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Employee Benefits Update

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Help retirees plan their retirement spending, survey says

Long after defined benefit (DB) plans became scarce in the private sector, many employees still mourn their departure. With DB plans, participants are given an estimate of their monthly benefit at retirement. However, with defined contribution (DC) plans, participants often lack confidence in their understanding of how much their DC plan will provide in monthly income when they start drawing down their accounts. More and more 401(k) plan sponsors are beginning to try to address this concern in various ways — without revisiting the DB plan model.

A look at the numbers

According to a survey by Alight Solutions released earlier this year, more than half (57%) offer a distribution option that allows participants to "elect an automatic payment from the plan over an extended period of time." That isn't the same as telling participants *how much* they can sustainably withdraw over the course of their retirement. But 76% of those sponsors polled (up from 66% in 2018) give participants access to tools to help determine how much they can spend each year in retirement, so that they can take full advantage of the automatic periodic distribution options.

Encourage participants to sample multiple lifetime payout calculators before making a decision about a sustainable distribution rate.

One such tool is a lifetime payout calculator. Many different companies — often those selling financial services — provide these calculators on the Internet, and participants can take advantage of them. Some, including one created by the American Institute for Economic Research, are offered by entities that aren't also selling financial services. Encourage participants to sample multiple calculators before choosing a sustainable distribution rate.

Although spending unsustainably in retirement is an important concern, so too is underspending. Retirees with a limited understanding of what a sustainable spending pattern looks like are at risk of living far more frugally than they would choose to if they knew better.

Keeping assets in-house

As the Alight Solutions survey in the main article makes clear, incorporating an annuity option within a plan is only one of several options plan sponsors can pursue to help participants on the threshold of retirement, or in retirement.

For example, back in 2015, MGIC, a mortgage insurance company, began giving retirees the option of receiving automated periodic distributions. Retirees can choose to receive payments either monthly or quarterly. Part of the company's motivation for doing so was to discourage them from rolling their assets into an IRA, and thus out of the plan. Why that concern? MGIC worried that retirees could be left "in a vulnerable place" by doing so, a company executive stated.

In keeping with that view, the Alight survey indicated that only 5% of employers want retired or terminated employers to pull their assets out of the plan, down from 11% in 2014. One third prefer that participants keep their assets in the plan, and the remaining 62% expressed no preference one way or the other.

How to help participants

The Alight survey also trained a spotlight on more proactive practices to help participants create a sustainable payout in retirement. In particular:

- 47% (up from 39% in 2018) offer managed account options within their plans that allocate participant assets for income and manage annual payouts,
- 18% have "managed payout funds" that feature a "specific annual target payout percentage with no insurance guarantees,"
- 11% incorporate annuity or insurance products, such as guaranteed minimum withdrawal benefit plans and fixed annuities, as part of their fund lineup, and
- 9% help participants and retirees purchase annuities "outside the plan as options for plan distributions." The percentage of sponsors taking this approach dropped in 2019 from 15% in 2018.

If those numbers sound high, it could be due to a survey database consisting primarily of very large employers. Regardless, what works for large plan sponsors often also works for smaller ones.

Reluctance on "in-plan solutions"

The same survey asked the majority of sponsors that don't intend to offer in-plan income solutions, such as annuity options, why they hold that position. Most cited fiduciary worries, "waiting to see the market evolve more," and operational considerations. The fiduciary concerns stem from a perception that sponsors could be held liable for problems caused by an annuity provider implicitly endorsed by the sponsor because it's been given easy access to participants.

This isn't a new worry, and some legal guidance suggests that sponsors can be held responsible only for decisions that overlooked troubling information that was available when a sponsor added an annuity provider to the plan's lineup of lifetime income options. Although legislation has been introduced in Congress to make it less of a worry, so far none has been enacted.

Natural extension

A top priority for many plan sponsors is ensuring that participants will have accumulated sufficient assets to retire when they want to. Helping them avoid prematurely draining their savings in retirement is a natural extension of this goal. ◻

ERISA disclosure 101: A quick overview of plan sponsor obligations

Qualified retirement plan sponsors are subject to many disclosure requirements. Here's a "top ten" (and thus incomplete) list of key required defined contribution plan disclosure documents from the Department of Labor (DOL), offered to reinforce a general understanding of those requirements. A note of caution: This list doesn't include IRS disclosure requirements. Also, while disclosures are generally directed to plan participants, a plan beneficiary, in the case of a participant's death, typically would also be covered by the disclosure rules.

The top 10

1. Summary plan description (SPD). You must provide this automatically to new participants within 90 days of their becoming covered by the plan. It's the most basic and comprehensive document describing the plan and its operations. The SPD must be written in language that can be understood by the average participant, and be current as of no more than 120 days from the date the plan is established. You must then furnish an updated SPD to all covered participants every five years if there are changes, and every ten years if the SPD hasn't changed.

