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PLAN CONSULTANT

SUMMER 2019

ARE RETIREMENT INCOME PROJECTIONS WORTHWHILE?

3(16) services and the pitfalls of payroll

DOL's 12 tips for monitoring service providors

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And Now for Something Completely Different

Think the retirement saving system is failing our retirees? Think again.

It often seems that the preponderance of news and metrics related to retirement security tends toward the gloom-and-doom stuff. How about some good news about retirement security for a change?

In mid-May, the House Budget Committee held a hearing that featured a lively debate on that topic. Among the experts who testified was Andrew Biggs, Resident Scholar at the American Enterprise Institute, whose testimony centered on "facts, figures and ideas with which Members of Congress may not be familiar" – some of which would be "surprising and contrary to what you believe or have read," he said.

I don't believe much of what I read, and I read a lot – and I have to say I found most of Biggs' "facts, figures and ideas" both unfamiliar and contrary to what I believed. Maybe you will too. Here's a selection of the most encouraging ones.

People are saving more than ever. "The news media rarely mention it, but Americans today are putting aside a substantially larger share of their paychecks toward retirement than ever before," says Biggs. He cites data from the National Income and Product Accounts that in 1984, combined employer and employee contributions to workplace retirement plans stood at 9.9% and rose to 12.8% in 2017.

Retirement savings are higher than they have ever been. Biggs cites Federal Reserve data showing that retirement savings were equivalent to 48% of total employee wages in 1975, "at the peak of worker coverage in traditional pension plans," but were seven times higher in 2017 and amounted to more than 337% of employee wages.

Retirees say that they're doing fine. A strong majority of retirees – 80% – told Gallup that they have sufficient funds to "live comfortably" and not just survive, reports Biggs. He cites other figures as well: 78% of retirees in a study by Health and Retirement say their retirement is as good or better than in previous years, and 75% of Americans age 65 or older told the Federal Reserve in its 2016 Survey of Consumer Finances that they have at least enough income to maintain their standard of living.

The poverty rate for retirees is falling. Biggs cites a 2017 U.S. Census Bureau analysis of IRS tax data which found that in 1990, 9.7% of retirees had income under the poverty threshold; in 2012, 6.7% did. He adds that the Social Security Administration's Model of Income in the Near Term projects that trend will continue.

The typical retiree has a pre-retirement income replacement rate better than what financial planners recommend. Biggs cites a variety of data showing that retirees are exceeding the 70% replacement rate that financial planners say will allow retirees to maintain their standard of living after retirement. To wit:

- IRS data says retirees now "typically have incomes equal to 90% of their average pre-retirement earnings";
- the Investment Company Institute and the IRS, in 2017 research, found that the average middle income retiree household earned 113% of its spendable income just before retirement; and
- in 2017, two Census Bureau economists found a median replacement rate of 94% of earnings in the 15 years before retirement.

Seniors' out-of-pocket health spending is not eating that much more of their incomes. Out-of-pocket health expenses have increased, Biggs observes, but he argues that retirees' incomes on average have been growing faster. While this doesn't mean that retirees have no problems funding health care expenses, Biggs says, "the fact that average incomes have risen as quickly as the average retiree's health expenses says that the retirement saving system is doing its job well."

Just thought I'd share.

Hat tip to ASPPA Connect managing editor John Iekel for reporting on Biggs' testimony.

Questions, comments, bright ideas? Email me at jortman@usaretirement.org.

JOHN ORTMAN
EDITOR-IN-CHIEF

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BY JIM NOLAN

More on the Three E's and a V

What's the most important element of ASPPA's education and advocacy efforts?

As the spring comes to an end for much of the country and summer beckons, we find that ASPPA's precepts of "education, education, education, and volunteerism" – the three E's and a V – are on full display.

I opened the *ASPPA Connect* e-newsletter this week to find that the House Ways & Means committee unveiled a bill called the Setting Every Community Up for Retirement Enhancement (SECURE) Act. The SECURE Act pulls from a number of bipartisan bills introduced over the last several years, including RESA, the Family Savings Act, and the Retirement Plan Savings and Simplification Act. ASPPA and ARA have worked closely with the authors of all of these bills to help them be as constructive as possible for, and to, the private retirement plan system. Both organizations work continually with members of Congress and their staffs on both sides of the aisle to accomplish this goal.

In June, ASPPA and ARA volunteers and staff are scheduled to meet with DOL and IRS regulators over 2 days to discuss ongoing regulatory projects in hopes of conveying the industry perspective on these projects.

The above illustrates the first "E" – educating our representative government on the effects of legislation and regulation on the private retirement plan system.

In March, ASPPA President-elect Missy Matrangola and I attended one of many, many meetings of volunteers and staff forming the committee that is supervising and creating the agenda for the 2019 ASPPA Annual Conference on October 20-23. First, let me say it was a great meeting! Secondly, this represents one of the ways (along with the LA Advanced Pension & 401(k) Conference meeting in January, the Eastern Regional Conference in Philadelphia in April, and the Cincinnati Regional Conference in November) that ASPPA and ARA take the knowledge of the laws and regulations passed by our representatives and regulators and convey this content to ASPPA members.

It addition, we have on-demand CE presentations available online. ASPPA is continuingly upgrading our examination and education content. Each of those education offerings requires countless hours of volunteer and staff time.

These are just some of the ways in which ASPPA and ARA accomplish the second "E" – education of the membership.

Last, but absolutely not least, we – the membership – educate other business advisors, our clients, and participants on how to work their way through all of the rules, regulations and laws that surround retirement and financial planning. This would be impossible without the contributions of ASPPA members, who are vital to the process of ensuring that plan sponsors comply with the dictates of those laws and regulations.

You will note my use of the word **VOLUNTEER** quite a bit in this column. ASPPA and ARA cannot accomplish the work without volunteers. I call on any of you who wish to help in this vitally important process – please contact us so that we can place you in the appropriate volunteer activity.

That's all for this quarter. More on these subjects in the fall. PC

> "ASPPA is continuingly upgrading our examination and education content; each of our education offerings requires countless hours of volunteer and staff time."

James R. Nolan, QPA, is CEO of The Nolan Company, a Division of T Bank, NA, a TPA providing recordkeeping, administration, actuarial and plan design services in 50 states. He serves as ASPPA's 2019 President.

BY BRIAN H. GRAFF

A Story to Tell

We make a difference in people's lives every day. Let's start sharing *those* stories.

As the HBO series Game of Thrones recently wound to the close of its eight-season run, Tyrion Lannister, who had experienced plenty of the best and worst that world had to offer, and looking back on that history and the mistakes he and others had made, posed a question with regard to choosing a way forward. "What unites people?" he asked. "Armies? Gold? Flags?"

And then he answered his own question: "Stories. There's nothing in the world more powerful than a good story. Nothing can stop it. No enemy can defeat it."

While it's nearly 18 months away, we are well into the 2020 election cycle. Earlier this year, several Democratic presidential aspirants in Congress lined up behind the "Wall Street Tax Act," a bill that would actually take a big slice out of middle-class American workers' savings, as it imposed a tax on every purchase or sale of a stock, bond or derivative, including those held by mutual funds and collective investment trusts in retirement plans. A tax that, the Investment Company Institute estimated, would increase equity fund expense ratios by 31%.

Subsequently, some of those same presidential aspirants introduced the "Inclusive Prosperity Act," yet another financial transaction tax that would also take a cut from retirement plan contribution investments. It seems that Washington needs to be reminded not only that the 401(k) is where America saves – it's where they invest as well.

Those storm clouds notwithstanding, as we head to press, there are signs of hope on the horizon. Sens. Portman and Cardin have recently reintroduced bipartisan legislation they first unveiled in the last Congress. The Retirement Security & Savings Act includes a broad set of reforms and contains more than 50 provisions designed to strengthen Americans' retirement security, including a new automatic safe harbor, increased catch-up contribution limits for older workers, help with student loan debt, an expanded Saver's Credit, and a number of enhancements designed to encourage small business plan start-ups.

As we head to press, the House of Representatives has just passed the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 – the most significant piece of retirement plan legislation in more than a decade – by an incredible 471-3 margin, and the Senate is awaiting its turn to weigh in.

The American Retirement Association and its members have championed the key provisions in both bills. We were very engaged in helping ensure that the proposed expansion of "open" MEPs included protections for participants and plan sponsors, in line with current IRS and Labor Department guidelines. Just ahead of the SECURE Act vote, members were given the opportunity to correspond with your representatives in Congress, and hundreds did. Your efforts – and your voice(s) – matter.

On the regulatory front, in a major victory for the advocacy efforts of the American Retirement Association, the IRS in April expanded its Employee Plans Compliance Resolution System (EPCRS) self-correction program (SCP). (For more on this, see page 10.) The ability to use the expanded SCP will be particularly beneficial to the sponsors of smaller plans who will, as a result, now be able to correct a broader array of mistakes without having to actually file with the IRS and pay a user fee. While not all the ARA recommendations were adopted, Rev. Proc. 2019-19 is a great start – and a testament to the hard work of the Government Affairs Committee over an extended period, and the willingness of the staff at the IRS to take your perspectives into account.

Let's not forget, however, that it took a hard-fought battle over a number of years – and several Congresses – to get this far. Each election brings new faces to Capitol Hill, and while there is always the opportunity for a fresh perspective, in many respects your Government Affairs team has to start over – providing background, explaining the often unanticipated consequences, and emphasizing the crucial difference that retirement plan access makes in helping American workers prepare for a financially secure retirement. In recent weeks, for example, the Government Affairs staff has conducted a series of information sessions for Capitol Hill staff. Not only have they been very well received (and attended), we fully expect these sessions to pay dividends for our advocacy efforts in the future.

We have a great story to tell: We help people save. We make a difference in people's lives every single day. It's time we started sharing *those* stories. PC

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

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QKA SCHOLARSHIP PROGRAM APPLICATION OPENS JULY 1

PenChecks Trust Company of America and **ASPPA** are pleased to offer the sixth annual QKA Scholarship Program for ASPPA's Qualified 401(k) Administrator (QKA) credential program.

The 2019 PenChecks Trust ASPPA QKA Scholarship will be awarded to six individuals who make the most compelling case for how the prestigious QKA designation will enhance their career in the retirement plan industry. The scholarship is valued at $2,300, which will cover the expenses associated with course registration and materials necessary to attain the QKA credential. This year's recipients will be announced at the **2019 ASPPA Annual Conference, October 20-23** in National Harbor, MD.

"PenChecks is proud to expand its partnership with and support ASPPA's educational programs because we believe that highly motivated and well trained professionals are essential to sustaining excellence across the retirement industry. Over the last three years, we've seen a significant increase in the number of applicants, reinforcing our belief that developing qualified industry ambassadors will lead to continued industry innovation and thought leadership — areas in which PenChecks believes deeply."

— Peter Preovolos, CEO of PenChecks Trust

APPLICATIONS FOR THIS YEAR'S SCHOLARSHIP OPEN ON JULY 1 AND ARE DUE NO LATER THAN SEPT. 20.
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IRS Expands EPCRS' Self-Correction Program

In a big win for the ARA's advocacy efforts, Rev. Proc. 2019-19 looks to be a great start in helping plan sponsors and practitioners more efficiently address potential compliance issues.

BY NEVIN E. ADAMS, JD AND JOHN IEKEL

In a major victory stemming in part from the advocacy efforts of the American Retirement Association, the IRS has expanded the self-correction program (SCP) under its Employee Plans Compliance Resolution System.

Effective April 19, 2019, the expansion announced in Rev. Proc. 2019-19:

- allows the SCP to be used to resolve certain plan document failures;
- creates additional correction options;
- makes it possible for there to be relief from deemed distributions associated with specified failures involving plan loans made to participants; and
- provides additional opportunities for correcting certain operational failures by plan amendment.

Moreover, the expansion of the SCP to accommodate a number of issues common among smaller plans may well mute some of the negative financial impact of changes in the VCP fee structure that disproportionately affected smaller plans. The IRS claims that the fee structure shift better reflected the average time spent on those cases.

2018 ARA COMMENT LETTER

In April 2018, the American Retirement Association submitted a comment letter to the IRS recommending modifications to EPCRS that would expand the use of the SCP and reduce the burden imposed on small business plans by the new pricing structure that the IRS had put in place for the Voluntary Compliance Program (VCP).

While not all the ARA recommendations in the comment letter were adopted, Rev. Proc. 2019-19 looks to be a great start to help plan sponsors and practitioners more efficiently address potential compliance issues. "This is a

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> “In some MEPs – most often an Association MEP – an oversight board is appointed from among the participating employers.”

big win for retirement plan practitioners and plan sponsors alike,” noted Craig Hoffman of Trucker Huss, who led ARA’s advocacy on the issues addressed in Rev. Proc. 2019-19 when he was ARA’s General Counsel. “The ability to use the expanded SCP will be particularly beneficial to the sponsors of smaller plans who will, as a result, now be able to correct a broader array of mistakes without having to actually file with the IRS and pay a user fee. This result is a testament to the hard work of the Government Affairs Committee at ARA over an extended period, and the willingness of the staff at the IRS to take those perspectives into account.”

MORE DETAILS

The update that Rev. Proc. 2019-19 makes is a limited update and primarily expands the application of the SCP to permit correction of certain plan document failures and specific plan loan failures, as well as to provide an additional method of correcting operational failures by plan amendment under the SCP. The changes include:

New rules for correcting by plan amendment under the SCP. Rev. Proc. 2019-19 adds new rules for correcting operational failures by plan amendment under the SCP. Now such failures may be corrected by plan amendment under the SCP if three conditions are satisfied:

1. the plan amendment would result in an increase of a benefit, right, or feature;
2. the increase in the benefit, right or feature is available to all eligible employees; and
3. increase in the benefit, right or feature is permitted under the Internal Revenue Code and satisfies the correction principles of section 6.02 of Rev. Proc. 2018-52.

