

CAA/IPEBLA Joint Pensions Conference
April 23, 2012
1:45-2:45 p.m.

Plenary #3: Pension Regulation Key Issues
From a U.S. Perspective

Jeffrey D. Mamorsky
Chairman, Global Benefits & Compensation Group

Contact:

Jeffrey D. Mamorsky / Greenberg Traurig / mamorskyj@gtlaw.com / 212-801-9336

Current Regulatory Environment

- **IRS Employee Plans Examination Program**
 - **New IRS Focus on Employer Self Audit Procedures**
 - **Large Plan Audit Program**
- **New Auditing Standards and Procedures**
- **Transparency of Plan Fees and Expense Disclosure**

Current Regulatory Environment

IRS Employee Plans Examination Program

IRS imposes monetary sanctions on employer plan sponsors for:

- **Failure to operate 401(k)/retirement plans in accordance with IRS qualification requirements.**
- **Failure to follow the terms of the plan documents even if plan operation is within compliance with IRS qualification requirements.**

Current Regulatory Environment

IRS Employee Plans Examination Program (cont'd.)

Annual issuance of IRS Revenue Procedures establishing Employee Plans Compliance Resolution System:

- **Requires self-audit internal control procedures to qualify for IRS self-correction program and mitigate the amount of IRS monetary sanctions.**

Sanctions imposed by IRS on audit even if failures are unintentional discrepancies between plan operation and plan documents that result in no harm to plan participants.

- **Initial sanctions generally 20% of plan assets.**

Current Regulatory Environment

IRS Employee Plans Examination Program (cont'd.)

IRS Audit Initiative Targeting “Large” Retirement Plans
(covering 2500 or more participants)

- **Different in size, scope and intensity than previous audits of qualified plans.**
- **IRS Audit Team consists of 6-8 Agents (including benefits and computer audit specialists, benefits attorney and actuary).**
- **Typical large plan IRS Audit exam expected to last 200-300 staff days.**
- **401(k) plans, cash balance plans, ESOP’s and other risk profilers specifically targeted.**

Current Regulatory Environment

IRS Employee Plans Examination Program (cont'd.)

Change in focus of IRS Audit Initiative

- **IRS has modified their auditing procedures to focus on the Employer's Internal Controls**
- **Commencement of Audit: IRS Internal Control Questionnaire**
- **IRS 401(k) Plan Checklist (Guide for Monitoring Operational Compliance)**
- **401(k) Questionnaire compliance check to assist Employer Plan Sponsors to focus on Internal Controls**

Current Regulatory Environment

IRS Employee Plans Examination Program (cont'd.)

IRS 401(k) Plan Checklist

IRS Model Guide for Monitoring Operational Compliance

- **Important that you review operational requirements of your retirement plan every year**
- **Many mistakes can be corrected easily without penalty and without notifying the IRS**
- **See www.irs.gov/ep (Publication 4531)**

Current Regulatory Environment

IRS Employee Plans Examination Program (con't)

IRS 401(k) Fix-It Guide

Potential Mistake

How to Find the Mistake

How to Avoid the Mistake

<p>Are the plan's operations based on the terms of the plan document? Failure to follow plan terms is a very common mistake.</p>	<p>Independent review of plan and its operation.</p>	<p>Develop a communication mechanism to make all relevant parties aware of changes on a timely and accurate basis (best practices). Perform a review at least annually to ensure you are following plan terms.</p>
<p>Is the plan's definition of compensation for all deferrals and allocations used correctly?</p>	<p>Review the plan document.</p>	<p>Perform annual reviews of compensation definitions and ensure that the person in charge of determining compensation is properly trained to understand the plan document.</p>
<p>Were employer matching contributions made to all appropriate employees under the terms of the plan?</p>	<p>Review the plan document to determine the correct matching contribution formula and compare it to what is used in operation.</p>	<p>Contact plan administrators to ensure that they have adequate and sufficient employment and payroll records to make calculations.</p>
<p>Has the plan satisfied the 401(k) nondiscrimination tests (ADP and ACP)?</p>	<p>Independent review to determine if highly compensated and nonhighly compensated employees are properly classified.</p>	<p>Communicate with the plan administrator to ensure proper employee classification. Ensure both you and the plan administrators are familiar with the terms of the plan.</p>

