Dopkins & Company, LLP
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

EMPLOYEE BENEFIT PLANS
AN UPDATE ON INDUSTRY DEVELOPMENTS

2020 Issue 2

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PLUS: Dopkins 2020 Employee Benefits COVID-19 Special Report

Document Retention Best Practices

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One area that is frequently challenging for Plan Administrators is determining which plan records should be retained and for how long. Section 107 of the Employee Retirement Income Security Act of 1974 (ERISA) requires records for benefit plans used to support plan filings to be retained for a minimum of six years after the filing date. These records include the Form 5500, compliance testing results, employee communications, financial reports and related supporting documents, fidelity bond coverage, and income tax returns. Section 209 of ERISA requires an employer to retain records used to determine benefits, as required by the Department of Labor (DOL). The DOL regulations issued in 1980 indicate that participant benefit records should be retained "as long as a possibility exists that they might be relevant to a determination of the benefit entitlements of a participant or beneficiary." These records include Plan documents and related documents, census data and supporting documentation, participant account records, supporting documentation for loans and distributions, Board or Administrative committee minutes, and Trust documents.

There are certain best practices for proper document retention in regard to employee benefit plans. These include creating a written document retention policy for the organization, and ensuring the policy is followed consistently, as well as properly categorizing and organizing records so that they can be easily recovered.

While following proper document retention procedures, Plan Administrators should also be aware of the need to protect personally identifiable information (PII) and protected health information (PHI). Best practices include reducing paper documentation and increasing encrypted electronic information, as well as only retaining necessary documents and destroying unneeded PII. These actions reduce susceptibility of this sensitive data.

The Future of ESG investments in Retirement Plans

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One of the most popular investment trends over the last few years has been the emergence of ESG or Environmental, Social and Governance investment funds. Like most investment mutual funds, these funds are a collection of various equity securities of different companies, packaged together and sold to investors. What makes these funds different is that the investments chosen typically have a common theme, such as focusing on companies who have good environmental operations, friendly corporate governance or social standing in the community. Previously these funds were referred to as SRI or Socially Responsible Investment funds. Whatever you call them, they currently represent over $30 trillion in investable assets as of 2018 according to Global Sustainable Investment Alliance.

Currently ESG funds are very popular with Millennials and Generation Z. With the explosion of ESG funds across the investment spectrum, obvious questions arise as to their place in qualified retirement plans. This is not a new discussion. The Department of Labor (DOL) has addressed ESG funds several times in the past, but the guidance has left many asking more questions than getting answers. Recently the DOL issued proposed regulations concerning ESG funds and their use in retirement plans. The new proposed rules try to outline the process plan fiduciaries should follow when investigating ESG funds inclusion in the investment menu for retirement plans.

The DOL's rules have always guided fiduciaries that when selecting investments for inclusion in the plan, their focus must be on the plan's financial returns and that furthering the interest of plan participants and beneficiaries in financial benefits under the plan must be paramount. Guidance has stated that ESG investments could be consistent with ERISA's fiduciary obligations, but that fiduciaries need to make sure that the ESG investment has an expected rate of return that is commensurate to the rates of return of alternative investments with similar risk characteristics that are available to the plan, and that the investment is otherwise an appropriate investment for the plan in terms of such factors as diversification and the investment policy of the plan.

The DOL's aim is to assist ERISA fiduciaries by establishing clear regulatory guidelines for plan fiduciaries in light of recent trends involving ESG investing that the DOL is concerned may lead ERISA plan fiduciaries to choose investments or investment courses of action to promote environmental, social, and public policy goals unrelated to the interests of plan participants and beneficiaries in financial benefits from the plan and expose plan participants and beneficiaries to inappropriate investment risks.

