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The Insider's Guide to Plan Design, Administration, Funding & Compliance

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Rewrite Your Service Agreement to Protect Your Business

Peter Gulia, Esq.

Whether you like or shun New Year's resolutions, try this improvement. Whether your agreement is a third-party-administrator agreement, a 3(16) agreement, a 3(38) investment-management agreement, a 3(21) investment-consulting agreement, or something else, rewrite your agreement to protect your business. These ten tips can help you rewrite your agreement to get stronger protection. The focus is on methods that don't depend on hiring a law firm to do the work.

1. Organize your word-processing file.

In your rewrite, use your word-processing software's features to mark text styles, including a hierarchy of headings and subheadings, so you're set up to automate cross-references and a table of contents. If you do this thoroughly as you work on the text, you'll never again worry that adding or deleting text will throw off the document's pagination or any internal cross-reference. Your forms will be ready for changes in your business.

2. Get rid of legalese; write plain language.

It's easier to respond to a complaint or dispute if you can show that a reasonable person would have understood what you promised, and, often more important, what you didn't promise. If your contract is dense legalese, that sets up empathy for the buyer. But if you make the agreement understandable, everyone can see the fairness in holding a businessperson to the clear expectations you set.

Also, plain language helps you and your coworkers understand what your contract says. That makes it easier to check whether it's what you want.

3. Don't use the word *client*.

Many businesspeople use the word *client* to mean nothing more than someone who receives services from one's business. But lawyers and judges understand the word to refer to a relationship in which a lawyer, certified public accountant, enrolled actuary, or similar professional has fiduciary duties to the client. This can impose on you responsibility beyond your contract obligations. Even if you think of your service recipient as a client, why take on unnecessary duties? Further, using the word *client* could negate your warning that you don't provide tax or legal advice.

4. Call the service recipient *you*.

Too many contract forms still use role labels—like "the Client", or "the Employer"—to refer to a counterparty. (Despite software that makes it easy to fill-in names, businesspeople fear delays and mistakes.) Instead, replace references to your counterparty with *you* and *your*. And if you've used a role label to refer to yourself, replace it with a short business name. This quick fix makes your contract shorter and more readable. It helps you spot opportunities to write plain language. It avoids a clumsy label. And *you* is the simplest way for your reader to see herself in what you hope to communicate.

5. Focus on who does what.

In a service contract, many provisions are about who does what. While you're rewriting, look for sentences in the form "{task} will be {verb-ed}" and rewrite them as "{actor} will {verb} the {task}." For help in finding those and other passive-voice sentences, use your word-processing software's grammar checker or, even better, add-on editing software. Most sentences should be simple sentences in active voice. But read the next tip about setting conditions that limit an obligation.

6. When you rely on others, don't promise more than you get.

Sometimes, you provide your services relying on products you licensed from others. Don't promise more than your legal rights against others. For example, if you use software for coverage and non-discrimination testing, don't promise more than you can get under the software licensor's warranties. If your ability to assemble a Form 5500 report, or your investment-consulting report, depends on receiving data or other information not in your control, condition your obligations to follow when you receive the needed information.

7. Show what you *don't* do.

In theory, a contract need specify only the services you promise. But your agreement can defeat expectations (whether real or feigned) about functions for which your service is something less than an *un*informed person might imagine. Explain carefully limits on your services. For all these expressions, begin with saying you have no obligation beyond those the contract specifies. But then give examples about what you don't do. Say the examples are just illustrations, and don't limit the range of what you don't do.

8. Include a part for the employer/administrator's obligations.

In theory, it's unnecessary to say anything about the plan administrator's duties; public law provides them. But in your agreement, state your counterparty's obligations to administer the retirement plan according to its

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governing documents and applicable law. Those promises set up your contract-law rights to pursue a breach that harms you. You hope you'll never need to use those rights, but it can't hurt to have them. Further, provisions that flag at least some of the plan administrator's duties might help you when the complaint is "why didn't anyone tell me?"

9. Anticipate changes in law, and in practical circumstances.

Although retirement-services providers adapted much more efficiently than many other businesses, a public-health emergency taught us to be prepared for changes. While some changes are too hard to imagine, there are many changes you can plan for.

10. Don't use anything you don't understand.

Know your business purpose and the legal effect of every clause, especially those in your agreement's boilerplate provisions. If you're not sure, delete the clause. It's better to have an absence of expression than to have something that might disadvantage you. Or if you worry about omitting something, get your lawyer's explanation of what the provision does, and then consider whether it helps you protect your business.

