher participation rates are subject to a higher employer match, increasing the employer contribution above initially planned investments.) An educational program for these plan sponsors may simply include the distribution of paper materials without much guided participant education.

These are just a few of the scenarios to consider when you're evaluating participant education programs. Selecting the right program helps to ensure success as defined by the plan sponsor's overall goals for the plan. PC

Michael Billings is President of Billings and Company. Carrie Ridler, QKA, is a Senior Processing Analyst at Billings and Company. Dan Moran is a Client Relationship Associate with RHI, and Kerry Lockart is Participant Services Team Lead with RHI. Billings and Company and RHI are affiliate companies of Group RHI, a national leader in retirement services.

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Human Capital Due Diligence in a Merger or Acquisition

Key talent plays a critical role after the transaction. Here's a look at what to ask for and what to look for.

BY RADHIKA PHILIP & DANNY QUANT

In theory, the expectations from a human capital due diligence effort are significant. The due diligence should provide an understanding of the target's workforce and workplace. It must identify, and quantify where possible, payments and investments that impact closing, transition, and ongoing costs. The due diligence is also expected to assess human capital strengths and risks that potentially affect the generation of future value.

With this broad reach, the topics for review in a merger or acquisition include key talent and workforce profiles, capabilities and associated agreements; compensation, benefit plans and liabilities, and HR polices and compliance; organizational design, and even the organizational culture.

In reality, the scope of the review tends to be more constrained. The questions vary – often greatly – based on the transaction specifics[1] and circumstances. If the transaction is competitive and highly confidential, then time and available data may be limited during due diligence. In these instances, the buyer writes conditions into the transaction agreements to protect itself from unanticipated human capital risks and costs, and conducts substantial investigation only after signing. If the transaction is noncompetitive, and the seller is amenable to providing the information requested, the buyer has the privilege of time and access to perform a more thorough due diligence.

This article will focus on three critical key talent topics in due diligence:

- assessing contractual obligations;
- identifying key high-performing talent; and
- designing retention and termination packages.

ASSESS CONTRACTUAL OBLIGATIONS

One of the first things the buyer does during due diligence is to request all individual employee contracts, especially the non-standard or tailored contracts (typically in place for key talent), and evaluate the associated terms and financial obligations. Clauses specifying payments that need to be made with a termination or a change of control are hot buttons because of their potential material impacts. With this, it is important to determine whether the proposed transaction consistitutes a change-of-control event under the employment and transaction agreements.[2]

For key executives, payments to be made with a termination or change of control can be significant, and are accordingly termed "golden parachute" provisions. They can include severance, accrued or deferred incentive payouts that have been earned but not paid, and equity cashouts. They may include accelerated payouts of long-term compensation, defined benefit payments, accelerated retirement payouts, continued access to post-employment medical plans, and, in some instances, lifetime health care commitments. Some individual contracts may commit to a duration of employment, with compensation to be provided through the end of the term, even if the employee is terminated prior to term completion. There may be obligatory outplacement costs, and expatriates may have housing, school fees, relocation and other extraordinary costs to be settled.

The buyer needs to assess the cost impacts of such employee contractual obligations irrespective of whether these obligations are to be assumed by the buyer in the go-forward entity or paid out with the change of control or termination. The buyer also needs to determine the extent to which funds to cover these obligations have been accrued on the seller's balance sheet and calculate payments to be made (at closing or at specified events) to close funding gaps. These amounts – whether they are to be paid into the organizational balance sheet, or to the individual – can be a material input in price negotiations.

Going forward, the ideal is to replace employee contracts with at-will employment. The reality, however, is that to retain key talent it may be necessary to continue with select employee contracts and related provisions. Where possible, though, the buyer should identify how to limit the scale and scope of such contracts.

> "Due diligence is often conducted in competitive and confidential contexts, when the information provided is limited and the timeframe compressed.