Specifically, the DOL has outlined five additions to the existing regulation. They include:

1. New regulatory text to codify the DOL's longstanding position articulated in interpretive bulletins (IBs) published in 1994, 2008, and 2015 that ERISA requires plan fiduciaries to select investments and

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investment courses of action based on financial considerations relevant to the risk-adjusted economic value of a particular investment or investment course of action. *

2. An express regulatory provision stating that compliance with the exclusive purpose (loyalty) duty in ERISA Section 404(a)(1)(A) prohibits fiduciaries from subordinating the interests of plan participants and beneficiaries in retirement income and financial benefits under the plan to non-pecuniary goals.*

3. A new provision that requires fiduciaries to consider other available investments to meet their prudence and loyalty duties under ERISA in furthering the purposes of the plan.*

4. The proposal acknowledges that ESG factors can be pecuniary factors, but only if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories. New regulatory text sets forth required investment analysis and documentation requirements in the rare circumstances when fiduciaries are choosing among economically "indistinguishable" investments (related to the so-called "tiebreaker rule" in the 1994, 2008, and 2015 IBs). The documentation requirement is intended to provide a safeguard against the incentive for fiduciaries to improperly find economic equivalence and make decisions based on non-pecuniary benefits without a proper analysis and evaluation. Fiduciaries already commonly document and maintain records about their investment selections. The provision in the proposal would make that general practice required where a fiduciary determines that alternative investment options are economically indistinguishable and where the fiduciary chooses one of the investments on the basis of a non-pecuniary factor.*

5. A new provision on selecting designated investment alternatives for 401(k)-type plans. The proposal states the DOL's view that the prudence and loyalty standards set forth in ERISA apply to a fiduciary's selection of an investment alternative to be offered to plan participants and beneficiaries in an individual account plan (commonly referred to as a 401(k)-type plan). The proposal describes the requirements for the selection of investment alternatives for such plans that purport to pursue one or more environmental, social, and corporate governance-oriented objectives in their investment mandates or that include such parameters in the fund name.*

Some have commented that the proposed rule seems to make existing regulations tighter and, therefore, less likely that plan fiduciaries would be willing to include ESG funds in their investment menus. Although that remains to be seen, it is clear that the DOL is indicating that fiduciaries should not forgo the potential financial benefits to participants in lieu of a more social investment policy when making fund selections. It is also very clear that, as it always has been, plan fiduciaries need to have a solid documented process when it comes to the selection and monitoring of the plan's investment menu. That is even more important if a plan fiduciary is considering an ESG investment to the plan.

Early feedback from industry and congressional parties indicates that many feel the DOL has gone too far in overly regulating the investment selection process for retirement plan sponsors and providers. The comment period is scheduled to end on July 30, 2020.

*Per Department of Labor Notice of Proposed Rulemaking on Financial Factors in Selecting Plan Investments Fact Sheet dated June 23, 2020.

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Trends in EBP Litigation and EBP Fiduciary Best Practices

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For several years we've witnessed a growing volume of litigation related to employee benefit plans. According to a Bloomberg Law analysis, ERISA class settlements in employee benefit disputes hit $449M in 2019, up significantly from 2018 ($291M) and nearly reaching 2017 levels ($559M). 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 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 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 the fiduciary must carry out these functions in the same manner as a prudent person, the IRS indicates it may be the fiduciary's best interest to consult experts in such fields as investments and accounting. Hiring an expert can help reduce the fiduciary's liabilities 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;
- 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;

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    - 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 the fiduciary 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; and
- Party-in-interest transactions and considerations.

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Update on Hardship Withdrawal Rules

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Regulations issued by the IRS have clarified new hardship withdrawal rules for 401(k) and 403(b) plans under the Bipartisan Budget Act of 2018. Prior to these changes, participants were suspended from making salary deferrals following a hardship withdrawal for a period of time. With the new regulations, participants no longer are subject to this restriction. In addition, participants will no longer be required to first obtain a loan from the plan, prior to taking a hardship withdrawal. These changes are effective on or after January 1, 2020 with early adoption permitted as early as January 1, 2019. Another change is that Plan Administrators may rely on an employee's written self-certification of insufficient assets to satisfy the financial need, unless the Plan Administrator has knowledge to the contrary.

