ERISA ROUNDUP

A quarterly recap of recent publications from BDO's ERISA Center of Excellence.

Q2 2019

A NOTE FROM BDO'S NATIONAL ERISA PRACTICE LEADER

Summer is in full swing and as you get back to normal work life after June 30 deadlines and a long holiday weekend, we are here to help bring you up to speed on the latest news updates and industry trends.

In addition to our regular insights, this quarter we're sharing key learnings from the AICPA Employee Benefit Plans Conference which took place in New Orleans in May, as well as a special 2-part piece on what plan sponsors need to know when it comes to business combinations.

We understand it's your mission to help guide your employees to financial freedom, and with that in mind, we're looking at new ways to share our expertise. Next quarter, we'll be launching a podcast that will be taped live once a month and available for you to listen to through the Apple Podcasts app.

As always, we invite you to keep up with our insights as they're published at www.bdo.com/erisa.

Sincerely,

BETH GARNER
National Practice Leader, ERISA

BDO's ERISA Center of Excellence is your source for insights on emerging regulations, industry trends, current topics, and more. Visit us at www.bdo.com/erisa or follow along on Twitter: @BDO_USA and #BDOERISA.

IN THIS ISSUE

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2019 Deadlines and Important Dates for Plan Sponsors

JULY 2019

- **1** / Plans with publicly traded employer stock must file Form 11-K with the Securities and Exchange Commission by July 1.
- **25** / File PBGC Form 200 by July 25, if plan sponsor of a single-employer defined benefit plan does not make the July 15 required contribution, causing the plan to have more than $1 million in unpaid contributions.
- **31** / Large plan audit must be completed by July 31 to avoid requesting Form 5500 extension.
- **31** / IRS Form 5500 must be filed by July 31.
- **31** / To request a Form 5500 extension, Form 5558 must be submitted by July 31.
- **31** / Pay Patient-Centered Outcomes Research Institute (PCORI) fee by July 31. Self-insured health plans must pay $2.45 per person (covered by health plan).

AUGUST 2019

- **14** / File PBGC Form 10 by Aug. 14, Post-Event Notice of Reportable Events for single-employer defined benefit plans.
- **31** / Plans that failed compliance testing may take this mid-year opportunity to run compliance tests. Aug. 31

SEPTEMBER 2019

- **15** / If an extension was filed, Sept. 15 is the deadline to fund employer contributions.
- **15** / Minimum funding deadline for single- and multi-employer defined benefit plans.
- **25** / File PBGC Form 200 by Sept. 25, if plan sponsor of a single-employer defined benefit plan does not make the Sept. 15 required contribution, causing the plan to have more than $1 million in unpaid contributions.
- **30** / Sept. 30, Summary Annual Report sent to participants with Dec. 31 plan year end.

OCTOBER 2019

- **1** / Make sure procedures align with language in plan document. Oct 1.
- **1** / Annual notices to participants begin Oct. 1, including 401(k) Plan Safe Harbor Notice, automatic contribution arrangement safe harbor and qualified default investment alternative.
- **15** / File PBGC Form 10 by Oct. 15, Post-Event Notice of Reportable Events for single-employer defined benefit plans.
- **15** / Oct. 15 is the extended deadline for filing Form 5500.
- **15** / Oct. 15 is the extended deadline for filing individual and C-Corp tax returns.
- **15** / Oct. 15, multi-employer defined benefit plans file PBGC Comprehensive Premium document and pay $29 per participant flat-rate premium.
- **15** / Oct. 15 to open a Simplified Employee Pension (SEP) plan for extended tax filers.
- **25** / File PBGC Form 200 by Oct. 25, if plan sponsor of a single-employer defined benefit plan does not make the Oct. 15 required contribution, causing the plan to have more than $1 million in unpaid contributions.

NOVEMBER 2019

- **14** / File PBGC Form 10 by Nov. 14, Post-Event Notice of Reportable Events for single-employer defined benefit plans.

DECEMBER 2019

- **1** / Annual Participant notices must be distributed by Dec. 1. These include: 401(k) safe harbor, annual automatic contribution and qualified default investment alternative (QDIA) notices.
- **15** / Dec. 15 is the extended deadline to distribute Summary Annual Report (SAR) for calendar year plans.
- **31** / By Dec. 31, process corrective distributions for failed ADP/ACP testing; a 10 percent excise tax may apply.
- **31** / Amendments to change traditional 401(k) to safe harbor design, remove safe harbor feature or change certain discretionary modifications must be completed by Dec. 31.
- **31** / Required minimum distributions for participants age 70 ½ must be completed by Dec. 31 for calendar plan years.
- **31** / Plan sponsors must amend plan documents by Dec. 31 to account for any discretionary changes made during the year.

CONTRIBUTION PLAN LIMITS AND OTHER ROLLING NOTICES FOR 2019

In addition to those important deadlines and dates, plan sponsors should be aware of the contribution plan limits and other rolling notices for 2019:

- Employee salary deferral limits for 401(k), 403(b) and 457 plans will be $19,000. Age 50 catch-up contribution limit stays unchanged at $6,000.
- Health Savings Account contribution limit is $3,500 (single) and $7,000 (family). Age 55 catch-up contribution stays at $1,000.
- Traditional and Roth Individual Retirement Account contribution limit will be $6,000. Catch-up contributions for participants age 50 and over stays at $1,000.
- Limitation for the annual benefit under a defined benefit plan under Section 415(b)(1)(A) will be $225,000.
- Newly eligible employees must receive a Summary Plan Description (SPD) within 90 days.
- Provide quarterly statements and fee information to participants.

Highlights from the AICPA Employee Benefit Plans Conference

Staying on top of the latest accounting and auditing trends that affect employee benefit plans is important to our ERISA services team to better serve Plan Sponsors.. Several BDO representatives recently attended the American Institute of Certified Public Accountants (AICPA) **Employee Benefit Plans Conference** in New Orleans, where they learned from regulators, and service providers about the top accounting and auditing developments affecting employee benefit plans today.

The three-day conference covered a range of topics, from regulatory updates to plan design trends. Here are three areas that we identified as being the most relevant for plan sponsors as we enter into this filing season.

CYBERSECURITY

Plan sponsors and their auditors should be paying attention to cybersecurity risks that specifically affect an organization's benefits plans. In addition to holding assets, these plans also contain massive amounts of sensitive information including names, Social Security numbers and addresses that could be easy for hackers to steal if appropriate protocols are not in place.

While there are several types of cybersecurity threats, phishing techniques were a top conversation at the conference. This hacking method involves stealing login credentials and passwords through a phony email. It is usually posed as being sent from one executive to another, asking for sensitive employee data. Also, the email may look like it came from an outside provider—like a record keeper—to get the valuable information.

Speakers on the topic stressed that organizations need to have a cybersecurity strategy that is specific to the company's benefit plans. Often, companies have cybersecurity protocols for the overall organization but don't consider the needs of such protocols for their benefit plans.

In addition, it is important to remember that even though service providers may claim they have cybersecurity controls and are fiduciaries to the plan, it is the plan sponsor's ultimate fiduciary responsibility to make sure data is safe. The AICPA hosts a **Cybersecurity Resource Center** to help companies learn how to set standards and best protect their sensitive information.

Cybersecurity attacks can carry hefty penalties and consequences, including time, investigative costs and potential fiduciary breaches. In addition to establishing protocols for reducing the risk of a cyberattack, plan sponsors also need to establish plans for how they will respond if a breach occurs. Having a plan in place may not prevent a cyberattack, but it will allow for centralized control and a set path of correction that is tailored to the organization's benefits plans.

