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PRESENTS

PENSION PLANNER

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BRINGING A UNIQUE UNDERSTANDING OF KEY ISSUES FACING BENEFIT PLANS

FROM THE EDITOR - TANIA QUIGLEY, CPA

When it comes to pension plans, many employers find themselves conflicted. They want to establish a plan to assist their employees, and themselves, to develop a nest egg for their retirement years, however, the land-mines that exist in pension plan administration and regulation are so intense, that they are afraid of accidently setting one off. Pension plans are essential for attracting and retaining new staff. If you don't offer one, you could be at a disadvantage compared to your competition, but having one comes with a high level of fiduciary responsibility.

Personally, I believe that the rewards of offering a pension far outweigh the risks, and many of the risks can be mitigated by surrounding yourself with the right advisors. Think about it, *don't you wish you would have invested more money in your own retirement when you first entered the workforce?* Setting up the right plan, with provisions that foster contributions and growth, coupled with regular education of your staff, could be one of the greatest things you can do for your employees.

In an effort to help you navigate your pension plan and your related responsibilities, welcome to the inaugural issue of the Pension Planner. In this issue, we have provided insight into how to keep your plan compliant, keep provisions that you can add to your plan to increase its effectiveness, some of the pitfalls that we typically see while auditing plans, and new pension regulations. In addition, we will be regularly adding additional pension plan information to our website to keep you informed, so that you have a place to turn for pension plan questions.

Finally, if you have questions, we work with some of the top pension attorneys and administrators, and we provide services to a large number of plans, please reach out to us. We be more than happy to provide you with the answers you need.

Thanks for reading, and we hope to hear from you.

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KEEPING YOUR PLAN MANAGEABLE

If you have a pension plan, you have a fiduciary responsibility to ensure that your plan is compliant with regulations. You also have a responsibility to your employees, to help them to maximize their benefit under the plan. In order to meet these responsibilities, there are certain best practices that you should consider:

PUT IN PLACE A PENSION COMMITTEE:

If you're like most business executives, you are busy focused on the various aspects of running and growing your business. Your company's pension plan is one of the last things your focused on. The problem is, whether you're focused on it or not, you can still be held liable if something goes wrong. To ensure that your pension plan is getting the attention it requires to keep it in compliance with the various rules and regulations handed down by both the Department of Labor and the Internal Revenue Service, it is important to put in place a pension committee. The pension committee functions as a sort of the board of the pension plan, whose goals are to protect the benefits of the plan members and to conserve and enhance pension fund assets. Like any other board, the minutes of the committee should be maintained to memorialize the discussions that take place surrounding the plan.

BENCHMARK YOUR PLAN:

Monitoring your plan's investments is one of your fundamental fiduciary responsibilities. Investment performance should be reviewed at least annually, although ERISA recommends quarterly reviews as a best practice. Establishing a formal investment policy, that provides appropriate guidelines for selecting, monitoring, measuring, and making decisions for your plan's investments is a critical part of the benchmarking process. To benchmark your plan, you should consider the following:

- Reviewing the fees charged by the investment manager and third-party administrators. This includes both the direct fees charged as well as the hidden fees included within the plan. If a plan invests in mutual funds, the plan should not be buying retail shares, but instead should be in lower cost institutional shares.
- Reviewing investment performance. Each investment alternative has risks and yields. Plan managers should be reviewing the return received based upon the risk undertaken and compare that to similar investments on a periodic basis. In instances where an investment is underperforming with respect to the risk, the investment should be replaced with a more appropriate investment.
- Ensure that an appropriate number and type of funds are included in the plan. While you don't want to overwhelm employees with too many options, you want to make sure that all the key investment types are available; money market, bond, equity, etc. If your plan does not already offer target date funds, you should consider offering these. These are funds that develop a balanced investment strategy based upon the anticipated retirement dates of your employees, so that the target date fund of an employee retiring in 5 years is less risky/aggressive than one designed for an employee retiring in 20 years.

EDUCATE YOUR STAFF:

Most of your employees do not understand the importance of contributing to the retirement plan or how the time value of money dramatically benefits them the earlier they start. In addition, often times employees are intimidated by the various investment choices available. Rather than make a mistake, they opt to do nothing at all. You can really help your staff by ensuring that your plan custodian or broker speaks to your staff at least once or twice a year to explain to them why its important for them to contribute, how much they should contribute, what match provisions exist, and how they should invest their funds. This will not only assist them in preparing for retirement, but it could also have a significant impact on your ability to benefit from the plan as the more that employees participate, the less likely you will fail your nondiscrimination testing.