IDENTIFY KEY HIGH-PERFORMING TALENT

Key talent tend to make disproportionate contributions to the organization's value. Hence, a primary due diligence objective is to understand the key talent profile – who they are, what they are responsible for, their capabilities and their contributions. The buyer then applies this understanding to the transaction strategy to determine who is essential to continue with the go-forward entity, and who might not be as critical.

How does one identify key high-performing talent? Start with individuals who have tailored, non-standard employment contracts, assuming that the existence of a contract implies that the individual makes a notable contribution. Augment this list with leaders who may not have employment contracts (the top two levels below the CEO in the organizational chart is a useful rule of thumb), and senior individuals in core value-creating functions, which will vary by industry. Collect additional data to refine the list: research publicly availabile information on key talent, and request job descriptions and records of key contributions – for example, reports on sales and key account relationships by individual. Inspect individual total compensation and incentive compensation, which are useful proxies for value created. Consider market competition for critical capabilities, as well as retirement age, to assess potential flight and retirement risks.[3]

With the information that you now have at hand, conduct exploratory discussions with the seller to answer open questions about individual capabilities, contributions and retention risks.

At this point, you are ready to prepare a tiered list of individuals with commentary on the risk to organizational value upon their departure, and any insights on retention risk.[4] Analyze this list in light of the resources and capabilities that you think are necessary to realize the deal strategy and determine who should be earmarked for potential retention or termination packages.[5]

DESIGN RETENTION AND TERMINATION PACKAGES

The financial retention package[6] typically offers a series of structured payouts made at intervals post-close, portions of which are tied to performance. The retention incentive can be offered in conjunction with total rewards. The buyer may revise the legacy reward components and associated weights to align with the deal strategy and reward philosophy, keeping the overall package the same or better.

The retention award also has a nonfinancial aspect, focused on role scope and growth. This can be a gray area to navigate. In the case of a merger or partial integration, the future organizational design is probably not in place, so one cannot reasonably commit to a certain position. Perhaps more importantly, the buyer may not have sufficient knowledge of the key talent bench during due diligence, making it difficult to assign them to roles in the go-forward entity. It is in the period between signing and close – and more so, in the months after close – that the buyer learns about key talent capabilities. At that point, the buyer has had better access to information about historical individual performance, and likely interacted with many through the transaction and transition processes. Only at this point is it realistic or feasible to map individuals to roles in the go-forward entity. With this in mind, it is advisable to build in elbow room when communicating role scope in key talent retention packages, if such commitments are needed prior to signing.

When it comes to employee terminations, they generally occur post-close,[7] but it is necessary to record anticipated key talent termination costs as part of the deal closing and transition costs. For individuals with contracts, follow contractually based severance commitments, when such contracts are assumed by the buyer. For individuals without contracts, turn to severance practice (used by the buyer or seller), or develop severance formulae for the transaction.

CONCLUSION

Due diligence is often conducted in competitive and confidential contexts, when the information provided is limited and the timeframe compressed. In these instances, clearly specify key talent unknowns and risks in the due diligence report, and state qualitative conditions (when the quantitative analysis cannot be completed because the information received is insufficient) in the relevant transaction agreements.[8] Ideally, these conditions are met before signing, but if that does not happen, write in the necessary language for price adjustments for the close. Key talent contractual obligations as well as retention and termination agreements can be sensitive and contentious topics, with real material impacts to transaction negotiations and price. PC

Radhika Philip is Managing Director of HR Transformation and People Strategies at Milliman; she can be reached at Radhika.philip@milliman.com.

Danny Quant is a Principal and Consulting Actuary; he can be reached at danny.quant@milliman.com.

