EMPLOYEE BENEFIT PLANS

AN UPDATE ON INDUSTRY DEVELOPMENTS

2018 Issue 1

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Changes to IRS Determination Letter Program

Brendan P. Brady, CPA ◦ bbrady@dopkins.com

IRS Revenue Procedure 2016-37, which was effective January 1, 2017, makes significant changes to the IRS's determination letter program. Most importantly, Rev. Proc. 2016-37 eliminates the ability for individually designed benefit plans to obtain periodic determination letters from the IRS. Plan administrators of individually-designed plans are now entirely responsible for ensuring that Plan documents are updated to remain in compliance with revisions to the Internal Revenue Code, with no means for receiving periodic assurance of the plan's tax-exempt status from the IRS. In the event of revisions to the Internal Revenue Code affecting employee benefit plans, this increases the risk that individually designed plans may not be designed and operated in accordance with applicable sections of the Code. To assist sponsors of individually-designed plans ensure that all required amendments to Plan documents are made, the IRS will publish a required amendments list on an annual basis (see https://www.irs.gov/retirement-plans/required-amendments-list). It is important that administrators and fiduciaries of individually-designed plans monitor this list, as the IRS regularly issues notices requiring amendments to certain benefit plan documents (for example, in 2017 the IRS issued guidance related to amendments to certain defined benefit and collectively-bargained plans).

The determination letter program remains available for pre-approved plans submitted for approval by providers or mass submitters; one way sponsors of individually designed plans can mitigate the risk of noncompliance with the Code is to switch to using a pre-approved plan document. In an effort to encourage plans to use pre-approved plan documents, the IRS issued Revenue Procedure 2017-41 in June 2017. This Revenue Procedure, which had an effective date of October 2017, increases the types of plans eligible for pre-approved status and allows greater flexibility in the design of pre-approved plans.

Missing Participants in Employee Benefit Plans

John F. Matte, CPA ◦ jmatte@dopkins.com

> ***Plan fiduciaries have a fiduciary responsibility under ERISA to attempt locate missing participants.***
> -U.S. Department of Labor

Recently, the Department of Labor (DOL) has begun to put an eye towards "missing participants" in the world of employee benefit plans. A "missing participant" is a terminated employee who still has a balance in a plan and therefore, is still a participant in that plan, but for whom the plan administrator does not have a current mailing address. Plan fiduciaries have a fiduciary responsibility under ERISA to attempt locate missing participants. However, the DOL has no definitive guidance on how exactly this should be accomplished or what steps are "enough" when attempting to locate a missing participant, but ultimately failing. The problem becomes even greater when terminated participants reach age 70 ½ and are legally required to take distributions. While the inability to locate a participant may be interpreted as a breach of fiduciary duty by the DOL, the inability to make a required distribution can jeopardize that plan's ability to qualify as a tax-exempt entity.

It's recommended that any plans with missing participants exhaust all options available to them in locating missing participants, especially those with larger balances. Steps include (but are not limited to) sending requests via certified mail, using other employer records which may have more up to date information and using free electronic search tools. Given the DOL's recent aggressiveness in pursuing plans with missing participants and the high legal risks associated, it is also recommended that any plans who have missing participants consult with legal counsel on the best course of action in locating missing participants.

Proposed Changes to Employee Benefit Plan Auditor Reporting

James A. Krupinski CPA ◦ jkrupinski@dopkins.com

In response to a request from the Chief Accountant of the DOL, the AICPA Auditing Standards Board (ASB) began a project in 2015 to consider how employee benefit plan auditors' reports could be strengthened. As a result of this project, the ASB released a proposed standard for reporting on audits of employee benefit plans in April 2017. The ASB received comment letters and made revisions to the proposed standard and are expected to finalize it soon. One revision to the final standard eliminates the requirement that auditors include in their reports compliance findings from the audit. This issue was consistently disputed in comment letters over concerns of making these findings public through the Form 5500 filing. It was determined that any reportable findings would be communicated, in writing, to management and those charged with governance. The final audit standard will also include revisions to the limited scope audit opinion where the plan administrator obtains a certification from a qualified institution that the investment information is complete and accurate and that investment information is excluded from the scope of the audit. The proposed standard is aimed at improving consistency and quality over auditing employee benefit plans.