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Reminder: Cycle 3 Restatement Deadline Is Quickly Approaching

Douglas S. Neville, Esq.

Now that 2022 is here and the press of the 2021 year-end is behind us, it is time to start work on any Cycle 3 plan restatements for 401(k) plans and other defined contribution plans that use pre-approved plan documents and have not yet been restated. Many employers likely have already restated their plans, but employers that have not should quickly begin work on their restatements to meet the upcoming restatement deadline.

In Announcement 2020-7, the IRS provided that the deadline for adopting Cycle 3 plans is July 31, 2022. That deadline has not been extended due to the pandemic or otherwise. Therefore, any existing plans that use pre-approved plan documents must be restated by that date. In addition, any new plan that is established under an IRS-approved Cycle 3 plan by the July 31, 2022, deadline will be considered to have adopted the plan within the third six-year remedial amendment cycle that ends on January 31, 2023.

Employers may apply for favorable determination letters under certain circumstances. For example, an employer that adopts a non-standardized pre-approved Cycle 3 plan with modifications may apply for a determination letter using Form 5307, but only if the modifications are not extensive. Employers may also apply for determination letters using Form 5300 in certain limited circumstances. The circumstances under which employers may request determination letters are described in Sections 12.02 and 12.03 of Rev. Proc. 2021-4. For employers that are eligible to apply for determination letters, the deadline for doing so is July 31, 2022.

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DOCUMENT UPDATE

Is Cybersecurity Compliance at the Top of Your Task List?

Mary Giganti, Esq.

There is no doubt that cybersecurity has become an important area of compliance and investigation by the Department of Labor (DOL). On April 14, 2021, the Department of Labor issued guidance related to "Tips for Hiring a Service Provider," "Cybersecurity Program Best Practices," and "Online Security Tips." This guidance assists plan sponsors, fiduciaries, and participants to safeguard retirement plan benefits and personal information and

highlights the "importance that plan sponsors and fiduciaries must place on combatting cybercrime."

The DOL continued by stating this guidance complements EBSA's regulations on electronic records and disclosures which include ensuring electronic recordkeeping systems have reasonable controls, adequate records management practice, and measures to protect personally identifiable information. Cybersecurity compliance is the responsibility of not only plan sponsors, fiduciaries and participants, but also service providers.

A recent district court case, *Walsh v. Alight Solutions*, LLC, No. 20-cv-2138 (N.D. Ill. Oct. 28, 2021), highlights this statement. The case began as a DOL investigation in July, 2019, when the DOL discovered that Alight, an ERISA plan recordkeeping, administrative and consulting service provider, processed unauthorized distributions from its ERISA plan clients' accounts as a result of cybersecurity breaches and that Alight failed to promptly report the breaches to its clients and restore the unauthorized distributions to the affected ERISA plan accounts.

As part of the investigation, the DOL issued an administrative subpoena to Alight which requested "all documents" in the company's possession, custody or control related to 32 inquiries, covering a time period from January 1, 2015, to the date of production. In particular, the DOL requested documents relating to (1) communications, event logs, and reports of any incident involving information security or cybersecurity regarding any ERISA plan clients; (2) system penetration testing or other ethical hack reports relating to its ERISA plan clients; (3) information security or cybersecurity controls (including internal cybersecurity procedures and policies, patch management reports, and cybersecurity assessment reports); (4) crises management plans and corporate continuity plans relating to information security and/or cybersecurity; (5) cybersecurity awareness training; and (6) physical access controls, including key cards, biometric controls, and video cameras relating to information security and/or cybersecurity that relate to any ERISA plan clients. You will note that this listing is similar to the April 14, 2021, guidance issued by the DOL. It has also been reported that these items have also been added to the laundry list of items the DOL requests during an investigation.

In determining whether the subpoena should be enforced, the Court agreed with the DOL and Alight that the DOL must demonstrate: (1) the subpoena is within its authority; (2) the demand is not too indefinite; and (3) the information sought is reasonably relevant to the DOL's investigation. The court also acknowledged its duty to consider the potential burden of compliance on Alight.

The Court began its analysis by stating that the DOL's subpoena power is broad and permits the DOL to "investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not." Alight argued that the subpoena power only extends to ERISA fiduciaries and, as a non-fiduciary, it is not required to respond to the subpoena. The Court rejected Alight's argument, finding no such limitation in the relevant statutes or case law. Thus, the Court concluded that the DOL had the authority to issue the administrative subpoena to Alight.