SCP is now available to correct certain plan loan failures. Rev. Proc. 2019-19 permits certain plan loan failures to be corrected under the SCP. The revenue procedure also provides that errors relating to the failure to repay a plan loan according to plan terms (a defaulted loan) may be corrected under the SCP. The correction methods for a defaulted loan are the same as those provided under Rev. Proc. 2018-52; i.e., permitting correction by either a single-sum repayment, re-amortization of the outstanding loan balance, or a combination of the two.

Reporting of deemed distributions. Section 6.07(2) of Rev. Proc. 2019-19 eliminates the requirement that reporting relief must be requested in order to report the deemed distribution in the year of correction.

Plan loan statutory failures. Section 6.07(3)(b) and (c) provides that failures related to two types of plan loans may be corrected only under VCP or the IRS Audit Closing Agreement Program (“Audit CAP”):

- plan loans that are made in excess of the loan limits under Code Section 72(p)(2)(A); or
- plan terms that do not meet the requirements of Section 72(p)(2)(B) or (C).

Failure to obtain spousal consent for a plan loan. Section 6.07(4) of Rev. Proc. 2019-19 provides a new correction method for failure to obtain spousal consent for a plan loan. Under the new correction method, the plan sponsor must notify the affected participant and spouse so that the spouse can provide spousal consent. If spousal consent is not obtained, section 6.07(4)(b) provides that the failure must be corrected using either VCP or the Audit CAP.

Expanding SCP to correct certain plan loan failures by plan amendment. Section 6.07(5) of Rev. Proc. 2019-19 provides that a plan sponsor may correct a failure resulting from granting a number of plan loans that exceeds the number of loans permitted under a plan. It may do so by adopting a plan amendment in accordance with the correction by plan amendment methods set forth in Rev. Proc. 2019-19’s Appendix B, section 2.07(3).

Number of plan loans. New section 2.07(3) of Appendix B adds a new correction method for plan loans when the number of plan loans exceeds the number permitted under the plan, in addition to the current correction method relating to the failure of granting plan loans to a participant under a plan that does not permit plan loans. Under section 2.07(3), the plan sponsor may correct by plan amendment if:

1. the amendment satisfies Code Section 401(a);
2. the plan as amended would have satisfied the qualification requirements of Section 401(a) (and the requirements applicable to plan loans under Code Section 72(p)) had the amendment been adopted and effective when plan loans were first made available; and
3. plan loans (including plan loans that exceed the number permitted under the terms of the plan) were available to either all participants, or solely to one or more participants who were non-highly compensated employees. PC

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How to Roll Over Participant Loan Notes

Coordination and communication – especially by the recordkeepers – is crucial to implementing a loan note rollover effectively.

BY PAUL R. HINDEREGGER

Participant loans are very common in qualified retirement plans, both in terms of the number of plans that permit loans and the percentage of participants who have an outstanding loan.[1]

Generally, if a participant with a loan has a severance from employment, the loan becomes due and payable. Many participants do not have the ability to repay such loans and the loan is offset, thus causing the participant to incur taxation (and if applicable, a 10% early distribution penalty) on the outstanding loan amount.[2]

These adverse tax consequences are especially painful in situations where the severance from employment is the result of an employer-initiated event such as a corporate divestiture where the participant had no control over the timing of the severance. Luckily, there is a solution that would avoid the loan becoming a taxable distribution and would permit the loan to be continued in another retirement plan. This

technique is often referred to as a loan rollover.

The loan rollover technique may be utilized in any situation where an employee has a severance from employment that causes them to cease to be eligible for one plan and become eligible for another. However, since the majority of loan rollovers occur due to a corporate acquisition (usually an asset acquisition), this article will focus on the dynamics associated with loan rollovers in an acquisition situation.

WHAT IS A LOAN ROLLOVER?

A loan rollover is a distribution of the loan note from the seller's retirement plan followed by a direct rollover into a buyer's retirement plan. This technique may also be called a "loan note rollover" to clarify that the loan note from the seller's plan is continued in the buyer's plan.

It is equally important to understand what a loan rollover is not. A loan rollover is not a transfer of assets and liabilities pursuant to Code Section 414(l). Plan sponsors and the TPAs and recordkeepers involved in facilitating the loan rollover need to understand the difference between a 414(l) transfer and a loan rollover in order to ensure that the appropriate procedures are followed.

Neither ERISA nor the Internal Revenue Code directly address loan rollovers. However, a participant loan note is generally considered to be an eligible rollover distribution under Code Section 402(c)(4) and as such, may be part of a direct rollover from one plan to another.[3]

The most common situation that triggers a loan rollover is a corporate acquisition. For example, suppose that on July 1, 2019, some of the assets of Alpha Corporation ("Seller") are sold to Beta Corporation ("Buyer"). The asset acquisition results in 100 employees transferring employment from Alpha Corporation to Beta Corporation on July 1, 2019. Of the 100 employees, 20 of them have loans in the Alpha Corporation 401(k) plan, the terms of which require that participant loans are due and payable upon a severance from employment. It is possible for Alpha Corporation and Beta Corporation, along with their respective recordkeepers, to facilitate a rollover of the loan notes from the Alpha plan to the Beta plan.

WILLIAM POTTER / SHUTTERSTOCK.COM

ROLE OF THE SELLER AND ITS RECORDKEEPER

The Seller and the its recordkeeper will largely dictate the timing of the loan rollover and control the participant experience. Some of the responsibilities of the Seller and its recordkeeper include:

- Providing the affected participants with the forms and procedures for electing the loan rollover. The Seller's recordkeeper will likely require the affected participants to complete a distribution election application in order to satisfy the IRS notice and consent rules.[4] Special handling may be required to ensure that loans are not offset during the distribution processing.
- Issuing a Form 1099-R for the direct rollover distribution of the entire account balance.
- Ensuring that the Seller's plan document permits distribution of property (in-kind).
- Providing the Buyer's recordkeeper with data on the loan notes being rolled over (i.e., origination date, interest rate, term of loan, amortization schedule, etc.). It is advisable that the Seller's recordkeeper and Buyer's recordkeeper establish any data file layout requirement so that there is no delay in processing the loan rollovers into the Buyer's plan.
- Wiring the non-loan account balances to the Buyer's recordkeeper. Typically, the Seller's recordkeeper will require the participant to roll over both their loan and non-loan account balances to the Buyer's plan in order to simplify the distribution process. However, if the number of participants involved is low, it may be possible to issue individual distribution checks rather than a wire transfer.

It is important to keep in mind that not all participants with loans in the Seller's plan will participate in the loan rollover. Some of the participants may have a small loan balance in the Seller's plan that the participant can pay off. Alternatively, the participant may not want to continue the loan in the Buyer's plan and will accept the tax consequences of the loan offset.

ROLE OF THE BUYER AND THE BUYER'S RECORDKEEPER

The Buyer and its recordkeeper are responsible for:

- Ensuring that the Buyer's plan document permits property (in-kind) loan note rollovers.
- Setting up the loans in the Buyer's plan. If the payroll frequency of the Buyer is different than that of the Seller (e.g., the Buyer has a weekly payroll and the Seller has a biweekly payroll), then it may be necessary to re-amortize the loans using the payroll frequency for the Buyer. This will change the participant's per-paycheck loan deduction amount and the new payment amounts will need to be communicated to the Buyer.
- Having the participants complete any of the Buyer's forms or applications that apply to participants making rollover contributions from other retirement plans.
- Documenting the change in obligee on the loan notes from the Buyer to the Seller.
- Ensuring that any unpaid loan payments do not exceed the last day of the calendar quarter following the calendar quarter in which the missed payment was due (a.k.a. the "cure period").[5]
- Establishing payroll deduction of the loans in the Buyer's payroll going forward.

NUMBER OF LOANS

If the Seller's plan permits more loans than the Buyer's plan (e.g., the

> It is important to keep in mind that not all participants with loans in the Seller's plan will participate in the loan rollover."

Seller's plan permits two loans but the Buyer's plan only permits one), then the Buyer may want to consider amending their plan document (or loan program) to permit more than one loan outstanding.

To the extent that the Buyer's plan is not amended to permit more than one loan, then participants who have multiple loans in the Seller's plan will need to pick which loan in the Seller's Plan is being rolled over to the Buyer's plan. The loan that is not selected to be rolled over to the Buyer's plan will need to be repaid by the participant, otherwise the loan may be offset.

TO ROTH OR NOT TO ROTH

If the Seller's plan permits Roth 401(k) contributions but the Buyer's plan does not, it would not be possible for the Buyer's plan to accept a loan rollover attributable to a Roth 401(k).[6] In such situations, the Buyer will need to decide whether it makes sense to add Roth 401(k) contribution provisions to the Buyer's plan. The other option is to accept loan rollovers only from those participants whose account balances consists entirely of non-Roth amounts. However, this essentially penalizes those participants who made Roth 401(k) contributions in the Seller's plan.

MIND THE GAP

A loan rollover will almost certainly involve a "gap period" under which no payroll deduction of loan payments will be made to the loan. As such, it is recommended that arrangements be made to facilitate loan repayments to the Seller's plan during the gap period. For example, the participants may be able to make loan repayments directly to the Seller's plan or the Buyer may be able to withhold loan repayments and send them to the Seller's plan.

Alternatively, it may be possible for the loans to be re-amortized at the time they are set up in the Buyer's Plan or for participants to make up the missed payments once payroll deduction of loan payments begins by the Buyer.

KEYS TO SUCCESS

The acquired participants often experience a lot of anxiety and confusion working for their new employer. In addition to adjusting to a new employer, they will also need to make a decision regarding their retirement savings in a short period of time. As such, proper communication to the affected participants is critical in ensuring that the participant does not incur any unexpected tax consequences.

Additionally, the Buyer and Seller and their recordkeepers may benefit from a conference call to discuss the loan rollover project and begin identifying roles and responsibilities. Then, a project plan with specific dates to which all parties can agree can be established.

CONCLUSION

The loan rollover technique can be an effective way to roll over loan notes from one plan to another in order to avoid adverse tax consequences for participants. However, the technique may not fully be understood by all stakeholders (i.e., the Buyer, the Seller, the Buyer's recordkeeper, the Seller's recordkeeper and the participant), so proper coordination and communication among all parties is crucial to implementing a loan note rollover effectively. PC

Paul R. Hinderegger, CPA, QPA, CPC, is the Director of ERISA Consulting for Schwab Retirement Plan Services, Inc. He has been involved in retirement plan compliance, consulting and administration with Schwab for the past 24 years.

FOOTNOTES

1. According to EBRI/ICI, 19% of participants have a loan and the average outstanding loan balance is $7,907; Jack VanDerhei, Sarah Holden, Luis Alonso, and Steven Bass. "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2016." EBRI Issue Brief, no. 458, and ICI Research Perspective, Vol. 24, no. 6 (September 2018).
2. IRC §402(a); IRC §72(t).
3. Private Letter Rulings 9729042 and 9617046.
4. IRC §411(a)(11); IRC §417 and IRC §402(f).
5. Treasury Regulation §1.72(p)-1, Q&A-10(a).
6. Treasury Regulation §1.402A-1, Q&A-1.

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The Plan Sponsor Wants the Plan to Pay for *What*?

Which expenses may be paid from plan assets, and which may not?

BY PHILLIP LONG

Plan expenses paid with ERISA assets are under close examination from participants and regulators, particularly since ERISA requires prudent use of plan assets and regulations require clear disclosure of expenses.

For some plans, the employer pays almost all plan expenses,[1] simplifying the fiduciary and disclosure considerations. However, some employers seek payment by the plan for as many expenses as possible. Could these expenses include those "intrinsic" to the employer, such as employee salaries, printing, computer costs and similar expenses? The employer may have some recourse from the plan, but there are complex legal requirements to navigate carefully to avoid scrutiny. This article explores some of the issues an employer must consider before seeking payment for such expenses.

FIRST, KNOW THE FUNDAMENTALS

Before using any plan assets for an expense, the employer must ensure that the expense meets the fundamental requirements for payment of expenses with plan assets under ERISA and the Internal Revenue Code. Those requirements include:

- The plan's written terms must not forbid the use of plan assets for expenses.[2]
- Participant-directed plans must disclose expenses paid from plan assets in accordance with ERISA Reg. § 2550.404a-5.
- The expense and its underlying arrangement must be necessary, reasonable, and in the best interest of the plan and its participants.[3] This determination is fact specific.
- The expense must relate to the plan's maintenance and not to a "settlor" function. That is, the expense must be for the plan's "exclusive benefit" and must not relate to a plan design decision or a decision that primarily benefits the employer. For example, expenses for a study examining profit-sharing formulas are settlor expenses and may not be paid with plan assets.[4]
- Paying the expense is not a prohibited transaction. (For employer expenses, this is addressed below.)

COULD EMPLOYER COSTS BE A PROPER PLAN EXPENSE?

Most plan sponsors do not run all parts of the retirement plan themselves. Instead, they outsource much of the work done for a plan, such as engaging corporate trustees, investment managers, recordkeepers and third-party administrators. Expenses pertaining to this outsourcing may be payable with plan assets. Even with outsourcing, a plan sponsor will almost always incur some costs with the plan, because its decision makers and HR department will likely be involved with implementing plan decisions – involvement that will involve some cost to the sponsor in terms of overhead, employee time, materials (such as paper and printing) and similar costs.

ERISA § 408(c)(2) states that the prohibited-transaction rules do not necessarily forbid a fiduciary, like a plan sponsor, employer, retirement plan committee or plan administrator, from having its direct expenses incurred in providing services paid with plan assets. The key is that the expenses must be direct, which does not include overhead or any expense that the employer would have incurred even without the plan.[5]

This second requirement is a "but for" test: the employer's expense may be paid by the plan if the expense is only occurred because of (or "but for") the plan. For example, a direct expense could be non-overhead printing costs for distributing the annual fee disclosure notice to participants. However, the expense also must meet the fundamental requirements listed above, such as being reasonable and disclosed in accordance with ERISA.

