Am I a Fiduciary?

For ERISA Plans, Non-ERISA Plans, and Plans That Aren't Sure

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First Question - is my plan subject to ERISA?

- Governmental plans always exempt
- Church plans exempt unless they elect ERISA coverage by making an election under IRC section 410(d)
  - Governmental plans cannot make a 410(d) election
- Questions may arise around some entities related to governmental and church organizations
- DOL "safe harbor" for certain salary reduction only plans with little employer involvement

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ERISA coverage issues on the fringes for governmental and church-related organizations

- Governmental plans – definition in IRC 414(d), ERISA 3(32)
  - Main issue - when is an entity an “agency or instrumentality” of a state or political subdivision of a state
    - Questions around charter schools depend upon facts and circumstances
- Church plans – definition in IRC 414(e), ERISA 3(33)
  - Main issues:
    - When is an entity sufficiently “controlled by or associated with” a church or convention or association of churches for its plans to be church plans?
    - When is an entity a church versus a religious charity (e.g., parachurch organizations)?
- Note that the IRS has these definitions under review

ERISA safe harbor for nongovernmental/non-church plans

- Basic requirements of the DOL "safe harbor"
- How does new FAB 2007-2 affect those?
- Have the final IRS regulations made the safe harbor become more difficult to meet?

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Safe harbor plans - 29 C.F.R. § 2510.3-2(f)

- Non-ERISA safe harbor treatment under 29 C.F.R. Sec. 2510.3-2(f)
- Dates to 1979
- Principal requirements:
  1. Plan must be voluntary, salary reduction only
     - No match or employer contributions <u>at all</u>
  2. All rights under the annuity contract or custodial account are enforceable solely by the employee or beneficiary of such employee, or their representative
  3. The employer must receive no consideration other than reasonable reimbursement for the services rendered in connection with the employer's obligations under the agreements with employees

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Safe Harbor requirements, cont'd

4. The involvement of the employer is limited to certain optional specified activities:
   - permitting an annuity contractor to publicize its product to employees;
   - requesting and summarizing relevant information in a manner which will help employees compare various programs;
   - collecting, recording and remitting payments, as required by its agreements with employees; and
   - being the holder of a group policy covering employees

- Note: this means that employer exercise of discretion beyond these does not satisfy the safe harbor

Safe harbor plans – limiting vendors

5. Plan may only limit the funding media or products available or the annuity contractors who may approach employees, to a number and selection which is "designed to afford employees a reasonable choice in light of all relevant circumstances"

- Relevant circumstances may include:
  - Number of employees affected,
  - Number of contractors who have indicated interest,
  - Variety of available products,
  - Terms of the available arrangements,
  - Administrative burdens and costs to the employer, and
  - Possible interference with employee performance resulting from direct solicitation by contractors

Safe Harbor – limiting vendors

- 1979 Preamble: "It may be that in some circumstances it would be reasonable for the employer to limit to one the number of contractors who may deal with employees under the section 403(b) program."
- Does the DOL still think so in 2008?

Safe harbor – employer discretion

- Employer cannot make discretionary determinations in administering the program, but can allocate that responsibility to an issuer (or possibly a TPA) - but not to the participant
  - Employer authorizing hardship distributions and loans not permitted
- FAB 2007-2 further provides that "discretionary determinations" under the regulation include
  - Authorizing plan-to-plan transfers
  - Processing distributions
  - Satisfying applicable QJSA/QPSA requirements
  - Making determinations regarding hardship distributions
  - Making determinations regarding qualified domestic relations orders (QDROs)
  - Determining eligibility for or enforcement of loans
  - Negotiating contract terms with the vendors
- Sharing information, certifying facts, monitoring 402(g), 415 limits okay

DOL safe harbor – new guidance

- DOL Field Assistance Bulletin (FAB) 2007-2
  - Available at http://www.dol.gov/ebsa/regs/fab2007-2.html
- Adoption of a single document okay – so is termination
- Can limit employees to exchanges among providers who have adopted the plan, or transfers into the plan PROVIDED THAT those are limited only as required to afford employees a reasonable choice in light of all relevant circumstances per the safe harbor
- Alternatively, an employer may limit the number of providers to which it will forward salary reduction contributions as long as employees may transfer all or a part of their funds to any product which complies with the Code, and agrees with the plan's division of tax compliance responsibilities among the employer, provider and participant (ISA)

Consequences of being subject to ERISA

- Fiduciary requirements
- Timing of remittances to the plan
- Reporting and disclosure
  - SPDs, SMMs, 5500s
- QJSAs, QPSAs
- QDROs
- Additional loan rules
- Eligibility and participation rules
  - 1000 hour, 1 year of service rule
- Vesting
- Termination issues

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Form 5500s

- Non-ERISA plans do not file 5500s
- For ERISA 403(b) plans, 5500 reporting conforms to 401(k) rules for 2009 plan year
- More complex – may require accounting assistance
- Outside audit beginning in 2009 for large (100+ participant) ERISA plans
  - Issue: what old contracts are plan assets to audit? Will the DOL provide guidance?