Alight then argued that the document requests were "too indefinite." Specifically, Alight argued that the subpoena request would require it to produce "virtually every document concerning its ERISA business" and that the DOL failed "to name or identify a single plan or security incident subject to its ongoing investigation." The Court did not find any of the requests to be so indefinite that Alight should be relieved of its compliance obligation.

Alight also argued that the subpoena was irrelevant to the investigation. The Court stated, in the ERISA context, the proper scope of an investigation can be determined "only by reference to the statute itself; the appropriate inquiry is whether the information sought might assist in determining whether any person is violating or has violated any provision of Title I of ERISA . . . ." The Court concluded that the requests were reasonably relevant to the investigation, because the requests permissibly sought information that may be relevant to whether ERISA violations had occurred.

The Court finding that the subpoena should be enforced, next considered whether Alight's burden to comply with the subpoena outweighs the enforcement of the subpoena. Alight argued that compliance with the subpoena would be unduly burdensome, requiring "thousands of hours of work just to identify potentially responsive documents" in addition to the time and expense that outside counsel would incur in reviewing, redacting, and producing the materials. Alight further stated that the subpoena would require it to "pull, review and produce thousands, if not tens of thousands, of documents related to its ERISA business." While the Court recognized the burden of compliance may potentially be significant, the Court stated Alight must demonstrate that compliance with the subpoena is *unduly* burdensome. The Court further noted that the Seventh Circuit previously upheld enforcing a subpoena where it was estimated that compliance would require more than 200,000 hours. Thus, the Court found the burden did not outweigh the potential relevance of the requests.

Alight requested a protective order to de-identify plan data since providing such data threatens the confidential information of Alight's clients, clients' employees, and clients' plan participants. The Court rejected this request, finding that Alight did not show good cause that the information is uniquely at-risk as a result of disclosure. To support its determination, the Court noted that federal law would protect this information from disclosure by the DOL to outside parties.

This case highlights the DOL's increased interest in cybersecurity and it demonstrates the DOL's broad administrative subpoena power on service providers. Many of the documents requested in the subpoena mirror those addressed in the April 14, 2021, guidance. Review that guidance with your current documented policies and procedures. Should you update your current policies and procedures in light of the DOL guidance? Are you following your documented policies and procedures, and is there documentation of your compliance? If there has been any incident involving cybersecurity relating to your ERISA plan clients, have you documented the incident and response to the incident? Finally, let's not forget how this case began (according to the Court): Alight processed unauthorized distributions as a result of cybersecurity breaches, failed to immediately report the breaches and unauthorized distributions to its ERISA plan clients, and failed to restore the unauthorized distribution amounts.

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LEGAL UPDATE

Year End Reminders for Retirement Plans 2021 Edition

Marcia S. Wagner, Esq.

As the end of 2021 approaches, employers and plan sponsors of retirement plans need to be aware of their year-end responsibilities and some of the issues they will need to consider going into 2022.

- Year-end amendments: Plans may need to adopt amendments by December 31, 2021, even if the plan's plan year is not the calendar year:
  - Final hardship distributions regulations: The Internal Revenue Service (IRS) issued final regulations updating the requirements for 401(k) plans and 403(b) plans that permit hardship distributions. Some changes are required while others are optional. **The deadline to adopt such an amendment is December 31, 2021, regardless of the plan year.**
  - Discretionary changes: If a plan implements discretionary changes during a plan year, an amendment must be adopted by the last day of that plan year.
  - Defined benefit pension plans that specify the mortality table to use for determining lump sum values, as opposed to incorporating the tables by reference, must be amended by the end of the 2021 plan year.

The Wagner Law Group, and other ERISA attorneys, can draft or review amendments to ensure they are legally compliant and complete.

- Annual notices: Each year an annual notice must be distributed to plan participants at least 30 days and not more than 90 days before the start of a plan year for defined contribution and 403(b) plans that:
  - rely on a safe harbor design (safe harbor matching contributions or qualified nonelective contributions) to satisfy nondiscrimination requirements,
  - provide for automatic enrollment with or without a safe harbor design, and/or
  - use a qualified default investment alternative (QDIA) for participants who do not make investment elections.

Safe harbor notices must describe the general terms of the plan and the requirements, if any, to receive safe harbor contributions. Automatic enrollment notices must remind employees they were or will be automatically enrolled in the plan, the deferral percentage and, if automatic enrollment is coupled with an automatic escalation feature, the manner in which deferrals will increase. Plans with a QDIA must inform participants as to which investment option the contributions will be invested in the absence of an investment election.

We've reviewed many annual notices that are poorly written and confusing, or incomplete and noncompliant. A qualified ERISA lawyer can review your notices to verify they meet applicable requirements and redraft them if necessary.