Plan sponsors must provide information about plan investment options both before the time the participant provides investment instructions and on request.

2. Summary of material modification (SMM). Plans must provide an SMM to plan participants no later than 210 days beyond the end of the plan year in which the plan was "materially" changed. In effect, this is an update to the SPD.

3. Summary annual report (SAR). Participants must receive the SAR within nine months of the end of the plan year, or, if an extension to file the IRS Form 5500 is made, two months following the extended deadline. This report is a narrative description of the information on the Form 5500.

4. Plan documents. Plan sponsors have to furnish the plan's highly detailed governing legal documents on receipt of a request from a participant. You have 30 days from receipt of the request to do so. These include your trust agreement, Form 5500 and the documents listed above.

5. Notification of benefits determination. This document explains the basis of an adverse determination decision. You must generally provide it within 30 days of that decision. It must reference specific plan document provisions that the decision was based on, and explain appeals procedures.

6. Periodic benefit statement. You must provide a periodic benefit statement at least quarterly for participant-directed individual account plans and annually for all other individual account plans. Among other things, the statement must cover the participants' account balances, their ability to change their investment selections and a statement that holding more than 20% of a portfolio "in the security of an entity (such as employer securities) may not be adequately diversified."

7. Participant plan investment options, investment fees and other expenses. Plans must furnish this disclosure to participants at least annually. It must describe general administrative and investment costs, as well as individual charges to participants for particular services such as plan loans. For each investment option, it must also include a chart showing fees and expenses,

investment performance, and relevant investment benchmark data.

8. Section 404(c) plan investment options. You must provide information about plan investment options both before a participant provides investment instructions and on request. This notice gives sponsors the legal protections from possible participant litigation involving the adequacy of investment options offered by the plan.

9. Qualified default investment alternative (QDIA) notice. Participants must receive an initial QDIA notice within at least 30 days of plan eligibility or 30 days of when any QDIA investment is made on behalf of participants. It must describe the circumstances under which participant contributions will be directed to a QDIA, the investment objectives of the QDIA and what participants need to do if they don't want their contributions invested in that vehicle.

10. Automatic funding notice. This is essentially equivalent to the QDIA notice; participants must be informed if the plan will be defaulting participants into a deferral pattern.

Just the beginning

As noted, this isn't a complete list. But it should give you a head start when you sit down with your plan administrator for a more comprehensive education on ERISA's disclosure requirements for defined contribution plans. Most of the above also apply to defined benefit pension plans, but those plans have many additional disclosure requirements. Failing to provide required disclosures may result in fines and penalties. ◻

Compliance Alert

Upcoming compliance deadlines:

6/30* Deadline for processing corrective distributions for failed actual deferral percentage / actual contribution percentage (ADP/ACP) tests from plans with eligible automatic contribution arrangements (EACAs) without 10% excise tax

7/29 Summary of material modifications is due (210 days after the end of the plan year in which the amendment was adopted)

7/31 Form 5500 is due for calendar year plans or a request for an extension on Form 5558

7/31 Form 5330 to report excise tax on prohibited transactions and excess 401(k) plan contributions is due

7/31 Form 8955-SSA for calendar year plans to report separated participants with a deferred vested benefit is due, unless an extension is requested

** This due date falls on the weekend this year. The IRS historically hasn't extended due dates for required disclosures, contributions or distributions.*

Not every plan that benefits retirees is an ERISA plan

The fact that a compensation arrangement can provide a substantial source of income in retirement doesn't make it subject to ERISA. That was the result the U.S. Court of Appeals for the Second Circuit delivered to three former partners of Booz Allen, a consulting company. The case serves as a helpful primer on the definitional limits of an ERISA "retirement" plan.

Partners only

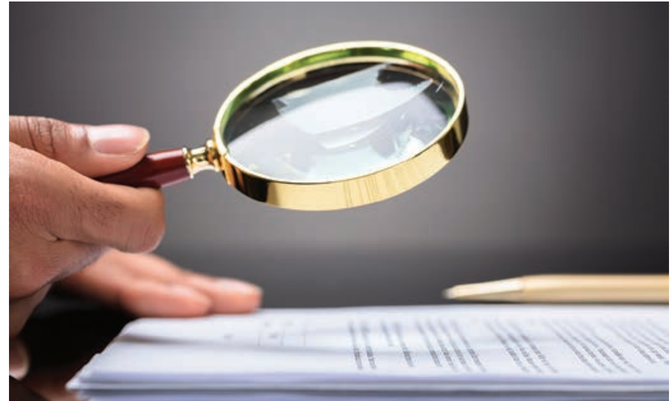
The trio sued the company when they didn't receive the payout they were expecting. Under Booz Allen's Stock Rights Plan (SRP), partners can acquire company shares at attractive prices. The only people who stand to benefit from the SRP are Booz Allen partners who own the privately held company. Under the SRP, Booz Allen buys back the common shares within two years of a partner's separation from the business, including because of retirement.