FOOTNOTES

1. The human capital questions are informed by: a) the transaction financial structure (for example: full or partial investment; asset or stock purchase); b) the transaction type (for example, merger, partial integration, joint venture, or a spin-off); c) the transaction strategy components (for example: goals related to growth, integration, transformation, cost takeout), and d) the target's scale and complexity. It is necessary to tailor the due diligence information request to issues critical to the particular transaction and circumstance.
2. Note that a transaction may not trigger a change of control. In some instances, the obligations of the employment agreements are simply assigned to and assumed by the buyer. If the transaction is in fact a change of control event the conditions that trigger payments will need to be assessed. For example, some payments may be triggered immediately upon a change of control, and others are payable only upon the occurrence of additional events.
3. Review year-to-date (YTD) data and the last two years of the employee census file or payroll run to obtain insights into compensation and demographic parameters.
4. For example, if the transaction triggers a golden parachute, the individual may choose to leave.
5. There are a number of reasons why an individual ends up on the termination list. It might be a matter of role duplication in the case of a merger or need to realize cost synergy targets. Or an individual may simply not be a good fit with the capabilities and culture required to realize deal value. Sometimes an individual makes a termination list because that person's reward costs are significantly more than the buyer thinks worthwhile.
6. There will be differences in retention incentives offered. For example, individuals critical to driving the deal strategy will likely have stronger retention packages than those who are needed primarily to facilitate the transition for a period of time post-close.
7. In instances when the buyer wants to terminate one or more individuals pre-close, raise and negotiate such terminations with the seller, and offer associated adjustments to the purchase price, and indemnifications.
8. These agreements can include access to requested key talent information, commitments to pay or share payment of accrued and unfunded liabilities, retention, and termination payments.

BY WILL HANSEN

There's No Such Thing as a Stupid Question

Here's how you can play an important role in the SECURE Act's regulatory process.

After years of moving through the legislative process, the Setting Every Community Up for Retirement Enhancement (SECURE) Act was signed into law by President Trump on Dec. 20, 2019.

But that was just the beginning. Now that the legislative process is complete, we can move on to the next phase: regulations.

Many of the law's 25-plus provisions require regulatory guidance from either the Department of Labor or IRS, and it will take several years to complete all of the regulatory projects. The American Retirement Association (ARA) will be actively involved every step of the way.

As a first step, ARA submitted letters to the appropriate federal agencies that identified the sections of the SECURE Act that our members believe require guidance in order to be implemented properly. Those letters ranked in order of importance the guidance that should be released by the federal agencies.

In addition, we asked that the agencies provide relief from plan disqualification and penalties if a plan reasonably relies on the legislative language prior to the release of further guidance. Keep in mind that several provisions were effective immediately or at the start of the 2020 plan year.

Those letters were only the first step. We will need help from ASPPA members (as well as members of all the ARA sister organizations) as we move forward with the regulatory process.

What can you do to help? Ask questions! As ASPPA members review the provisions contained in the SECURE Act and ask the difficult questions, more conversations will arise on potential issues with implementing the various provisions. For example, if a plan sponsor is claiming the new credit for plan startup costs, when does the three-year time period commence – the year the plan is adopted or the year the expense is incurred (which could be the year after plan adoption)?

> "Your assistance will be immensely important over the coming years in helping to shape the new law."

That's just one of hundreds of questions that will be raised over the coming months. These questions will play an important role as the Government Affairs team drafts comment letters and other content for the federal agencies to consider as they develop guidance. So I encourage you to contact me or anyone on the team with your questions regarding the SECURE Act.

Besides the submission of questions, we also need boots-on-the-ground examples of issues that arise as you implement SECURE Act provisions. As we draft comment letters for the federal agencies, we will include examples that regulators can use in their guidance documents.

In addition to reaching out to the Government Affairs team with your questions and examples, you can also join one of the many Government Affairs Committees that hold monthly virtual meetings to discuss important retirement public policies. You can volunteer for a committee by visiting www.araadvocacy.org. As a member of one of these committees, you will be at the forefront of the regulatory process.

The SECURE Act is the most important retirement legislation enacted since the Pension Protection Act of 2006. Your assistance, whether it is by providing questions and examples, or by joining a committee, will be immensely important over the coming years in helping to shape the new law. I look forward to hearing from you! PC

Will Hansen is the American Retirement Association's Chief Government Affairs Officer.