- Required Minimum Distributions: The Coronavirus Aid, Relief, and Economic Security (CARES) Act allowed plan sponsors to suspend required minimum distributions payable in 2020. There is no similar relief for 2021. Required minimum distributions for 2021 must be paid no later than December 31, 2021, or by April 1, 2022, for initial required minimum distributions. Also, the Setting Every Community Up for Retirement Enhancement (SECURE) Act changed the required beginning date to age 72 for participants who had not attained age 70-½ by December 31, 2019.

We recommend confirming with your service providers that required minimum distributions will be timely processed for 2021.

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Q&A

The DOL's Proposed Rule on ESG Investments

Joshua Waldbeser, Esq.

The issue of social investing within ERISA plans has long been a political football, with the DOL under various Democratic and Republican administrations issuing competing back-and-forth guidance that has been a source of confusion and frustration for plan fiduciaries.

In recent years, the relevant guidance has been elevated from sub-regulatory guidance such as interpretive bulletins to formal rulemaking. On October 13, 2021, the Biden DOL issued a proposed regulation that would embrace the consideration of ESG factors for retirement plan investments, and undo the Trump-era "pecuniary factors" rule that has been seen by some as an ESG impediment.

In this Q&A, Mr. Waldbeser explains what the new Biden ESG proposal (if finalized in its current form) would mean for ESG investments in ERISA plans, how it would differ from the current pecuniary factors rule, and what plan sponsors and fiduciaries should do now.

Q What exactly is the "controversy" about ESG or other social investing within ERISA plans?

A The controversy has more to do with real-world practice than any disagreement on economic theory. Both sides of the aisle have consistently agreed that investment fiduciaries cannot accept lower returns or higher risks in order to serve unrelated social policy goals. To do so would violate ERISA's duty of loyalty. To understand why this still leads to a disagreement, it's helpful to look at the ways that ESG and other social factors can be used when selecting investments.

First, for many years the DOL (under both parties) has been consistent in its position that social factors or similar secondary considerations can be used to differentiate between otherwise-equivalent investment funds that are available. This is often referred to as the "tie-breaking scenario." But guidance issued under Republican administrations takes a cautionary tone, indicating that in the vast majority of cases it should be possible to select investments on purely economic terms. By admonishing fiduciaries not to be too quick to fall back on social factors, this guidance can be read to indicate that selecting ESG funds could be a potential red flag for the DOL.

It has only been in more recent guidance that ESG and similar considerations have been recognized as potentially relevant economic factors—that is, "primary" considerations that may be expected to influence risks and returns—for investment fiduciaries. A 2015 bulletin issued under the Obama administration was the first DOL guidance to acknowledge this concept, and therefore to state that fiduciaries shouldn't be discouraged from taking such considerations into account. The Trump Administration's "pecuniary factors" rule, which is the currently final rule on the books, also does not prohibit the consideration of ESG and similar factors as long as they are considered for pecuniary (economic) reasons. But similar to the tie-breaking scenario, Democratic guidance has taken a more permissive tone. A focal point of the 2015 Obama-era bulletin is that investments which utilize ESG and like considerations should not be subjected to any higher degree of scrutiny than other investments. In contrast, both the Trump letter and preamble commentary of the "pecuniary factors" rule emphasizes again and again that only *bona fide* pecuniary (economic) factors should be relied upon by plan fiduciaries, reading more like a warning. Stated simply, the implication is that the DOL could second-guess whether consideration of ESG factors was truly done for economic reasons, rather than social considerations.

Q Does that mean that ESG investments are not allowed, or are highly risky, under the current "pecuniary factors" rule?

A No, not at all. The currently applicable "pecuniary factors" rule does not prohibit the consideration of ESG factors or the selection of ESG investments. Rather, it just states that investments must generally be selected solely on the basis of factors deemed by fiduciaries to be pecuniary

(economic) in nature. It does not prohibit (or, at least on its face, even necessarily discourage) the consideration of ESG factors as long as they are employed as part of a prudent risk/return analysis.

That, of course, doesn't answer the more practical question of whether the DOL is likely to challenge ESG investments as part of an investigation. But again, in my view the answer is no, as long as the committee or other fiduciary selected them using a prudent and well-documented process. In fact, to help assuage this concern further, the DOL under President Biden took the additional step of announcing publicly that it would not enforce the Trump-era pecuniary factors rule even though it is part of the DOL's currently applicable regulation governing ERISA investment duties. The pecuniary factors rule technically became effective in January 2021, and in March 2021 the DOL announced the non-enforcement policy.