EBSA ENFORCEMENT OF BENEFIT PLANS

The Department of Labor's Employee Benefits Security Administration (EBSA) recently released its **enforcement statistics for 2018**, reporting that it recovered $1.6 billion for direct payments to plans, participants and beneficiaries—a $500 million increase from 2017. Breaking this total down, monetary recoveries were $1.1 billion from enforcement actions, $443.2 million from the informal complaint resolution program, $33.4 million from the abandoned plan program and $10.8 million from the voluntary fiduciary correction program.

This means that the EBSA's enforcement arm remains extremely active and that plan sponsors need to pay attention to their fiduciary responsibilities. In particular, the Terminated Vested Participant Project (TVPP) continues to be a significant project for the agency, which helped recover nearly $808 million owed to defined benefit plan participants. In 2017, only $327 million was recovered through this program. The TVPP investigates whether plan sponsors have sufficiently searched for missing participants.

RECENT IRS REVENUE PROCEDURES

Experts at the conference also covered two new Internal Revenue Service (IRS) revenue procedures. The first involves the Employee Plans Compliance Resolution System (EPCRS); and the second discusses changes for the IRS determination letter program for certain individually designed plans.

Rev. Proc. 2019-19 offers three correction programs. The new tweaks to the rule, which became effective April 19, 2019, eases certain correction processes:

- Internal Revenue Code (IRC) 401(a) plans can now self-correct specific failures under certain circumstances.
- Plan sponsors can adopt a retroactive plan amendment under the voluntary correction program (VCP) if certain conditions are met.
- Plan sponsors can self-correct specific loan failures after satisfying particular conditions under the rule.
- Plan sponsors can self-correct failures to get spousal approval to distributions through a retroactive consent.

Rev. Proc. 2019-20 provides a limited expansion of the determination letter program for individually designed statutory hybrid plans like cash balance and pension equity plans, as well as merged plans.

- Hybrid plans: Plan sponsors can submit determination letter applications beginning Sept. 1, 2019, and ending Aug. 31, 2020. Now, plan sponsors can ask the IRS to review the plan to make sure it complies with federal regulations. Plan sponsors may be able to correct failures without having to pay a penalty.
- Merged plans: Plan sponsors can submit determination letter applications on an ongoing basis. To qualify, plans need to have been merged no later than the last day of the first plan year that begins after the plan year that includes the date of the company merger. The merged plan determination letter application needs to be submitted no later than the last day of the first plan year of the new plan that starts after the date of the plan merger.

BDO INSIGHT: STAY ON TOP OF INDUSTRY TRENDS

In addition to the topics described above, another high-priority item covered at this year's AICPA Employee Benefit Plans Conference was the new employee benefit plan (EBP) auditing standard that was voted as a final standard in July 2018.

The new standard addresses the auditor's responsibilities for forming an opinion and reporting on ERISA plan financial statements. The new standard also addresses the form and content of the auditor's report issued as a result of an audit of ERISA plan financial statements, including changes to the form and content of the auditor's report when management elects to have an ERISA section 103(a)(3)(C) audit performed.

The new standard is effective for audits of financial statements for periods ending on or after December 15, 2020.

As we approach the upcoming filing season, we wanted to share the above topics to help you better understand the impact to your benefit plans. If you have any questions about any of these topics, your BDO representative is available to help explain the details.

Accounting Changes for Recognition of Pension Liability Settlements

BACKGROUND

An update to ASC 715 incorporating new pension accounting standards will impact the way plan sponsors approach the recognition of pension liability settlements. Accounting Standards Update (ASU) 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which was issued by the Financial Accounting Standards Board in March 2017, is effective in 2018 for fiscal years starting after December 15, 2017, for public entities and effective in 2019 for fiscal years starting after December 15, 2018, for private entities. Concurrently, many pension plan sponsors are considering or in the process of executing significant liability settlements. Such transactions will hit financial statements in fiscal years 2018, 2019 and beyond. Although these accounting standard changes will impact all pension plan sponsors, the focus of this paper is on the treatment of additional pension costs resulting from pension risk transfer activities such as lump sum windows and liability settlements from group annuity purchases.

PRIOR PENSION ACCOUNTING STANDARDS

Many organizations that sponsor a defined benefit pension plan have a significant portion of their balance sheet and income statement tied to and influenced by the volatility of pension liabilities and assets. Accounting for the long-term nature of these liabilities has always been complex. Users of financial statements often found it difficult to interpret operating results when pension finance is blended into the numbers. ASU 2017-07 was designed to provide more transparency in the sponsoring entity's operating results while providing more alignment between pension accounting under U.S. GAAP and international accounting standards.

Pension accounting requires recognition of an annual bookkeeping expense called Net Periodic Pension Cost (NPPC). The NPPC is comprised of:

- Service Cost
- Interest Cost
- Expected return on assets
- Amortization of actuarial gains & losses
- Amortization of prior service costs
- Recognition of curtailments and settlements

Service Cost is the value of new benefits being earned for active employees for an additional year of service during the fiscal year. Service Cost is essentially $0 for a frozen pension plan since no new benefits are being earned. It's important to understand that Service Cost is the only component of NPPC that truly represents an annual compensation/operating cost. The remainder of the cost or income components of NPPC represent a by-product of pension asset and liability changes that have accumulated from prior years.

For example, the Interest Cost represents the increased value of pension benefits earned in the past due to one less year of discounting the present value of those future obligations, the expected return on assets is a credit for what prior contributions are expected to earn in the market for the upcoming year, and the amortizations represent a partial recognition of costs attributable to past changes in funded status (e.g., unexpected changes in past assets and liabilities such as changes in interest rates or improved life expectancies).

Under ASC 715, all components of NPPC were aggregated and typically included with compensation costs as part of operating results in the income statement. This treatment is being changed to isolate Service Cost from the other components of NPPC.

NEW PENSION ACCOUNTING STANDARDS

Under ASU 2017-07, defined benefit plan sponsors will typically present NPPC as follows:

- Service Cost will continue to be included as a compensation cost in operating results;
- All other components of NPPC will be presented separately outside of operating results;
- The other components of NPPC can be presented in one or more separate line items, e.g., "Other expense/(income)" in the income statement and should be denoted with an appropriate description.

This new presentation will create more transparency for compensation and operations within the income statement. Operating results will now only include the value of new pension benefits being earned, which again, is $0 for a frozen legacy plan. However, underfunded frozen plans can still cause a sizable expense from the Interest Cost, Amortization and Settlement components. In that case, those items will now be presented outside of operating results. This should make it easier for plan sponsor executives to explain true operating results separate from special pension items which are based on market economics and related to benefits earned in prior years.

The next question is how pension lump sum windows and annuity settlements, both of which can cause a large one-year accounting expense, are accounted for under ASU 2017-07.

NEW ACCOUNTING FOR PENSION CURTAILMENTS AND SETTLEMENTS

A curtailment occurs when future service or benefits in a pension plan are significantly reduced or eliminated, such as when a plan is frozen and no longer provides new benefits. A settlement occurs when a significant percentage of liabilities is irrevocably transferred outside of the plan, such as a lump sum window that cashes out the benefit for plan participants or a group annuity purchase that transfers all future obligations to an insurance company.

As previously described, settlement and curtailment accounting for pensions previously flowed from Other Comprehensive Income through compensation costs and operating results. The result could theoretically be positive or negative in the financial statements but, given the current state of large unrecognized pension losses that many plan sponsors face, settlement and curtailment accounting today usually involves recognition of an additional one-time expense.

One problem with ASC 715 for a settlement charge is that a settlement usually happens during a fiscal year with the result being a large unexpected increase in operating expenses at year end. The investing public, credit rating agencies and lenders then react to the operating results with little initial understanding of certain non-operating drivers, i.e., how the pension impacted the results.

For this reason, many executives would defer desired pension settlements until a time when the impact could be planned and communicated in advance. Unfortunately, since the annuity markets and plan assets change daily, this delayed timing approach would often result in losing favorable market conditions for an annuity purchase and reduce the predictability of the outcome.