Justifying payment for discrete costs, like printing and mailing,[6] may be easier than justifying payment for employee salaries. How does an employer establish that the non-overhead employee salary was incurred only but for the plan? The U.S. Department of Labor has stated

> "Using an independent fiduciary, with full disclosure of the fees to be paid and the conflicts that exist, to make the decision may help eliminate any self-dealing issues."

that, "compensation paid by a service provider to its employees, including employees who exercise discretion regarding plan investments, may be a properly reimbursable expense under 29 C.F.R. § 2550.408c-2(b)(3) if the expense would not, in fact, have been sustained had the services not been provided, if it can be properly allocated to the particular services provided, and if the expense does not represent an allocable portion of overhead costs."[7] Essentially, these requirements are:

- meeting the "but for" test;
- having records of a prudent method of expense allocation; and
- not charging for overhead expenses.

If an employee spends all of his or her time on the plan, then documentation and analysis may more easily justify payment from plan assets compared with an employee who spends little time on the plan. If the employee spends time on different plans (e.g., retirement plans and welfare plans) of the employer, then the employee must allocate the time among the plans.

If audited by the DOL, the employer would need to justify that the employee's pay met the conditions above. Justification may come by way of careful, written recordkeeping, an independent fiduciary approving the arrangement, an opinion letter from the DOL, or an independent consultant comparing the overall benefit of the employer providing service versus a third party providing the same service. However, to the extent the employee is a fiduciary, the employee cannot receive full-time pay from the employer and also receive salary from the plan.[8]

Even if allowable, payment of the expense must not run afoul of ERISA's self-dealing prohibitions. A fiduciary must not use his or her authority to direct compensation to itself, and any payment cannot exceed actual costs.[9] Using an independent fiduciary, with full disclosure of the fees to be paid and the conflicts that exist, to make the decision may help eliminate any self-dealing issues.[10]

WHAT IF THE EMPLOYER PAYS THE EXPENSE FIRST?

The discussion above assumes that the plan would pay the particular expense directly. But what if the employer pays the expense and seeks reimbursement from the plan? The DOL could allege that a prohibited transaction may have occurred if the employer has extended credit to the ERISA plan. Two methods may allow the employer to avoid this concern. To the extent either method is used, reimbursed expenses should be reported on Form 5500 consistent with its instructions.

The first avenue is informal guidance from the DOL. The DOL has stated that when the language of the plan is permissive regarding payment of expenses by the plan, reimbursement may be appropriate when the employer and the plan have a "meeting of the minds" about reimbursement before services are rendered. While the

FOOTNOTES

1. Certain expenses internal to investments are much more difficult for the employer to pay without constituting an additional nonelective contribution to the plan subject to the Internal Revenue Code's litany of tests. See., e.g., Rev. Rul. 86-142.
2. DOL Opinion 97-03A (Jan. 23, 1997).
3. 29 U.S.C. §§ 1104, 1108(b)(2). This article doesn't attempt to define "reasonable" or "best interest."
4. See., e.g., DOL Opinion 01-01A (Jan. 18, 2001).
5. 26 C.F.R. § 54.4975-6(e)(4); 29 C.F.R. § 2550.408c-2(b)(3).
6. DOL Opinion 89-09A (Jun. 13, 1989). However, such expenses cannot be part of the employer's overhead expenses.
7. DOL Opinion 1993-06A (Mar. 11, 1993).
8. 29 U.S.C. §1108(c)(2) ("[N]o person so serving [as a fiduciary] who already receives full time pay from an employer or an association of employers, whose employees are participants in the plan, or from an employee organization whose members are participants in such plan shall receive compensation from such plan, except for reimbursement of expenses properly and actually incurred.").
9. E.g., 29 U.S.C. § 1106(b); 26 C.F.R. § 54.4975-6(a)(5)(i); 29 C.F.R. § 2550.408b-2(e).
10. See, e.g., 26 C.F.R. §54.4975-6(a)(5)(ii).
11. This DOL guidance was given in informal questions and answers (Q&A 10 and 11) with the American Bar Association's Joint Committee on Employee Benefits in 2002. (Available online at https://www.americanbar.org/content/dam/aba/migrated/2011_build/employee_benefits/2002_qa_dol.pdf.)
12. The extent to which 26 U.S.C. § 7872 (below-market loans) applies to the employer is not clear.

agreement or understanding need not be in writing, there must be evidence of a "clear understanding or agreement on or before the time the services are performed."[11] Also, in the DOL's informal opinion, "a significant delay in reimbursement may stretch the 'expectation' of reimbursement theory."

The second avenue is a more formal approach through an "interest-free loan" under Prohibited Transaction Exemption (PTE) 80-26 (as amended). Under PTE 80-26, the employer would lend the plan cash to pay the expense and then be repaid, without interest, from the plan at a later time. There are requirements under PTE 80-26, including:

- no interest or fee can be charged;[12]
- no discount for payment in cash can be relinquished by the plan;
- the payment must be for "the payment of ordinary operating expenses of the plan" or incidental expenses thereto;
- the loan must be unsecured;
- the extension of credit cannot be from a plan or be an ESOP acquisition loan; and
- if the loan term is at least 60 days, there must be a written loan agreement with all material terms.

CONCLUSION

Employers seeking to have their ERISA plan absorb internal costs must navigate applicable legal requirements carefully. First, the expenses must meet the best-interest, exclusive-benefit and disclosure standards under ERISA and the Code. Next, the employer must document that the expenses meet the DOL's "but for" test, is not "overhead," and can be reasonably allocated to the plan. And finally, to the extent the employer is reimbursing itself for a cost it has paid, and not paying the expense directly from the plan, the employer must be sure not to run contrary to the prohibited-transaction rules.

All of those steps show that the decision to pay employer costs with ERISA plan assets must not be made casually. Rather, any decision must be made with care based on all the facts and circumstances, and documented in the plan's records with the understanding that auditors or participants may question the arrangement. PC

Phillip Long is an attorney in Greensboro, NC who works with retirement plans of all types. The views expressed in this article do not necessarily represent the views of his employer and are not legal or tax advice. Phillip is a member of the Plan Consultant Committee.

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Using Stochastic Modeling in Planning a Pension Plan

Better planning is crucial to avoiding runaway future costs. Is stochastic modeling the key to better planning?

BY JOHN CIERZNIAK

At the start of the 20th Century, pension plans offered by companies were and far between, but they came to dominate the benefits landscape as large corporations grew along with the U.S. economy. As time went on, however, some pension plans started to fail as plan sponsors saw their pension costs rise in seemingly unpredictable and frustrating ways.

The causes of a gradual decline in the financial health of a pension plan are numerous and sometimes uncontrollable. One common reason is poor planning at the start, especially in over-promising future benefits versus the levels of budgeted contributions. Also, as conditions change for the plan, there can be failures to make needed changes to funding policies, investment allocations or plan design, yielding undesirable results. To avoid downturns for a pension plan, effective consulting includes always looking at the different paths a plan could take.

NATURE OF ACTUARIAL REPORTING

In the actuarial reporting world, the main task is to tell "what is" – that is, what is the value of a benefit, what is the value of liabilities and what is the current level of needed contributions? Over the course of time, the questions of "what *will* be" or "what *could* be" have rightfully entered into the equation. One vital reason for this is to avoid a decline in the health of a pension plan given the foreseeable financial resources of the plan sponsor.

There are a couple of approaches an actuary can take to project common measurements of a plan. One is to take a direct and defined route to determine future values – commonly called the *deterministic* method. This method basically defines what values will be assigned to the assumptions for each year in the future. One example of this for the pension liability side is to set a single future path of the discount rates to apply over time; a second is to plan out the retirement timing of participants – especially ones that could be significant.

While the deterministic method is useful in that it can be quickly understood and the calculations are direct, the output is limited to the predefined scenarios. Alternatively, there is a different method encompassing as many possible scenarios as desired over a future time frame that realistically stretches out 10, 20 or even 30 years. This method is called a *stochastic* model.

The basic premise of a stochastic model is to employ numerous variations of pertinent inputs to produce an extensive array of possible results. The various assumptions in a stochastic model are moving parts in the future with varying degrees of connectivity or correlation with each other. While the assumptions follow the correlations with each other through time to certain degrees, they still go through a random walk throughout the projection years.

Stochastic models are most useful when the random walk scenarios or simulations are done thousands of times. This can give a wide range of results. but probable patterns will emerge from this exercise. Examples of such modeling include stress tests in the banking industry, research into the spread of infectious diseases and the effectiveness of medicines to combat them, and even attempts to predict the outcome of a sporting event. Hollywood even featured a type of stochastic model in the 1983 movie *War Games*, in which a runaway military supercomputer ran through flashy thermonuclear war scenarios in rapid fashion seeking a way to proceed with an actual winning strike.

NEW RISK-BASED REPORTING

The use of models helps greatly in identifying the magnitude of future risks that a pIan will face. The top three types of risk are investment risk, interest rate risk and longevity risk. The actuarial profession recognized that these risks (and others) are ever-present in pension plans and need to be more at the forefront of discussions with plan sponsors. As a result, late last year the Actuarial Standards Board made effective a new Actuarial Standards of Practice (ASOP) announcement to address this need to constantly keep on top of these risks. The announcement, ASOP No. 51, centers on the future outlook of a pension plan in the form of risks it could encounter.

Providing information about the future includes identifying risks and the likelihood of those outcomes. Stochastic models – along with other types of predictive processes such as scenario and sensitivity tests – are made-to-order for ASOP No. 51.

So what would a stochastic model look like and entail for a pension plan? The model that addresses most of the pension risks is an asset/liability model that runs as many years in the future as practicable. As the name suggests, this type of model addresses the movements of both the pension assets and liabilities.

STOCHASTIC MODELING KEYS

Measuring liabilities is based on an array of assumptions such as discount rates, mortality, turnover and retirement rates, among others found in a valuation. A stochastic model will run scenarios where those assumptions will change under different future economic environments, as well as impute new participant profiles along the way. Similarly, the plan's asset portfolio is included in the model's future scenarios. The basis of the future investment movements is through a set of capital market assumptions that contains long-term views of investment returns by asset class, the volatility of those returns, and how asset classes are correlated with each other.

Many investment banks issue their version of capital market expectations each year. The ones that are most useful for asset models are those that have a view of 20 years or more.

> "To avoid downturns for a pension plan, effective consulting includes always looking at the different paths a plan could take."

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By running thousands of multi-year simulations that have changing inputs, patterns will emerge showing the likely paths a plan will take over the projected years. These patterns involve the liabilities' growth, investment performance, contribution and accounting expense levels, and funded status, to name a few. Adverse scenarios will also be explained better, and precautions can be taken depending on the severity and probability of possible pitfalls.

Other applications of stochastic models for pensions include the formation of efficient asset allocation glide paths for Liability-Driven Investing (LDI) portfolios and optimum timing for de-risking actions, such as annuity purchases and lump sum windows. Financial decisions such as these are obviously what-if types of discussions that can benefit from looking at a multi-year picture of staying the course versus pursuing LDI or de-risking strategies.

In the small-plan world, especially the growing segment of cross-tested cash balance paired with 401(k) plans, managing the expectations of the plan sponsor is a critical part of making these arrangements run smoothly. Often, a plan is designed right at the testing limit in the initial year, which could take an unwelcome turn in a subsequent year due to reasons such as a key demographic change in the plan or poor (or sometimes even too high) investment returns. An actuary can usually employ a straightforward scenario test for the following year to anticipate changes and get ahead of potential client communication problems. Some of these plans can be rather complex, so it might be worthwhile to consider many scenarios over multiple years.

By incorporating stochastic modeling for these plans and keeping the plan sponsor abreast of the different paths the plan may take in upcoming plan years, this outlook for the plan helps in the business owner's multi-year planning for the company's prospects in conjunction with the contribution requirements of the plan.

FUTURE DIRECTION OF PENSION MODELING

The models used for asset/liability studies typically have provided a uniform output of their thousands of simulations. While they are useful in gathering likely outcomes and basic patterns, the real world of future scenarios probably would not render a uniform distribution of possibilities.

One reason for this can be traced to models that are static. In other words, while the assumptions themselves will change, the relationships between the assumptions stay the same. An example of this is the correlation or relationship between asset classes. Those are set in the capital market expectations, but those correlations are apt to change under extreme movements in the market.

As the pension industry becomes more accustomed to using stochastic and other types of modeling in forecasting, plus the continued growth in faster and more powerful computing, the modeling will become more dynamic, better identify fat-tail or extreme risks, and produce greater precision of results on searching for optimum paths as well as looking out for future shocks.

In a sense, the pension industry can be seen as embarking into the area of artificial intelligence. Stochastic modeling is a probability component of artificial intelligence and helps frame the decision-making process. In the future, the modeling will become more dynamic – meaning that not only do the assumptions change, but also the relationships among the assumptions can shift given different economic circumstances. Additionally, the creation of data output sets will become larger. The challenge will be to logically group and interpret the model's big data sets and communicate useful strategies for the plan sponsor to employ.

In the past, much of the decline of America's private pension plans was caused by runaway future costs. Better planning of pension plans is critical in avoiding the errors of the past. One worthwhile tool is to utilize stochastic models in order to monitor future risks.

Gone are the old days of setting a plan and letting the chips fall where they may. Now the pension world is fully embarking on a path of preparing for how and when those chips may fall. PC

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Lessons from the *Sacerdote v. NYU* Lawsuit

Knowledgeable investment committees and a broad range of cost-efficient, diversified investment options can help keep plan sponsors out of court.

BY JAMES W. WATKINS

Regardless of how the various 401(k) and 403(b) lawsuits turn out, there are usually lessons that can be learned from each one that can help plan consultants going forward. Last year's court decision dismissing one 403(b) action, *Sacerdote v. New York University* (or "the NYU action"), is such a case.

