Defined contribution legislative and regulatory update

For government clients
September 2016

We are committed to providing you with the information and tools you need to help meet your fiduciary responsibilities as a plan sponsor and to offer your employees an exceptional retirement plan. This newsletter is designed to inform you about the latest legislative and regulatory developments that may affect your plan.

In this issue

From the hill
Tax and pension reform in 2017 and beyond
Potential impacts of DOL fiduciary rule on plan sponsors

From the courts
Plan sponsor sued as co-fiduciary for alleged plan investment advisor breaches
Court finds participant in breach of ERISA for failure to return overpayment

From the regulatory services team
IRS issues proposed regulations under Code Section 457

FOR PLAN SPONSOR OR ADVISOR USE ONLY.

From the hill

Tax and pension reform in 2017 and beyond

With the November election rapidly approaching, a better picture of the prospects for tax and pension reform in the new congress and administration is coming into focus. In June, the House republicans released a series of reports as part of their "Better Way" initiative. The topics examined included poverty, national security, the economy, the Constitution, healthcare, and tax reform. The efforts on the tax reform report, released on June 24, were led by House Ways and Means Chairman Kevin Brady (R-TX).

The plan proposes collapsing the current seven tax brackets into three. The 10% and 15% brackets would be replaced by a 12% bracket, the 25% and 28% by a 25% bracket, and the 33%, 35% and 39.6% brackets would be lowered to 33%. The plan would also raise the standard deductions to $24,000 for joint filers and $18,000 and $12,000 for head of household and single filers, respectively. Only two itemized deductions would be allowed — deductions for charitable giving and home mortgage interest.

One of the stated goals of the proposal is to be revenue neutral. While part of the revenue neutrality is projected to be achieved through increased economic growth, the report also considers reductions to existing tax expenditures. The two largest tax expenditures, as scored by the Office of Management and Budget, are for healthcare and retirement savings ($2.74 trillion and $1.54 trillion, respectively, over 10 years). With respect to healthcare, the report proposes a cap on the current exclusion of the value of employer-provided healthcare insurance, although no specifics are given as to the level of the cap.

With respect to retirement savings there is some uncertainty. The report states that it "will continue tax incentives for retirement savings," but also says that it will "examine existing tax incentives for employer based retirement and pension plans in developing options for an effective and efficient overall approach to retirement savings." It should be noted that an earlier republican tax proposal, introduced in 2014, funded income tax rate reductions in part by limiting the amount of 401(k) contributions that could be made on a pretax basis and freezing any increases to current contribution limits for a 10-year period.

Former Secretary Clinton's tax policies regarding retirement savings mirror much of what we've seen in President Obama's budget. She proposes limiting the tax value of certain exemptions and deductions to 28%. This would include pretax contributions to retirement plans as well as the value of employer-provided healthcare. Mr. Trump recently made revisions to his tax policy that would bring it closer in line with the House GOP proposal, although he has in the past suggested limiting the value of itemized deductions.

Tax reform has always served as a good vehicle for pension reform, and there are areas where there is a good deal of bipartisan support. Multiple-employer plans (MEPs), arrangements that allow small employers to band together in a common retirement plan and outsource most of the administration, are a good example. Both sides of the aisle favor removing the current DOL requirement that employers must have some common interest and eliminating the IRS "bad apple" rule, which states that a disqualifying event by a single employer disqualifies the entire arrangement.

Other areas of agreement can be found in a report issued by the Senate Finance Committee last July including increasing startup credits for small employers, encouraging higher default rates for automatic enrollment and promoting automatic acceleration of contributions, and encouraging plan sponsors and participants to consider lifetime income options.

Senators Rob Portman (R-OH) and Ben Cardin (D-MD) have also expressed interest in working together to develop a comprehensive pension reform proposal. When they were in the House of Representatives, Senators Portman and Cardin were the primary architects of the pension reform provisions that were in the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) in 2001. Nothing is certain as of yet as Senator Portman is facing a strong challenge in his reelection bid this November. Key areas that they've expressed a desire to address include lifetime income and simplification of administrative hurdles.