In contrast, ASU 2017-07 should make settlement and curtailment expenses easier to communicate and understand. Rather than aggregating these expenses into NPPC and operating results, one-time settlement and curtailment charges can be itemized with their own line items outside of compensation costs. With executives being evaluated and compensated based on their ability to predict and meet forward-looking earnings projections, the ASU 2017-07 treatment of non-operating pension expenses should provide investors, credit agencies and lenders with more transparency about the executive team's ability to deliver consistent operational results.

Pension Accounting Standards Under ASU 2017-07

Prior **Net Periodic Pension Cost**		New **Net Periodic Pension Cost**	
Operating Costs	Non-Operating Costs	Operating Costs	Non-Operating Costs
Service Cost		Service Cost	
Interest Cost			Interest Costs
Expected Asset Return			Expected Asset Return
Amortization Costs			Amortization Costs
Curtailment Costs*			Curtailment Costs*
Settlement Costs**			Settlement Costs**

*Curtailment costs include effects of plan freezes and workforce reductions

**Settlement costs include effects of plan terminations, annuity buyouts and bulk lump sums

IMPLICATIONS FOR THE PENSION RISK TRANSFER MARKET

The pension risk transfer market has heated up in recent years and is expected to continue growing as more and more plan sponsors seek to eliminate their legacy pension liabilities and costs when markets are favorable. ASU 2017-07 should make it easier for executives to isolate the impact of these transactions on their financial statements and eliminate some of the rationale for delaying a transaction when it otherwise seems optimal to move forward. However, these changes will NOT alter the actual costs of a lump sum window or group annuity purchase, nor the amount of the settlement charge itself, so many might still choose to avoid exceeding settlement accounting thresholds until more favorable conditions are presented.

For many that executed a lump sum window or group annuity purchase in 2018, the new accounting treatment will be required for fiscal year 2018 disclosures starting over the next few months. Others planning to execute a pension liability settlement in 2019 will be disclosing these expenses as non-operating items for fiscal year 2019.

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Health Plan Held to Same ERISA Fiduciary Standards as Retirement Plans

The U.S. Department of Labor (DOL) recently asserted against a not-for-profit health plan sponsor breaches of Employee Retirement Income Security Act (ERISA) fiduciary duties and prohibited transactions for allegedly allowing the plan to pay excessive fees to its service providers.1

Notwithstanding the fact that the DOL lost in a federal district court, this case reminds health plan sponsors that their ERISA fiduciary duties — including selecting and monitoring service providers and their fees — should be viewed essentially the same way as their retirement plan fiduciary duties. Even if employers outsource health and welfare plan administration (which is very common), this case confirms that employers still have a duty to monitor co-fiduciaries and plan service providers and to make sure that the plans do not pay excessive fees.

BDO INSIGHT

Health care plan sponsors of all sizes should periodically evaluate their procedures to ensure they can document prudence in exercising their fiduciary duties in plan operations.

ROADMAP FOR EMPLOYERS

The court's meticulous dissection of DOL's claims gives health and welfare plan sponsors a "procedural prudence" roadmap to follow in assessing whether their plan operation may trigger potential ERISA liability exposure. Investing in a robust fiduciary process often yields victory (or at least better results) for employers, as shown in the recent wave of 401(k) and private university 403(b) retirement plan excessive fee lawsuits.

In this case, the employer proved that it did not simply delegate authority and turn a blind eye on the plan. Rather, the employer showed that its oversight process included:

- Regular review of third-party administrator (TPA) and insurance broker's services and fees, including their effectiveness and scope.
- Annual meetings with the TPA, broker and individual trustee, including reviewing each of their annual reports.
- An annual plan audit performed by an outside accounting firm.
- Outside legal counsel's review of service provider contracts.
- Periodic monitoring of the plan's administrative and claims procedures.
- Informal market information collection on service provider options and alternatives by talking to other service providers at conferences and gauging their fees, even though formal, written requests for proposals (RFPs) were not undertaken.

NO RFP, NO PROBLEM

The court specifically rejected DOL's position that ERISA requires RFPs to ensure that the plan pays the lowest cost. The court said that ERISA does not require fiduciaries to "scour the market" to find the cheapest option for participants. Rather, reasonableness is all that is required. The court found that the employer was prudent in relying on its advisors and informal external sources because the employer's demographics and industry limited the universe of potential service providers for this particular plan to only two possible TPAs. Moreover, the plan had already used one of those two TPAs before switching to the other one.

1 Acosta v. Chimes District of Columbia, Inc.

The employer primarily hires individuals with intellectual developmental disabilities who provide janitorial services to federal, state and local government agencies. Many of those government contracts are subject to the federal Service Contract Act (SCA). The SCA mandates that employers must pay employees performing services on that government contract "prevailing wages" and allows employers to provide a certain amount of health or other fringe benefits in lieu of cash. The employer contributed the required SCA prevailing wage amount to a self-funded health and welfare trust, which was coordinated with stop-loss insurance. Many of the government contracts also involved dealing with unions. And many plan participants were also eligible for Medicaid.

Accordingly, the TPA needed to be familiar with the SCA, union and Medicaid rules, understand self-funded plans and stop-loss insurance, and be equipped to handle the special challenges of dealing with a plan where 75 percent of the participants are disabled (1,500 out of 1,900 total plan participants were disabled). Informal market research showed that very few TPAs could service the plan's unique needs, so doing a traditional RFP did not make practical sense for this plan. Even DOL's expert witness conceded that if the employer had conducted a formal RFP, the incumbent TPA may have been selected as the winner due to its unique ability to handle the plan's needs.

Even without doing a formal RFP, the employer considered six other TPAs who lacked experience in one or more of the plan's special needs and concluded that only one of the six was a feasible candidate. The employer decided to remain with their existing TPA, since the disruption to plan participants of a vendor switch did not seem to be in the best interests of plan participants. The court looked favorably at the employer's "best value" and "best fit for participants" approach, even if it was not the lowest cost.

EMPLOYER NEGOTIATED FEES

An important factor in assessing the prudence of the employer's process was that the employer periodically negotiated the plan's service fees. Such negotiations lead to decreased fees for 2006 and 2007, which held steady in 2008. In 2009, the TPA and broker agreed not to increase fees for five years (through 2014) and in 2011, the fee freeze was extended to 2019 — such that their fees were unchanged for 10 years (from 2009 to 2019).

EVEN SMALL EMPLOYERS AND NON-PROFITS CAN INCUR SIGNIFICANT LITIGATION EXPENSE

This case shows that DOL is willing to take employers (even smaller employers and not-for-profit employers) to court over allegations of health and welfare plan excessive fees. The case took four years to reach this decision. The bench trial (i.e., the judge heard the case without a jury) took eleven days, featured eleven witnesses (including four experts) and over 140 exhibits were filed. Even though the employer successfully defended this lawsuit, each party typically bears its own litigation costs, which can be substantial.

New Law Eases SBA Financing Rules for ESOPs

Small business owners looking to convert their organization to an employee-owned company may have an easier path thanks to a new law signed by President Donald Trump last year.

Before the law was passed in August 2018, the rules surrounding loans backed by the Small Business Association (SBA) used to create Employee Stock Ownership Plans (ESOPs) often discouraged small business owners from using this valuable succession-planning and employee-retention tool. The new provisions, found in the John S. McCain National Defense Authorization Act, streamline and modernize some of the rules that previously had made ESOP financing cumbersome—or in some cases prohibitive—for many small business owners.

ESOPS AS AN EXIT STRATEGY

As baby boomers approach retirement, more small business owners are looking for ways to generate liquidity for their equity while also rewarding employees and maintaining the corporate culture that the owner worked so hard to build. ESOPs can be an effective tool for accomplishing all of these goals. According to the National Center for Employee Ownership, there are 6,717 ESOPs operating nationwide covering 14 million participants with $1.3 trillion in assets.