SELECTING PLAN INVESTMENT COMMITTEE MEMBERS

The NYU action had a number of interesting fact scenarios that the court had to consider. One of the glaring issues that the court had to deal with was the obvious lack of qualifications and interest of some of the plan's committee members.

Some of the members admitted that they just blindly accepted the advice of the plan's advisor. And as this court pointed out, blind reliance on third parties is a violation of ERISA. As other courts have consistently pointed out, one of ERISA's core requirements is that a plan's fiduciaries must conduct an independent and objective investigation and evaluation of all investment options being considered by an ERISA plan.

Plan consultants should advise plans on the importance of selecting investment committee members and other plan fiduciaries who are both qualified and want to assume such roles. The NYU action highlights the need on the part of plan sponsors to incorporate annual fiduciary education classes into their plans.

The court noted that the plan's investment committee had problems evaluating two of the plan's investment options – the CREF Stock account and the TIAA Real Estate account – due to their "uniqueness." The court noted that the investment committee held "special" discussions with TIAA-CREF officials regarding such issues.

However, a plan consultant should advise a plan that a failure of a plan's investment committee or other fiduciaries to perform the legally required independent and objective investigation and evaluation of a plan's investment options is a per se breach of the plan's fiduciary duties. If a plan is unable to properly evaluate a prospective plan investment option, for whatever reason, then the prudent course of action is probably to just remove that investment option from consideration.

RECORDKEEPING FEES

A common allegation in 401(k) and 403(b) actions is that the plan paid third parties excessive fees for recordkeeping and other administrative services. Those same allegations were a part of the NYU action.

In the action, TIAA-CREF and Vanguard provided recordkeeping for the NYU plan. There was evidence that the plan's advisor recommended consolidating the plan's recordkeeping, advising the plan that multi-vendor recordkeeping arrangements are not cost-efficient.

In the NYU action, complicating factors included the restrictions and conditions that TIAA-CREF places on their annuities. These special restrictions and conditions effectively prevent other recordkeepers from providing recordkeeping services in relation to TIAA-CREF investment products. As a result, plans choosing to offer TIAA-CREF products as investment options within their plan will be faced with the threat of multi-vendor excessive fees claims if they choose anything other than TIAA-CREF investment options.

This is definitely an issue that plan consultants need to factor into the advice that they provide to plans. There is no vendor-specific exception in ERISA's fiduciary duty to control costs. The courts apply an "objectively prudent" standard in determining fiduciary prudence under ERISA. A plan offering investment options from only one vendor presents obvious fiduciary prudence issues.

APPLYING THE APPROPRIATE PRUDENCE STANDARD

One of the most valuable services a plan consultant can provide to a plan is to make sure that the appropriate prudence standard is applied in selecting the plan's investment options. One surprising aspect of the NYU action was the court's statement that, "Fiduciaries should consider the prudence of each investment as it relates to the portfolio as a whole rather than isolation."

That position is totally inconsistent with the statement contained in the preamble to the regulations enacted pursuant to Section 404 of ERISA. The preamble clearly states that:

> *The regulation, however, is not intended to suggest either that any relevant or material attributes of a contemplated investment may properly be ignored or disregarded, or that a particular plan investment should be deemed to be prudent solely by reason of the propriety of the aggregate risk/return characteristics of the plan's portfolio… The Department also believes that appropriate consideration of an investment to further the purposes of the plan must include*

> "One of the glaring issues that the court had to deal with was the obvious lack of qualifications and interest of some of the plan's committee members."

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consideration of the characteristics of the investment itself.

So according to the applicable ERISA regulations, the proper prudence test in selecting a plan's investment options is not a "portfolio as a whole" standard or an "each individual investment" standard, but rather both.

CLOSET INDEXING

Equally important for plan consultants are the court's observations that the CREF Stock account "closely tracked the performance of its benchmark index."

This raises questions as to whether the CREF Stock Account should have been considered a "closet index" fund given the investment's high correlation of returns to an index or comparable index fund. Closet index funds are generally defined as mutual funds claiming to provide active management, and charging substantially higher fees for that. However, the actual performance of such funds essentially tracks the performance of a comparable index or index fund.

Closet indexing is by definition imprudent. While there are no universally accepted standards for designating a fund as a closet index fund, there is general agreement that funds with high fees and a high R-squared/correlation-of-returns number are prime candidates for closet index status.

There is no evidence that the court even explored the issue of closet indexing.

Closet indexing is receiving increasing international attention due to its impact on investors and questions as to whether such strategies constitute violations of securities law for misrepresentation of services provided. Thus, plan consultants should consider the potential liability implications for themselves as a result of potential closet indexing investments within a plan.

EMERGING PERSONAL LIABILITY ISSUES FOR PLAN CONSULTANTS

The NYU action involved several other potential liability issues that plan consultants should consider. Many plan advisors insert fiduciary disclaimer language in their advisory contract with plans, believing that the clause insulates them from any liability for the advice they provide to a plan. However, plan advisors can still potentially be sued under the common law and concepts such as negligence and breach of contract.

So what's the bottom line for plan consultants? Two dominant themes of ERISA are cost-consciousness and the avoidance of large losses through diversification. With that in mind, I advise my ERISA clients to only recommend a broad range of cost-efficient and effectively diversified investment options. PC

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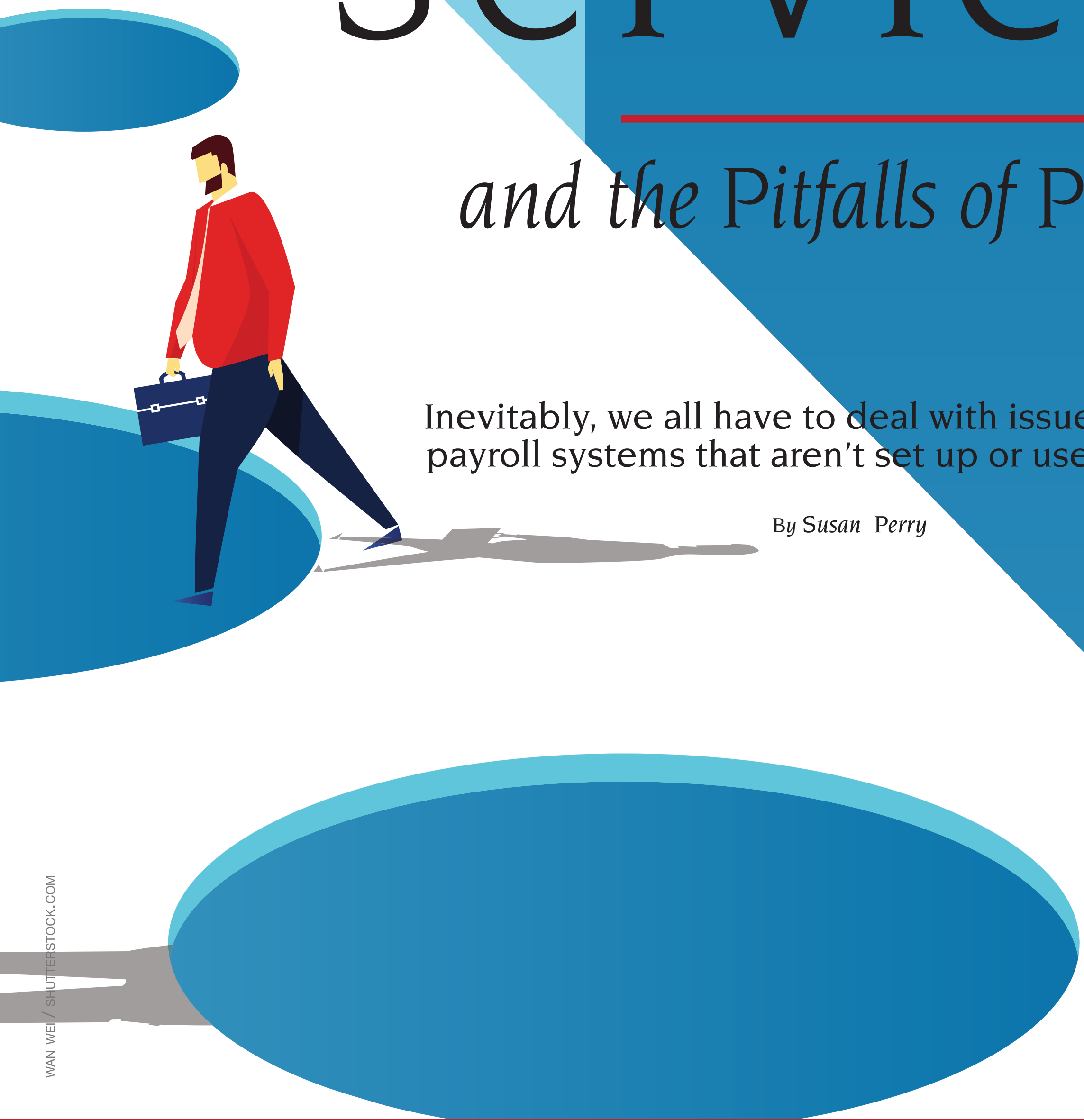
3(16) services

and the Pitfalls of Payroll

Inevitably, we all have to deal with issues raised by payroll systems that aren't set up or used properly.

By Susan Perry



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Which payroll service an employer uses may not be our choice, but the nature of our role as retirement plan administrators is such that inevitably, we will have to deal with issues raised by payroll systems that aren't set up or used properly.

The data in a payroll feed is the foundation for successful plan administration. If census data isn't readily available for all participants, notices may not be provided to everyone and enrollments may not happen on a timely basis. If the contributions are calculated wrong, account balances will be wrong. If account balances are wrong, distributions will be incorrect. If the hours worked reported are wrong, vesting and eligibility may not be accurate. And if the compensation provided for compliance testing is wrong, testing may not be accurate. For a 3(16), this data is critical to ensuring that plans run properly.

Here are a few of the issues we have encountered in our time working with client payroll data – and some suggestions for dealing with them.

Census Data

Let's assume there's a payroll system we'll call "Small Business Payroll System" (SBPS). Assembling census and contribution data to a single upload file is very difficult with SBPS. There is one export where a plan sponsor can obtain census data in spreadsheet format and another for contribution information. One export has no Social Security numbers on it, while

A recordkeeper once told me that 60% of the calls they receive from plan sponsors are payroll related. That's a significant opportunity for clients to be upset with you.

the other has masked Social Security numbers. Records must be matched up by names. The only place to obtain the Social Security numbers is on a PDF report. The payroll person must merge two files together, using employee name, and then enter the Social Security numbers manually. This is a cumbersome process prone to errors.

When we take over a plan using this payroll company, for the most part, only contribution information is being provided to the recordkeeper each pay period. Plan sponsors balk at the idea of creating the files needed in the correct format due to SBPS's limitations.

Many payroll companies, especially those focused on small businesses, don't have the capabilities that I used to think would be standard… like being able to export Social Security numbers and being able to customize or download reports.

From the 3(16)'s perspective, this type of payroll system causes problems, including:

- Without complete census data, how will you determine who should receive enrollment packages?
- Without addresses being updated automatically, how will you determine the correct addresses for notice mailings?
- Without information on all employees, how will you verify participant counts for 401(b), ADP and/or ACP testing?
- Without updated termination dates, how will you confirm that you are issuing in-service withdrawals to employees who are still working?

Contributions

A recordkeeper once told me that 60% of the calls they receive from plan sponsors are payroll related. Another once told me that 50% of the corrections work they do relates to contribution errors caused by bad payroll data. That's a significant opportunity for clients to be upset with you.

Sometimes the plan sponsor's payroll processor makes a mistake. But more frequently, the issue is in the setup of the payroll system. Following are a couple of examples of easy-to-make errors that most plan sponsors wouldn't even realize they are making until it is too late.

1. In 401(k) plans, matching contributions get capped at the 401(a)(17) compensation limit. In a SIMPLE plan, there is no compensation cap on the match calculation. Highly paid employees can potentially receive much larger matching contributions in a SIMPLE plan. In order to know which type of plan the sponsor has, some payroll systems have a flag that reads something like: "Ignore 401(a)(17) cap for calculating match? Yes/No." The hitch is that there is usually a default answer. If the payroll system defaults to Yes, then when setting up a 401(k) plan, someone has to know to change the answer to No. It's challenging enough for a payroll clerk to know this question even exists, let alone answer it correctly.
2. Very rarely do I get calls to provide a plan document to the payroll company who is setting up payroll for a company for the first time. If the payroll companies aren't getting plan documents to set up compensation calculations for the plan, who does the setup? The usual default answer is the payroll processor at the plan sponsor. As pension professionals, we take classes to learn the differences between §415, W-2 and §3401(a) wages. Who is educating the payroll person at the plan sponsor's

If the payroll companies aren't getting plan documents to set up compensation calculations for the plan, who does the setup?

office? It's likely that the payroll processor at the plan sponsor's office takes a guess or goes with the default option. If the plan sponsor is small, with simple payroll needs, the three basic definitions of compensation may be exactly the same. But, for many plan sponsors, especially larger ones, the three basic compensation definitions can produce different results.

Hours Worked

How many hours did the employee get paid for this pay period? We need that number of hours, usually for vesting and/or eligibility. If only payroll systems made obtaining this information simple – but many don't.

Let's take a situation that arose not long ago. In this scenario, the plan sponsor had elected to use 180° payroll integration between their payroll system and their recordkeeping company's system. Each pay period, the payroll company sent a file to the recordkeeper with all of the census and indicative data.

In this example, the plan sponsor had both salaried and hourly employees. Hourly employees are paid based on hours worked, so they were being reported correctly. The issue is the salaried employees.

Here's what was happening: Salaried employees were automatically reported as working 80 hours for every biweekly pay period. The client was tracking the number of sick days, vacation days, company holiday days, etc., for salaried staff through the use of "memo hours."