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Fiduciary Requirements – Non-ERISA

- Long history of hands-off approach to investments offered for many non-ERISA plans
- For non-ERISA plans, no ERISA fiduciary requirements, but concern is that other requirements may apply

Fiduciary Requirements – Non-ERISA

- For governmental (school district) plans, review statutory authority and local ordinances
  - Because applicable local laws or binding rules may be hard to identify (e.g., AG opinions, policies), may need assistance of school district counsel
  - RFP rules may provide a form of fiduciary requirement
- Review possible impact of state fiduciary laws for public pension plans – sometimes written broadly (or may provide a good standard to follow)
- Consider applying ERISA-like fiduciary standards voluntarily
  - Don't let plaintiffs' lawyers create the standard through litigation

Fiduciary Requirements – Church and safe harbor plans

- Safe harbor plans – employer cannot exercise discretion, so only standard for limiting vendors or contracts should be the "administratively practical" and ISA/plan agreement standard
- Church plans
  - Some view common law of trust or duties of nonprofit officers and directors rules as applicable
  - Consider following the ERISA standard of fiduciary behavior as the "gold standard"

Overview of ERISA fiduciary standards

- General rule:
  - must act solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and defraying reasonable expenses of administering the plan with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims
  - by diversifying the investments of the plan so as to minimize the risk of large losses
  - in accordance with the documents and instruments of the plan, so far as consistent with ERISA

ERISA 404(c) – individually directed plans

- If a participant or beneficiary exercises control over the assets in his or her account, such participant shall not be deemed a fiduciary and no person who is otherwise a fiduciary shall be liable under ERISA for any loss resulting from such exercise of control
- A number of requirements (blackout notices, etc. apply, but it is important to remember that plan fiduciaries retain basic overall or "backstop" duties under ERISA; particularly their fundamental obligations to select and monitor the investments available in a 404(c) plan, and in selecting the default investment (see recent DOL guidance on QDIAs)

How are these ERISA duties implemented?

- ERISA does not provide a roadmap, but best practices have developed
- Documentary compliance:
  - Fiduciary provisions of the plan document
  - Proper appointment of fiduciaries
    - E.g., a committee (most common in for-profits), officers by title
    - Should be informed of their duties and knowledgeable enough to complete them
    - If the organization, can result in uncertainty as to who responsible, and may put more responsibility on the board
  - Written investment policy

ERISA fiduciary best practices

- Procedural due diligence (not a comprehensive list)
  - Periodic meetings
  - Review of investments
    - Against IP, benchmarks
    - Asset classes, appropriateness, duplication
    - If investment expertise needed, can be retained
  - Review administration
  - Review provider contracts periodically
  - Review employee communication
  - Review fees and expenses
- Take actions where necessary and memorialize it

Why such review of practices?

- A focused review process helps to maximize investment results
- Establishes a process that helps protect the Plan, participants and the organization by minimizing liability (especially important in today's environment of increased fiduciary scrutiny and a litigious society)
- Confirms that the Plan is deriving value from fees paid to investment providers
- Helps ensure that the Plan maintains compliance and competitiveness in the industry
- Creates a due diligence review process to ensure that informed decisions are made and consistent with prudent investment practices

Plan terminations under ERISA

- Treasury regulations describe termination process
  - Distribution of annuity contracts or certificates is a distribution, so no longer a plan asset
  - IRS has informally indicated that a 403(b)(7) custodial account must be distributed in cash
- Does the DOL agree?

Potential trap in the 20 hour rule under IRS regs for ERISA plans

- Final IRS regs on the "universal availability" rules provide that an employee normally works fewer than 20 hours per week *if and only if*
  - For the 12 month period beginning on Employee's commencement date, the employer reasonably expects the employee to work fewer than 1000 hours of service
    - As defined in 410(a)(3)(C), which would seem to bring in the hour equivalence rules for elapsed time plans; and
  - For each plan year ending after the close of the 12 month period beginning on the employee's commencement date (or if the plan so provides, each subsequent 12 month period), the employee worked fewer than 1000 hours of service in the *preceding* 12 month period

Potential trap, cont'd

- However, ERISA section 202 also imposes a "minimum participation" standard of 1 year of service (1000 hours) (2 years if 100% vesting) and age 21
- Thus, an ERISA 403(b) plan may have to provide the ERISA rule as a fallback
  - The ERISA rule applies to the year in question (to determine if the employee has a year of service), while the IRS Reg is a essentially a lookback (the "preceding" year)
  - If you don't count hours, the "equivalency rules" based on elapsed time may apply (e.g., each month counts as 190 hours)
- The ERISA minimum participation rule would also apply to any nonelective contributions in an ERISA-covered plan

ERISA and nondiscrimination rules

- For ERISA plans:
  - Universal availability
  - Minimum participation (ERISA section 202)
  - 401(a)(4), (5)
  - 401(a)(17)
  - 401(m)
  - 410(b)
- For governmental plans:
  - Universal availability and 401(a)(17) only
- For safe harbor non-ERISA plans:
  - Universal availability
- For church plans:
  - None, unless a non-QCCO, in which case subject to same rules as an ERISA plan except minimum participation

Time for making contributions – ERISA versus non-ERISA

- For **non-ERISA** plans: contributions must be transferred to the provider within a period "that is **not longer than is reasonable** for the proper administration of the plan"
  - For elective deferrals, the plan my provide a specified period after the date the amounts would otherwise have been paid to the participant
  - **Example: within 15 business days following the month in which the amounts would have been paid to the participant**
- For **ERISA** plans:
  - for **elective** contributions, **as soon as they can be reasonably segregated**, but no later than 15th business day of the month following the month in which the amounts would otherwise have been payable to the participant in cash
- Also keep in mind the **415** rule if there are nonelective contributions:
  - Contributions made by an employer exempt from tax (including a governmental employer), must be made to the plan **no later than the 15th day of the 10th calendar month** following the end of the calendar year or fiscal year, as applicable, with or within which the limitation year ends

Have fun between now and
January 1, ~~2009~~ 2010!