ESOPs are a type of qualified defined contribution plan that invests primarily in company stock, which is distributed to employees. The company either borrows money or uses cash on hand to purchase the owners' shares on behalf of the employee participants. Then the shares are distributed to employees' ESOP accounts, which are held in a trust, over time. When participants leave the company or retire, the stock they own gets cashed out of the ESOP.

HOW THE NEW LAW ENCOURAGES ESOPS FOR SMALL BUSINESSES

The new law includes several significant changes that will make it easier for business owners to secure financing through the SBA to establish an ESOP. It also contains a provision for the SBA to create outreach programs as well as an interagency working group to promote employee ownership.

The most significant changes in the law include:

- Business owners are now allowed to obtain loans through the SBA's preferred lenders instead of having to go through the SBA itself, which can be a slow and bureaucratic process.
- SBA loans for ESOPs can be made directly to the company, so long as the ESOP trust owns 51 percent of the organization. Previously, SBA loans had to go the trust, which made the underwriting process more difficult.
- Business owners can remain involved in the business following the creation of the ESOP. Previously, owners were prohibited from easing out of the business over time if an SBA loan was used to create an ESOP. Under the new law, as long as the ESOP owns 51 percent of the shares, the seller shareholder can remain an owner, officer or other key employee in the organization. Sellers who remain as owners must provide a personal guaranty for the SBA loan.
- ESOP transaction costs can be folded into SBA loans. Previously, these loans couldn't pay for costs associated with setting up an ESOP, but the new law reverses this policy.
- Previously, owners needed to contribute equity equaling at least 10 percent of the total transaction cost when securing an SBA loan. Under the new law, the SBA can waive this requirement on a case-by-case basis.

BDO INSIGHT: TIME TO TAKE A SECOND LOOK AT ESOPS

Now that the SBA loan process has been streamlined and some of the eligibility rules have been eased, owners of small businesses who previously feared that SBA financing, or even traditional senior financing vehicles, would not be available to establish an ESOP may want to take a second look. In addition to the more borrower-friendly underwriting process, the opportunity for the owner to remain involved in the company after the establishment of the ESOP may make the plans significantly more appealing for owners who want to gradually phase out of the business.

In addition to the new rules, there are many other factors to consider when evaluating whether an ESOP is appropriate for your organization. If you are interested in learning more, the BDO ESOP Advisory Practice can answer any questions you may have about how an ESOP could affect your business, your employees and your exit strategy. Also, the SBA is still in the process of finalizing its guidelines related to the new law, so BDO will provide additional updates when those rules are completed.

IRS No Longer Prohibits Retiree Lump Sum Windows in Defined Benefit Pension Plans

Defined benefit (DB) plan sponsors can once again offer retirees and beneficiaries receiving annuity payments a limited opportunity to convert their benefits into a lump sum. IRS Notice 2019-18, issued on March 6, ends a de facto ban on retiree lump sum windows, which had become a popular DB plan de-risking strategy until the IRS essentially outlawed it in Notice 2015-49, issued July 9, 2015.

IRS'S SURPRISING CHANGE OF VIEW

The 2015 Notice said that the IRS would propose regulations under Section 401(a)(9) retroactively effective to July 9, 2015, forbidding the acceleration of in-pay status benefits into lump sum cash outs. But the 2019 Notice says that the IRS will not issue those regulations after all. The 2019 Notice also confirms that the IRS will:

- Not challenge plan amendments adding retiree lump sum windows as possible Section 401(a)(9) violations of the required minimum distribution rules.
- No longer issue private letter rulings on retiree lump sum windows.
- No longer caveat determination letters for plans that include retiree lump sum window provisions.

Senior citizen groups had pushed hard for the 2015 ban out of concern that retirees would outlive their income if they could convert lifetime income streams into lump sums. Even though the 2019 Notice says that the IRS will continue studying the issue, no rationale was given for the sudden (and somewhat surprising) change.

PROS AND CONS OF RETIREE LUMP SUM WINDOWS

The list below shows some pros and cons of a retiree lump sum window.

Pros

- Reduction in plan administrative expenses, including Pension Benefit Guaranty Corporation premiums
- Removes longevity and investment risk from balance sheet
- May provide positive balance sheet impact if the accounting obligations booked are more than the lump sums actually paid
- Reduction in headcount could exempt plan from onerous IRS funding and Pension Benefit Guaranty Corporation filing requirements, and could even exempt plan from audit if headcount falls to less than 100 participants as of the first day of the plan year

Cons

- "Adverse selection," meaning that retirees most attracted to the lump sum option may be those in poor health, and paying a lump sum to these participants may be more expensive than continuing to pay their annuity
- Retirees may need to be given the opportunity to re-elect all optional forms of payment, so retirees with spouses that have died since retirement could increase their annuities to higher amounts
- Settlement accounting rules could trigger a one-time non-operational expense in the year that lump sums are paid
- Up-front administrative costs of offering a temporary lump sum program for retirees

BDO INSIGHT

Notice 2019-18 introduces new considerations for DB plans. An actuary or ERISA counsel can help plan sponsors make informed decisions about whether retiree lump sums make sense for their plans.

Your BDO representative can help explain the various choices related to DB plans and the outcomes they can provide for your organization.

Employer's Business Insurance Did Not Cover Its Failure to Pay Employee Benefit Plan Premiums

Many employers carry general business liability insurance with fiduciary clauses to hedge against potential losses that may result from negligent acts of some sort committed by their employees. But employers may be surprised to find that the broad policy terms of their fiduciary clauses do not cover as much as they thought, especially when a particular claim is filed. A construction company with 150 employees recently learned that lesson the hard way in a federal case.[1] The court ruled that it is not reasonable to expect business liability insurance (covering negligence or breaches of fiduciary duties) to cover claims where the employer forgot to pay its bills for employee life and disability insurance premiums.

The employer argued that this type of negligence — where an employee failed to perform his duties — was exactly why it purchased business liability insurance. But the court said that the employer's obligation to pay life and disability insurance benefits arose from its contractual promises to the plan participants (as set out in the life and disability insurance plans), which cannot be passed on to business insurers, even if negligence caused the unpaid premiums.

HOW DID THIS HAPPEN?

The construction company's controller was responsible for administering the company's employee benefit plans, including processing insurance premium invoices. The controller forgot to pay life and disability insurance plan premiums and did not tell the company or plan participants when the coverage lapsed. Unfortunately, three employees suffered injuries or death that would have been covered under those plans. The employees and beneficiaries demanded the amounts they would have received if the insurance had been in effect. The company settled with them for over $200,000 and sought reimbursement under two business liability insurance policies. The insurers denied the claims on the grounds that failing to pay premiums is not a covered event under the policies. The employer sued, but the court sided with the insurers.

WRONG KIND OF NEGLIGENCE

The employer's business liability insurance policies covered losses arising from "negligent acts or omissions or fiduciary breach associated with administration of the employer's benefit plans." The employer asserted that the controller's mishandling of life and disability insurance premiums and failure to tell anyone that those coverages had lapsed were negligent acts that fell within the policies' coverage terms. Although the court acknowledged that the policy terms were ambiguous (since it wasn't clear what "administering" employee benefit plans meant), it examined other policy definitions and found that the employer's claim did not fall within those terms. Importantly, the court said that the obligations to pay the benefits arose from contractual promises the employer had made to employees through the plans, and that such obligations could not be passed on to the business liability insurer by failing to pay insurance premiums, even if the failure was negligent or a breach of fiduciary duty.