Imagine the pay period starts next Monday and ends 14 days later. Joe has requested vacation time for next week and the following week. That's 80 hours of memo vacation time. When reporting for this pay period, the file being transmitted in the 180° payroll feed showed 160 hours (80 hours of regular hours plus 80 hours of memo hours). In other words, hours were being double counted. Salaried staff who terminated in May and June were being overpaid due to the double counting of hours.

Neither the TPA, the recordkeeper nor the plan sponsor was even aware there was an overpayment issue before the CPA auditor discovered it. Someone had to restore the improperly distributed monies to the plan.

Nondiscrimination Testing

If compensation and contribution data aren't correct, and/or if you don't have all of the employees in the data, then the testing won't be correct. How can you tell when the data might be problematic?

Have you ever run an ADP test and noticed that most participants don't have an actual deferral percentage that is a round percent? Let's think about that for a minute:

1. We know the majority of participants don't change their deferral elections – ever.
2. For people with flat dollar deferral elections, of course we wouldn't get a nice round percentage.
3. For people with a percent deferral election, payroll systems can do math, so we should be off by more than $0.01 each pay period.

Assume Sam elected to save 4% of pay for the whole year. She is employed for the entire plan year. She makes $30,000 per year. Sam should have saved 4% of $30,000 or $1,200. As the 3(16), when you see the ADP test, you see that Sam has saved only $1,140 for the year.

The missing $60 is not due to rounding. The difference is an indication that the compensation used in the calculation of the deferral

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amount isn't the same compensation as the one used in the ADP test. Payroll systems can calculate 4% of pay and get the right amount – but they can only do it if compensation is correct.

Should a 3(16) sign off on this ADP test if 40 out of 42 eligible participants in the ADP test don't have round deferral percentages? What actions should the 3(16) take to figure out what went wrong with the testing or, more likely, with the payroll system?

What Can a 3(16) Do?

As a 3(16), you may not be responsible for payroll data being transmitted. Or perhaps you have agreed to take some responsibility for the payroll data being transmitted. Either way, when something goes wrong, the plan sponsor is likely to be unhappy and may point fingers. Perhaps the best approach is to be proactive in thinking through the likely scenarios based on what you know about their setup:

- Do you have the ability to check that the payroll system is set up correctly?
- Do you have the ability to check that the correct data is transmitted each pay period?
- What does your service agreement say about payroll-related issues?
- What does your client think you are responsible for with regard to payroll and related issues?
- What does your client's advisor think you are responsible for with regard to payroll and related issues?

Good information – especially good payroll information – is vital to plan administration and related fiduciary actions. Consider advising clients on best practices that enhance success and limit cost and risk. Think about your desired role and business model and whether it's appropriate for you to assist or even take over some of these responsibilities. There is no absolute answer. It's just a matter of aligning to your purpose and goals. PC

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RETIREMENT INCOME PROJECTIONS: SUN OR CLOUDS ON THE HORIZON?

HOW WORTHWHILE AND USEFUL ARE RETIREMENT INCOME PROJECTIONS? IN THE RETIREMENT BENEFITS AND PLANNING WORLD, THE VERDICT IS FAR FROM UNANIMOUS.

BY JOHN IEKEL

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SUNNY TODAY, AND THE LONG-RANGE PREDICTION SHOWS…

That could be the forecast of any meteorologist. But it could just as easily be a report concerning retirement income: A balance statement that shows a decent figure today, and a long-range outlook that suggests what may lie ahead.

But anyone who pays attention to forecasts knows that long-range predictions can be fraught with inaccuracy, or at the very least not pan out the way they seem certain to.

There are some retirement service providers and experts who regard a retirement income projection – a calculation that, they argue, can help guide one in making a participant's nest egg real and not illusory – as being as reliable as a long-range prediction based on hard science and experienced observation.

Seems simple enough. But like those who find that long-range predictions are sometimes off the mark, the retirement benefits and planning world is far from unanimous on how worthwhile and useful retirement income projections really are.

PROJECTION PROPONENTS

ERISA attorney Fred Reish, a partner at DrinkerBiddle in Los Angeles, is one of them. Reish has written that such projections are a key element in putting balance statements in a context that makes them not just raw figures, but trajectories that suggest whether a participant's account balance at retirement will be a pot of gold or a thin envelope.

Account balance statements, of course, show where an account is at one particular time. A "snapshot" is how Reish characterizes them in his blog, adding that they fail to provide "the most important information, which is whether a participant is on course to have a financially secure retirement."

The LIMRA Secure Retirement Institute agrees. They reported in 2018 that their research showed that just over half – 52% – of U.S. workers age 20-79 said that it is difficult to know the monthly income that results from retirement account balances.

On the other hand, Reish says, retirement income projections make real information available to a participant – something more substantive than a static report. And together with analysis, they can help indicate whether retirement income will be adequate and meet any benchmarks that have been set.

At a 2018 hearing on retirement income held by the Department of Labor's ERISA Advisory Council – which advises the Secretary of Labor on ERISA issues – Reish testified on his views and those of fellow DrinkerBiddle partner Bruce Ashton regarding lifetime income.

Among the points that Reish raised with the Council were that, "The conversation about defined contribution plans needs to increasingly and emphatically include retirement income," and that "Plan sponsors and participants need good quality, reasonably priced retirement income products and services." Among the recommendations he made to the Council was that "The Department of Labor should discuss 401(k) and other defined contribution plan vehicles for retirement income." He continued, "Words matter. Retirement income projections are not just projections – they are perspective. I cannot think of a better way to change the perspective and, thereby, change the conversation."

"My view of the future is that, if retirement income projections and gap analysis are offered to participants, with annual updates, we will have better outcomes... because participants will be empowered to make smarter decisions about deferral rates, investing, retirement ages, and so on," Reish wrote in his blog shortly after he testified in Washington.

LIMRA found in its 2018 research that retirement income estimates helped improve retirement savings – finding that after seeing estimated income, just under half of all workers increased the amount they save for retirement. And that was

"WORDS MATTER. RETIREMENT INCOME PROJECTIONS ARE NOT JUST PROJECTIONS — THEY ARE PERSPECTIVE. I CANNOT THINK OF A BETTER WAY TO CHANGE THE PERSPECTIVE AND, THEREBY, CHANGE THE CONVERSATION."

— *FRED REISH, DRINKERBIDDLE*

even more true for Millennials; 55% of the workers LIMRA studied who belong to that vast young demographic boosted their retirement savings after seeing projections.

Like Reish, Matthew Drinkwater, the LIMRA Secure Retirement Institute's Director of Retirement Research, expresses support for the utility of retirement income estimates. In "Future Shock — Do Income Estimates Affect Saving Behavior?" Drinkwater argues that providing and promoting estimates of retirement income that show what a person's hypothetical future income would be, based on saving levels and assumptions about investment returns, wage increases and asset allocation, could help motivate individuals to save more effectively for a secure retirement.

Drinkwater cites findings concerning the results when workers were provided with retirement income projections:

- 89% believed the information was at least somewhat accurate, and 44% considered it to be very accurate;
- most found that the information was what they expected to see, but 25% were shocked because they expected the figure to be higher;
- 40% increased their savings rate; and
- estimates can boost workers' confidence that they are saving enough – 41% of those who took action because of the information were more confident, and 57% of those who saw the information and acted on it are.

WAIT A MINUTE

Even Reish in his blog acknowledges that retirement income projections could be inaccurate, but says that even if they are, they still are "directionally correct" and can "provide valuable information to participants about whether they are saying enough to meet their goals." In addition, he observes that retirement income projections are updated annually, allowing

ANYONE WHO PAYS ATTENTION TO FORECASTS KNOWS THAT LONG-RANGE PREDICTIONS CAN BE FRAUGHT WITH INACCURACY, OR AT THE VERY LEAST NOT PAN OUT THE WAY THEY LOOK CERTAIN TO.

Worker Retirement Readiness Self-Calculations

Measure	% of Workers Who Have Made the Calculation
Monthly Income Needed During Retirement	39
Savings Needed in Order to Live Comfortably in Retirement	37
Amount of Money Needed for Withdrawals from Retirement Savings and Investments During Retirement	33
Planning for How to Cover an Emergency or Major Expense During Retirement	31
Money Needed to Cover Health Expenses in Retirement	29

Source: Employee Benefit Research Institute and Greenwald & Associates, 2019 Retirement Confidence Survey.

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participants to adjust their contributions and how their funds are invested, recalibrations that can enhance the likelihood of meeting the goals for financing retirement.

Reish's admission regarding retirement income projections' accuracy is not unique. Ken Raskin, Partner and Employee Benefits and Executive Compensation Practice Chair at King & Spalding, who also chairs the Plan Sponsor Council of America's (PSCA) board of directors, is definitive. "Estimates will never be the right number. There are too many assumptions," he says.

Another problem, their detractors suggest, is that there just are too many variables involved. "So many products yield positive rates of return," says Mike Sasso, Partner and co-founder of Portfolio Evaluations, Inc. and PSCA board member, adding, "How does one choose a rate of return?"

Nevin Adams, Chief Content Officer at the American Retirement Association, argues that retirement income projections are just too limited in scope. "Projections can look at one account, but not the whole picture," he says.

PSCA Executive Director Jack Towarnicky also thinks that part of the problem with retirement income projections is that there are "all kinds of factors" to consider. He cites an instance in which a participant in a defined benefit plan who was approaching retirement started using a cash balance formula four years before he planned to retire. The participant's account grew, but interest rates fell at that time as well, yielding a smaller nest egg than the worker had expected. And, Towarnicky adds, inflation should be considered as well. "Unless a plan offers an in-plan annuity, no matter what estimate you give, it may not be accurate," Towarnicky warns.

Christopher Carosa, Chief Contributing Editor of *FiduciaryNews*, has expressed a similar sentiment: "In general, income projections are the 'fuzzy math' of the finance industry. With the possible sole exception of U.S. Government securities, no promised income is guaranteed. Just ask anyone who bought GE stock for its dividend a couple of years ago."

Towarnicky adds that retirement income projections entail a level of complexity that most participants can't handle. "For the most part, they're just not there," he said. Reish had expressed a similar sentiment in his testimony before the ERISA Advisory Council: "Participants need help making decisions about retirement income products and services. They are not, by and large, educated or experienced in the analytical processes for determining which products or services to select for 20 or 30 years into the future or the amounts to be allocated among such products and services. This is analogous to the fiduciary services that participants receive for investing their accounts, for example, target date funds and managed accounts."

A further problem can arise when there are multiple projections for the same participant account, Carosa says.

He argues that "Income projections are as much art as they are science. This means it's possible to receive two different projections from two difference sources on the same retirement portfolio. When that happens, good due diligence suggests you dig deep into the prevailing assumptions of each projection. Then it's your turn to invoke the art (as opposed to the science). For me, I'd always lean towards the more conservative projection. Why? Because I prefer my surprises to be on the upside."

And Adams suggests that for an employer, there may even be an element of danger, or at least risk. "People can see a projection as a promise," he says. And a disgruntled participant could take legal action; a plaintiff's attorney may take up such a case, he notes.

GETTING PERSONAL

The views of experts and theoreticians are all well and good, but what about the people for whom those theories and concepts translate to bread and butter?

The Employee Benefit Research Institute (EBRI) says in its 2019 Retirement Confidence Survey provides some insight into workers' awareness of the long-term needs and their readiness to meet them. Two-thirds of those in the study are confident that they will have enough to live comfortably in retirement, and 23% think they will be able to live very comfortably.

Adams, in his review of the survey's results, argues that confidence about retirement and preparation "are logically intertwined." He notes that "Prior versions of the RCS have found that despite higher savings goals, workers who have done a retirement savings needs calculation are more likely to feel very confident about affording a comfortable retirement (33% vs. 12% who have not done a calculation in 2016)." And in 2018 LIMRA said that it found that nearly 70% of workers who received retirement income projections were confident that they could live as they wished in retirement, and 70% were confident that they would be comfortable.

But, says Adams, "Confidence about retirement is one thing, of course, and preparation something else."

And the level of preparation is nowhere near the level of confidence, says EBRI. They found that many workers have not even tried to calculate how much they will need to save in order to have a comfortable retirement. They report that overall 42% were in that boat; 12% of those who participate in a retirement plan have made such an attempt, and only half of those who do participate have done so. Just 39% have estimated how much income they would need per month when they are retired, and 37% calculated how much they would have to save in order to have a comfortable retirement.

Some – but not many – workers, EBRI says, are employing other resources to give them an idea of what they will need. Just under 30% are working with a financial advisor, and 21% are using online planning tools and calculators.

LIMRA found in 2018 that Baby Boomers were more likely than Millennials or Gen Xers to have seen a monthly

LIMRA FOUND THAT AFTER SEEING RETIREMENT INCOME PROJECTIONS, 48% OF ALL WORKERS INCREASED THEIR RETIREMENT SAVINGS, AND THAT THE EFFECT WAS MORE PRONOUNCED AMONG MILLENNIALS.

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income estimate; LIMRA reports that Baby Boomers found it more meaningful to see estimates of their monthly income expressed as dollar figures, not as a percentage of pre-retirement income.

In that study, LIMRA also found that after seeing retirement income projections, 48% of all workers increased their retirement savings, and that the effect was more pronounced among Millennials.

But experts are not alone in their reservations about retirement income projections. In 2014, LIMRA found that most employees who responded said that they were very helpful; however, some did not. They, too, had reservations over projections' accuracy. Employees also had concerns that they were too hypothetical or, as Towarnicky observed, that the projections were confusing. Still others found them frightening, because they cannot save more than they already are, no matter what the projections showed. And LIMRA's Alison Salka added another wrinkle: participants who lack a clear idea of their monthly income and expenses would similarly have a hard time grasping the import of net income projections.

