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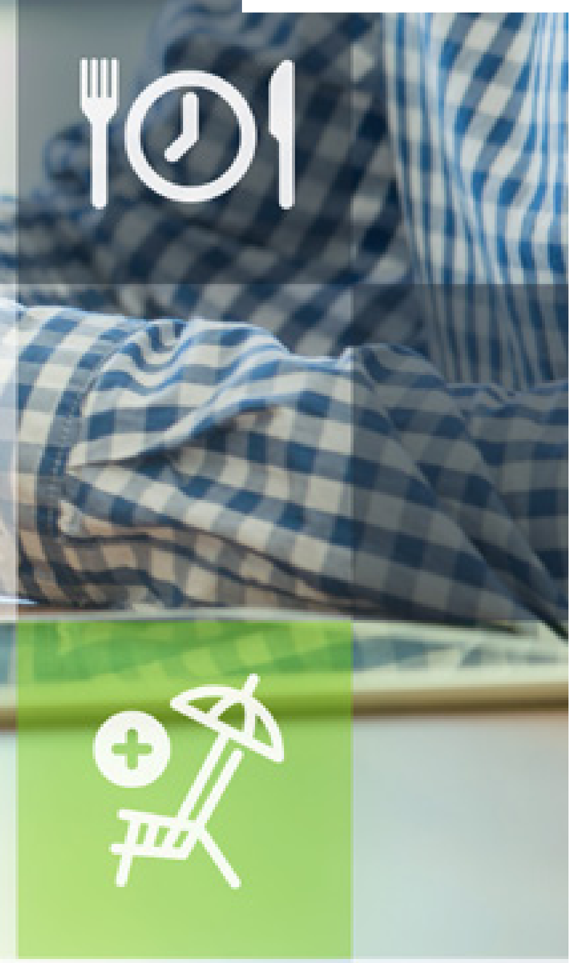
EMPLOYEE BENEFITS

Under the Radar: Employee Benefit Developments in 2020

And, believe it or not, they're *not* COVID-related

By Elizabeth Nedrow



The story of the year has been the coronavirus. COVID-19 has dominated news headlines, social media, and virtually every aspect of our lives. The virus has likewise dominated legal and tax news. Lawmakers and agencies have enacted multiple pieces of legislation and other guidance to help employers navigate the changes COVID-19 has wrought in the workplace. Those new laws and rules have rightly been the focus of our attention. But at some point before the end of 2020, it's worthwhile to look at the other legal developments that have flown under the radar this year. Here's a roundup.

PEPs

For many smaller employers, maintaining a retirement plan is a significant burden. They struggle to keep up with record-keeping, disclosure, and fiduciary obligations. And those obligations are only increasing. To be sure, there are many experienced and expert third-party administrators who will help employers navigate the requirements. But for years, the Internal Revenue Service and the Department of Labor have held the employer itself responsible for any compliance mistakes. Employers have clamored for relief from this situation, asking for an effective way to offload the responsibility on someone with more expertise. At the same time, advocates have argued for a platform for smaller employers to pool their purchasing power to negotiate for lower fees. Congress addressed these concerns when it amended ERISA and the Internal Revenue Code to include the concept of a "pooled employer plan," or PEP.

PEPs were created as part of the SECURE Act passed in December 2019. The concept is that employers who have no common interest or ownership can join together to provide a multiple-employer plan. Multiple-employer plans have always been permitted but have offered little relief or benefit to employers due to what is referred to as the "unified plan rule" or, more descriptively, the "one bad apple" problem: if one employer in a multiple-employer plan has an operational error, it risks the disqualification of the entire plan.

In the SECURE Act, Congress set out a platform where unrelated employers can avoid the "one bad apple" rule if they maintain a PEP. To qualify, a PEP must designate a "pooled plan provider" (a PPP, because who doesn't need more acronyms?) as a named fiduciary and plan administrator. In August 2020, the DOL proposed regulations that move the concept of a PEP closer to fruition (apple pun intended).