In my experience, plans that offer ESG investment alternatives have not generally walked away from them. And once the Biden ESG proposal becomes final, their use will increase, because fiduciaries will have a clear path for doing so.

Q What specifically would the new Biden ESG proposal change?

A There are two primary changes that are more general in nature, plus a third specific change that defined contribution plans should know about:

- First, and most importantly, the proposal amends the ERISA prudence duty described in DOL regulations to specifically provide that evaluating the projected returns of available investments "may often" require consideration of the economic effects of climate change, and other ESG factors. It goes on to explain that fiduciaries may consider **any** factor that is material to a risk-return analysis, and offers three non-exclusive categories of examples. To paraphrase:
  i. **Climate change-related factors**, including both direct exposure to climate change risks and the effects of government policies and regulations (whether positive or negative in respect of the specific investment) to mitigate climate change;
  ii. **Governance factors** such as Board composition, executive compensation and "transparency and accountability in corporate decisionmaking," as well as legal and regulatory compliance; and
  iii. **Workforce practices**, including progress on diversity and inclusion, investments in training, equal employment opportunity and labor relations.

  To emphasize two particular points, these types of considerations are endorsed in the proposal as likely being *bona fide* economic considerations, and not merely secondary factors relied upon to break ties. And, the proposal does not merely permit the consideration of such factors, but rather indicates that they may often need to be considered by prudent fiduciaries, at least in many cases.
- Second, the proposal retains the concept of using social factors (i.e., as non-economic, secondary considerations) in the tie-breaking scenario described above, but relaxes the standard a bit. According to the pecuniary factors rule, this was only permitted where fiduciaries are "unable to distinguish on the basis of pecuniary factors alone." As no competing investment alternatives are ever identical, the "unable to distinguish" standard has been criticized as being unrealistically strict and unclear in its practical application. The proposal would instead permit fiduciaries—following a prudent risk/return analysis of available alternatives—to rely on ESG factors as secondary consideration between options that would "equally serve the financial interests of the plan over the appropriate time horizon." For designated investment alternatives offered to participants under 401(k) and other participant-directed plans, the social or other considerations used to break the tie must be disclosed to participants. I should point out that the special disclosure presumably would not be required where fiduciaries rely on ESG factors as part of the primary risk/return analysis.
- Third, the proposal would abolish the special prohibition in the pecuniary factors rule against using funds that "include, consider, or indicate the use of one or more non-pecuniary factors" as QDIAs for participant-directed plans. This prohibition is a good example of how the pecuniary factors rule has been seen as implying a "special scrutiny" standard to ESG investments. The proposal would instead simply apply the same standards—including those summarized above—that are to be used for all investments.

Q Are there any other issues relating to ESG that the DOL could address in the final rule?

A That's certainly possible, although it's difficult to predict specifics. But just for example, many younger workers want to have ESG options available to them, and there is even polling data indicating that they're more likely to participate in a plan if they are offered. It would be interesting to get the DOL's take on whether it thinks fiduciaries can consider the encouragement of plan participation as a factor

in making investment decisions. It would also be helpful for the DOL to provide clarification on the fiduciary protection at Section 404(c) of ERISA and how it is affected by offering a larger number of investment options—for example both ESG and traditional equity funds—although that is a broader topic for discussion.

Q What should plan sponsors and fiduciaries be doing about this now?

A First and foremost, be on the lookout for the final rule. In terms of timing, public comments on the proposal have to be submitted no later than December 13, 2021. The final rule cannot be issued until after the DOL has evaluated the comments received, but otherwise it's difficult to predict exactly when we should expect it to be issued. And again, the current DOL isn't going to enforce the Trump-era pecuniary factors rule in the meantime. But, the final rule could include changes and clarifications on certain issues that investment fiduciaries may need to incorporate into their processes.

At the same time, I think it's probably a good idea for committees and other fiduciaries to talk to their advisors and get out in front of this issue a bit. In particular, with the assumption that the proposal will probably be finalized in something close to its current form, fiduciaries may wish to evaluate their current investment policies, and speak with their providers, with an eye toward current practices and how they may need to change. Again, the DOL proposal indicates that ESG factors is something that likely should be considered, at least in many cases, and not merely something that might be considered if fiduciaries wish to do so.

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BENEFITS CORNER

William F. Brown, Esq.

So What Is a TPA Anyway?

I have been in the TPA business for over 20 years, but in all that time, I can't recall ever seeing an article discussing what TPAs are, or what they do. Until now. In a post on the ThinkAdvisor website, entitled *What a Retirement Plan TPA Can Do*, Rita Taylor-Rodriguez discusses the various important tasks handled by a TPA.

