Benefit Trust

Blog Series

eBook

2018 – 2019

Featuring:

Fees and Fee Disclosures

Internal Controls

Plan Check-Ups

A Fiduciary Calendar

Investment Policy Statement (IPS)

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FEES AND FEE DISCLOSURES

FIVE FIDUCIARY RESPONSIBILITIES

- **Act solely in the best interests of the plan participants**
- Carry out duties prudently
- Diversify investments
- Follow the terms of the plan document
- Pay only reasonable plan expenses

INVESTMENT POLICY STATEMENT

The prudent selection of a retirement plan's investment menu is one of the most important fiduciary responsibilities for a plan sponsor. Once the menu of investments has been selected, most 401(k) plans allow participants to decide how their contributions should be allocated among the available investments. In recent years, plan participants have brought multiple lawsuits. These lawsuits allege that plan sponsors breached their fiduciary duties because they failed to monitor the appropriateness of plan investments or because they offered investments with excessive fees when lower cost options were available. To help ensure that plan investment selection is prudent and that the chosen investment alternatives continue to be appropriate for the plan, many plan sponsors adopt an Investment Policy Statement (IPS). Conducting an annual investment and fee analysis following the criteria described in an IPS can help plan sponsors manage their investment fiduciary requirements.

INVESTMENT DUE DILIGENCE

Firstly, ERISA requires plan fiduciaries to offer investments that:

- ARE PRUDENTLY SELECTED
- CHARGE REASONABLE FEES
- ARE DIVERSIFIED TO MINIMIZE THE RISK OF LARGE LOSSES

ERISA does not require plan fiduciaries to always pick the best performing investment options. As with other fiduciary responsibilities, procedural prudence is key to managing investment responsibilities. Setting investment objectives, developing a due diligence process to evaluate investments, and keeping records of due diligence activities are the primary elements of a prudent process.

Evaluating investment options can be challenging. Especially considering the broad range of investments, fee structures, and revenue sharing options available to retirement plans. Most plan sponsors engage Benefit Trust to help design a prudent investment selection process. Benefit Trust advisors can also help build an investment menu that is diversified and appropriate for plan participants. Plan sponsors also look to Benefit Trust for support in setting investment objectives, benchmarking performance and fees against comparable investments, and documenting the due diligence process.

CREATING AN INVESTMENT POLICY

While not required by ERISA, creating an IPS has become a best practice for plan sponsors. An IPS is a written policy that defines the plan's investment philosophy, and the criteria and process for selecting and monitoring investments. This helps provide the structure for conducting periodic investment reviews and for assessing plan fees. Documenting key investment decisions relative to the criteria described in the IPS can help demonstrate how plan sponsors are meeting their fiduciary responsibilities to prudently select and monitor plan investments.

If a plan has an IPS, all investment decisions must align with the terms of the IPS. Failure to follow the IPS may be considered a breach of fiduciary responsibility. For this reason, some plan fiduciaries elect not to adopt a formal IPS. The IPS should be reviewed periodically and may need to be updated for changes in investment products available to the plan. Additionally, it might need updates for changes in plan demographics or business objectives.

IPS COMPONENTS

Many plan sponsors tap into Benefit Trust to help draft the IPS for the plan. Following is a list of some of the components that may be in an IPS:

INVESTMENT POLICY STATEMENT

INVESTMENT PHILOSOPHY

Describes the plan sponsor's general investment objectives for the plan and participants, including the goals, expectations, and risk tolerance.

ROLES AND RESPONSIBILITIES

Identifies who will be responsible for choosing and monitoring investment alternatives. Ex. the plan sponsor, the plan sponsor and an investment advisor who shares fiduciary investment responsibility, or an investment manager who has discretionary responsibility for plan investments.

TYPES OF INVESTMENTS

Defines the types or asset classes of investments permitted for the plan (should include flexibility regarding the types and number of investments allowed so the fiduciary can add or remove options as the plan's needs and market conditions change).

CRITERIA FOR SELECTING AND MONITORING INVESTMENTS

Describes the performance and fee criteria that investments must meet to remain on the investment menu.

CRITERIA FOR CHANGING OR REPLACING INVESTMENTS

Explains the metrics or standards that will trigger putting an investment on a watch list, as well as when an investment must be removed.

PERFORMANCE REVIEW TIMING AND METHOD

Sets guidelines as to how frequently investments will be reviewed (e.g., annually). Furthermore, it specifies the process for measuring investment performance and fees such as benchmarking against comparable investments or an index

404(C) AND DEFAULT INVESTMENTS

States whether the plan intends to delegate certain investment responsibilities to participants in compliance with ERISA Section 404(c). Or, whether the default investment is intended to be a Qualified Default Investment Alternative (QDIA)

START HERE

Consequently, plan sponsors who elect to adopt an IPS typically rely on Benefit Trust to help them

- Review and understand the terms of the plan document
- Keep the plan document up to date with any necessary amendments
- Confirm they are providing all the required information on a timely basis

Finally, if you don't have an IPS, Benefit Trust can help evaluate whether an IPS would be beneficial for you.

INTERNAL CONTROLS

FIVE FIDUCIARY RESPONSIBILITIES

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ADMINISTRATIVE RESPONSIBILITIES

As an ERISA fiduciary to a retirement plan, the plan sponsor must administer the plan according to the terms of the plan document. A plan sponsor must also make sure that the plan is operated in compliance with the rules that apply to retirement plans under the tax code to preserve the tax benefits of saving in a retirement plan.

These fiduciary services responsibilities include tasks such as:

- Enrolling employees when they become eligible to participate in the plan.
- Making contributions according to the formula in the plan document.
- Timely depositing employee salary deferrals.
- Performing annual nondiscrimination testing.
- Filing annual reports with the IRS and Department of Labor.
- Providing notices and disclosures to participants.
- Following plan terms in all aspects of plan operations (e.g., applying correct definition of compensation for various purposes).
- Keeping the plan document up to date.