CONSIDER ADDING 3(38) AND 3(16) FIDUCIARY PROTECTION TO YOUR PLAN:

As a fiduciary of your plan, you have significant responsibility to your participants and a substantial liability if you do not appropriately carry out your responsibilities. The **Employee Retirement Income Security Act (ERISA)** holds you to high standards but does not really provide you with appropriate guidance as to what you're supposed to do. Unfortunately, many fiduciaries don't even know that they are fiduciaries or have any level of risk at all. Many organizations have elected to add 3(38) and 3(16) fiduciary protection to their retirement programs, reducing the burden on in-house HR staff and mitigating risk that the plan is not compliant with relevant regulations.

- In a 3(16) fiduciary relationship, you can outsource many of your responsibilities to a specialized plan administrator that takes complete responsibility for all aspects of your plan administration, assuming full discretionary control. This does not completely absolve you of your fiduciary responsibility, but it does shift much of the liability to the 3(16) fiduciary. The 3(16) fiduciary signs off on the ERISA plan related documents, making them liable for plan errors.
- A 3(38) fiduciary has the authorization to make investment decisions for the plan. In situations where a 3(38) is not present, you would typically get advice from a financial or plan advisor, and then you would determine the direct course of action. The 3(38) takes you out of the equation.

As a fiduciary, you can never completely eliminate your risk, however, by putting in place key controls, documenting the procedures performed, and surrounding yourself with individuals that can help guide you through the regulatory environment, you can significantly reduce your risk.

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IS YOUR PENSION PLAN COMPLIANT?

They say that no good deed goes unpunished. You establish a pension plan to help your employees provide for their retirement, and in so doing, you create a potential minefield of regulatory booby traps and compliance trip wires that can wind up costing you extra money in plan penalties. Unlike many other areas of your business, in the area of pension plans you have both big brother (*the Internal Revenue Service*) and big sister (*the Department of Labor*) looking over your shoulder to make sure your doing things correctly, and with an uptick in the number of government audits, it behooves you to establish a regular compliance review of your pension plan.

There are many places where your plan can be out of compliance, but we'll just touch on some of the bigger ones here:

FAILURE TO COMPLY WITH/ UPDATE YOUR PLAN DOCUMENT:

Companies grow. We get it. That's a good thing. You implement new practices, offer new incentives, offer more flexibility to attract staff … all the things you should be doing to grow a successful business. Great, but when was the last time you looked at your plan document to see if those changes have been incorporated into your pension plan administration. When your making payroll and human resource changes, you need to make sure that you consider how those changes could potentially impact the administration of your pension plan. We suggest that every few years you review your pension plan to see if you are operating in compliance with your plan documents.

INCORRECT DEFINITION OF COMPENSATION FOR CONTRIBUTIONS:

Within your plan document, you can define the contribution base on which employee and employer contributions are made. Many plans use a catch all definition of *"all compensation."* Sometimes, however, one-off type things happen; such as stipends, bonuses, vacation and sick pay-outs, etc., which are considered compensation, but you may not handle them correctly from a pension calculation perspective. This can result in an under withholding of staff contributions to their pension plan, and unfortunately, it can be your responsibility to make them whole (*plus investment returns*). Make sure you understand how compensation is defined, and your payroll and fiscal staff are informed, so that they can insure that the correct contributions are made.

NOT MAKING TIMELY DEPOSITS OF PARTICIPANT CONTRIBUTIONS:

Each pay period, you withhold money as directed by your staff to make pension contributions. You have a fiduciary responsibility to ensure that those funds are deposited into their pension account in a timely basis. If you read the regulations, they state that contributions must be made as soon as they as it is reasonably possible to segregate them from your assets, but in no event should this be more than 15 days. *Spoiler alert* ... 15 days is not a safe harbor. A safe harbor of 7 business days does exist for small plans with less than 100 participants, but for those of you with more than 100 participants, you need to get it in quicker. For those of you that use a payroll service, as soon as the payroll is processed, you know the amount of the required pension contribution and you know who had how much deducted. That sounds like reasonably possible to segregate to me. The reality of the situation is, you should be able to contribute the funds within 1 or 2 business days of the time your payroll is processed. Failure to do so could require you to reimburse the plan for any lost income your employees had.