For 401(k) plans, hardship withdrawals are permitted from elective deferrals, Qualified Non-Elective Contributions (QNEC), Qualified Matching Contributions (QMAC) and safe harbor contributions and earnings on these amounts. For 403(b) plans, hardship withdrawals are permitted from elective deferrals and earnings on amounts that are ineligible for hardship withdrawals. Hardship withdrawals from QNEC and QMAC are limited to certain non-custodial 403b plans.

Changes to the safe harbor list of eligible hardship expenses include:

- Hardships for medical, educational or funeral expenses may be incurred by the 'primary beneficiary under the plan.'
- Casualty loss damage to a principal residence does not have to be due to a federally declared disaster area.
- New category of hardship for expenses incurred as a result of a federally declared disaster designated by FEMA, only if the participant's principal residence or place of employment is located in the disaster area.

Plan amendments will be needed for the hardship withdrawal changes. Individually designed plans will need to be amended no later than the end of the second calendar year following the issuance of the hardship changes on the required amendment list, while pre-approved plans will need interim amendments likely in the year following the issuance of the final regulations.

New Auditing Standard for Employee Benefit Plans

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As a result of the coronavirus pandemic, the AICPA Accounting Standards Board Audits has decided to delay the effective date, by one year, for the Statement on Auditing Standards 136, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA (SAS 136)*. Auditors of employee benefit plans subject to the Employee Retirement Income Security Act of 1974 (ERISA) will be required to comply with SAS 136 for plan year ends after December 15, 2021. This new audit standard has the goal of addressing the Department of Labor's concerns about poor audit quality over employee benefit plans primarily by firms that do not have significant experience with these types of audits.

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SAS 136 provides more specific guidance in audit requirements of employee benefit plans. Specifically, the audit requirements cover the following topics:

- Engagement acceptance;
- Audit risk assessment and responses, including consideration of the plan's provisions;
- Communication of reportable findings to those charged with governance; and
- Auditor's responsibility regarding the ERISA required supplemental schedules.

A new audit report format from SAS 136 provides more information on the scope of the audit, responsibilities of the auditor as well as management's responsibilities, and enhanced reporting relating to going concern. The limited scope audit report is also modified and referred as the "ERISA section 103(a)(3)(C) audit" and will have a two-pronged opinion that is based on the audit and on the procedures performed relating to the certified investment information. This audit standard also requires certain compliance findings to be communicated to those charged with governance over the plan.

Retirement Plan Contributions and the PPP – Some Clarification

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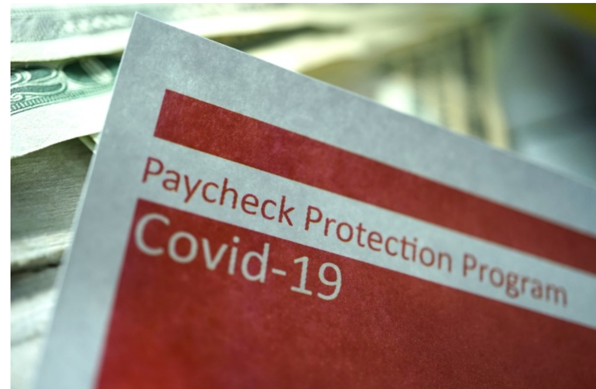
Section 1102 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 created the Paycheck Protection Program (PPP) to help small businesses affected by the COVID-19 crisis by covering their near-term operating expenses and providing incentives to retain employees. PPP loans will be fully forgiven when used for certain expenses, including payroll costs. Among other things, under Section 1102, payroll costs include "payments of any retirement benefits."



Questions have arisen as to how "payments of retirement benefits" are considered when employers are making various payments to retirement plans.