First, the acronym "TPA" stands for "third-party administrator." In contrast, under ERISA, a plan's "administrator" is the entity responsible for managing the day-to-day affairs of the plan, including among other things: hiring service providers; determining plan eligibility, vesting, and benefit accruals; advising participants and beneficiaries of their rights under the plan; ruling on benefit claims; and directing distributions. The administrator is normally designated in the plan document, and most smaller plans designate the sponsoring employer as the administrator. In turn, the plan administrator contracts with the outside TPA to assume many of these duties. Thus, the scope of the TPA's duties regarding the plan is defined by that agreement with the administrator. Due to this contractual arrangement, the TPA is solely responsible to the administrator and owes no legal duties to any other service provider to the plan.

Ms. Taylor-Rodriguez points out the many important aspects of a TPA's role. First, a TPA should be a problem solver, providing "practical answers" regarding "plan compliance, administration, consulting, and innovative design options." Second, because clients needing a new service provider often ask the TPA for a recommendation, a TPA can serve as a "referral service" for other service providers. Third, a TPA and the plan's investment recordkeeper can work well together when they understand their "respective roles and responsibilities." Fourth, a TPA offers "technical support" ranging from plan design consulting to "regulatory expertise and compliance testing solutions." Finally, the right TPA can provide support to plans of all sizes. Smaller employers generally don't have even one employee dedicated to plan management. The TPA is a resource regarding most plan responsibilities that are dumped on one or more employees (or the owner) along with myriad other duties. Larger plans "tend to be more complex," and the right TPA can offer the technical expertise regarding such areas as "sophisticated plan design, compliance consulting and regulatory updates."

The last point is crucial. A TPA whose client base is primarily mid-size manufacturers may not be suitable for a small professional employer. Understanding a particular TPA's strengths is a vital part of the selection process. More importantly, a TPA must be *knowledgeable*, *responsive,* and

competent. In her article, Ms. Taylor-Rodriguez uses phrases like "good TPAs" and "a skilled TPA," with the implication that some are not. Selecting the right TPA is one of the most important decisions a plan administrator can make.

[Editor's Note: A good TPA (including a great TPA) will never do it alone. The good TPA will recognize when it needs to check with its own ERISA counsel and the ERISA counsel, if any, of the client. The good TPA will not render legal advice. It will recommend the client see outside counsel. The good TPA will not dig a bigger hole, for itself and the client, by incorrectly trying to fix a mistake of its own doing in the first place. It will not be penny-wise, pound-foolish. And it will always do right by and be straight with the client.]

IRS Considers COVID Rehires

In March 2020, President Biden signed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). Its Section 2202 provides for special distribution options and rollover rules for retirement plans and IRAs and expands permissible loans from certain retirement plans. As a follow-up, the IRS has posted two Q&As on its website addressing COVID rehire situations.

The first considers a qualified plan that does not allow in-service distributions. A participant has a "bona fide retirement," and the plan begins paying retirement benefits. Due to "unforeseen hiring needs related to the COVID-19 pandemic," the employer rehires its former employee. The IRS generally takes a dim view of a rehire shortly after the payment of retirement benefits because it suspects a subterfuge to create an in-service distribution that the plan doesn't provide to all participants. Whether or not there was a bona fide retirement is determined by using a facts and circumstances analysis.

In this situation, however, the IRS says that "a rehire due to unforeseen circumstances that do not reflect any prearrangement to rehire the individual will not cause the individual's prior retirement to no longer be considered a bona fide retirement under the plan." It uses the example of a school district that must rehire a retiree because it experienced "a critical labor shortage due to the COVID-19 pandemic that was unforeseen at the time of an individual's prior bona fide retirement." The answer has the caveat that the employer must respect any plan provision that defines a "bona fide retirement in a way that prevents the rehire" or any other applicable plan term, such as a suspension of benefit payments. This part of the answer mentions "plan amendments," so the IRS doesn't appear to have a problem with the removal of any plan document impediments.

The second Q&A addresses whether a plan can permit individuals who are working to commence in-service distributions. In a word, yes. The answer notes that a plan "generally may allow individuals to commence in-service distributions if the individuals have attained either age 59½ or the plan's normal retirement age." It adds that a plan provision permitting in-service distributions prior to age 59½, which is possible with some plan money sources, could expose a younger participant to the 10 percent early distribution excise tax. Of course, in order for a plan to allow in-service distributions (*i.e.,* distributions during employment), the plan must contain the correct plan provisions to allow them.