KEY TAKEAWAYS

Although the employer has filed an appeal, this case reminds employers to ensure their policies have specific language for the intended coverage and to thoroughly train and monitor any internal employees who administer employee benefit plans — especially smaller employers who may not have human resources staff. Often responsibility for employee benefit plans falls to controllers or other accounting or finance department staff, who may lack ERISA or other employee benefit plan knowledge, skills or experience. BDO can help fill those gaps.

BDO INSIGHT

We have seen similar situations where employee benefit plan premiums were not timely paid to the insurer. In one case, the employer sent the money to their broker, but the broker failed to forward it to the insurance company, leaving the broker on the hook to pay the benefit.

M&A and Employee Benefits: Pre-Transaction Considerations

Corporate mergers or acquisitions are complex, labor-intensive processes with high-stakes outcomes. To successfully bring together two companies, there are a tremendous number of issues that need to be analyzed and thought through both before and after the transaction closes.

In many cases, employee benefits get overlooked while the management teams of the buyer and seller—as well as their investment bankers, attorneys and other advisors—prepare for the transaction. This is a mistake that can have major consequences for both parties. In some cases, overlooked compliance or accounting issues related to employee benefits could hurt the value of the transaction or derail the deal altogether.

In this two-part series, we will first examine some of the benefits-related issues that buyers and sellers should consider before a transaction closes. In the second article, we will review key things benefits managers should consider after the transaction closes to ensure a smooth transition for employees.

PREPARING FOR DUE DILIGENCE

To facilitate the due diligence phase of the transaction process, the seller should be able to provide all the necessary documentation about its employee benefits. This includes retirement plan, health and insurance documents, Form 5500s, procedures and policies, remittance schedules, contracts with service providers, and more. The seller should also provide information about Internal Revenue Service (IRS) and U.S. Department of Labor (DOL) audits or other examinations that may have happened in the past three years.

In reviewing these documents, the potential buyers are trying to determine whether there are any problems that could negatively affect them and, in turn, the amount they are willing to pay for the company. If there are any outstanding errors, before the deal is finalized, the seller may have to follow the IRS's correction program (the Employee Plans Compliance Resolution System) or the DOL's correction program (the Voluntary Fiduciary Compliance Program).

OPTIONS FOR HANDLING RETIREMENT PLANS

The due diligence period is also when the buyer should begin thinking about how it will handle the 401(k) and/or pension plans of the seller. The options for this depend largely on whether the transaction is structured as a stock sale or an asset sale.

In a stock sale, the buyer acquires the selling company's stock and takes ownership of the seller's legal entity. As a result, the buyer becomes the new sponsor of the retirement plan when the transaction becomes final, assuming all of the past and future obligations associated with that plan. This is why it's critical to make sure the plan is compliant with all regulations including all reporting, disclosure and testing requirements.

In a stock sale, buyers have three options for how to handle the seller's retirement plan: terminate it (or require the seller to terminate it immediately pre-close), continue operating it as a separate plan (assuming it and the seller's other retirement plans can pass testing post-closing with separate plans, after the special M&A transition rule under Section 410(b)(6)(C) has expired) or merge it with their own plan. There are pros and cons to each approach.

With an asset sale, the seller maintains ownership of its legal entity and the buyer acquires only the assets and liabilities that are specified in the transaction agreement. As a result, the buyer doesn't necessarily need to take ownership of the seller's benefits plans. If the seller retains ownership of the retirement plan, they may choose to keep the plan open or terminate it. If it's kept open, employees who don't work at the selling company after the merger can request a distribution based on their termination of employment with the seller.

BDO INSIGHT: EVERY COMPANY SHOULD CONSIDER ITSELF AN M&A CANDIDATE

Even if your company doesn't consider itself to be an acquisition target in the near future, you should approach the oversight and recordkeeping of your employee benefits as if you were getting ready for a due diligence process. It's a simple, good practice to maintain updated records, processes and documents so that when and if an M&A opportunity arises, your organization is prepared. If your company is a potential buyer, the importance of conducting thorough due diligence of a seller's benefits well before the deal becomes final can't be stressed enough.

Regardless of whether your company is considering a merger or acquisition, it might be a good time to see whether you are "M&A ready." Your BDO representative can explain the process of evaluating your benefits plans and related recordkeeping. Mapping a plan today can improve the chances of a smooth transition down the road.

M&A and Employee Benefits: Post-Transaction Considerations

As we discussed in our last post, employee benefits should be an important consideration for both buyers and sellers as they prepare for a merger or acquisition. Once the due diligence is completed and the transaction closes, however, there is still much work that needs to be done to ensure that the transition to the new benefits plan goes smoothly.

In addition to educating employees of the seller about their new benefits, the buying company needs to think about compliance and accounting issues. While this is true for all types of benefits, compliance is especially important when it comes to retirement benefits.

In most acquisitions, buyers have three options for how to handle the seller's retirement plan: terminate it, continue operating it as a separate plan or merge it with the buyer's plan. (When the transaction is structured as an asset sale instead of a stock sale, however, merging the plans usually isn't an option.)

For each of these three options, we examine some of the rules and situations that buying companies need to consider.

TERMINATE THE BUYING COMPANY'S PLAN

- Participants become 100% vested due to plan termination.
- The terminating plan must notify all plan participants and others who have a connection to the plan, such as beneficiaries of deceased participants and alternate payees under qualified domestic relations orders (QDROs).
- 401(k) "successor plan" rules may prohibit distributions from the terminating plan if the plan is terminated after the deal closes, so buyers often terminate 401(k) plans pre-close so plan termination distributions can be made.
- Participants must decide whether to take a distribution or roll the assets into an Individual Retirement Account (IRA) or the new organization's plan. A final Form 5500 will need to be filed for the terminated plan after all plan assets have been distributed. Failing to check the "final" box at the top of the first page of Form 5500 is likely to result in an inquiry from the DOL when future Form 5500s are no longer filed for the terminated plan.

OPERATE BOTH PLANS SEPARATELY

- Under a special M&A transition rule, if the buyer doesn't make any changes to the seller's plan and operates it separately, the buyer can avoid aggregating its plans with the acquired plan for IRS testing purposes during a limited timeframe.
- Companies can conduct separate non-discrimination tests for the plan year of the transaction as well as the following year; the plans must be aggregated for testing starting in the third year. As long as they pass the required tests, the plans could continue to be kept separate (or could be merged later). But in many cases, the separate plans cannot satisfy the testing rules and would need to be merged.

MERGE THE PLANS

- Buying companies need to determine whether the combined plan triggers an independent audit; generally, plans that have 100 or more employees are required to have an independent audit, and a transaction may cause the new combined plan to jump above this threshold.
- Certain benefits are considered protected and are not allowed to be reduced or eliminated when plans merge; these include accrued benefits, early retirement benefits, more favorable vesting schedules, and some distribution options. Unprotected benefits include the right to take hardship withdrawals and loans and the right to have certain investment options.
- If the seller's plan had forfeiture accounts those would need to be analyzed to determine how those assets can be used.
- Before the deal closes, the plan should communicate to participants with outstanding plan loans what will happen to their loans under the merged plan when the deal closes.

BDO INSIGHT: USE THE TRANSITION AS AN OPPORTUNITY FOR IMPROVEMENT

Going through an acquisition can be very stressful for employees of the selling company. They may worry about whether their jobs will be eliminated or how the acquisition will affect their career prospects. Trying to understand how their benefits will change as a result of the acquisition can be another layer of stress.

Buying companies can mitigate much of the worry about benefits by developing an effective communication strategy to help the selling company's employees understand their new benefits and get on-boarded smoothly. These efforts can go a long way in strengthening employee morale.

Mergers also provide companies the opportunity to strengthen employee benefits. It can be an opportune time to implement design features such as automatic enrollment, Roth options, matching contributions, new vesting schedules or improved investment lineups.