Under the proposed regulations, a PPP must register with the DOL and the IRS at least thirty but no more than ninety days before beginning operations (that is, before it begins publicly marketing a PEP). This initial filing will require disclosure of the PPP's structure, affiliates, marketing activities, services to be offered, and any pending legal or regulatory proceedings. In addition, the filing must disclose the PPP's chief compliance officer's name and contact information.

The proposed regulations specify that once a PPP has a PEP lined up and ready to go, another filing is required. The PPP must submit a supplemental filing listing the PEP's name, trust identification information, and plan employer identification number (EIN). This filing will be accomplished through a new EBSA Form PR (Pooled Plan Provider Registration) and handled through the same system used to file Form 5500s. Notably, this will mean that the PPP's information will be publicly available on the DOL's website.

The SECURE Act authorized PEPs to begin operations as soon as January 1, 2021, so we can expect this market to develop quickly. Employers looking to offload a significant portion of their plan administrative burden—and potentially save costs at the same time—should reach out to their advisors and see what opportunities exist.

Given the increased risk in this area, an employer would be wise to check its COBRA notices and make sure they are current and complete.

Lifetime Income Demonstrations

In programs for defined benefit plans, participants always have a clear picture of how much and for how long they will have a retirement benefit. They are told, for example, that they will receive a monthly payment for life, equal to a fraction of their average wages. But defined benefit plans are almost extinct, having been replaced by defined contribution plans (the most common of which is the so-called 401(k) plan, named after its ability to accept employee deferrals of their own wages). And in defined contribution plans, the participant knows only how much is in her account now. It is complicated to predict how much might be in the account at retirement, what investment returns will do after retirement, and how much will be "safe" to withdraw over time. Perhaps to ease the transition from defined benefit to defined contribution structures, decades ago it wasn't uncommon for defined contribution plans to offer an annuity form of distribution. But due to expense and fiduciary risk, plans have almost entirely eliminated annuities. In most plans, a single lump sum is the only distribution alternative. As a result, participants in a defined contribution program are left to decide for themselves how much they need to save for their retirement. Policymakers have long heard tragic tales of participants who outlived their savings. After the chorus of "There oughta be a law!" became loud enough, Congress passed new rules for retirement plans aimed at solving the problem.

In December 2019, Congress passed the SECURE Act, which includes three provisions aimed at addressing this issue. The first of these provisions has officially been launched. In August, the DOL issued an interim final rule implementing the provision that requires an annual lifetime income disclosure to participants in 401(k) and other defined contribution plans. Here are a few highlights.

- A defined contribution plan must at least once per year express the participant's current account balance as two estimated lifetime monthly income streams: 1) a single life annuity and 2) a qualified joint and 100 percent survivor annuity.
- The plan is not required to predict or estimate the participant's future account balance. Only current account balances are used in the calculations.
- The regulations provide the plan with assumptions to use to convert account balances to the lifetime monthly income streams. These assumptions include that the annuity start date is the date of the statement, that the participant is sixty-seven years old on that date, and that the participant is married with a spouse of equal age.
- The regulations provide the plan with model language that includes the caveats that the estimated monthly payments are not guaranteed.
- The regulations do not require defined contribution plans to offer annuities—it is simply another disclosure obligation.

The regulation will be effective one year after its publication. So we can expect that no later than mid-2021, employers should hear from their service providers about how they expect to communicate this new information to participants.

EXPANDED ACCESS TO 401(K) PLANS FOR PART-TIME WORKERS

The second provision of the SECURE Act makes it more likely that part-time workers will be eligible to participate in 401(k) plans. Previously, the general rule was that plans couldn't have more restrictive eligibility rules than 1,000 hours per year. That is, if an employee worked 1,000 hours in a twelve-month period, she had to be allowed to make deferrals and earn employer contributions. The SECURE Act modified these rules. Starting in 2021, employees must be allowed to make elective deferrals if they have completed at least 500 hours of service per year for three consecutive twelve-month periods. They can still be excluded from matching and other employer contributions under the previous eligibility standards.