Practical considerations

Changes in tax and pension law can have a profound impact on plan design and administration. Although none of the current pension proposals would impact governmental defined contribution plans, new incentives and opportunities may arise as well as new constraints. Plan sponsors and their service providers need to keep a close eye on any developments that could potentially impact governmental plans.

At Empower Retirement, we are active in retirement industry advocacy efforts and will keep you apprised of new initiatives and actions.

FOR PLAN SPONSOR AND ADVISOR USE ONLY.

From the hill

Potential impacts of DOL fiduciary rule on plan sponsors

The Department of Labor's (DOL's) new rule (the "Rule") redefining who is a fiduciary by virtue of providing "investment advice for a fee" will go into effect in April 2017. While the primary impact of the Rule will be on service providers to retirement plans subject to the Employee Retirement Income Security Act (ERISA), there are many ways in which it will also affect plan sponsors. The Rule significantly expands the types of communications that can trigger fiduciary status. A "recommendation" is defined very broadly to include even a "suggestion" that someone take or refrain from taking a particular action. Even one-time communications, such as a call between a plan participant and call center representatives, can trigger fiduciary status. For a detailed explanation of the new Rule, please ask your Empower representative for a copy of the Instant Insights article published in April of this year.

Although the Rule does not cover advice provided to non-ERISA governmental retirement plans, it will impact governmental plans when a recommendation is made to a participant regarding a distribution from the plan or a rollover in or out of the plan. The purpose of this article is to highlight some of those potential impacts of the Rule that governmental plan sponsors may want to consider.

1. Protect your employees

Although the Rule does not apply to conversations about the investments in a governmental plan, it could trigger fiduciary status when employees are talking to a participant about a distribution or rollover. For example, a conversation between a Human Resources (HR) employee and a terminating employee about what to do with the retirement plan account could trigger fiduciary status if there is any compensation (defined very broadly to encompass any benefit) received in connection with the transaction. The DOL created an exemption from fiduciary status for staff members so long as:

- Providing the advice or recommendation is not part of the employee's job,
- The employees do not hold any securities or insurance license under state or federal law, and
- The employees do not receive separate compensation for the advice.

Employers may want to review the job descriptions for their HR staff dealing with terminated participants, as well as their compensation practices, to ensure compliance with this exemption. They may also want to avoid putting employees with securities or insurance licenses into those roles.

There is also an exemption available to protect employees who make recommendations to plan fiduciaries. For example, HR or finance staff may provide reports or recommendations related to an investment decision to an individual fiduciary or a fiduciary committee. The employees providing the recommendation to the plan fiduciary will be exempt from the Rule so long as they do not receive separate compensation for making the recommendation.

2. Understand the impacts on your service provider relationships

The Rule impacts recordkeepers, anyone providing distribution, asset consolidation or investment counseling to participants, and potentially others. For example, under the Rule, communications that meet the definition of "Education" will not be treated as investment advice. Thus, some service providers will be making changes to their participant communications intended to ensure that they remain educational and do not contain a recommendation. Some may also be changing how fees are paid. Many service providers are still finalizing their decisions and implementation strategies, but as we move into the 3rd and 4th quarter of 2016, you should begin to get information about what the impact of those decisions will be on your plan.

3. IRAs are covered by the rule

Although the Rule does not apply to governmental plans, it does apply to IRAs. Thus, communications about distributions from the plan or rollovers into the plan may be covered by the Rule. Additional due diligence may be required in understanding how your service providers will be communicating with participants about distributions from the plan or consolidating assets from prior employer plans or IRAs into the plan. This includes "live" communications as well as web-based interactions and mailings. It will be important for you to understand whether and when your provider will treat those communications as fiduciary advice and how they intend to ensure compliance with the Rule.

Practical considerations

Plan sponsors may want to begin conversations with their service providers in this second half of 2016 to understand the implications of the Rule on their plans.

FOR PLAN SPONSOR AND ADVISOR USE ONLY.

From the courts

Plan sponsor sued as co-fiduciary for alleged plan investment advisor breaches

The plan sponsor of a large 401(k) plan was recently sued in federal court by plan participants for various alleged fiduciary breaches. The suit claims the plan's investment advisor failed to act prudently with respect to the selection of plan investments and the plan sponsor has co-fiduciary liability for those alleged failures.