IRS Discusses Coronavirus-Related Distributions

The IRS has also posted a separate set of Q&As regarding the coronavirus-related distributions (CRDs) relief the CARES Act authorizes. The CRD Q&As mostly contain a rehash of the rules regarding the taking of a CRD. Q&A2 notes that the IRS anticipates releasing CRD guidance "in the near future." The answer notes that Notice 2005-92 had guidance on the tax-favored treatment of distributions and plan loans in the wake of Hurricane Katrina, and the CRD guidance will apply "the principles" of that Notice to the extent of similarities between the CARES Act and Katrina legislation.

Q&A3 notes that the CARES Act allows the Treasury and IRS to expand the list of factors that allowed a participant to request a CRD, and they are reviewing public comments requesting expansion of those factors. Q&A6 explains that a CRD is generally "included in income ratably over a three-year period," starting with the year the participant received the distribution. If the participant received a $9,000 CRD in 2020, he or she would report $3,000 income for each of the three taxable years 2020, 2021, and 2022. The participant also has the option of reporting the entire CRD amount in income for the year of distribution. The reporting is done with Form 8915-E, which Q&A13 discusses. The employer reports the CRD using Form 1009-R, and Q&A14 says that the IRS will provide more information about that later in 2021.

Q&A7 discusses the repayment of a CRD, which must occur "within three years after the date that the distribution was received." The participant will not owe federal income tax on the amount repaid. The participant would have to file an amended return regarding any repayment that was reported as income prior to the repayment. Q&A12 notes that the IRS generally "anticipates" that an eligible retirement plan will accept repayment of a CRD, which is treated as a rollover. A plan can prohibit any rollovers into it, however, and is not required to change its provisions to accept repayment of a CRD.

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REGULATORY AND JUDICIAL UPDATE

Item	Statement	Status
ERISA does not prevent government seizure of 401(k) account to satisfy criminal restitution order.	***United States v. Frank*, U.S. Court of Appeals, Fourth Circuit, No. 20-6706, August 10, 2021.** ERISA's anti-alienation rule did not prevent enforcement of a criminal restitution order, issued under the Mandatory Victims Restitution Act (MVRA), against an individual 401(k) account, according to the U.S. Court of Appeals in Richmond (CA-4). However, as the government's garnishment authority is limited to only property or rights to property held by the individual in the account, the case was remanded for a determination of the individual's actual property interest, including the effect of applicable tax limitations and tax penalties. Using its authority under the MVRA, the United States sought to garnish the 401(k) account of an individual in service of a restitution order against him for embezzling over $19 million from his employer. The individual moved to quash the garnishment writ, arguing that the government could not garnish his retirement account because it was shielded by ERISA's anti-alienation rule. A federal magistrate rejected the argument, holding that the MVRA authorizes the enforcement of restitution orders against retirement plan benefits, notwithstanding ERISA's anti-alienation rule. In affirming, a federal trial court further ruled that the government was authorized to force the immediate liquidation of the individual's entire 401(k) account. The trial court did not consider any limitations on the individual's current property rights in the account. However, the government was required to remit 10 percent of the account to the individual in order to offset any tax penalties. Once at the appeals court, it aligned with the nationwide judicial consensus, that the MVRA authorizes garnishment of ERISA-protected retirement funds to satisfy criminal restitution orders, even if those funds would otherwise be protected from alienation by ERISA. Adopting the reasoning of the magistrate, the court agreed that the unambiguous text of the MVRA expressly states that criminal restitution orders may be enforced against "all property or rights to property," notwithstanding any other federal law. With respect to the individual's property interest in the 401(k) account, the court first noted that MVRA authorizes the government to take all property or rights to property held by individuals in their 401(k) accounts. An individual's property interest, thus, is of integral importance because the government's rights to an individual's 401(k) funds are precisely the same as those of the individual. The court agreed with the trial court that because the individual was entitled to a lump-sum distribution from his account the government was similarly entitled to such a distribution. Dismissing the additional tax liability to be incurred by the individual, the court explained that the government's authority to seize funds from the individuals' 401(k) account was based upon the rights the individual possessed, and not upon the rights he would prefer to exercise. The individual further argued, however, that the mandatory 20 percent withholding on distributions and the 10 percent penalty on early distributions also imposed limits on his present ability to withdraw funds from his account. The trial court, in ruling that the government was entitled to the individual's entire account, did not address the tax limits cited by the individual on his present ability to withdraw account funds. Accordingly, the appeals court remanded the case to the trial court for a determination of whether the terms of the 401(k) plan required the plan administrator to withhold 20 percent of any present withdrawal and whether the distribution would trigger the 10 percent early withdrawal penalty. In the event the 20 percent withholding and the early withdrawal penalty applied, the government's recovery would be limited.	**ERISA's anti-alienation rule does not prevent enforcement of a criminal restitution order, issued under the Mandatory Victims Restitution Act, against an individual 401(k) account.**