ACTION STEPS

Reish suggests that information, education and advice, as well as the assistance of knowledgeable professionals, will help plan participants to best use retirement-related products and services. And LIMRA suggests that financial professionals do more than report savings totals, and also promote income estimates. PC

DOL'S 12 TIPS FOR MONITORING SERVICE PROVIDERS

Monitoring service providers is a fiduciary obligation. Here's a closer look into how a list of 12 tips from the DOL can help.

By Mary Patch & David J Witz

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While the obligation under ERISA to monitor investments is well known and widely addressed, it is equally important to monitor all service providers. In fact, according to the courts, a failure to monitor service providers is a fiduciary breach of duty.[1]

This duty to monitor is described in 29 CFR §2509.75-8 (FR-17Q):

> "At reasonable intervals, the performance of trustees and other fiduciaries should be reviewed by the appointing fiduciary in such manner as may be reasonably expected to ensure that their performance has been in compliance with the terms of the plan and statutory standards, and satisfies the needs of the plan. No single procedure will be appropriate in all cases; the procedure adopted may vary in accordance with the nature of the plan and other facts and circumstances relevant to the choice of the procedure."

In addition to that regulation, the DOL has expressed the view that the duty to monitor is a fiduciary obligation that meets the general duty of loyalty and prudence standards imposed by ERISA §404(a)(1). We see this expressed by the DOL in a 1996 Interpretative Bulletin:

> "As with any designation of a service provider to a plan, the designation of persons to provide investment educational services or investment advice to plan participants and beneficiaries is an exercise of discretionary authority or control with respect to management of the plan; therefore, persons making the designation must act prudently and solely in the interest of the plan participants and beneficiaries, both in making the designation(s) and in continuing such designation(s)."[2]

Besides the Interpretive Bulletin, the DOL has also addressed the duty to monitor in an Information Letter stating that:

> "In choosing among potential service providers, as well as in monitoring and deciding whether to retain a service provider, the trustees must objectively assess the qualifications of the service provider, the quality of

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the work product, and the reasonableness of the fees charged in light of the services provided."[3]

While it is clear that ERISA does not establish any explicit due diligence monitoring standards, the DOL has issued "Tips for Selecting and Monitoring Service Providers for Your Employee Benefit Plan," which provides tips that would apply to monitoring the activities of any fiduciary or non-fiduciary service provider. However, it is important to recognize that these tips are not comprehensive, but rather represent a guideline that must be evaluated under the facts and circumstances specific to the plan and service provider. A review of the DOL's 12 tips along with appropriate questions that a responsible fiduciary should consider follows.

TIP 1: Consider what services you need for your plan – legal, accounting, trustee/custodial, recordkeeping, investment management, investment education, or advice.

Legal
Confirm that legal counsel have expertise in Title 1 and 2 of ERISA.

Accounting/Audit
Confirm Accountant has extensive experience auditing retirement plans.

Trustee/custodial
Is directed or discretionary services desired? Does the custodian produce certified statements if an audit is needed? Is the custodian reputable and insured? Can the custodian hold the investments the plan holds (e.g., ETFs, mutual funds, CITs, separate accounts, stocks, bonds)?

Recordkeeping
Does the recordkeeper have extensive experience with the following?

- The plan's design (e.g., defined contribution, defined benefit, cash balance, 457, 403(b), ESOP, KSOP)
- Services that are important to employees (e.g., mobile access, multilingual support, call center, voice response system, online advice portal, retirement readiness tracking)
- Services that are important to administrative staff (e.g., online enrollment, distributions and loans, mailing

While there is no requirement to select the lowest-cost provider, it is important to state the reasons why a higher-cost one is selected.

services, payroll integration, retirement readiness monitoring, and audit support)
- Compliance obligations such as required notices and testing
- Fiduciary support services such as those provided by an ERISA §3(38), §3(21), and/or §3(16) provider

Investment Management
Does the committee have the expertise and technology to accurately evaluate and monitor the investments? If not, does the advisor or investment manager have that expertise, and will they accept fiduciary liability as an ERISA §3(21) or ERISA §3(38) fiduciary? Are custom models or managed portfolios a desired service, and does the advisor have experience delivering those services? If so, can the recordkeeper accommodate the models and/or managed accounts? If the committee prefers target date funds as a QDIA, does the advisor have a documented process to select and monitor those funds based on DOL's guidance?

Investment Education or Advice
Has the committee determined which employee education topics and the method of delivery are most likely to assist employees to meet their retirement objectives, and can the service provider deliver those services? Is the service provider capable of implementing a retirement readiness program?

TIP 2: Ask service providers about their services, experience with employee benefit plans, fees and expenses, customer references or other information relating to the quality of their services and customer satisfaction with such services.

Provider Services
Does the provider offer bundled and/or unbundled services? Is a detailed list of specific services outlined in a service agreement provided so the committee may monitor whether promised services were delivered on time, accurately and professionally?

Experience
Does the provider have staff with the necessary experience, education and skill to serve the plan's administrative and operational needs as well as the best interests of plan participants? The committee should confirm years of experience working with similar plans, the number of plans they service, staff experience and designations, and continuing education protocols.

Fees and Expenses
Does the provider deliver a comprehensive §408(b)(2) disclosure that outlines all direct and indirect fees tied to services provided as well as the source of the fees paid? Does the provider offer flat fees? Are flat fees more competitive for the plan based on historical growth? Does the provider outline costs for ancillary services such as fund changes, plan transfer, distribution and loan fees, transition, hourly consulting, self-directed accounts, enrollment booklets, allocation calculations, Form 5500 filing and extensions, compliance testing, and employee education meetings?

References
The client should ask each service provider to provide references from existing and terminated clients.

TIP 3: Present each prospective service provider identical and complete information regarding the needs of your plan. You may want to get formal bids from those providers that seem best suited to your needs.

When the committee decides to conduct a formal Request for Proposal (RFP) – an event that should occur every 3 to 5 years depending on the size of the plan – the committee should consider retaining an ERISA consultant who is familiar with industry standards, service provider deliverables and pricing to assist with developing a comprehensive RFP and identifying the best candidates to fulfill the objectives of the plan.

TIP 4: You may also wish to consider service providers or alliances of providers who provide multiple services (e.g., custodial trustee, investment management, education, or advice, and recordkeeping) for a single fee. These arrangements are often called "bundled services."

Determining whether a plan should use a bundled or unbundled provider depends on many factors, some of which include plan complexities, "white glove" support, extensive nature of the vendor review, and disclosure of potential conflicts of interest associated with affiliated service providers. Here again, though not required, leveraging the expertise of an ERISA consultant is often the best solution for addressing those issues.

TIP 5: Ask each prospective provider to be specific about which services are covered for the estimated fees and which are not. Compare the information you receive, including fees and expenses to be charged by the various providers for similar services. Note that plan fiduciaries are not always required to pick the least costly provider. Cost is only one factor to be considered in selecting a service provider.

It is important to break down costs by services rendered to fully understand any direct or indirect fees (i.e., revenue sharing) that may be used to pay service providers. If indirect fees are collected by service providers, the committee should request a breakdown annually of the total amount received from each service provider and the service provided for those fees. The committee should be able to "follow the money" to determine whether fees are reasonable. Keep in mind that stable value and guaranteed investment accounts create their own challenges because the net return may be adjusted to reflect the payment of indirect fees. When an RFP is conducted, is it best to develop a side-by-side comparison of fees for services rendered to make an informed decision. Equally important is to document the reasons for the selection, especially if the winning provider is not the lowest-cost one. While there is no requirement to select the lowest-cost provider, it is important to state the reasons why a higher-cost one is selected.

TIP 6: If the service provider will handle plan assets, check to make sure that the provider has a fidelity bond (a type of insurance that protects the plan against loss resulting from fraudulent or dishonest acts).

Bonding is a requirement under ERISA §412 for anyone who handles assets. A committee will need to determine whether a provider is handling assets as well as the amount of the bond that the provider will need to secure. In addition, while it is not required by ERISA, the committee should confirm that their all providers carry first-party Error and Omission (E&O) insurance. The committee should pay attention to the amount of liability retained by the provider to ensure that the provider has the necessary capital to cover the deductible amount and whether the amount of coverage is reasonable given the size of the plan.

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TIP 7: If a service provider must be licensed (attorneys, accountants, investment managers or advisors), check with state or federal licensing authorities to confirm that the provider has an up-to-date license and whether there are any complaints pending against the provider.

A defensible due diligence process includes a review of a service provider's good standing with the state. If the committee is working with an advisor, review their Form ADV part 1 and 2 for any required disclosures and pull reports from the SEC and FINRA. (Also see www.adviserinfo.sec.gov/ and https://brokercheck.finra.org/.)

TIP 8: Make sure you understand the terms of any agreements or contracts you sign with service providers and the fees and expenses associated with the contracts. In particular, understand what obligations both you and the service provider have under the agreement and whether the fees and expenses to be charged to you and plan participants are reasonable in light of the services to be provided.

Determining whether fees are reasonable for services rendered is a fiduciary obligation under ERISA §408(b)(2). In addition, the committee will need to determine:

- Whether to pay fees directly, deduct them from employee accounts, or use indirect fees.
- Whether a service provider has acknowledged in writing to act as an ERISA fiduciary.
- Any liability the committee retains with respect to the provider selected.
- The cost of and notice requirements needed to leave the provider.
- Whether the agreed-upon services match the terms of the contract.

These objectives are best met with the help of ERISA legal counsel.

TIP 9: Prepare a written record of the process you followed in reviewing potential service providers and the reasons for your selection of a particular provider. This record may be helpful in answering any future questions that may arise concerning your selection.

ERISA imposes a fiduciary standard of procedural (the process) and substantive (the merits) prudence. This is best accomplished with proper documentation. The committee should retain the records from their review in their fiduciary file. This should include the analysis of services, vendor pricing analysis, and proposals presented to the committee along with minutes, reports, and notes regarding the vendor review process that was conducted.

TIP 10: Receive a commitment from your service provider to regularly provide you with information regarding the services it provides.

The committee should annually review each provider by comparing the services delivered to the services promised. The process should answer five key questions:

Services provided should be evaluated in light of any legislative, regulatory or judicial changes, as well as any technological or industry changes.

- Was the promised service delivered?
- Was it timely delivered?
- Was it accurately delivered?
- Was it professionally delivered?
- Was it delivered to your satisfaction?

In addition, any policies and written procedures should be reviewed annually to confirm that all services that were provided support the objectives outlined in those documents. Also, the services provided should be evaluated in light of any legislative, regulatory or judicial changes, as well as any technological or industry changes.

TIP 11: Periodically review the performance of your service providers to ensure that they are providing the services in a manner and at a cost consistent with the agreements.

Reviews should be conducted at least annually of the current fees paid compared with the prior year's fees for the services provided. As the plan assets grow, any asset-based fees associated with the plan should be reviewed to confirm that any increase in the dollar amount paid is reasonable and not excessive relative to the services provided.

TIP 12: Review plan participant comments or any complaints about the services and periodically ask whether there have been any changes in the information you received from the service provider prior to hiring (e.g. does the provider continue to maintain any required state or federal licenses).

This is not an ERISA obligation, but surveying participants for comments or complaints is a best practice to gauge the success of the retirement program.

CONCLUSION

The DOL does acknowledge that this list is a "starting point." That said, most sponsors will struggle to convert these tips into an effective process for monitoring without the assistance of an ERISA consultant. Of course, with or without such help, a committee, at a minimum, should demand that all retained service providers deliver a written service agreement that outlines fees assessed for services rendered. Without a written agreement, it is virtually impossible to measure and monitor a service provider – and, as noted above, a failure to monitor can lead to a breach of fiduciary duty under the general duties of ERISA §404(a)(1).

Keep in mind that the DOL emphasized the need to monitor in Interpretive Bulletin 94-2:

> "…compliance with the duty to monitor necessitates proper documentation of the activities that are subject to monitoring."[4]

And the DOL's position has been supported by more than one federal court:

> "…[t]rustees also have an ongoing obligation to monitor the fees charged and services provided by service providers with whom a fund has an agreement, to ensure that renewal of such agreements is in the best interest of the fund."[5]

Bottom line: monitoring service providers is a fiduciary obligation for all service providers, not just the ones that handle the investments. PC

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FOOTNOTES

1. See, *Atwood v. Burlington Indus. Equity, Inc.*, 18 E.B.C. 2009 (M.D.N.C. 1994) (failure to monitor appointees leads to liability for breach of fiduciary duty).
2. **DOL Interpretive Bulletin** 96-1, 29 CFR §2509.96-1.
3. **DOL Information Letter,** Qualified Plan Services (July 27, 1998).
4. **DOL Reg.** §2509.94-2, Interpretive Bulletin 94.2 (July 29, 1994).
5. *Liss v. Smith*, 991 F. Supp. 278, 300 (S.D.N.Y. 1998), citing *Whitfield v. Tomasso*, 682 F. Supp. 1287, 1304, 9 E.B.C. 2438 (E.D.N.Y. 1988).

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Are You a Target for Cyber Thieves? (Part 1)

The average cost of a data breach is more than $1 million, including lost productivity, negative customer experiences, and loss of reputation. Don't let it happen to your firm.

BY DAVID J. DISCENZA

As a third-party plan administrator, you're busy every day. The collection and safeguarding of sensitive participant data falls to you. You're concerned with the timely distribution of payouts to participants or their beneficiaries. You're concerned with the day-to-day management of the funds under your direction as well as creating strategic policies for their future management. You are responsible for compliance with all IRS regulations. You're taking phone calls, attending meetings, and responding to emails. You're busy from the time you get to work to the time you leave.

There's one other thing you are: a target for cyberthieves! If you don't believe it, consider what happened to Target Corporation. In 2013, Target reported that the credit card information of 40 million customers had been stolen by hackers. Cyberthieves had gotten access to the point of service (POS) credit card readers in the stores. When a customer swiped a card to make a purchase, the hackers stole the information. Target only learned about the breach when they were contacted by the U.S. Department of Justice; they had missed their own internal warning of the breach.[1] In January of this year, Target raised the estimated number of compromised cards to 70 million, creating a huge public relations nightmare.