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Employee Benefit Plan Cybersecurity Considerations

John F. Matte, CPA ◦ jmatte@dopkins.com

The threat of cyber-attack and the breach of data are pervasive throughout the entire business world. Given the highly sensitive data contained within an employee benefit plan, these entities are no different. Because of this, the American Institute of Certified Public Accountants (AICPA) has listed cybersecurity among its "hot topics" in its 2018 Employee Benefits Plan Industry Developments audit risk alert. Within that publication, the AICPA asserts that Plan Sponsors "…may have a cybersecurity strategy for their business needs, but not a separate strategy for their employee benefit plans. Cybersecurity concerns for ERISA plans require special consideration because they are unique and differ from the business enterprise's issues." The risk alert also indicates that employee benefit plan cybersecurity is specifically deficient in strategies for protecting the data and assets of plans.

In November 2016, the Department of Labor (DOL)'s *Advisory Council on Employee Welfare and Pension Benefit Plans* released a publication entitled "Cybersecurity Considerations for Benefit Plans" (https://www.dol.gov/sites/default/files/ebsa/about-ebsa/about-us/erisa-advisory-council/2016-cybersecurity-considerations-for-benefit-plans.pdf). The intent of the publication was to give plan sponsors, fiduciaries and service providers some tools to use in developing a proper cybersecurity plan related to employee benefit plans. It built on previous advisory council work, dating back to 2011. In it, the advisory council went into detail on currently effective cybersecurity frameworks. It also spelled out industry trends and reiterated the use of the AICPA's Service Organization Control (SOC) reports for data at third party service providers. Overall, the lengthy document gave many useful tips and best practices that can be implemented by any employee benefit plan regardless of size.

>> Based on the focus of the AICPA and the DOL, as well as the current business and political landscape, it is clear that cybersecurity is a very real issue for employee benefit plans. It is also clear that administrators and plan sponsors are not doing nearly enough to prevent their plans from cyber-attacks.

Changes to Hardship Distributions Rules

James A. Krupinski CPA ◦ jkrupinski@dopkins.com

As a part of the Bipartisan Budget Act of 2018, the rules for hardship distributions have been changed to make it easier on participants of a 401(k) Plan. These changes are effective on the first day of the plan year that begins in 2019 (January 1, 2019 for calendar year end plans). Employees will no longer be required to suspend their contributions for six months, thereby allowing them to continue contributing to the plan and receiving any applicable employer match. The Budget Act allows for hardship distributions from qualified nonelective contributions, qualified matching contributions and earnings on elective deferral contributions. It also allows for hardship distributions without regard to whether participants have obtained a loan from the plan. Not all changes are allowed for 403(b) type plans. Plan Sponsors should discuss with their plan service provider or legal counsel to ensure any required amendments are made to the plan document for these rule changes.

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Trends in EBP Litigation and EBP Fiduciary Best Practices

Andrew J. Reading, CPA ◦ areading@dopkins.com

For several years we've witnessed a growing volume of litigation related to employee benefit plans (EBP). According to the Bloomberg Bureau of National Affairs, ERISA Litigation Tracker (2018), over 100 complaints were filed for the years 2016 and 2017. These lawsuits have gained mention in the news, the web, and even television commercials with attorneys seeking retirement plan participants whom believe they've been "harmed". Recently, the AICPA noted this trend in their 2018 Risk Alert for Employee Benefit Plans. They cite the subject of the lawsuits to include the following:

- Unreasonable fees charged;
- Failure to monitor fees charged to participant accounts;
- Improper investment options;
- Failure to monitor investment performance; and
- Plan oversight bodies have not operated for the exclusive benefit of the participants.

According to the Internal Revenue Service (IRS), a fiduciary is a person who owes a duty of care and trust to another and must act primarily for the benefit of the other in a particular activity. The IRS defines basic fiduciary responsibilities to include the following:

- Acting solely in the interest of the participants and their beneficiaries;
- Acting for the exclusive purpose of providing benefits to workers participating in the plan and their beneficiaries, and defraying reasonable expenses of the plan;
- Carrying out duties with the care, skill, prudence and diligence of a prudent person familiar with the matters;
- Following the plan documents; and
- Diversifying plan investments.