When it comes to transitions as monumental as an acquisition, having a roadmap is essential—both before the transaction closes and after. Your BDO representative can help you understand your options for managing the benefits-related aspects of the transaction and ensure that the merger goes as smoothly as possible.

IRS Expands Self-Correction and Determination Letter Programs for Retirement Plans

The IRS recently expanded two existing programs for tax-qualified retirement plans — the Employee Plans Compliance Resolution System (EPCRS) and the determination letter (DL) program for individually designed plans. Generally, an individually designed plan is a retirement plan drafted to be used by only one employer. A DL expresses the IRS's opinion on the tax-qualified status of the plan document. These new changes to the EPCRS and DL programs could be a great help to employers, since they offer opportunities to increase compliance while reducing costs and burdens.

EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM (EPCRS)

EPCRS is an IRS correction program that has existed since 1992. Its purpose is to give employers a path to voluntarily correct plan mistakes at a cost that is less than what it would be if the failure was caught by the IRS on audit. For some errors, employers can simply self-correct and keep documentation in their files under the Self Correction Program (SCP) component of EPCRS. But other (more serious) types of failures require a formal Voluntary Correction Program (VCP) application seeking IRS approval, which also requires paying a user fee of up to $3,500.

With each new iteration of EPCRS, the IRS has expanded the types of errors that qualify for self-correction. Rev. Proc. 2019-19 significantly expands SCP. The current iteration responds to requests from the retirement plan community for self-correct of a greater number of more common missteps without having to file a VCP application and pay a user fee (where the cost of the filing often outweighed the cost of correction). Beginning April 19, 2019, employers with tax-qualified retirement plans and 403(b) plans can now self-correct more plan document and loan failures and retroactively amend plans to fix more operational failures without filing anything with the IRS. Employers can use the new SCP features immediately.

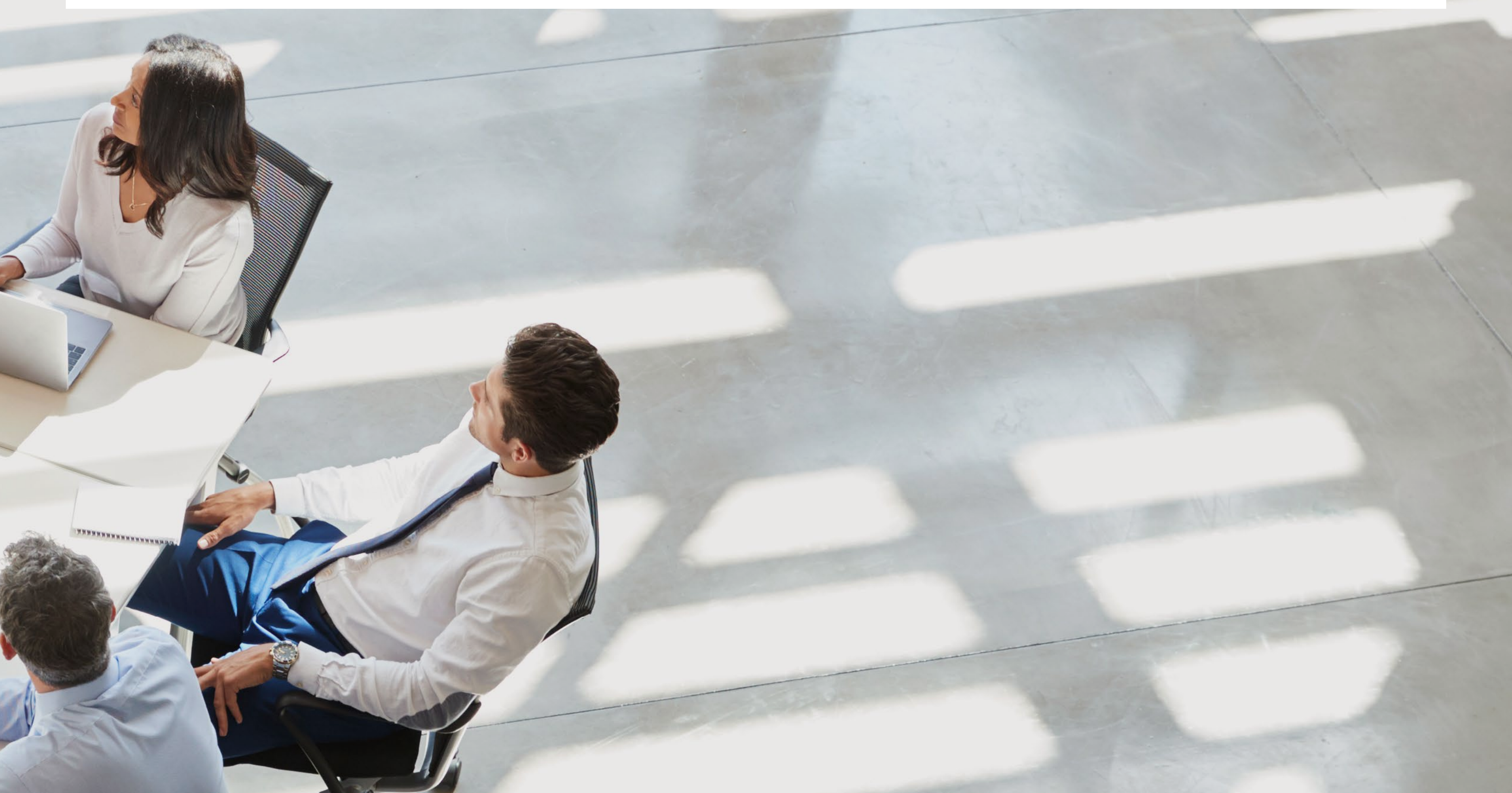
Plan document failures

For many years, the SCP allowed employers to correct certain significant operational failures (if the plan had a DL) and most insignificant operational failures without paying any user fees or penalties. But until now, the SCP was generally not available to self-correct plan document failures (instead, employers had to submit a VCP application to the IRS and pay a user fee to correct such failures). A plan document failure is a plan provision (or the absence of a provision) that causes a plan to violate the qualified plan or 403(b) plan rules.

Plan document failures are considered “significant” failures. So employers using SCP to fix plan documents must have a DL and complete the correction by the end of the second plan year after the failure occurred.

The new and improved EPCRS now allows these types of failures to be self-corrected if certain requirements are met:

- The plan document must have a favorable IRS letter covering the most recent mandatory restatement.
- The error is not a failure to timely adopt the plan’s initial document.
- The failure is corrected before the end of the correction period, which is generally no later than end of the second plan year following the year in which the plan document failure occurred.



Retroactive plan amendments

Although prior versions of EPCRS allowed employers to retroactively amend their plans to fix a very limited number of operational failures,[1] the new program adds other types of failures that may be corrected in this way, including (under certain conditions), correcting operational failures with retroactive plan amendments. SCP now provides that the following errors may be corrected through retroactive plan amendment:

- Defined contribution plan allocations that were based on compensation in excess of the IRC Section 401(a)(17) annual compensation limit.
- Early inclusion of employees who had not yet satisfied the plan's eligibility requirements.
- Loans and hardship distributions under plans that don't provide for them.
- Loans exceeding the number of loans that are permitted under the plan.

Besides those situations, under the new SCP, employers may now also retroactively amend their plans to correct other operational failures, but only if: (i) the plan amendment would increase a benefit, right or feature; (ii) the increased benefit, right, or feature is available to all eligible employees; and (iii) increasing the benefit, right or feature is permitted under the IRC and satisfies EPCRS's general correction principles. If those conditions are not satisfied, the error may still be corrected by filing a VCP application with the IRS and paying a user fee.