Service prior to 2021 is disregarded for purposes of this new eligibility rule, so it will be several years before part-time workers can earn the right to enroll. In the immediate term, however, employers should review their part-time employee population and make sure their recordkeeper counts workers' hours of service appropriately.

OPTIONAL DISTRIBUTIONS FOR QUALIFIED BIRTH OR ADOPTION EXPENSES

Yet a third provision of the SECURE Act that is currently relevant to qualified retirement plans is the option to permit in-service distributions for qualified birth or adoption distributions. If the criteria are met, the individual taxpayer will not be subject to the ten percent early distribution tax. The amount of the distribution is limited to $5,000, although it is available to each parent, and is multiplied in the event of a multiple birth or multiple adoption. If the plan doesn't permit this option specifically, participants may still take a distribution to the extent available under the plan and then claim the tax benefit on their tax return.

This provision became effective January 1, 2020, so it's likely that employers have already heard from their administrators on the topic. If the employer has already implemented or wishes to implement the new provision, amendments don't have to be made to the plan document until the end of the 2022 plan year.

Determination Letters and Opinion Letter "Cycles"

Remember when, in days of yore, employers had individually designed qualified retirement plan documents? Every five years, these custom programs had to be submitted to the IRS for a new "determination letter"—the official IRS blessing that the plan document contained the requisite language to make it a qualified plan. As part of an industry trend toward preapproved documents (so-called prototypes and volume submitters), the determination letter program was scaled back dramatically in 2016. At that time, the IRS said it would accept determination letter applications only from individually designed plans at the time of initial qualification or plan termination, or in other "specified circumstances."

For employers that may still have individually designed retirement plans, a few recent developments concerning the ability to file for a determination letter have emerged. In guidance it issued in 2019, the IRS opened the determination letter program for two types of plans: 1) those that use a statutory formula (such as cash balance plans, pension equity plans, and certain variable annuity plans), and 2) merged plans. The window for filing for statutory hybrid formula plans closed August 31, 2020, after the IRS declined to extend it due to the pandemic. But the window for merged plans is unique to each plan—the deadline for filing is the last day of the first plan year that begins after the effective date of the merger. So if a merged plan was formed in 2019 after a corporate transaction that closed in 2018, the company would have until December 31, 2020, to file for a determination letter on that merged plan.

On the other side of the fence, the IRS has continued to modify and maintain its process for ensuring that preapproved documents are also updated to reflect changes in the law. Instead of a determination letter, the providers of these plans obtain an "opinion letter" on the form of the document. Employers signing on to the document can then rely on the provider to keep the document current and compliant without having to apply for a determination letter specific to one employer. All document providers must completely restate and refresh their plan documents every six years. During that cycle, the document provider goes back to the IRS for a new opinion letter. Then, to complete the cycle, the IRS requires that employers renew their adoption of the preapproved plan within two years after the IRS issues its opinion letter to the document provider.

This cycle of restatement, reapproval, and readoption helps the IRS ensure that the preapproved plan industry keeps up with the many changes in the law. But it also has the practical effect of ensuring that the connection between document providers and employers doesn't thin or even break, leaving employers thinking they have a reliable document when in fact they have been "orphaned" and might be missing key developments.

The IRS' reapproval process differs for defined contribution and defined benefit plans.

- For defined contribution plans, the most recent completed cycle required document providers to submit their updated documents to the IRS by July 31, 2018, and opinion letters were issued starting June 30, 2020. The clock now starts for employers, who have from August 1, 2020, until July 31, 2022, to adopt the new plan documents. Significantly, this process includes, for the first time, employee stock ownership plans (ESOPs) and 401(k) versions of ESOPs (KSOPs). Previously, such plans had no preapproved option and had to be individually designed. *If you are an employer who has signed on to a preapproved defined contribution plan document*, you should hear from your provider in the coming months to refresh.
- In the defined benefit plan arena, document providers are preparing to submit their updated documents starting August 1, 2020 (since their "remedial amendment cycle" closed July 31, 2020, after an extension, due to COVID, from April 30, 2020). We can expect opinion letters to be issued in 2022. *If you are an employer who signed on to a preapproved defined benefit plan document*, you should check with your document provider to make sure your documents have been resubmitted. You shouldn't have to take any action until 2023.

