Fiduciary Commentary:
Top Compliance Risks for Employer Plans

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Brant Griffin QKA, AIFA®
Partner

w 800 403 7065 x211
e brant.griffin@npier.com
www.npier.com

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For many retirement plan sponsors the mere thought of plan compliance is overwhelming. Filing deadlines, internal controls, fiduciary duties… the list continues to get longer and more complex. Nonetheless, retirement plan compliance must be a top priority for plan fiduciaries to ensure company benefit plans are sound.

Plan compliance is a top concern to regulators, and every year thousands of employee benefit plan audits are conducted by the IRS and DOL. In fact, in recent years nearly one in three workplace retirement plans have been audited. Most employers are horrified at the thought of having to undergo a regulatory agency audit due to the fear that an unknown plan failure will be discovered.

Qualified retirement plans are generally policed by two federal agencies, Employee Benefits Security Administration (EBSA) through the Department of Labor (DOL) and the Internal Revenue Service (IRS) through the Department of Treasury. Each agency has their own focus and jurisdiction when conducting plan oversight. EBSA is focused on fiduciary compliance, reporting and disclosure and ERISA centric responsibilities, while the IRS is concentrated on the qualified status of plans and ensuring the plan is abiding by the standards that permit its tax-favored status.

The frequency of retirement plan audits seems to vary based on a wide range of factors. While the regulatory agencies do not divulge its audit selection criteria, it is often a function of geographical region and the agency's budget. However, there appears to be several focal points in DOL and the IRS audits. The following are common audit risks for qualified retirement plans.

Late Deposit of Salary Deferrals

The most common finding during an audit continues to be delinquent employee payroll deposits. The law requires that employers contribute the participants' salary deferrals to the plan trust on the earliest date that the deferrals can reasonably be segregated from the employer's general assets. However, in no event can the deposit be later than the 15th business day of the following month (this is a firm deadline, not a safe harbor). With that being said, the DOL has established a seven business day safe-harbor rule for plans with fewer than 100 employees.

In practice, the DOL will review the history of the employer's deposit patterns and identify the quickest that the company was able to make contributions to the trust and then apply that time period as the maximum deadline for payroll deposits over the scope of the audit. If employee contributions are not found to have been made in a timely manner, errors are typically corrected through the DOL's Voluntary Fiduciary Correction Program which will require the calculation of earnings attributed to the contribution delay. Additionally, the DOL may require a completed Form 5330 along with an excise tax penalty of 15% of the earnings amount.

Offering Target Date Funds

Another issue that auditors have begun to turn its attention to is due diligence of a plan's target date funds (TDFs). TDFs are investments that contain a mix of various assets that change their risk characteristics over time so that as the participant approaches retirement age, the investment becomes more conservative. TDFs are commonly offered as the plan's qualified default investment alternative (QDIA) and are therefore held to a higher level of scrutiny. The DOL has issued guidance (February 2013) on target date retirement funds for plan fiduciaries detailing the selection and monitoring criteria of TDFs and other investments. Plan fiduciaries should establish and document their process in comparing, selecting and monitoring TDFs including their performance, understanding of the underlying investments, glidepath and review of the fund's expenses, among other attributes.

Updating the Plan Document

The failure to amend a plan to reflect recent tax law changes is another top audit issue. Qualified retirement plans are required to maintain a formal written plan document that meets all the terms and conditions of applicable law, namely the Internal Revenue Code and ERISA. When a new tax law is passed, the IRS will identify a timeline for amending the trust to conform to the new tax laws.

Additionally, these plan amendments will typically necessitate updates to the plan's other formal documents. A review should include the comparison of adoption agreements and summary plan descriptions to determine if amendments are required to reflect any changes made to the plan for the tax law change. Finally, board of director resolutions and/or minutes reflecting the adoption of such amendments should be drafted. A periodic review of plan documents and related plan materials is also strongly suggested. Plan sponsors should periodically compare their retirement plans against an IRS list of required amendments to confirm that their plans are in compliance.

Lost Participants and Force Outs

A recent wave of audits has revealed a new DOL focus, participant force-out distributions and locating lost participants. Today, nearly all plans have a "force out" provision in plan documents for account balances less than $1,000. While employers are generally aware of this provision, it is not applied consistently. Many plan documents are drafted with language that states employers "will" force out benefits, not "may". As a result, failure to routinely distribute small balance accounts will produce an ERISA violation.

Further, the DOL has begun targeting plan procedures relating to lost participants and beneficiaries as it has been recognized as the cause of investors losing track of their plan benefits. While it would seem logical that the responsibility to update plan address would fall to the participant, it is not the case. Due to the requirement that employees receive numerous plan communications, without current participant address information these obligations cannot be satisfied. Therefore, employers are required to attempt to locate missing participants on a regular basis.

Employers should review the force-out provisions and coordinate with their custodians to determine the best method for distributing these amounts on a periodic basis. They should also initiate a process to regularly receive a list of lost participants, so efforts can be made to track former participants without up to date address details.

Definition of Compensation

Failing to follow the plan's definition of eligible compensation is a common plan error. Various definitions of pay are identified throughout plan documents for use in calculating benefits, contribution limits and discrimination testing (ADP/ACP and top heavy). Frequently, the complexity of compliance and risks are amplified with larger corporations use of numerous payrolls.

Auditing the proper administration of the plan with the terms of the document is done by contrasting plan document definitions to the payroll codes for such deductions as participant plan deferrals. As compensation errors are often identified when plan limits are exceeded, such as an employee's compensation or deferral limit, identifying errors is easy for auditors to find.

Plan sponsors should conduct periodic reviews of the various definitions of plan compensation in the plan document. Plan sponsors should ensure their payroll department's application of these definitions are being applied properly and consistently.

Internal Controls

Another hot topic for the DOL upon audit are the company's internal controls. A company's internal controls demonstrate how the company and/or the plan sponsor documents its processes with respect to the plan. Retirement plan committee minutes and resolutions must be reviewed to make sure that they are complete and accurate. This proves to the DOL that there is likely a procedure being followed and the right processes are in place and documented.

Proactive compliance reviews of plan operations and processes should be given a high priority at organizations. Plan failures discovered internally can be fixed comparatively easily through voluntary correction programs. After being notified of an audit, correction programs are no longer available and plan failures are remedied through fines or excise taxes. Establishing and maintaining sound compliance program is the best defense and if the IRS or the DOL decides your plan is next on the list, be ready for them.