NOT FOLLOWING ELIGIBILITY REQUIREMENTS:

Your plan document spells out when an employee is eligible to participate in a plan. This considers new employees as well as employees who left your company and have returned. In determining this, such things as hours worked, years of eligible service, and other factors come into play. You need to have a tracking system in place to appropriately measure these factors and you need to effectively communicate with your staff their eligibility to participate in the plan. That communication should be in writing, with a formal declination letter maintained if an employee elects not to be in the plan to substantiate that the communication took place. In cases where a formal declination letter is not utilized, some items that you can use to support your communication of the plan to your employees is the signed acknowledgement of the employee handbook (*so long as information about the plan is included*) or email correspondence to the employee when they become eligible. Guess what happens if you fail to timely invite an eligible employee into the plan … you may have to contribute past contributions and related investment returns into the plan on their behalf.

IMPROPER LOANS AND HARDSHIP WITHDRAWALS:

The plan document should outline what your loan and withdrawals policies are (*are they allowable, for how much, are hardship withdrawals allowed, etc.*). Remember, when it comes to your plan, the plan document is the bible. If you don't follow it, you could run into trouble. It is important that your HR staff is aware of the loan and withdrawal provisions so that when they are advising staff, they are providing the right advice.

FAILURE TO PERFORM DISCRIMINATION TESTING:

Discrimination testing is something that is typically done by your **Third-Party Administrator ("TPA")** to determine that the plan is fair and that the upper level management is unduly benefitted by the plan. In order for the TPA to do their job, they need information from you, and that information needs to be accurate. Make sure you have good open dialogue with your TPA and your providing timely information, so that you can strategize to maximize your benefit, and if excess contributions are made, they can be timely distributed to avoid penalties.

FAILURE TO FILE/ACCURATELY FILE FORM 5500:

The penalties for not filing or filing your form 5500 late are fairly steep. In addition, errors on your 5500 could open you up for an audit, as 5500 errors are one of the top reason plans get selected for audit. It is important that you understand who is responsible for filing your 5500 (*not all TPA's prepare these forms*) and it is also important that the return is reviewed for accuracy by a knowledgeable party.

INAPPROPRIATE FIDELITY BOND LEVELS:

All pension plans are required to have in place a fidelity bond. You should have coverage equal to the lesser of 10% of your plan assets or $500,000. If you don't have the appropriate fidelity bonding, this will be disclosed in your 5500, and could increase your likelihood of a plan audit. We quite often see that crime coverage under your general liability insurance policy is interpreted as the fidelity bond coverage. The fidelity bond is separate coverage from your general liability insurance, as this insurance is specific to the plan and insures the plan assets against fraud and dishonesty from those individuals that handle plan assets. When looking to obtain the fidelity bond, you should ensure that the insurance company is named on the Department of Treasury's Listing of Approved Sureties.

A pension plan is an important benefit that you can offer to your staff, but it is vital that you understand and follow your fiduciary responsibilities to avoid things blowing up on you.

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PICKING YOUR

PENSION PLAN PROVISIONS

Developing a pension plan document can be a difficult undertaking. When creating a plan document, the plan sponsor must be aware of not only IRS and ERISA regulations, but also of keeping administrative costs low while providing maximum benefit to their employees. Because of this, employers should consider adding provisions in order to streamline plan operations, reduce plan overhead costs, and provide better retirement planning to participants.

One simple, but immensely beneficial, provision is auto enrollment. Adding an auto enrollment provision to a plan is an easy way to ensure compliance with federal law. Federal law requires employers to notify their employees of the plan's participation requirements and when the employee is eligible to participate in the plan. Traditionally, once employers inform their employees that they are eligible, the employer must wait to receive acknowledgement from the employee that they wish to participate before beginning deferrals. Employees also have the option to decline to participate. Automatic enrollment, however, immediately enrolls employees into the plan when they are eligible and begins deferring a part of the employee's wages at a default percentage stated in the plan, unless the employee elects otherwise. Adding an auto enrollment provision, effectively requires employees to opt out of the plan rather than opt in. This eliminates the hassle of repeatedly following up with employees to ensure that they properly complete the necessary paperwork to enroll or decline participation in the plan in a timely manner. It is also a great benefit to employees, getting them in the plan and focused on retirement as soon as possible.

Another key provision to reduce a plan's administrative burden, and possibly avoid an audit, is auto distribution of account balances below $5,000. In many industries with high employee turnover, employees will enter a plan, begin making deferrals, and then separate from their employer all in a short period of time, resulting in a large number of terminated employees with small balances within the plan. These small account balances often become a major burden to employers. These accounts remain inactive for long periods of time racking up management fees and artificially inflating the number of plan participants. This buildup of small account balances is potentially costly to the plan sponsor, because once the plan has over 120 participants, the plan must engage an independent auditor to audit the plan. By adding an automatic distribution provision to a plan, employers can efficiently manage the number of plan participants and reduce their administrative costs, all while avoiding the need for a potentially costly plan audit.