How could this happen? The hackers did their homework. They probably:

- used Google to scour the web for information, including the names of vendors that do business with Target;
- found information online about the structure of Target's computer network infrastructure;
- discovered detailed information about the POS system used by Target in a case study posted on Microsoft's website; and
- using false credentials, sent an email to all of Target's vendors that contained malware.

The malware they sent was designed to steal passwords. The email was opened by a Target vendor and the malware was released into their computer system. The vendor did have antivirus/antimalware software in place; however, it was the *free* version – which wasn't licensed for corporate use and only ran when someone thought to scan the network. The hackers got the passwords necessary to access Target's network through the vendor portal. Armed with the knowledge gleaned from their search, they were able to attack Target's POS system and steal the credit card information.

What does this have to do with TPAs? Plenty! The hackers got into Target through a service provider's poorly guarded "back door." Your firm could become a "back door" to Fidelity, or John Hancock, or Nationwide, to name a few. Hackers know that major financial firms have spent millions in resources to prevent

> Most cyber attacks are relatively unsophisticated – nothing more than an email with a malware attachment or a link to a phony website."

a successful frontal attack on their computer networks. They also know that small firms do not invest the resources in cybersecurity to the same extent that major companies do. Only 16% of small business owners think they are susceptible to a cyberattack, according to a poll from Insureon and Manta, yet, 61% of attacks occur at smaller businesses.[2]

Cyber attacks occur every minute of every hour of every day. It is estimated that one takes place every 39 seconds.[3] While the popular depiction of hackers in film and on TV is of someone using sophisticated technology to break into a target's computer network, the opposite is actually true. Most cyber attacks are relatively unsophisticated – nothing more than an email with a malware attachment or a link to a phony website where the unwitting victim gives up vital information without realizing it. Cyber thieves don't spend a great deal of time inventing ways to fool people into letting them in or giving up vital information. They rely on human nature to work for them.

When the bank robber Willie Sutton was famously asked why he robbed banks, he reportedly replied: "Because that's where the money is." Today, there's money to be made in stealing information and selling it. In fact, by 2024, the losses from cyber crime in the United States are expected to reach $5.2 trillion. To put this in more accessible terms, the average cost of a data breach is over $1 million, including lost productivity, negative customer experiences, and loss of reputation.

Cyber attacks fall into two basic categories: external and internal. External attacks include:

- Phishing and "smishing" attacks
- Malware and malicious mobile apps

Internal attacks include:

- Physical security attacks
- Unsecured networks

Let's look at each type of external attack to understand how they work and what you must do to protect yourself and your firm.

PHISHING

Social engineering is at the root of "phishing" attacks, along with their variants of "spear-fishing," "vishing," "pharming" and "smishing." Social engineering is the use of deception that counts on the trust of the person being attacked in order to succeed. For example, let's say you receive an email from your boss with an attachment that instructs you to open the attachment. You do as you're instructed because the email is from your boss. When you click on the attachment, nothing happens. So, you click on it again with the same result. While it may seem to you that nothing has happened, in fact you've introduced a virus into the computer network. Yes, it's that simple.

So, do you need to become paranoid and see every email as an attack? Not necessarily, but you and your employees do need to become wary and savvy about the methods used by attackers. Here are some steps to protect yourself from phishing emails:

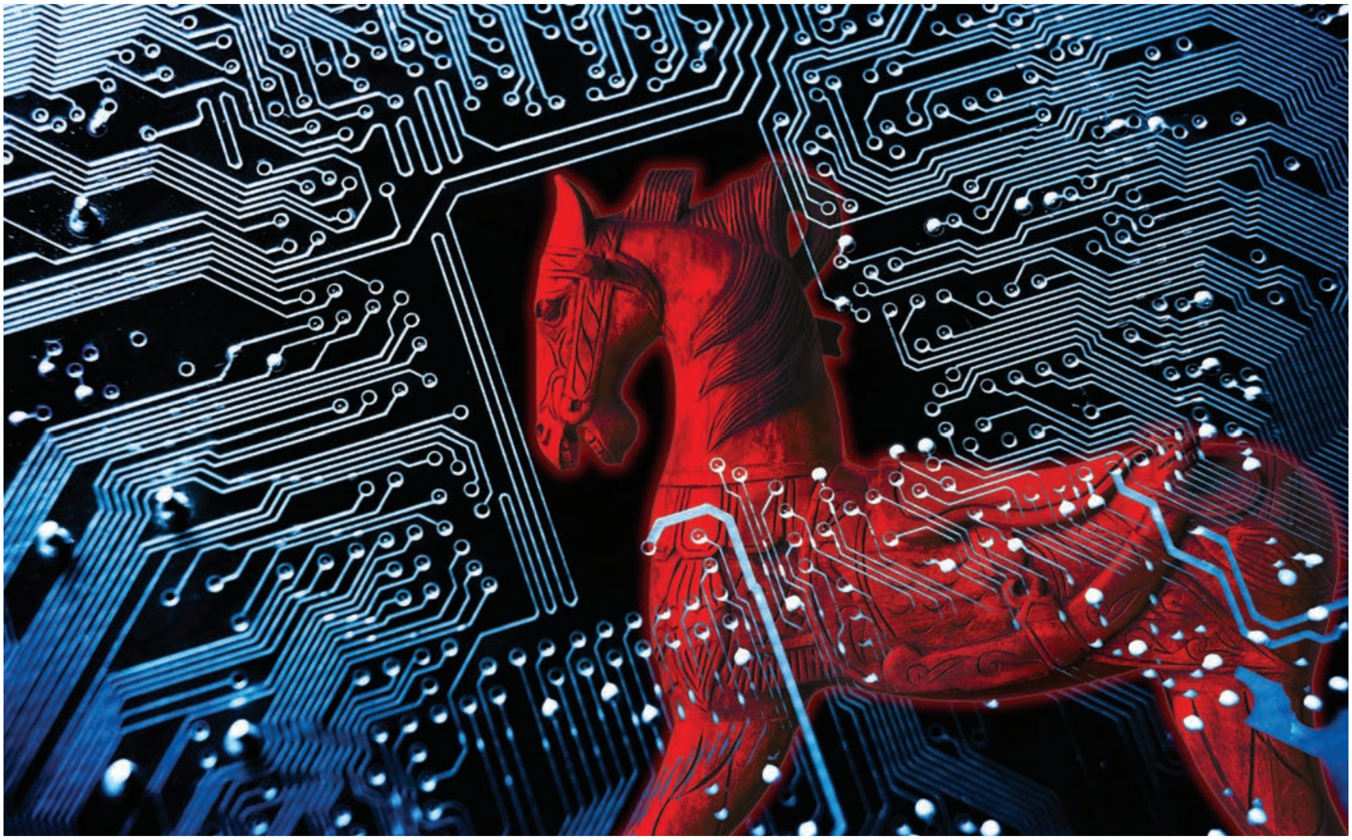
- Take the time to look carefully at the email. Are there obvious misspellings? Are there obvious grammatical errors? If you hover your cursor over a link, does a different link show up?
- Send a separate email to the person who sent the email to verify that it is from them.

Contact your IT department and ask how you should handle any suspicious emails.

MALWARE ATTACKS

Malware is short for "malicious software." It is any type of computer software designed to harm or compromise a computer system introduced via a disguised attack. It may come as an attachment to an email or through an infected memory stick handed out at a conference. It may be hidden in third-party software downloaded from a website. Regardless of the delivery method, the end result is the same – an "infection" of the computer or the computer network with software meant to do harm. Malware comes in many forms:

- **Computer Viruses –** A type of malicious code or program written to alter the way a computer operates and is designed to spread from one computer to another.[4]
- **Trojans –** Named for the mythical horse of Troy, trojan software is a type of malware that is often disguised as legitimate software.[5]
- **Spyware –** Generally defined as software that's designed to gather data from a computer or other



device and forward it to a third party without the consent or knowledge of the user.[6]

- **Keyloggers –** Keystroke logging malware records every keystroke made on a computer and reports it to a third party without the knowledge and consent of the individual.
- **Ransomware –** Software designed to hold your computer system hostage until a ransom is paid and a code is transmitted that will restore the system.

Malware affects computers, computer systems and smartphones. Cyber criminals know how to attack all the devices you use every day.

What can you do to protect your computer and network from malware? Here are some steps you should take:

- Run the commercial version of an antivirus program on your computer that scans the computer continuously.
- Never install unauthorized software on your computer.
- Never use a "memory stick" to access files unless the stick has been scanned first for malware.
- Only download phone apps from trusted sources such as the Apple Store or Google Play.
- Read the comments section of any phone app you want to install to see if there are any comments about hidden malware.
- Make certain that your computer operating system is up to date.
- When your IT department sends a link to update the operating system, click on the link. Cybercriminals exploit gaps in operating systems. These "patches" that IT provides are meant to close those gaps. Don't give the cybercriminals a back door to your computer! PC

David Discenza, CBCP, is president of Discenza Business Continuity Solutions. His firm provides operational risk management consulting to businesses primarily in the Mid-Atlantic region.

FOOTNOTES

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2. https://www.businessnewsdaily.com/10469-business-technology-trends.html
3. https://www.securitymagazine.com/articles/87787-hackers-attack-every-39-seconds
4. https://us.norton.com/internetsecurity-malware-what-is-a-computer-virus.html
5. https://usa.kaspersky.com/resource-center/threats/trojans
6. https://usa.kaspersky.com/resource-center/threats/spyware

There's an APP for That

Industry innovators are tackling the missing participant problem. Is RCH's Auto Portability Program the solution?

BY ILENE H. FERENCZY

One of the most difficult issues facing plan sponsors and administrators nowadays is that of missing participants. As more and more people are covered by a retirement plan, the possibility increases that while an employee may leave a company, his or her benefit funds remain in the plan.

This may mean that no one reviews the account's investments and ensures that they continue to be appropriate for the participant. The fees for the maintenance of the account may be charged to the account, thereby depleting the benefits. Financially it may be better for the participant to have all of his or her retirement plan money commingled, but that may not occur because the participant has become inattentive.

The problem becomes even more critical if the plan is terminated. At that point, it must pay out all benefits, and it may not be able to find the participant. There are several options available to the plan if that occurs, including rolling all benefits into an IRA, moving the funds to the PBGC's Missing Participant Program, purchasing an annuity (if the plan permits and the account is sufficiently large), or even setting up a bank account in the participant's name.

None of these solutions is hugely satisfying, however, because there is always the concern that the participant will never find the right path to locate those funds.

The problem, at its core, is one of portability. Moving one's retirement plan funds from one plan to another or into an IRA takes time and energy, and requires some expertise

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that the average plan participant might not possess. Many participants' reluctance to communicate with a former employer is a major reason why they go missing. And once the link between a former employee and that individual's retirement funds is severed, it can be very hard to reestablish it.

As a result, some in our industry have turned their attention to finding a way to improve the chances that former participants can be reunited with their retirement funds. One proposed solution, Retirement Clearinghouse's "Auto Portability Program" (APP) has received a positive ruling from the Department of Labor (DOL) regarding how it would work, and RCH is now awaiting the receipt of a Prohibited Transaction Exemption regarding the fees that would be charged. While this is not the only concept in the wings, it has received a good amount of publicity due to the DOL ruling. Let's take a closer look at it.

> "Once the link between a former employee and that individual's retirement funds is severed, it can be very hard to reestablish it."

THE AUTO PORTABILITY PROGRAM CONCEPT

Retirement Clearinghouse, LLC (RCH) a recordkeeper, has proposed the Auto Portability Program as a way of helping to reunite missing participants with their retirement plan funds. Something like a version of the Ancestry.com method of finding relatives, the APP seeks to search the financial universe to link funds with their missing participants.

Under the program, plan sponsors and administrators, financial institutions, and recordkeepers would agree to provide the APP with information about accounts they maintain for the benefit of separated participants. The process would begin with automatic rollover of funds to an IRA recordkept by RCH or the plan's recordkeeper. If RCH is the recordkeeper, the funds would be held by an unrelated custodian and invested in products provided by a financial institution unrelated to RCH.

Once the rollover IRA is established, RCH or the other financial institution would send the participant a welcome letter describing the IRA options and fees. In addition, the letter would advise the participant of a separate RCH program in which RCH would provide information on an at-least-monthly basis to the recordkeepers who have agreed to be part of the APP to identify potential matches between the IRA rollovers and active employer retirement plans.

If a match is found, RCH would validate the information and send a "consent letter" to the participant using the address provided by the active plan. This letter would advise the participant of the match and give the participant the opportunity to accept or decline the rollover of the IRA into the active plan. If the participant approves or fails to respond, and the employer that sponsors the active plan agrees, the IRA amount would be rolled over to the active plan. As a result, the participant's "old" and "new" retirement funds would be joined in a single active account that is more easily managed by the participant.

This proposed process would better enable the retirement monies of a given participant to "keep up" with the participant's employment changes, offering an enhanced potential that the funds will not be lost.

In Advisory Opinion 2018-01, the DOL confirmed that plan sponsors which participate in the APP will be acting as fiduciaries when they decide to take part in the program. They will cease to be fiduciaries with regard to participants' funds once the funds are rolled over to an IRA, and will not be fiduciaries in relation to any subsequent rollover to an active plan.

The DOL also confirmed that the accepting plan (i.e., the active plan) sponsor or trustee will not be fiduciaries in relation to the rollover decision, although they would be responsible for ensuring that the roll-in of the funds is consistent with the active plan's terms. Also, RCH would be a fiduciary in regard to the transfer of the funds to the active plan unless the participant affirmatively approves the rollover.

RCH has applied to the DOL for a Prohibited Transaction Exemption to allow it to receive fees in relation to the transactions embodied in the APP.