In FAQs released April 6, 2020, the Department of the Treasury clarified that employer contributions to both defined contribution plans and defined benefit plans are included in the definition of payroll costs when calculating the maximum amount of a PPP loan. Further, the $100,000 cap on compensation applies only to salary; the cap does not apply to employer contributions to DC and DB plans. There is, however, one restriction on the amount of retirement benefit payments that can be forgiven related to owners. Employer contributions to retirement plans on behalf of self-employed individuals or general partners, are not eligible for forgiveness, while contributions on behalf of other owner-employees are capped at 2 ½ months' worth of the 2019 contribution amount for those owner-employees.

The Treasury Department FAQs make it clear that payroll costs include employer contributions to retirement plans, and those retirement plan contributions are not capped by the $100,000 limit. The $100,000 cap only applies to the salaries of employees.

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Missing Participants in Employee Benefit Plans

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A recent "hot topic" within the Department of Labor (DOL) has been the fiduciary responsibility under the Employment Retirement Income Security Act of 1974 to maintain accurate retirement plan participant contact information, especially when participants have terminated employment with the plan sponsor. By not doing this, plans run the risk of having "missing participants," or those participants who are no longer under employment but still have benefits available under the plan. Continuously maintaining current participant data can be a challenging task for all types of retirement plans; however, can prove especially difficult for defined benefit plans, where it is common to have participants who have not worked for the plan sponsor in (potentially) decades. Additionally, the industry continues to see increases in company mergers, spin-offs, acquisitions, or changes in service providers, which all may result in the loss or inadvertent destruction of original personnel information. Locating missing participants can create a major headache for plan fiduciaries when those participants are required to take distributions, either as stipulated by the plan document (for example, upon retirement age for a defined benefit plan), or by regulation (for example, upon the attainment of age 70 ½).

In the event there are missing participants, the fiduciary's responsibility extends to making every attempt possible to locate them. Failing to do so not only constitutes a breach of this responsibility, as determined by the DOL, but may also jeopardize the plan's tax-exempt status if those participants do not receive distributions in accordance with the plan document. Unfortunately, the DOL has provided little authoritative guidance on what actions need to be taken to locate these participants, and at what point fiduciary responsibility in this regard has been exhausted. While specifically discussing missing participants as it relates to terminated defined contribution plans, the DOL in its Field Assistance Bulletin No. 2014-01 (FAB 2014-01) does list the following search methods as the minimum steps the fiduciary must take to locate a participant:

- Send a notice using certified mail
- Check the records of the employer or any related plan of the employer
- Send an inquiry of the designated beneficiary of the missing participant
- Use free electronic search tools

FAB 2014-01 also provides distribution options available for a participant who, upon using the above search methods, still cannot be located. Given recent DOL attention on this issue, it is also recommended that any plans who have missing participants consult with legal counsel on the best course of action in locating them.

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Unexpected Retirement Plan Problems Due to COVID-19

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One aspect of the current pandemic and subsequent business layoffs and furloughs that is not being talked about very much is the impact to corporate retirement plans in regards to the impact that those layoffs could have on a plan's non-discrimination testing for the plan year 2020. Although almost a year away, business owners should start thinking about how any business interruptions could negatively impact their 401(k) testing for plan year 2020 that occurs in 2021.

Every year, with certain exceptions, 401(k) plans need to conduct and pass a variety of compliance tests to demonstrate to the government that the plan is equitable. It needs to be equitable between all plan participants, including both the highly compensated and non-highly compensated employee groups. These tests can potentially limit how much a highly compensated employee can contribute to the plan or how much an employer has to contribute. Factors such as an employee's annual compensation, the number of hours they worked in the year, the amount they contributed to the plan and any employer contributions they received all factor into the testing requirements and impact the results.

