Defined Contribution Legislative and Regulatory Update

For Government clients

March 2017

We are committed to providing you with the information and tools you need to help you meet your fiduciary responsibilities as a plan sponsor and 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.

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EMPOWER RETIREMENT™

From the Hill

Update on DOL fiduciary rule

The Department of Labor's (DOL) fiduciary rule expanding the definition of who is a fiduciary for purposes of providing investment advice to plan participants and IRA owners has a current implementation date of April 10, 2017. On February 3, 2017, however, President Trump issued a memorandum directing the Secretary of Labor to review the rule in order to determine whether it adversely affects "the ability of Americans to gain access to retirement information and financial advice." On March 1, the DOL proposed a 60-day delay to allow them to conduct that analysis. Comments on the proposed 60-day delay were supposed to be submitted to the DOL on or before March 17, 2017.

The president's memo states that the rule should be rescinded or revised as appropriate and consistent with law IF (1) the DOL's review of the rule results in an affirmative determination as to any of the considerations listed below or (2) the DOL concludes for any other reason that the rule is inconsistent with empowering Americans to make their own financial decisions. The DOL must determine whether:

- the anticipated applicability of the rule has harmed or is likely to harm investors due to a reduction in access to retirement savings offerings, retirement product structures, retirement savings information or related financial advice;
- the anticipated applicability of the rule has resulted in any disruption within the retirement services industry that may adversely affect investors or retirees; and
- the rule is likely to cause an increase in litigation or an increase in the prices that investors and retirees must pay to gain access to retirement services.

So what does this mean for all of us working toward the April 10 implementation date? Empower Retirement is pushing forward with plans to be in compliance with the rule as we monitor the progress of the steps that must occur before a final rule can be published:

- DOL review of the comments received on the proposed 60-day delay (due March 17, 2017)
- Completion of an Office of Management and Budget (OMB) review
- Publication of the proposed rule in the Federal Register
- Completion of the period for public comment (expect a 45-day comment period)
- Review of public comments by the DOL
- Drafting of the final rule (to the extent there are changes from the proposal)
- OMB review of the final rule
- Publication of the final rule in the Federal Register

The DOL has indicated that upon completion of its examination, it may decide to:

- allow the rule to become applicable,
- issue a further extension of the applicability date,
- propose to withdraw the rule, or
- propose amendments to the rule.

The DOL has acknowledged that its examination of the rule could require more time than the proposed 60-day extension. Given the complexity of the issues, and the time it will take for the DOL to review the comments to the delay proposal, the applicability date of the rule could well be extended for much longer than 60 days, or even indefinitely.

Practical considerations

Although the proposed DOL rule applies to retirement plans subject to the Employee Retirement Income Security Act (ERISA) and to Individual Retirement Account (IRA) owners, it does not directly impact public school and other non-ERISA plans. Rollovers between a non-ERISA plan and an ERISA plan or between a non-ERISA plan and an IRA, however, will be subject to the new fiduciary rule. Everyone impacted by the rule will need to conduct their own assessments of how to move forward with implementation efforts. Empower will continue to actively communicate with you as events unfold, so look for additional updates and information soon. If you have questions in the interim, please contact your Empower representative.

From the Courts

403(b) lawsuits an important wake-up call for 457(b) plans with multiple vendors

More than a dozen large private universities have recently been sued for excessive fees in their 403(b) plans. These lawsuits claim that the universities breached their fiduciary duties under ERISA by allowing excessive fees to be charged to plan participants. Although these lawsuits are similar in many respects to the numerous 401(k) plan fee lawsuits filed over the past 10-15 years, certain claims against these 403(b) plans are of particular importance to 457(b) plans with multiple vendors.

The complaints allege that the 403(b) investment committees at Yale, NYU, Duke, Vanderbilt, Johns Hopkins, Northwestern, MIT, Columbia, USC, Emory and Cornell acted imprudently by failing to leverage their negotiating power to demand lower-priced recordkeeping services and lower-cost investment options. The complaints also include a new argument that the universities breached their fiduciary duties to participants by using multiple recordkeepers and allowing participants to choose from hundreds of investment options. Important lessons can be learned from the key arguments in the complaints:

- **Reasonable fees.** Fee reasonableness is a fundamental and widely discussed fiduciary topic but, unfortunately, neither the DOL nor the IRS has given much insight or guidance as to what is considered a reasonable fee. Much of the interpretation of what is and is not reasonable has therefore come from the courts. It is important for fiduciaries to learn as many lessons as possible from the alleged breaches as well as the related complaints, settlements and court decisions in order to prudently manage fee risk in the future.
- **Recordkeeping fees.** Plans that pay recordkeeping and other administrative expenses through asset-based fees called revenue-sharing payments result in higher fees to the recordkeeper as the plan's assets grow. Plan fiduciaries must monitor these fees to ensure they do not exceed "reasonable" fees. Plan fiduciaries should also negotiate lower fees and consider implementing per-participant fees for recordkeeping rather than asset-based fees.
- **Multiple recordkeepers.** The complaints allege that employing more than one recordkeeper for a plan undermines its ability to negotiate favorable fee terms and streamline the plan's administrative services. Because every recordkeeper employed by a plan must fulfill each and every recordkeeping service, this results in fewer participants paying higher costs. Not only does a single recordkeeper reduce the per-participant cost for recordkeeping; it also reduces the time and effort plan fiduciaries must spend monitoring the fees and performance of service providers and reduces fiduciary liability.
- **Too many or inappropriate investment options.** Offering too many funds to plan participants results in duplicative investment options, many of which have high fees and perform poorly due to a lack of fiduciary oversight. An excessive number of investment options in a plan not only confuses participants, causing some to put off enrolling in a plan, it also indicates that fiduciaries are not prudently monitoring and making fund changes as warranted. The lawsuits allege as well that it is imprudent for plan fiduciaries to offer variable annuity products due to the high fees and distribution restrictions inherent in such products.

Practical considerations

This litigation underscores the importance of maintaining appropriate investment policies that require plan fiduciaries to monitor and review plan investments and service provider fee terms and prudently perform fiduciary duties on a regular basis. Plan sponsors employing multiple recordkeepers or allowing large numbers of funds to be offered to participants should carefully consider what steps may be appropriate to ensure they are meeting their fiduciary duty to adopt and maintain a process for reviewing not only the lineup and performance of investment options but also administrative fees and the structure of their plans' recordkeeping relationships. Although these lawsuits only target private universities subject to ERISA, public entities with 403(b) or 457(b) plans should also consider the potential impact such litigation may have on public plans with similar features. See the article entitled "Government 457(b) and 401(a) plans fiduciary responsibility" below for more information on fiduciary responsibility.

From the Regulatory Services Team

Government 457(b) and 401(a) plans fiduciary responsibility

Maintaining a healthy public defined contribution (DC) retirement savings plan requires some time and effort on the part of the plan sponsor. As fiduciaries, plan sponsors have come under increasing scrutiny and media attention in recent years, in part due to volatile markets, new emphasis on plan fees, class action lawsuits brought against plan sponsors by their plan participants and more frequent audits by the IRS.

A person is a fiduciary when he or she manages assets of another. Section 401(a) plans have always been held in trust, and since 1999, public 457(b) plan assets have been required to be held in trust for the sole benefit of plan participants and their beneficiaries. As a plan sponsor, you stand in a special relationship of trust, confidence and legal responsibility to the plan and its participants. You are charged with managing the plan and plan assets without any conflicts of interest. Every plan-related decision must be made to advantage the plan and its participants. As a plan fiduciary, you will want to establish a standard of excellence to guide your decision-making processes.

Many of you are aware of the numerous lawsuits filed against private 401(k) plan sponsors for allegedly breaching their fiduciary duty to their plan participants. These lawsuits and a number of settlements have resulted in millions of dollars in costs for plan sponsors. Recently, lawsuits have been filed against more than a dozen large university 403(b) plans. These suits allege that participants were subject to excessive fees due to the use of expensive share classes, failures to establish and follow a prudent process of selecting and monitoring funds, and the systematic use of multiple recordkeepers that resulted in significantly higher administration costs.

It is time for governmental plan sponsors to pay attention to their fiduciary responsibilities and learn valuable lessons from these court decisions and settlements. While plan sponsors who have established prudent processes and followed their governing plan documents have been exonerated, those who fail to select funds and providers that only charge reasonable fees or fail to actively monitor their funds and providers have been found to have breached their fiduciary duties.

Even though public 457(b) and 401(a) plan sponsors are not directly subject to the fiduciary responsibilities outlined in ERISA, you are subject to very similar rules under state law. The Uniform Prudent Investor's Act passed in each state imposes fiduciary responsibilities on public plans that are the focus of the recent lawsuits. Many public plans also use ERISA rules as a best practice for fulfilling their fiduciary duties.

Most breaches of fiduciary responsibility are inadvertent. Thus, it is important to identify your fiduciaries and ensure they know they are fiduciaries and understand their basic responsibilities. You are a plan fiduciary when implementing and administering the plan. Prudently performing each of your many fiduciary duties will require a significant amount of time and effort, but it will also result in a well-maintained plan that benefits your employees and limits your fiduciary liability.

Such fiduciary duties include, but are not limited to, administering and operating the plan, keeping your plan document and Investment Policy Statement updated, selecting and monitoring plan investments and service providers, and ensuring fees are reasonable.