While many plan sponsors seek to structure their plans to reduce their costs as much as possible, ensuring that their employees are adequately prepared for retirement should be another important goal of managing their plan. Those sponsors wishing to take in interest in their employee's retirement savings patterns, may want to take advantage of various tracking features of their plan. Many plans offer the ability for sponsors to quickly view the average funds available to each employee. Using this information, plan sponsors can get a better idea of how prepared their employees are for retirement. If these results show that many employees are not making adequate deferrals, plan sponsors may be interested in adding an automatic contribution escalation provision to their plan. Under this provision, an employee's contribution amount is automatically increased each year by a certain percentage. For many employers, this is a simple way to help employees increase their retirement savings without requiring yearly input from employees. Gradually increasing an employee's contribution amount is helpful in maximizing investment returns and ultimately plan savings. Enabling escalating contributions by default will greatly increase participants' returns in the long run. If employees do not want to make increased contributions, they can always opt out of the escalating contributions provision. Another plan provision that could greatly benefit employees is changing the default investment options. When an employee chooses to make deferrals, but does not select which funds to invest in, their contributions will be invested in the plan's default option. Often, these default options are money market funds or other similar low-yield investments. Many employees who invested in these default options find that they have much less money than they expected when they choose to retire. Although it is ultimately the employee's responsibility to appropriately invest their retirement contributions, employers can help their employees by selecting better default investments, such as target funds. Target funds are intended to adjust risk based on the employee's estimated date of retirement. Typically, as the time to retirement increases so too does the risk that an employee can accept, and therefore the potential yield of the target fund. This often means that target funds with very distant retirement dates will be heavily invested in stocks and only slightly in bonds and other fixed income vehicles. As the retirement date approaches, these funds will be rebalanced to focus more on fixed income vehicles and less on stocks. Utilizing these target funds as the default investment option will greatly benefit employees in the long run.

Creating an effective and efficient plan document requires significant time and energy. Plan sponsors often have various goals that they wish to accomplish but only limited resources available. Employers typically want to ensure compliance with applicable regulations while keeping administrative costs low and maximizing benefit to their employees. All of the above provisions are excellent ways to increase the utility of a pension plan and will greatly benefit both plan sponsors and participants.

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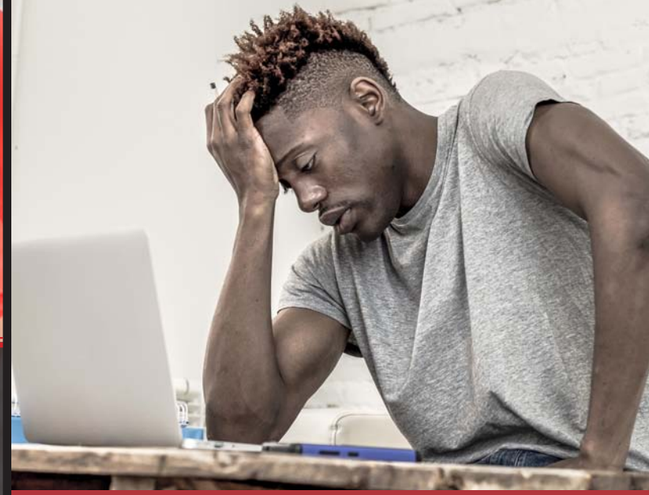

HARDSHIP

WITHDRAWALS

401(k) retirement plans often have a feature to allow participants to take a hardship distribution. These distributions come with stricter rules and regulations that plan management must follow. These include distribution amounts can only be taken from the participant's vested balance, participant must exhaust the loan option first, and they cannot defer amounts into the plan for six months after taking a hardship withdrawal. In 2018, the **Bipartisan Budget Act of 2018 (the "Act")** was passed and it changed these rules. Although this is effective for plan years beginning after December 31, 2018, the mandatory implementation of these changes to the plan document will be effective January 1, 2020.

Here are the changes brought on by the Act:

- Eliminates the six-month suspension on employee contributions;
- These types of contributions are now allowed to be included in the amount of hardship:
  - *Profit-sharing contributions*
  - *Qualified Nonelective Contributions (QNEC)*
  - *Qualified Matching Contributions (QMAC)*
  - *Earnings on any contributions deposited into the participant's retirement account;* and
- Eliminates the requirement for the participant to first take a loan against their retirement account.

If you have not already done so, we encourage you to discuss these changes with your third-party administrator to update the plan document so that it is compliant with the Act. The Act currently only impacts 401k plans with a cash or deferral arrangement.

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