All of these factors could have been impacted by COVID-19 and the business interruptions that resulted. Business owners need to ask themselves the following:

- Are you a business that had to layoff employees?
- Did employee hours have to be cut back?
- Did employees have to take pay cuts?
- Was your business forced to lower or suspend employer 401(k) matching contributions?
- Did the business owner front load plan contributions for themselves early in the year?

These are just a few of the business situations that could have resulted from COVID-19 that can impact 401(k) testing. All of these factors can lead to testing problems and potential failures for the plan year 2020. This could further lead to reduced contributions to business owners and/or key employees, or even result in the refund of employee deferrals or require additional employer contributions and costs to staff. The time to review and act is now. Adjustments can still be made in 2020 to minimize the negative impact to retirement plans and business owner's retirement savings.

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Changes to Retirement Plans due to the SECURE Act

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The Setting Every Community Up for Retirement Act (SECURE Act) was signed into law by the President of the United States on December 20, 2019. The objective of the law is to help all Americans save for retirement. While the SECURE Act made many additions and changes to employees' retirement plan especially for smaller businesses there were two big changes for larger benefit plans and they are:

- Changing the age to start taking Required Minimum Distributions (RMD's)
- Employers are now required to offer their retirement plan to long-term part-time employees

Changing the age to start taking RMD's

With the passing of the SECURE Act, participants start taking RMD's by April 1st of the year the participant reaches age 72 and this is effective for participants whose date of birth is July 1, 1949 or later. For example:

- If a participant was born on June 30, 1949, the participant must follow the old rules and take RMD's by April 1st of the year the participant reaches age 70 ½ or April 1, 2020
- If a participant was born on July 1, 1949, the participant must start taking RMD's by April 1st of the year the participant reaches age 72 or April 1, 2022.

Offering retirement plans to long-term part-time employees

With the passing of the SECURE Act, employers must offer long-term part-time employees' eligibility to their retirement plan. A long-term part-time employee is defined as an employee who has worked at least 500 hours per year for the previous three years. It is important to note that the hours prior to 2021 are not considered. Based on these rules, the earliest entry for these employees would be January 1, 2024.

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EMPLOYEE BENEFIT PLANS SPECIAL REPORT

A COVID-19 UPDATE ON INDUSTRY DEVELOPMENTS

IN THIS SECTION -

A summary of the key provisions impacting retirement plans including:

- Coronavirus distributions
- Loans to plan participants
- Required minimum distributions
- Defined benefit plans

>Visit our Coronavirus Business Resource Center for more information: www.dopkins.com/covid

The Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law by the President of the United States on March 27, 2020. The CARES Act, among its many provisions, provides relief for both retirement plan participants and plan sponsors. A summary of the key provisions impacting retirement plans is provided below:

Coronavirus distributions

Section 2202 of the CARES Act introduces a new category of retirement plan withdrawals, referred to as coronavirus-related distributions (CRD). A CRD can be taken by a qualifying participant who meets one of the following criteria:

- The participant has been diagnosed with the virus SARS-CoV-2 or COVID-19 disease by a test approved by the Centers of Disease Control and Prevention (CDC),
- The participant's spouse or dependent is diagnosed with such virus or disease by a test approved by the CDC, or
- The participant experiences an adverse financial consequence as a result of:
  - Being quarantined,
  - Being furloughed or laid off,
  - Having work hours reduced,
  - Being unable to work due to lack of child care,
  - Closing or reducing hours of a business owned or operated by the participant, or
  - Other factors as determined by the Secretary of the Treasury

It is important to note that a participant does not have to experience a financial hardship to meet either of the first two criteria listed above.

CRDs must also be made from an eligible retirement plan on or after January 1, 2020 and before December 31, 2020, and, together with any other CRDs for the participant's taxable year, cannot exceed $100,000.