Plan loan failures

Making loans to plan participants seems like it should be simple, but there are a lot of ways to make mistakes. Even though loan failures are pretty common, correction has always been quite burdensome and costly, requiring a lengthy application for IRS approval for what is often a very small dollar amount. Plan loan rules fall under both IRS and U.S. Department of Labor (DOL) authority. The DOL does not recognize self-correction, so in the past the IRS required even the simplest and smallest loan failures to be formally submitted for approval.

BDO INSIGHT

The IRS has always been very hesitant to allow correction by retroactive plan amendment (for example, to align the plan document with the plan's operation). When it has been allowed, the IRS generally required a VCP filing. So expanding EPCRS to allow retroactive plan amendments is perhaps the greatest area of relief for employers.

The initial failure to adopt a qualified plan or the failure to adopt a written 403(b) plan document timely cannot be corrected by SCP.

Demographic and employer eligibility failures still cannot be corrected under SCP.

Also, the SCP expansion does not apply to SEPs and SIMPLE IRAs. Rather, as under Rev. Proc. 2018-52, SCP is available to correct only insignificant Operational Failures for SEPs and SIMPLE IRAs.

Although Rev. Proc. 2019-19 replaces Rev. Proc. 2018-52, it does not make any changes to the recently updated filing methods under EPCRS. Keep in mind that only electronic VCP filings will be accepted on or after April 1, 2019.

Employers may now use SCP to correct plan loan failures if the participant defaults or the loan is administered incorrectly. But, employers still cannot use SCP to correct plan loan terms that violate the maximum permissible loan amount and repayment period and level amortization repayment rules (since those are statutory violations, so sponsors must use VCP to correct those failures).

Until now, employers could voluntarily correct loan defaults by filing a VCP application and paying a user fee. Now employers can also use SCP. Under both programs, the default can be corrected by a single-sum repayment (including interest on missed repayments), re-amortization of the outstanding loan balance or a combination of the two. But employers that want the protection of a no-action letter under the DOL's **Voluntary Fiduciary Correction Program** (VFCP)[2] will still need to use the IRS's VCP program to correct the error. DOL will not issue a no-action letter for a loan default unless the VFCP application includes proof of payment of the loan and an IRS VCP compliance statement approving the correction.

Employers can now use SCP to correct failures to obtain spousal consent for a plan loan when the plan requires such consent. (For example, if distribution of a participant's benefit requires spousal consent under the QJSA rules, spousal consent is also required for a plan loan.) The sponsor must notify the participant and the spouse and give the spouse an opportunity to consent. If the spouse doesn't consent, the sponsor can still correct the error under VCP (which generally requires the employer to make a QJSA available to the spouse for the full amount of the participant's plan benefit, as if the loan had not been made to the participant).

Prior versions of EPCRS generally required employers to report deemed distributions resulting from loan failures on IRS Form 1099-R in the year of failure. However, depending on the type of loan failure, employers could request the following relief:

- No reporting of deemed distributions caused by loan defaults and violations of the maximum permissible loan amount, maximum repayment period and requirement to repay loans over a level amortization period.
- Reporting of deemed distributions caused by other loan failures in the year of the correction (instead of the year of the failure).

Under the new EPCRS, sponsors no longer have to request this relief; rather, they can simply "self-correct" and use such relief without an IRS filing.

Determination Letter (DL) Program

Rev. Proc. 2019-20 opens the IRS's DL program for one year (starting September 1, 2019) for individually designed "hybrid" retirement plans (like cash balance or pension equity plans). It also opens the DL program to merged plans, so long as the DL is requested within a proscribed timeline. The guidance also extends the remedial amendment periods for these plans[3] and offers penalty relief for plan document failures discovered during the DL review. Since 2017, the IRS has accepted DL applications only from new or terminating individually designed plans, but reserved the right to open the DL program for other circumstances. This is the first time IRS has opened the program for such "other circumstances."

Hybrid plans

Fortunately, since IRS curtailed the DL program in 2017, there have been very few changes in the law that would require plan amendments. But there have been required amendments for cash balance and other hybrid plans based on final regulations, so the IRS is allowing a one-year review period for those plans. As part of this process, the IRS will review the entire plan for compliance with the 2016 and 2017 Required Amendments Lists and all Cumulative Lists issued before 2016.[4]

The IRS will not impose any sanctions for document failures it discovers during the DL review that are related to plan provisions required to meet the hybrid plan regulations. For plan document failures that IRS discovers during the DL process that are unrelated to the hybrid plan regulations (but that satisfy certain conditions), the IRS will impose a reduced sanction equal to either the amount the employer would have paid under EPCRS if the plan sponsor had self-identified the error or 150 percent or 250 percent of the EPCRS user fee (depending on the duration of the failure). So employers should correct any failures under EPCRS before filing under the DL program to avoid having to pay more than the regular EPCRS user fee.

Even if an employer is confident that the hybrid plan does not have any document failures, obtaining a new DL provides important protection if the IRS audits a plan and could reduce some of the complications that could arise with aging DLs.

Merged plans

Beginning on September 1, 2019, the IRS will accept DL applications for individually designed "merged plans" — i.e., single-employer, individually designed plans that result from consolidating two or more plans maintained by unrelated entities in connection with a corporate merger, acquisition, or other similar transaction. An employer can request a DL on the merged plan if:

- The plan merger occurs no later than the last day of the first plan year that begins after the effective date of the corporate transaction.
- The DL application is filed with the IRS by the last day of the merged plan's first plan year that begins after the effective date of the plan merger.

The IRS will review a merged plan for compliance with the Required Amendments List issued during the second full calendar year before the DL application and all earlier Required Amendment and Cumulative Lists.

Plan mergers typically require amendments related to eligibility, vesting, and maintaining protected benefits, etc. If an employer does not submit a merged plan for a DL under the expanded program, the employer could not rely on the plan's prior DL for changes made to the plan to effectuate the merger.

Although it is not clear, it appears that the expanded DL program would be available when a preapproved prototype or volume submitter plan is merged into an individually designed plan. Often larger employers have individually designed plans while smaller employers have preapproved plans, and larger employers often acquire smaller employers and merge the smaller employer's preapproved plan into the larger employer's individually designed plan. But employers should keep in mind that the merged preapproved plan can cause a plan document failure for the individually designed plan (for example, if signed and dated plan documents and amendments for the acquired plan cannot be located).

The IRS will not impose any sanctions for document failures related to plan provisions intended to effectuate the plan merger. For plan document failures unrelated to the plan merger that satisfy certain conditions, the IRS will impose a reduced sanction equal to either the amount the employer would have paid under EPCRS if the plan sponsor had self-identified the error or 150 percent or 250 percent of the EPCRS user fee (depending on the duration of the failure). As noted above, employers should correct any failures under EPCRS before filing under the DL program.

BDO INSIGHT

Plan mergers before May 2018 may not be eligible for the expanded DL program, since the DL application for the merged plan must be submitted within one year after the plan merger. Since IRS curtailed the DL program in 2017, such plans may be left without access to a DL on a merged plan even under the expanded program.

Employers who merged plans in May, June or July 2018 (or later) should consider hurrying to file a DL application before the one-year filing window permanently closes. But keep in mind that a Notice to Interested Parties must be given in advance of a DL filing.

The new guidance does not restrict the number of times that employers could request a DL on a merged plan, so presumably, an employer could file a new DL request for every plan merger.

KEY TAKEAWAYS

Employers considering whether to use the expanded SCP or DL program should consult with their tax advisers to ensure that the plan is eligible for the program (and that any other potential qualification issues are considered before requesting a DL). BDO can help.

Deadline Approaches for Remedial Amendments for 403(B) Plans

Maintaining compliance for 403(b) retirement plans historically has been challenging given the lack of historical regulatory oversight, guidance from the Internal Revenue Service (IRS), and non-profit organizations' limited resources. But the IRS has taken steps to address this, including publishing a list of providers offering pre-approved prototype plans and creating a remediation period ending in March 2020 for sponsors to self-correct non-compliant plan documents.