CONCLUSION

While the APP has the potential of improving the process of keeping participants' plan funds where they can be properly administered and used at retirement, it is clear that the complex web of retirement plan distribution and rollover rules prevents simple portability of these monies. It would certainly be easier to keep participants and their funds together if the distribution and rollover process were less onerous. It would also be better if participants would help their former employers keep track of their whereabouts so that they can be paid benefits when due. PC

Ilene H. Ferenczy is the Managing Partner of Ferenczy Benefits Law Center in Atlanta. An ASPPA member since 1984, she is a former member of the Leadership Council, a former Chair of the Government Affairs Committee, and a frequent speaker at ASPPA conferences.

Are You a Hybrid Consultant?

These "best in class" consultants incorporate the use of analytics and technology, creating a unified approach to consulting on the client's benefit programs.

BY PATRICK WILLIAMS

"If you going to engage the best and the brightest and retain them, they'll better think that you care more about them than you care about yourself. They're not about making you look good. You're about making them successful."

– Clorox CEO Don Knauss[1]

In today's business environment, creating and maintaining a sustainable competitive advantage over a long period of time is going to be challenging. Disruption, innovation and speed to market are now measured in months, weeks or even days. Business leaders recognize that there's no guarantee that anything they do today will drive the future growth of tomorrow.

A corporation's agility and profitability are directly related to its ability to create and maintain an engaged workforce, which in turn creates internal stability within the organization. Engaged employees work with passion and feel a profound connection to the company. Ultimately, they are what drives innovation and moves the organization forward.

It's crucial to an organization's viability to recognize that maintaining an engaged workforce is the key to its short-term, as well as long-term, profitability. An engaged workforce can't be achieved unless workers view their current employment as not only providing a paycheck, but also contributing to their long-term financial well-being – especially their retirement security. Employers which successfully invest in supporting both employee health and employee confidence in their financial well-being drive a surprisingly high return on investment.

When organizations successfully engage their customers and employees, they experience a 240% boost in performance related to business outcomes compared with an organization with neither engaged employees nor engaged customers.[2] So, when we unpack the most recent data on

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today's workforce, we know that stress and anxiety about the future are common in all organizations. The facts are:

- 70% of Americans are not on track for retirement;[3]
- 57% of Americans can't afford a $400 shock claim; and[4]
- 50% of Americans don't have a savings account.[5]

Most employers have ignored these findings and taken a laissez-faire attitude toward their employees' financial wellness. This attitude is carried over to how firms fund, monitor and communicate retirement and health care programs to their employees. (The latter two are important fiduciary duties of any organization.) If a company doesn't assess the retirement readiness of its employees in a holistic manner, it won't be able to view their retirement programs from the employee's perspective.

The shifting of rising health care costs to employees has made the situation worse. This action is often done in a vacuum without any regard to how it will may affect participation in other benefits, let alone the effect on employees' 401(k) contributions, potentially resulting in a readiness gap at retirement. This trap is caused by a "siloed approach" of taking a "benefits cost perspective" by the employer.

In today's social media saturated world, the impact of this approach can be disastrous. Frustrated employees can poison the workplace culture. They can also expand their efforts to the Internet, causing reputational harm to the organization by posting their frustration on sites such as Glassdoor, much like a patron using Yelp to report bad service or food at a restaurant. This runs counter to an organization that is in growth mode.

How can you create positive change or disruption in the process?

Employers today are working with hybrid consultants – either individuals who understand both employee benefits and retirement plans, or a team of consultants that brings that level of expertise to the table. Through a convergence of models, these "best in class" consultants incorporate the use of analytics and technology, creating a unified approach to consulting on the employer's benefit programs. In doing so, they create a holistic, people-centric approach – a roadmap for the employer that encompasses engagement and communication programs for employees, thus boosting the enterprise value of the organization.

Hybrid consultants must become obsessed with the financial, claims, safety and scarcity data that is trapped at the organizational and vendor levels. And they must recognize and review both the structured data and the unstructured data.

Structured data is found in retirement, employee benefits, workers compensation and payroll. It can provide insight into retirement readiness within the organization and care gaps within the health plan's design and insurance funding strategies.

Unstructured data is found in surveys, focus groups and meetings with employees. Gathering this data will take time, and requires thought and discretion with the information. It is through these approaches that you glean insights into employees' lives. (Watch any episode of CBS's "Undercover Boss" series.) Employees are willing to share their most personal information if they believe you have their best interests at heart.

The liabilities associated with retirement readiness have a financial impact on the organization's balance sheet and cash flow statements. They can be quantified by analyzing the replacement and turnover costs of employees, and then reviewing the demographics of the workforce. Filtering the workforce into various age bands or groups will allow for discussion and problem-solving for each age group, such as education on topics like Medicare and Social Security for employees over age 55, for example.

Lastly, understanding a client's financial metrics is imperative to maintaining a long-term tenure with it – its operating ratio, profit margins, EBITA or net operating surplus. When presenting hidden liabilities and prescriptive solutions to resolve these issues, it's important to speak the client's language. Recently, for example, a client of ours eliminated a $3 million spend through plan design and direct contracting. Since it operates on a 10% profit margin, that reduction is the equivalent of $30 million in sales!

Helping employees engage and to better understand their employee benefits drives appropriate utilization, elimination of care gaps and unnecessary care and expenses. And retirement readiness prepares that individual to retire with dignity based on knowledge. Demonstrating your value as a consultant by leveraging analytics and technology for the employer and employee earns you a seat at the table. You will be viewed as a member of the team. PC

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FOOTNOTES

1. Adam Bryant, "Don Knauss of Clorox, on Putting Your Followers First," New York Times, March 23, 2014.
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E-Processing: Worth Your Time, Worth the Effort

Tips on making the transition to paperless processing.

BY MICHAEL BILLINGS & CRYSTAL BEALL

When the Employee Benefits Security Administration converted its filing practices to an electronic system in 2009, it may have seemed to some in our industry like just another governmental obstacle to overcome. Looking back now, though, it's clear that it should have been seen as a sign of the industry's future. It has become all too clear that it's time to put the paper away and do our work primarily, if not exclusively, in electronic formats. The advantages in user experience, data storage, security and precision are simply too great to overlook.

For those firms and individuals who haven't yet adopted electronic processing, it can certainly seem like a daunting idea: After decades of processing and filing everything on countless reams of paper, the shift to the electronic realm carries a significant learning curve and in some cases an entirely new way of thinking about day-to-day operations.

Our firms have both successfully transitioned to all-electronic or "paperless" processing, and we both found that it was worth the time and effort – for our business, and for our clients. Still, there are some important questions. Let's take a look at them and provide some answers.

WHY MAKE THE MOVE TO E-PROCESSING?

Basically, this boils down to a few key points. The first is data security. Our clients trust us to keep their data safe, and we have found that the security options afforded by working in a paperless format far exceed traditional measures. For instance, anybody can sign a form, but how do you verify their identity if you're just looking at a paper copy? With electronic data processing, there are more reliable security options like knowledge-based authentication, which prompts a signer to confirm their identity by answering a few questions that are specific to the individual (often taking references from their credit history).

Another key benefit is organization. Whether you store your electronic files on a central server or in a cloud-based system, the result is a more efficient way of managing all of the key pieces of data you need. We have connected our files to a CRM database, so every time we need to access a client's information in the CRM, access to all of their historical files is just a few clicks away. This can be especially useful for remote employees, who might otherwise have to come in to the office just to reference stored information. One of our firms is entirely remote, and yet we are able to serve clients in 18 different states because every employee has the access they need without having to open a single file drawer.

There's an added security benefit to the electronic storage: Some offices wisely utilize a "clean desk" policy, which allows no client-sensitive paperwork to sit unattended. This is

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> "The advantages in user experience, data storage, security and precision are simply too great to overlook."

a much easier standard to meet when you don't have to print anything out in the first place.

WHAT'S THE BENEFIT TO CLIENTS?

Though we do have some clients who still prefer to do a lot of things on paper, many have adopted e-processing as part of their standard operating procedures. The shift by the DOL to make the Form 5500 an electronic-only submission has certainly shown clients the importance of moving most, if not all, of their data to electronic formats, and we believe they're glad that they did.

Additionally, we're able to provide scalable service because we aren't putting further strain on our own resources. Electronic processing speeds up almost every task we do, which means we can get information to our clients that much quicker, while still keeping it secure and maintaining a high level of accuracy. We do occasionally have a client who prefers paper over electronic forms, but we have been able to show that we are able to keep our fees and practice as competitive as possible by reducing time and waste.

There will always be some resistance when it comes to adopting new methods and technologies. Yet as the prevalence of electronic forms and systems continues in every corner of life, from the way we manage our investments right down to ordering pizza on a mobile app, more and more people are becoming comfortable with relying on electronic data storage and processing as a better standard than old paper-based practices.

HOW DIFFICULT IS IT TO TRANSITION TO PAPERLESS PROCESSING?

Shifting from tried-and-true practices to something new can be intimidating, and for those who aren't as comfortable with new technology, it can be a real challenge. For some, it might even be too much of one – some firms that have spent decades doing things one way may end up hitting too many speedbumps if they try to change their methods now. For the rest, though, the process of transitioning to an all-electronic (or at least mostly electronic) practice is straightforward.

It starts with your internal organization. Create a filing system stored on an internal server or in the cloud that makes sense for your practice and for your clients. With that, you should develop naming standards for your files, so that it's easy to search for and understand the filenames of all of your important documents (e.g., "Acme_Form5500_2019.pdf").

Next, you will need to convert existing paper documents to electronic files. We recommend appointing an "ultimate scanner" – the person who will be in charge of organizing and processing those documents so there's consistency and chain of custody. Make sure they understand the file naming standards so they're inputting the documents in a way that they can be found later.

The next steps are a little less concrete, because here's where you may have to do some face-to-face selling. You're going to have to get your clients to buy in to the idea. If you can walk through it with them, show them the efficiencies, and have them understand that it's an easy experience, they'll accept it. Once they really see how it works and get more comfortable with it, they're bound to be more accepting of the change.

For your employees, you'll need their buy-in as well, and you will need to make sure everyone is on the same page about how files are processed, saved and secured. It takes a commitment from management to understand the efficiencies, a commitment from the staff to rethink how they save documents, and a collective commitment to believing in the long-term gain of being electronic.

It might feel like a scary proposition, and it may be one of the biggest fundamental changes your firm has ever experienced. But our experience has shown that once you start taking the steps toward an all-electronic practice, you will see that any anxiety you feel about the transition is overwhelmingly outweighed by the benefits. PC

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BY WILL HANSEN

What's Holding Back Adoption of Lifetime Income Products?

The threat of litigation is a powerful force — ask any large employer.

Lifetime income is one of the hottest topics in the retirement industry. Almost every day we see an article on lifetime income, a retirement research paper is released, or a new public policy is unveiled to assist an individual in securing lifetime income in retirement. Even Congress has focused on lifetime income, with three separate policies likely being implemented into law this year that are aimed at encouraging employers to provide lifetime income products in retirement plans.

With new public policies focused on lifetime income products and an overall push for ensuring that Americans are saving for a lifetime of needs, are employers rushing to provide lifetime income products within their retirement plans? The answer: "No."

Why? Because of the hundreds of lawsuits that have been filed against employers over the investment fund lineup provided within a retirement plan. The plan offers too many investment fund options. It doesn't offer enough investment fund options or the right mix of options. The plan provides the right mix of investment fund options, but certain fees are high compared to other fund options. The plan's funds provide a lower rate of return compared to other investment funds (but the fees are low!).

The primary claim keeps changing, and the lawsuits keep getting filed.

According to Bloomberg's Litigation Tracker service, between 2006 and 2017 approximately 428 lawsuits were filed that pertain to a 401(k) plan. Since 2017, dozens more lawsuits have been filed against large employers with deep pockets, including a slew of lawsuits against private universities over the handling of their retirement plans. A handful of law firms represent the plaintiffs in all of these lawsuits. Most defendants (employers) settle quickly to avoid costly litigation, which results in a large paycheck for the plaintiffs' attorneys for doing limited work. In fact, over the course of the past decade, settlements have exceeded $1 billion, and plaintiffs' attorneys walk away with up to one-third of the value of each settlement.

For those employers that decide to litigate the case, we've seen mixed results. A number of employers have received a positive result with a dismissal of the claims at an early stage in the litigation, but that has not prevented the plaintiffs from appealing the dismissal and forcing a lengthy litigation process. For example, the University of Pennsylvania received a dismissal of their claims, but the plaintiffs appealed and recently were rewarded with a reversal of the lower court's dismissal on some of the claims. I purposefully chose this case as an example because one of the judges, in

> "As long as the lawsuits persist, employers will avoid lifetime income products within 401(k) plans.

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her dissenting opinion at the higher court, supported the lower court's initial dismissal of the claim, but went further in supporting the argument that these lawsuits are primarily brought to provide a quick payday to the plaintiffs' law firms. Judge Roth (the daughter of the late Sen. William Roth, who sponsored the Roth IRA legislation) even questioned whether these lawsuits are preventing employers from offering a retirement plan in the first place.

Admittedly, these lawsuits most likely played a small role in shining a light on the fiduciary processes that an employer uses when selecting investment funds for the retirement plan. And, in turn, many employers fearful of a lawsuit have reviewed their investment fund lineup and made adjustments. What adjustments are employers making? One could argue that employers are changing the type of investment fund options to a variety of low-cost passive funds to defend against any potential lawsuit that homes in on the fees associated with investment funds. Whenever I speak to employers, I ask whether they are considering instituting alternative funds or lifetime income products in the retirement plans. The answer is always a resounding "no." The reason: possible lawsuits brought against the investment fund lineup. I firmly believe that as long as the lawsuits persist, employers will avoid lifetime income products within retirement plans.

For the past 10 years this column was written by Craig Hoffman, who recently retired as General Counsel for the American Retirement Association. I had the privilege of engaging with Craig on a number of issues during my career in retirement policy, and look forward to continuing his advocacy to improve the private retirement marketplace. PC

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

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