In this case, the plan sponsor hired a third-party investment advisor to select and monitor plan investments and to design custom target date funds (TDFs) for the plan. The suit alleges that the investment advisor was a named fiduciary in the plan as well as a functional fiduciary with respect to its control over plan assets. The plan participants have sued the investment advisor as a plan fiduciary claiming that the investment advisor (1) imprudently designed the custom TDFs by including improper asset classes and investments in the TDFs, and (2) failed to monitor the TDFs, allowing them to underperform their benchmarks from inception.

The participants have also sued the plan sponsor claiming imprudent hiring of the investment advisor to provide TDF services. They claim the plan sponsor has co-fiduciary responsibility for the failure to monitor and take action with respect to the TDFs' alleged poor performance. Under the Employee Retirement Income Security Act (ERISA), a fiduciary, with respect to the plan, will be liable for the breach of another fiduciary if he or she has knowledge of the breach and does not make reasonable efforts to remedy the breach. The participants claim that both the investment advisor and the plan sponsor failed to promptly remove the TDFs when it was apparent that they were imprudent.

Practical considerations

Although governmental plans are not subject to ERISA, many state laws impose fiduciary responsibilities on governmental plan sponsors that are substantially similar to those in ERISA. Additionally, many governmental plan sponsors use ERISA as a guide and best practice. Although it is unknown how this case will proceed and ultimately be resolved, it is important for plan fiduciaries to understand their co-fiduciary responsibilities and their duty of prudence when selecting and monitoring investment providers and other third parties.

In this case, the participants claim the plan sponsor acted imprudently by retaining an investment advisor that did not have the experience or track record for managing TDFs. The importance of utilizing prudent processes when making all plan-related decisions cannot be overstated. A prudent process for selecting a service provider requires a plan fiduciary to investigate and analyze the experience and qualifications of various providers in the marketplace before making a choice.

Likewise, plan sponsors have an ongoing duty to monitor third parties and their performance to ensure the services being provided continue to be in the best interest of the plan and participants. In this case, the plan sponsor would have been well served to have followed a formal process for monitoring the third-party fiduciary's ability to provide investment services, including designing the TDFs for the plan. Prudent monitoring should have allowed the plan sponsor to make reasonable efforts to remove the investment provider or the TDFs in a timely manner and thus avoid the claim of co-fiduciary liability. Documenting the prudent processes used in the hiring and firing decisions is also important.

Court finds participant in breach of ERISA for failure to return overpayment

In the normal course of plan administration, a plan may mistakenly pay a participant an amount that he or she is not entitled under the terms of the plan. The IRS generally considers such "overpayment" as a qualification defect that requires the plan sponsor to take reasonable steps to have the participant return the overpayment to the plan. The question for plan sponsors is what reasonable steps should they take and what legal remedies are available.

In a recent case, after a participant received her full benefit from the plan, the plan mistakenly paid the participant an additional amount of over $200,000. The plan notified the participant of the error and requested the overpayment be returned to the plan. When the participant failed to return the overpayment after a period of time, the plan filed suit against the participant in federal court for breach of fiduciary duty under ERISA. The U.S. District Court of New Jersey held that the plan participant, having refused to return the overpayment she received in error from a plan, was (1) deemed a fiduciary under ERISA with respect to the plan assets in her control and (2) was in breach of ERISA for failure to return the assets to the plan.

Under ERISA, a plan fiduciary is anyone who exercises any authority or control over plan management or plan assets. An ERISA fiduciary is defined in terms of functional control and

From the courts

authority over the plan and plan assets, and not in terms of a formal trusteeship or other appointment. In order to bring a breach of fiduciary duty claim, the defendant must be a plan fiduciary and must have breached his or her fiduciary duty that resulted in losses to the plan.

In review of the claim, the Court noted that ERISA's definition of fiduciary "encompasses those who knowingly and unlawfully retain plan assets to which they are not entitled" and that, in this case, the participant became a fiduciary because she retained control over plan assets that she was not entitled. The Court held that the participant breached her fiduciary duty to the plan by failing to return the overpayment and using the plan's assets for her own benefit and, as a result, is personally liable and must make the plan whole for any losses resulting from the breach.