The responsibility to be prudent covers a wide range of functions needed to operate a plan. Since you must carry out these functions in the same manner as a prudent person, the IRS indicates it may be in your best interest to consult experts in such fields as investments and accounting. Hiring an expert can help reduce your liability but it does not completely eliminate all responsibilities and liability. The IRS provides the following list of items to consider in selecting a plan service provider:

- Information about the firm's affiliations, financial condition, experience with 401(k) plans, and assets under their control;

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- A description of how the firm will invest plan assets or how it will handle participant investment directions, and its proposed fee structure;
- Information about the identity, experience, and qualifications of the professionals who will be handling the plan's account such as:
  - Any recent litigation or enforcement action that has been taken against the firm;
  - The firm's experience or performance record;
  - Whether the firm plans to work with any of its affiliates in handling the plan's account; and
  - Whether the firm has fiduciary liability insurance.
- Once hired, these are additional actions you should take when monitoring a service provider:
  - Review the service provider's performance;
  - Read any reports they provide;
  - Check actual fees charged;
  - Ask about policies and practices (such as trading, investment turnover, and proxy voting); and
  - Follow up on participant complaints.

These recent trends in litigation highlight the importance of documenting your actions of fiduciary oversight. A documented investment policy can be used as a tool to prudently monitor the investment line-up. Plan fiduciaries should also document oversight by regularly meeting to discuss relevant matters and documenting the minutes from these meetings. We recommend this documentation to include matters such as the following:

- Date, time and location of the meeting
- Identification of the people present at the meeting
- Reference to any investment reports used during the meeting
- Participation issues such as education, goals for increasing the number of participants, or deferral rates
- Plan fee matters including benchmarking for reasonableness and 408(b)(2) service provider notice compliance
- Fund performance matters including benchmarking, decisions to place a fund on a formal or informal "watch list", and decisions to replace/add a fund to the line-up
- Consideration and approval of amendments to the plan document
- Evaluation of service providers, including a review of SOC 1 reports obtained from service providers and considerations of end-user controls
- Employee/participant complaints or concerns, if known
- Compliance with ERISA regulations
- Party-in-interest transactions and considerations

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Updated Mortality Improvement Scales

Brendan P. Brady, CPA ◦ bbrady@dopkins.com

In recent years, the Society of Actuaries (SOA) has released mortality improvement scales each October, with Scale MP-2017, which reflects mortality data through 2015, released on October 20, 2017. GAAP requires plan sponsors to evaluate all available information through the date the financial statements are issued in determining the best estimate of the plan's future experience with respect to each individual assumption. The SOA has determined that Scale MP-2017 currently provides the best mortality estimate to be used in determining pension plan obligations. Plan sponsors may use an alternative method if they can demonstrate that its mortality experience of its employees differs and the alternative method is more appropriate. Continuing a trend that began in 2016, the updated table shows mortality improvement lower than previously expected, which could result in a decrease in pension liabilities of 0.7% - 1%.

Under regulations issued in 2008, the IRS required defined benefit pension plans to calculate their funded status based on a set of mortality tables that were originally developed in 2000. The IRS is required to update these regulations every ten years under the provisions of the 2006 Pension Protection Act, and, in October 2017, issued the required update to these regulations. The updated regulations are generally effective for plan years beginning on or after January 1, 2018, and call for pension plans to calculate their funded status based on mortality improvement scale MP-2016, which was issued by the SOA in October 2016. The IRS also indicated that it will more frequently update the required mortality tables going forward, and in January 2018 issued guidance requiring plans to use the mortality improvement scale MP-2017 to calculate funded status for years beginning on or after January 1, 2019. For most plans, the adoption of the updated mortality tables will result in an increase in liabilities and a decrease in funded status, which may require plan sponsors to make additional contributions to these plans. The IRS has made available a one-year deferral option for single employer plans satisfying certain requirements, which may allow plan sponsors to temporarily delay increasing contributions to affected plans.

For more information, please contact your existing Dopkins contact or one of the authors from Dopkins Employee Benefits team:

Brendan P. Brady, CPA bbrady@dopkins.com
John F. Matte, CPA jmatte@dopkins.com
James A. Krupinski CPA jkrupinski@dopkins.com
Andrew J. Reading, CPA areading@dopkins.com

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