Current Regulatory Environment

IRS 401(k) Fix-It Guide Potential Mistake

How to Find the Mistake

How to Avoid the Mistake

<p>Were all eligible employees identified and given the opportunity to make an elective deferral election?</p>	<p>Review plan document sections on eligibility and participation. Check with plan administrators to find out when employees are entering the plan.</p>	<p>Monitor census information and apply participation requirements.</p>
<p>Are elective deferrals limited to the amounts under IRC §402(g) for the calendar year and have any excess deferrals been distributed?</p>	<p>Inspect deferral amounts for plan participants to ensure that the employee has not exceeded the limits.</p>	<p>Work with plan administrators to ensure that they have sufficient payroll information to verify the deferral limitations of §402(g) were satisfied.</p>
<p>Have you timely deposited employee elective deferrals?</p>	<p>Determine the earliest date you can segregate deferrals from general assets; compare that date with the actual deposit dates and any plan document requirements.</p>	<p>Coordinate closely with payroll provider to determine the earliest date you can reasonably segregate the deferral deposits from general assets. Set up procedures to ensure you make deposits by that date.</p>
<p>Do participant loans conform to the requirements of the plan document and IRC §72(p)?</p>	<p>Review the plan document and all outstanding loans to ensure the loans comply with the plan's terms and that the employees are repaying their loans timely.</p>	<p>Review and follow the plan provisions relating to making loans, including the amount of loan, term of the loan and repayment terms. Make sure there are procedures in place to prevent loans that are prohibited transactions.</p>

Current Regulatory Environment

**IRS 401(k) Fix-It Guide
Potential Mistake**

How to Find the Mistake

How to Avoid the Mistake

Were hardship distributions made properly?	Review all in-service distributions and determine that hardship distributions met the plan requirements.	Be familiar with your plan document's hardship provisions. Implement procedures to ensure you follow the provisions in operation. Ensure that your plan administrators and payroll offices share the plan's hardship distribution information.

Current Regulatory Environment

IRS Employee Plans Examination Program (cont'd.)

IRS Internal Control Questionnaire and 401(k) Plan Checklist

- The implication is clear –
- The Employer's **Internal Controls** are the heart of compliance and
- Ultimately the **Employer** is responsible

Current Regulatory Environment

IRS Employee Plans Examination Program (cont'd.)

IRS List of Most Common Defects

- **Vesting errors**
- **Eligibility and compensation**
- **Distribution and Loans**
- **Plan document failures**
- **Fidelity Bond**
- **Failure to file required returns**
- **Failure to secure spousal consents**
- **Taxable distributions not included in income**
- **Assets - not valued**
- **Assets - prohibited transactions**
- **Administrative errors**

Current Regulatory Environment

IRS Employee Plans Examination Program (cont'd.)

401(k) Plans – IRS List of Most Common Defects

- **Late Deposit of 401(k) Deferrals**
- **Improper 401(k) Accelerated Deductions**
- **Failure to Use Correct Compensation**
- **Improper Exclusion of Eligible Employees for Purposes of ADP and/or ACP Testing**
- **Misclassification of Highly and Non-Highly Compensated Employees for Purposes of ADP and/or ACP Testing**
- **Failure to Correct or Timely-Correct ADP and/or ACP Failures**
- **Incorrect Employer Matching Contributions**
- **Deferrals in Excess of IRC Section 402(g) Limits**
- **Failsafe Provisions in a 401(k) Safe Harbor Plan**
- **Failure to Meet Hardship Distribution Requirements**

Current Regulatory Environment

New Auditing Standards and Procedures

SAS 115 Reporting Requirements

- **Management representation and Plan Auditor assurance that “ROBUST” INTERNAL CONTROLS exist between Plan Sponsor and TPA to ensure that the Plan is operationally compliant with the**
 - ❑ Plan document
 - ❑ IRS requirements
 - ❑ DOL requirements

Current Regulatory Environment

New Auditing Standards and Procedures (cont'd.)