Unfortunately, the biggest mistake many plan sponsors make is not realizing they are plan fiduciaries. The second-biggest mistake public plan sponsors make is assuming their consultant or service provider is the plan's fiduciary. Even if a plan sponsor retains a consultant who is a fiduciary by virtue of providing investment advice for a fee to assist with the plan, the plan sponsor is not relieved of their fiduciary responsibility.

Do not operate under the mistaken impression that you have no responsibility to provide prudent oversight over the fees and performance of your funds and your service providers. If you need help in selecting and reviewing the investments you offer to plan participants, consider retaining an independent investment professional to assist you.

From the Regulatory Services Team

We also recommend that you create formal governance procedures for your 457(b) and 401(a) plans to ensure compliance with your basic fiduciary standard of conduct, which includes:

- **Duty of loyalty** — The need to act solely in the best interests of the plan and its participants every time you make a plan-related decision while avoiding conflicts of interest.
- **Duty of prudence —** The need to act with the care, prudence, skill and diligence that a knowledgeable person would use when administering a DC retirement plan.
- **Duty to diversify and prudently select and monitor investments —** The need to diversify the investments of a defined contribution plan trust unless it is clearly imprudent to do so, and the need to actively monitor those investments in a prudent manner and make changes when warranted.
- **Duty to prudently select and monitor service providers —** The need to develop formal, objective processes for selecting and monitoring service providers and making changes when warranted.
- **Duty to follow your plan documents —** The need to ensure your plan documents remain compliant and up to date with applicable law and you are operating the plan in compliance with your governing documents, including your Investment Policy Statement.

It is also important to look for strategies to limit your fiduciary liability. Many public employers have found that the level of monitoring required of plan funds and service providers is too overwhelming with multiple providers. Consolidating to one platform with one provider immediately reduces the time and effort you must spend monitoring the provider and their fees. A single provider also drives down participant-paid costs and improves the overall operational efficiency of a plan. It is also a huge plus for plan participants, who often put off joining the plan when confronted with the task of choosing from multiple providers before they can even consider contribution levels and investments.

Practical considerations

Empower Retirement has created a brochure for public employers called *Focus on Fiduciary Responsibility*. Although it is not a legal interpretation of your responsibilities under applicable laws and is not intended to be a substitute for the advice of your retirement plan attorney or other professional, it is designed to help you navigate your basic fiduciary responsibilities. If you would like a copy of the fiduciary guide, please contact your Empower representative.

IRS clarifies plan correction options for 457 plans

The IRS requires public 457(b) plans to keep their plan documents compliant with IRS rules and regulations and to administer their plans in compliance with their documents. Although plan sponsors work diligently to ensure their 457(b) plans are operated pursuant to a compliant plan document, mistakes do happen. In Rev. Proc. 2013-12, the IRS clarified the circumstances under which the IRS Employee Plans Voluntary Compliance (VC) team will consider requests for voluntary correction for Code §457(b) plans. How a governmental 457(b) plan sponsor can correct an error depends upon the type of failure.

Written plan document failures — The IRS Employee Plans Voluntary Compliance (VC) team will not consider any issue relating to the form of a written 457(b) plan document, including a failure to adopt a plan or amend a plan for some tax law or income tax regulations. VC will not issue closing agreements for these matters and will decline to process these requests and refund any payments. Plan sponsors who want the IRS to review their 457(b) plan document or consider any other document form issue may request a private letter ruling. Private letter ruling requests are complicated and require a user fee. Consult your attorney about the viability of requesting such a ruling pursuant to Revenue Procedure 2017-1.

From the Regulatory Services Team

Governmental plan sponsors can self-correct, 180-day rule — Governmental plan sponsors may self-correct their 457(b) plans if they discover they did not comply with the Internal Revenue Code or IRS regulations. According to the IRS, under Code Sec. 457(b)(6) and Reg. §1.457-9(a), governmental entities have until the first day of the plan year that begins more than 180 days after the IRS notifies them of a plan failure to correct such a failure. Considering the time governmental entities have to self-correct plan errors, they may not need to make voluntary submissions to the IRS in most cases.

Employee Plans VC Program — If a governmental 457(b) plan sponsor needs to request additional relief or simply wants IRS approval for a correction method for a non-plan document failure, they may make a submission to the IRS VC team pursuant to Section 4.09 of Revenue Procedure 2013-12. VC retains complete discretion to accept or reject these requests. If a request is accepted, the VC team will consider it on a provisional basis outside the Employee Plans Compliance Resolution System (EPCRS) and will issue a special closing agreement.

Practical considerations

Make time to review your plan document to ensure it is compliant with the Internal Revenue Code and IRS regulations. Perform a self-audit to determine whether you are administering and operating the plan in compliance with the plan terms. If you find any operational failures, self-correct them as soon as possible using the 180-day self-correction option if possible. If you want a special closing agreement from the VC team, send your questions about submitting a request for voluntary correction for a 457(b) retirement plan to TEGE.EP.VC@irs.gov.

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