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IRS Guidance on Partial Terminations

The IRS website also has a set of Q&As regarding partial plan termination relief provided in Section 209 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (Relief Act), which is Division EE of the Consolidated Appropriations Act, 2021. Q&A1 explains that a plan is not treated as having a partial termination during any plan year which includes the period beginning on March 13, 2020, and ending on March 31, 2021, if the number of active participants covered by the plan on March 31, 2021, was at least 80 percent of the number of active participants covered by the plan on March 13, 2020. Q&A2 explains that the administrator should use a consistently-applied, reasonable, good-faith interpretation of the term "active participant covered by the plan."

Q&A3 explains that if plan years overlap the March-to-March period specified in the Relief Act, then the plan should apply the relief for both plan years. For example, a calendar year plan should apply the 80 percent test to the plan year ending on December 31, 2020, and the plan year ending on December 31, 2021. Q&A4 explains that the measure is simply the number of active participants covered by the plan on the two dates, regardless of whether the same individuals are in the two groups. Finally, Q&A5 explains that this relief is not limited solely to reductions in the number of active participants covered by a plan that are related to the COVID-19 national emergency.

Tacked on to the end of the CRD Q&As is Q&A15, which actually discusses one aspect of the partial termination rules independent of the Relief Act. It notes that, in general, a participant who has an "employer-initiated severance from employment," but is rehired before the end of an "applicable period," is not considered when calculating the turnover rate used to determine if a partial termination has occurred. This will apply to participants who were terminated due to the COVID-19 pandemic and rehired before the end of 2020.

LAST WORD ON 401(k) PLANS

Working with Actuaries, by an Actuary

Dennis M. Reddington

I work with several TPAs on cash balance/401(k) combo plans. My name is on the Schedule SB, but communications go through the TPA. If you work with actuaries, the best advice I can give is to ask about anything unclear. Part of our job as actuaries is explaining our work. You cannot clearly communicate to your clients the information the actuary has given you if you do not understand it. While you do not need to know all the ins and outs of cash balance operations, you need to know the basics. The following are a few of the concepts TPAs need to understand.

Required minimum distributions just work differently than under DC plans. Distributions need to be paid as an annuity, monthly or annually, unless the participant elects to roll over the entire distribution other than the portion paid to satisfy the RMD.

The top heavy minimum allocation should be provided in the 401(k), so an amendment is usually required when adopting a cash balance. If the minimum benefit were provided in the cash balance, it would be subject to interest rates that could make it substantially more expensive than the 5 percent top heavy minimum in the 401(k).

In IRC Sections 410(b) and 401(a)(4) nondiscrimination testing, $1 of profit sharing contributions typically results in a higher accrual rate than $1 of cash balance benefits. Therefore, increasing a nonhighly compensated employee's profit sharing contribution does more to pass than increasing the cash balance by the same amount. The result is that the common plan design has highly compensated employees receive most of their benefit in the cash balance and the others receive the bulk of their benefit in the 401(k).

We all know the maximum deductible employer contribution in a 401(k) plan is 25 percent of pay. With a cash balance, the deduction limit depends on whether the employer contribution to the 401(k) exceeds 6 percent of pay. If it does, the maximum to both plans is 31 percent of pay. If not, the maximum contribution to the cash balance is the actuarial maximum which is often very large. Limiting the profit sharing contribution leads to larger deduction possibilities.

Employers often want to make contributions during the year, but they need to be careful. Once they've contributed 6 percent of pay plus $1, they are locked into the 31 percent limit. To keep their options open, it is better to contribute after year end.

The 31 percent limit is really 6 percent of compensation for participants benefitting in the 401(k) plan plus 25 percent of compensation for participants benefitting in either plan.

If the employer contribution to the 401(k) plan is limited to 6 percent of pay, you need to be economical with your allocations. The 3 percent non-elective safe harbor is often more effective than the safe harbor match because it counts like profit sharing contributions in testing. The match counts towards the 6 percent but not for the gateway non-discrimination testing.

When you need to communicate an actuarial issue, ask the actuary for help. Explaining so you understand makes everything operate more smoothly, including the employer's expectations.

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