These deadlines consider several nuances, including whether the employer is a new adopter and whether the plan was individually designed in the previous cycle. If you are an employer relying on a third party's document, ask for an explanation of where the plan fits within the IRS' approval cycles.

Fiduciary Duties of Retirement Plan Investments

As discussed above, one pressure causing employers to look to PEPs is the increasing fiduciary risk of managing the retirement plan's investment portfolio. Even with participant-directed investment under ERISA 404(c), plan sponsors still face the threat of lawsuits and DOL penalties. Here, we will cover three particular areas of risk that were evident in 2020 and are likely to continue in 2021.

First is the marked increase in class-action lawsuits brought by participants alleging excessive fees. Across the nation, cases are being filed alleging employers allowed their plan to pay unreasonably high record-keeping fees, failed to prudently review the plan's investment options and their associated costs, and committed other broad and for the most part unsubstantiated fiduciary breaches. The best defense against claims like these is an arsenal of *process*—ideally the plan's fiduciary administrator or committee will have extensive records documenting the regular and thoughtful consideration of the plan's investment platform and alternatives. A careful employer will make sure that these records are well kept and organized.

Second is the continued risk in employer stock fund investments. In 2014, the US Supreme Court's decision in the *Dudenhoeffer* case radically altered the landscape, making it harder for plaintiffs to bring claims, particularly where the stock is publicly traded. In the years after *Dudenhoeffer,* the trend in case law was, as expected, in the employers' favor. But the battlefield has not been entirely quiet. A case known as *Jander* has made its way through the federal courts, concerning IBM retirement plan stock. The US Supreme Court ultimately considered the case. The Court's decision did not alter or provide any substantive changes in the principles previously set out in *Dudenhoeffer*. But what *Jander* shows is that participant challenges to employer stock funds on fiduciary grounds are still a definite possibility. Employers who maintain retirement plans with employer stock funds should not let their guard down and should remain vigilant on best practices to be prepared in the event a challenge is brought.

Third is the matter of socially conscious investment alternatives in employer plan lineups. Often called "ESG" investments (for environmental, social, and corporate governance), these funds offer investments that appeal to investors' consciences as well as their pocketbooks. Although these funds may argue that they offer equal if not superior returns to those of their peers, the DOL has recently flashed the caution sign. In a proposed regulation issued in June 2020, the DOL proposed amending its investment duties regulation to clarify that plan fiduciaries must evaluate investments solely based on financial considerations. The DOL characterizes ESG investing as a growing threat to ERISA's fiduciary standards. Given the DOL's clear opinion on the subject, plan sponsors should be careful to document the financial superiority of any investment in the plan's lineup that also touts its social, environmental, or other benefits.

COBRA Penalties

Although the previous roundup topics have focused on retirement plans, tax and benefits professionals within an organization also have to keep an eye on the company's medical benefit programs. These plans can have significant tax and financial consequences as well. One compliance topic recently in the news is COBRA. Multiple cases alleging insufficient COBRA notices have been brought. Plaintiffs' lawyers likely see these cases as easy money—the penalty for deficient COBRA notices is a clean $110 per day per participant.

What is frustrating to employers is that many of these claims allege deficiencies on notices that are substantially similar to the DOL's model notice. Employers seemingly have good grounds to fight the cases, but, as often happens in litigation, many cases are reportedly settled without resolution. Given the increased risk in this area, an employer would be wise to check its COBRA notices to make sure they are current and complete. Even if the notices track the DOL's model notices, consider bulking them up to counter some of the deficiencies alleged in the recent litigation. Many employers outsource COBRA compliance, in which case the services contract should state that the administrator will take responsibility for the sufficiency of the COBRA notices and will indemnify and defend the employer against any claims to the contrary.

Conclusion

Without question, 2020 has been a year to remember. Just make sure you don't lose track of the non-COVID issues and developments that may have flown under the radar!

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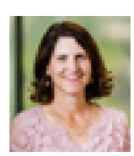

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