Two of the three plaintiffs had no common stock in the company under this buyback arrangement when Booz Allen sold a company division to an outside buyer. Thus, the plaintiffs claimed, they weren't sufficiently compensated for the sale. The lawsuit alleged that Booz Allen "improperly discriminated among different Booz Allen officers and violated the duties of due care, loyalty, and good faith, in violation of ERISA."

ERISA and the SRP

ERISA defines a retirement plan as:

> … any plan, fund, or program … to the extent that it … provides retirement income to employees, or results in a deferral of income by employees for periods extending to the termination of covered employment or beyond, regardless of the method of calculating the contributions made to the plan, the method of calculating benefits under the plan, or the method of distributing benefits from the plan.



The appeals court, like the trial court below it, found that the SRP "has little to do with retirement." Instead it's primarily a vehicle through which Booz Allen can remain entirely "owned by the partners, with no outside control," and obtain working capital. SRP participants receive an ownership stake in Booz Allen in exchange for a capital injection. The benefits of that ownership stake are enjoyed by SRP plan participants while they're working and aren't deferred until their retirement. This holds true even if the ownership stake can be turned into cash following retirement, the court concluded.

Also, according to the court, the ERISA language "provides retirement income" doesn't "cover every instance in which a person cashes out an investment after retirement, even though a participant will have anticipated this income when planning for retirement." The words "provides retirement income" refer to plans designed to pay retirement income. Under Booz Allen's SRP, participants received and enjoyed the present benefit from their contributions before retirement. The later receipt of cash on the sale of the asset after retirement doesn't mean that the SRP "provides retirement income" within the meaning of ERISA.

The court also found support for its conclusion in a Department of Labor regulation stating that partnership buyout agreements aren't subject to ERISA. Booz

Allen's repurchase of an SRP participant's stock is effectively a partnership buyout agreement, the court concluded, and the SRP isn't an "employee pension benefit plan." Thus, the plaintiffs' ERISA claims failed, as their claim to ERISA coverage was that the SRP is an employee pension benefit plan.

Caution ahead

The ruling referenced a cautionary statement from an earlier appeals court ruling that addressed a similar issue. ERISA's definition of "retirement plan," according to that court, shouldn't be "stretched to cover any content that can conceivably fit within its reach." ◻

Appeals court sacks spouse's attempt for QDRO

What makes a domestic relations order a *qualified* domestic relations order, or QDRO? The distinction is essential for retirement plan administrators when deciding whether to accept a state court's instructions to turn over some portion of a plan participant's (or, in some cases, a deceased participant's) retirement plan assets to an "alternate payee." The difference was part of a legal battle waged by the former spouse of a deceased professional football player covered by the NFL's retirement plan.

Playing with the facts

The player and his wife were already divorced when he received a lump sum payout of his pension. He gave one-third of it to his ex-wife as required under their divorce settlement. After the player died, his ex-wife sued to secure a domestic relations order requiring the plan to give her the remaining pension benefits.

However, the U.S. Court of Appeals for the First Circuit ruled that the deceased plan participant had already fulfilled his obligations to his ex-wife when he surrendered one-third of his lump sum distribution. The court found that the ex-wife was "attempting to rewrite the separation agreement to posthumously create new interests" in her former husband's retirement benefits, and thus the court wouldn't qualify the domestic relations order.

Qualifying an order

Plan administrators must determine whether an order satisfies ERISA and Internal Revenue Code rules for qualified status before acting. If it is a QDRO, the administrator must honor it.

An order *cannot* be qualified if it:

- Requires benefits to be paid to an alternate payee if benefits are already assigned to another alternate payee,
- Mandates a form of payment not allowable under the plan document, or
- Requires the plan to pay total benefits (combining the participant's and the alternate payee's) exceeding the original total amount owed to the participant.

Administrators have some latitude in assessing whether an order is qualified. For example, an ex-spouse might be given similar rights as a current spouse based on tax law rules governing survivor annuities. Another possible example: accelerating payments to an alternate payee. On receipt of an order, the plan sponsor should take immediate steps to freeze loans and distributions of the participant's benefits during the review period.

Getting it right

Your plan document should set out the rules for qualifying an order. Carefully review all domestic relations orders to determine whether to qualify them, and consult with an ERISA attorney if needed. ◻

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