Clients “believe” they are protected because

- **they have a TPA who is responsible for compliance**
 - ❑ TPA’s work is only as good as the data provided
 - ❑ Internal control issues
- **their vendor is under contract as the “plan fiduciary”**
 - ❑ Vendor monitors asset selection not compliance or internal control

Current Regulatory Environment

SOX Auditing Standards and Procedures

Issuance of “SAS No. 99 – Consideration of Fraud in a Financial Statement Audit” — by AICPA

- Requires auditor to obtain reasonable assurance that financial statements are free of material misstatements whether caused by error or fraud.
- Misrepresenting information in response to audit inquiries may result in fraudulent financial reporting.
- Management along with those who have financial reporting oversight (e.g., audit committee, board of directors) are responsible for establishing and monitoring internal controls consistent with management’s representations in financial report.
- Risk of material misstatement due to fraud involving development of management estimates such as pension accrued liabilities and internal control procedures.
- May be appropriate to engage a specialist to perform an independent review for comparison to management’s estimate.

Transparency Requirements

Transparency of Plan Fees and Expense Disclosure

- **Department of Labor (“DOL”) Plan Expense Audit Initiative**
 - Failure to disclose retirement plan expenses to plan participants (responsibility of employer plan sponsor).
 - Personal liability on plan fiduciaries for failure to monitor the reasonableness of plan expenses
- **DOL Final Regulations Requiring Disclosure of Service Provider Direct and Indirect Compensation**
- **Final Form 5500 Schedule C Rules on Service Provider Compensation**
- **DOL Participant Disclosure Regulations**

Transparency Requirements

THE BASICS

- **ERISA Fiduciary Duties**

- Section 404 – act **prudently** and **solely** in the interests of plan’s participants and beneficiaries.
 - For the exclusive purpose of providing benefits and **defraying reasonable expenses** in administering the plan.
 - Must be applied when selecting and monitoring service providers.
- Section 406 – prohibits the furnishing of goods, services, or facilities between a plan and a party-in-interest.
 - A service relationship between a plan and a service provider would be a prohibited transaction.
 - 15% Excise Tax on the Amount Involved
 - 100% Excise Tax if not corrected on timely basis

Transparency Requirements

- **ERISA Statutory Exemption**

- Section 408(b)(2) exempts certain arrangements between plans and service providers if:
 - Contract or arrangement is reasonable;
 - Services are necessary for the establishment or operation of the plan; and
 - No more than reasonable compensation is paid for the services.
- DOL regulations seek to provide guidance on what is meant by “reasonable” contract or arrangement.

Transparency Requirements

DOL Regulations Requiring Disclosure of Service Provider Direct and Indirect Compensation

- **Responsible Plan fiduciary must determine “reasonableness” of service provider direct and indirect compensation to qualify for Section 408(b)(2) exemption from prohibited transaction excise taxes**
- **Prohibited Transaction Exemption depends upon Plan fiduciary having “Reasonable Belief” that Service Providers Disclosed Required Information.**
- **Discovery of Disclosure Failure requires fiduciary to notify DOL and determine whether to terminate contract or arrangement.**
- **Catch 22: Despite Prohibited Transaction Exemption Disclosure Failure Often Results in Discovery of “Revenue Sharing” which can result in DOL or participant claim that fiduciary failed to monitor in violation of ERISA Section 404 prudence requirement.**

Transparency Requirements

Required Disclosure by Service Provider In Form 5500 Schedule C

- **Required Disclosure of Direct and Indirect Compensation to Service Providers.**
- **Required Identification of Service Providers that Fail or Refuse to Provide Compensation Information**
- **Plan Sponsor Must Contact Service Provider to Request Information Prior to Identification as Non-Compliant**

Transparency Requirements

DOL Participant Disclosure Regulations

- **Disclosure of Information Comparable to Service Provider Fee Disclosure**
- **Plan Sponsors Must Ensure that sufficient information provided for Participant-Directed Investments**
 - ❑ Administrative Expenses Charged to Participant Accounts
 - ❑ Fees and Expenses for Each of Plan's Investment Options
 - ❑ Other Fees and Expenses Charged to Participant Accounts