BACKGROUND ON 403(B) COMPLIANCE AND REMEDIATION

In 2007, IRS regulations were updated to require sponsors of retirement plans that fall under the Internal Revenue Code 403(b) to adopt and follow a plan document for their retirement plans as of January 1, 2009. Subsequently, relief was granted to extend this deadline to January 1, 2010. Before this time, many 403(b) plans did not have a plan document outlining specific operational and governing terms of the plan.

The IRS didn't provide robust guidance on how to create the plan document, so many plan sponsors made a good faith effort and cobbled together a collection of investment, administrative and service provider agreements—often referred to as the "paper-clip approach"—to comply with the new requirement.

In March 2013, the IRS made things a little easier by issuing a new ruling, **Revenue Procedure 2013-22**, which created a pathway for the agency to issue advisory letters for 403(b) prototype plan documents. The program offers sponsors of 403(b) plans an alternative to adopting individually designed plans in order to satisfy the written plan requirements of the 2007 regulations. The IRS will issue opinion letters on 403(b) prototype or volume submitter plans. By adopting a prototype or volume submitter plan that has already received an IRS opinion letter, the sponsor can feel confident that they have satisfied the latest regulatory requirements.

The IRS, however, didn't avail this program to plans with individually designed plan documents, as this was not considered the best use of the Service's limited resources. Considering there is no IRS determination letter process available to individually designed 403(b) plans currently, plan sponsors do not have many other choices.

The best option of individually designed plans would be to hire an ERISA attorney to provide assurance that their plan documents were up to date with the latest regulations.

Under Rev Proc 2013-22, the IRS offers a remedial amendment period, giving 403(b) plan sponsors the ability to restate or amend their plan documents to comply with the law. Eligible plan sponsors—ones that had a plan document in place by January 1, 2010—are allowed to correct certain defects that go back to the original effective date of the plan. The types of defects that can be corrected under the remedial amendment period would be missing amendments for certain regulatory updates such as EGTRRA and the HEART Act to name a few. But again this remediation period only applies to those plans using prototype or volume submitter plan documents.

Finally, in 2017, the IRS announced that it would close the remedial amendment program on March 31, 2020. Plan sponsors who have a prototype plan document have until this date to retroactively fix any regulatory compliance issues they may have.

What if your organization failed to adopt a plan document as of January 1, 2010? There is a fix for that. The plan should file through the voluntarily correction program under the IRS EPCRS program. Unfortunately, Rev Proc 2013-22 does not give folks who miss the boat in 2010 until 2020 to fix a missing document.

OPERATION MISTAKES

Perhaps during the process of reviewing your plan document, you find an operation error. An operational error is a mistake that occurs when the plan is not complying with the terms of the plan document. For example, a plan document might allow all employees to participant in a 403(b) plan, but in operation, the HR department is not allowing part time employees to participate. These types of operation errors cannot be corrected under Rev Proc 2013-22.

But not to worry. Correcting operation errors can be daunting. So the IRS created the **403(b) Plan Fix-It Guide**, which lists common errors, as well as how to find, fix and avoid them. The IRS also published a more general informational **publication** about 403(b) plans and resources to help plans stay in compliance.

BDO INSIGHT: START NOW TO CAPITALIZE ON THE REMEDIATION WINDOW

It's important for plan sponsors to start examining their plan documents now, to determine if they are in compliance with the latest regulations. Amendments may take months to prepare and adopt. Just like filing taxes, the closer you get to the deadline, the harder—and possibly more costly—it will be to address any issues that need to be resolved.

As a resource, the IRS created a list of **providers offering pre-approved 403(b) prototype plans**, making it easier for plan sponsors to ensure their plan is in compliance with the law. Plan sponsors with individually designed 403(b) plans don't have to adopt a prototype plan, but staying on top of the necessary amendments may be time-consuming. The IRS has also published a Required Amendments List that plan sponsors can reference each year when determining if another update is needed.

Feeling good about your plan document because it was prepared by your plan's service provider? Be sure to check that it is the latest version and whether a version with an IRS opinion letter is available. Often pre-approved prototype providers will send messages to notify plan sponsors about updates to the law and required amendments to comply with the federal changes. Check with your provider to make sure that service is offered.

To be clear, all remedial amendments to 403(b) plans should be adopted back to the January 1, 2010. If you adopt a new prototype as of 2019 going forward, your plan document before 2019 may still not be in compliance. Be sure to adopt retroactively to 2010 as allowed under the Rev Proc. Plan sponsors can adopt a pre-approved 403(b) plan prior to the March 31, 2020, deadline as an alternative to creating amendments to an existing plan.

Lastly, plan sponsors should engage an attorney who is an expert with the 1974 Employee Retirement Income Security Act (ERISA). By selecting an ERISA attorney, plan sponsors can be more confident that they are following IRS rules when it comes to amending plan documents. Your BDO representative can also help with questions you may have concerning the retroactive fixes to your 403(b) plan document.

ERISA “Top Hat” Plan Statements to be Filed Electronically Starting in Mid-August

On June 17, 2019, the U.S. Department of Labor (DOL) finalized proposed regulations requiring that all “top hat” plan statements and apprenticeship and training plan notices must be filed electronically, starting in mid-August. On average, the DOL receives about 57 apprenticeship and training plan notices, and about 1,815 top hat plan filings annually.

Mandatory electronic filing will reduce regulatory burdens on plans and will enable the DOL to make reported data more readily available to participants and the public. The new web-based filing system will also provide an instant confirmation of receipt of the completed filing, which was not available under the paper-based filing system. The final regulations made no changes to the content of the notices.

What’s a top hat filing? In 1975 (one year after the Employee Retirement Income Security Act of 1973, or ERISA, was enacted), the DOL issued regulations providing an alternative compliance method with ERISA’s reporting and disclosure requirements for unfunded or insured pension plans established for a select group of management or highly compensated employees (“top hat” plans). Under the simplified compliance method, the top hat plan administrator files a statement with the DOL by mail or personal delivery and agrees to provide plan documents to the Secretary of Labor upon request. In 1980, DOL adopted similar simplified procedures for welfare plans that only provide apprenticeship and/or training programs. Only one statement needs to be filed for each employer maintaining one or more of the plans provided that the notice describes each plan.

Electronic filing has been available since 2014. On September 30, 2014, DOL proposed rules to require electronic filing for top hat plan statements and apprenticeship and training plan notices. Simultaneously, the DOL launched a new web-based filing system for the plans. Using the web-based filing system was voluntary until final rules were adopted. Since then, about 65 percent of apprenticeship/training plan notices, and about 54 percent of top hat plan notices have been filed electronically. The DOL received only one comment on the proposed regulation, asking the DOL to go even further with electronic plan administration.

BDO INSIGHT

The proposed regulations are a reminder that although nonqualified deferred compensation plans are ERISA plans, they are exempt from some ERISA requirements. If the alternative method of reporting and disclosure is not satisfied by filing the one-time statement, the plan is technically required to file an annual report on Form 5500 (but if the top hat notice was not timely filed and Form 5500’s have not been filed, the plan may use the department’s Delinquent Filer Voluntary Compliance Program to file a late top hat notice instead of having to file late Form 5500’s).

Failure to timely file Form 5500 can result in IRS penalties of $25 per day up to a maximum of $15,000, and Department of Labor penalties of $2,194 per day without a maximum limit. However, a failure to file can easily be corrected by completing a submission under the department’s Delinquent Filer Voluntary Compliance (DFVC) Program.

Sponsors of nonqualified deferred compensation plans should confirm that the one-time statement was filed within 120 days after the date the arrangement became subject to Title I of ERISA and that the eligible group has not expanded beyond the top hat group. If no record of the filing can be located, the employer may want to consider submitting a DFVC Program filing.

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