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CRDs also receive preferential tax treatment. Section 72(t) of the Internal Revenue Code (IRC) generally imposes a 10% additional income tax on any amount received by a participant as an early distribution from a qualified retirement plan. CRDs processed under the CARES Act are exempt from such penalty. Additionally, the normal 60-day rollover period has been extended specifically for CRDs to three years (ie. a participant, after receiving a CRD, has three years from the date of such CRD to make one or more contributions to an eligible retirement plan in an amount equal to the CRD), to provide an exemption from mandatory 20% withholding requirements.

Loans to plan participants

Additionally, Section 2202 of the CARES Act addresses loans made to participants. Eligible retirement plans may now issue loans to qualifying participants, as previously defined, in an amount equal to the lesser of (1) $100,000 or (2) the participant's vested account balance. Previously, loan amounts were generally limited to the lesser of (1) $50,000 or (2) 50% of the participant's vested account balance. The expansion of the loan limitation is effective for loans made to qualifying individuals during the period beginning March 27, 2020 through September 23, 2020.

Section 72(p) of the IRC generally states that a plan loan to a participant must be repaid within 5 years and the loan must require substantially level amortization over the term with payments no less frequently than quarterly. The CARES Act alters this guidance by delaying any loan repayment originally scheduled to occur during the period beginning March 27, 2020 through December 31, 2020 by 1 year. The 1-year period will be disregarded for purposes of determining whether the loan meets the maximum term and level amortization requirements set forth by Section 72(p).

Any subsequent repayments with respect to any such loan shall be appropriately adjusted to reflect the delay in due date and any interest accruing during such delay.

Required minimum distributions

Section 2203 of the CARES Act provides relief to certain types of defined contribution plans by allowing for a temporary waiver of the required minimum distribution (RMD) requirements under Section 401(a)(9) of the IRC. For calendar year 2020, RMD requirements do not apply to plans of the following types:

- Tax qualified defined contribution plans, such as 401(k) plans;
- IRC Section 403(a) and 403(b) plans;
- Certain eligible governmental employer-sponsored non-qualified deferred compensation plans; and
- Individual retirement plans (IRAs).

For plan participants scheduled to begin receiving an RMD during 2020 (ie. a participant who attained age 70 ½ during 2019 and whose required beginning date for their first RMD is in calendar year 2020), the CARES Act has eliminated the requirement for any RMD. Participants within one of the plan types listed above and who meet these criteria would see a waiver of their 2019 and 2020 RMD.

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Note on plan amendments - While the provisions in the three previous areas can be implemented immediately, plans must formally amend their plan documents to allow for these provisions by the last day of the first plan year beginning on or after January 1, 2022 (or January 1, 2024 in the case of a governmental plan). During calendar year 2020, as long as the plan operates as though an amendment were being made to the plan immediately, plans will not be treated as failing to operating in accordance with their terms if they amend by this deadline.

Defined benefit plans

To assist sponsors of single-employer defined benefit plans in maintaining cash flow, Section 3608 of the CARES Act provides a deferral for minimum required contributions originally scheduled to be made during calendar year 2020 to January 1, 2021. This also includes quarterly contributions due in 2020. Contributions that are deferred will be adjusted for interest during the period between the original due date and when the payment is actually made. This interest adjustment is to be made based on the plan's effective interest rate for the plan year in which the contribution relates.

Additionally, Section 3608 of the CARES Act addresses a defined benefit plan's adjusted funding target attainment percentage (AFTAP). A plan's AFTAP can impact the level of benefit restrictions applicable to a defined benefit plan as specified by Section 436 of the IRC, including whether or not lump sum or other accelerated benefit payments may be paid, when plan amendments can take effect, and whether benefits can continue to accrue. Under the CARES Act, a defined benefit plan sponsor can elect to treat its plan's AFTAP for the last plan year ending before January 1, 2020 as the AFTAP for the plan years that include calendar year 2020. Since Section 3608 does not specifically address plans with non-calendar year-ends, we recommend consultation with your retirement plan administrator or plan attorney to determine applicability.

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