Practical considerations

This case clearly reflects the fact that fiduciary status and liability under ERISA are based on the actions and control of the individual or entity with respect to the plan and not on a particular plan title or role. There is no requirement that a person agree to become a fiduciary or be appointed to a fiduciary role; he or she may become a fiduciary due to his or her actions and control of plan assets. This case affirms that plan sponsors have a remedy under ERISA to recover overpayments from plan participants or others who have received plan assets in error and exercise control over such assets by refusing to return them.

Although governmental plans are not subject to the fiduciary rules in ERISA, most state laws impose rules and responsibilities on governmental plan fiduciaries that are substantially similar to those in ERISA. Check with your counsel to determine whether the reasoning in this case could apply to a governmental plan under your state's laws.

From the regulatory services team

IRS issues proposed regulations under code section 457

On June 22, 2016, the IRS issued proposed regulations under Code Section 457 with respect to federal legislation issued since the 457 regulations were finalized in 2003. Generally, the proposed regulations apply to compensation deferred under a 457(b) plan for calendar years beginning after the date the proposed regulations are finalized and published. Taxpayers may, however, rely on the proposed regulations immediately. The bulk of the proposed regulations apply to ineligible 457(f) plans and nonqualified deferred compensation (NQDC) plans of tax-exempt and for-profit employers. There are, however, some clarifications to eligible 457(b) plans. Most of the 457(b) clarifications apply to governmental plans, including guidance to plans with respect to:

- A non-spousal beneficiary's ability to roll over eligible amounts from a governmental 457(b) plan into an inherited IRA.
- Allowing eligible, retired, qualified public safety officers to make a tax-free transfer of up to $3,000 per calendar year from a governmental 457(b) plan to pay for qualified accident and health premiums. For this purpose, a public safety officer is defined as an individual serving a public agency in an official capacity with or without compensation as a law enforcement officer, a firefighter, a chaplain, or a member of a rescue squad or ambulance crew. To be eligible for the transfer, the public safety officer must have separated from service due to disability or attainment of normal retirement age under the plan.
- Enabling a beneficiary to receive benefits under a governmental 457(b) plan if a participant were to die while on qualified active military service equivalent to the benefits that would have been provided had the participant returned to work with the employer and then terminated employment.
- Roth accounts – the proposed regulations confirm the following:
  - Designated Roth contributions must be included in income in the year of deferral (made on an after-tax basis).
  - Contributions and withdrawals of a participant's Roth contributions must be credited and debited to a designated Roth account maintained for the participant, and the plan must maintain a record of each participant's investment in the contract (after-tax contributions) with respect to the account.
  - No forfeitures may be allocated to a designated Roth account and no contributions other than designated Roth contributions and rollover contributions described in §402A(c)(3)(A) may be made to the account.
  - Qualified distributions from a designated Roth account are excluded from gross income.

A provision in the proposed regulations that applies to both governmental and tax-exempt 457(b) plans deals with the first day of the month rule. The regulations clarify that if a participant wishes to either revoke or modify an existing participation agreement, that change becomes effective not earlier than the first day of the month after the revoked or modified participation agreement was entered into.

Practical considerations

Plan sponsors of eligible 457(b) plans will be well served to review their plan document provisions and procedures to ensure they are in compliance with the proposed regulations.

If you would like more information on the proposed regulations, we welcome you to reach out to your Empower plan contact.

This material has been prepared for informational and educational purposes only. Neither Empower Retirement nor its subsidiaries or affiliates provide tax, legal, accounting and/or investment advice. Please consult your tax advisor or attorney for such guidance.

Empower Retirement refers to the products and services offered in the retirement markets by Great-West Life & Annuity Insurance Company (GWL&A),Corporate Headquarters: Greenwood Village, CO; Great-West Life & Annuity Insurance Company of New York, Home Office: NY, NY; and their subsidiariesand affiliates. The trademarks, logos, service marks, and design elements used are owned by their respective owners and are used by permission. PT280117 (09/16)

FOR PLAN SPONSOR OR ADVISOR USE ONLY.