Retirement plan sponsors typically engage recordkeepers and third party administrators (TPAs) to help them accomplish all of these plan operations and more. However, each plan sponsor is ultimately responsible for making sure their plan is in compliance with all applicable rules.

IMPORTANCE OF "INTERNAL CONTROLS"

Furthermore, all the moving parts involved with operating a retirement plan, combined with ever-changing rules, contribution limits, and employee headcounts, leaves a lot of room for error. Plan sponsors can reduce the risk of compliance errors by establishing policies and procedures to ensure their plan is operating in compliance with their plan document and the tax laws that apply to retirement plans. The IRS calls these policies and procedures "internal controls." The IRS maintains that by establishing formal procedures for monitoring plan operations, plan sponsors can identify mistakes and prevent future plan errors, as well as reduce the scope and duration of a potential IRS examination. The IRS also notes that routinely following established policies and procedures is one of the requirements to be eligible to use the IRS's Self Correction Program under the Employee Plans Compliance Resolution System (EPCRS).

POLICIES AND PROCEDURES TO DEVELOP

When developing procedures for monitoring retirement plan operations, one of the most important steps is to review the terms of the plan document. A solid understanding of the features and definitions used in the plan is essential to making certain that the plan is being operated as the document requires. Plan sponsors may want to use the major sections of the plan document (e.g., eligibility, contributions, distributions) as a guideline for the types of processes that will be needed. Once drafted, the procedures should be provided to the individuals within the company responsible for plan administration (e.g., human resources and payroll staff).

> Here is a list of internal controls and processes that the IRS has identified to help promote operational compliance:

- Compare plan eligibility requirements with employment records to confirm that employees joined the plan once they met the eligibility requirements
- Verify the plan is using the correct definition of employee compensation for allocations, deferrals, and testing
- Compare salary deferral election forms with the amounts deducted from employees' wages
- Ensure the accuracy of the employee compensation records transmitted to the payroll processor
- Compare terminated participants' vesting years of service to the plan's vesting schedule
- Verify the validity of rollover contributions to the plan
- Ensure participants and beneficiaries received required minimum distributions when required
- Review the plan document periodically for amendments that may be required because of law changes

INTERNAL CONTROLS

In addition to developing processes and procedures for monitoring retirement plan operations, plan sponsors and staff should document when and how the procedures are followed to maintain (and prove) consistency over time.

START HERE

Having strong internal controls can provide peace of mind to plan sponsors that their plan is operating properly and can help lessen the scope of a potential audit.

Plan sponsors can work with their financial advisors, record keepers and TPAs to:

- Review and understand the terms of the plan document
- Keep the plan document up to date with any necessary amendments
- Confirm they are providing all the required information on a timely basis

PLAN CHECK-UPS

FIVE FIDUCIARY RESPONSIBILITIES

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PLAN CHECK-UPS

Conducting periodic plan check-ups is a critical step in making sure the plan is running properly. A pro-active self-audit will help plan sponsors identify any compliance missteps. That way, they can correct them before they pose a bigger risk to the qualified status of the plan.

For example, one common step in a self-audit is to confirm that each newly eligible employee had the option to enter the plan by the plan's entry date. The audit may confirm that all eligible employees were properly offered the option to enroll at the appropriate time. Or, it may uncover that some employees who were eligible to enter the plan were not notified of their plan eligibility. Or, that some employees entered the plan before they were eligible. When you complete self-audits on a regular basis, plan sponsors can identify mistakes early. This can make it easier and less costly to correct those mistakes as compared to waiting years and having the IRS find the mistake during an audit.

Plan sponsors who discover operational errors during a self-audit can adjust their internal controls when we post this. They should link to internal controls blog (i.e., policies and procedures) to address the issue and prevent future mistakes. For example, the plan sponsor that finds eligibility errors might want to implement a new process. New processes could include reviewing the plan document to confirm eligibility criteria, adding training for in-house personnel responsible for monitoring plan eligibility, and defining the steps that will be taken when errors are identified.

PLAN CHECK-UPS

The IRS believes that proactive self-audits and self-corrections are vital for operating a retirement plan in compliance with the tax code. They recommend that plan sponsors conduct regular reviews of their plans.processes that will be needed. Once drafted, the procedures should be provided to the individuals within the company responsible for plan administration (e.g., human resources and payroll staff).

SELF-AUDIT TOOLS | THE IRS

The IRS has created a tool, the 401(k) Plan Checklist, to help plan sponsors conduct self-audits to find any mistakes that may have been made. This checklist presents a series of 10 questions.

They design these questions to help plan sponsors assess a plan's compliance by touching on the top plan mistakes made in 401(k) plans such as:

- Failure to timely deposit deferrals
- Nondiscrimination testing failures
- Errors in allocating contributions
- Missed document amendments
- Mishandled loans
- Plan entry errors

As a companion to the checklist, the IRS has also developed the 401(k) Fix-It Guide. This interactive tool is designed to help plan sponsors understand the rules, so they can determine whether a compliance mistake has occurred and, if so, how to fix the mistake. They organize the information into sections that provide background on the law. Additionally, they include instructions on how to research or confirm whether someone has made a mistake. Once plan sponsors identify a compliance error, the Fix-It Guide also has links to instructions for fixing the mistake and for establishing internal controls to prevent future mistakes.

CORRECTING MISTAKES

The IRS is aware that mistakes happen in retirement plan operations and wants to improve plan compliance. They do this by promoting voluntary corrections by plan sponsors who discover errors on their own. The IRS correction system, the Employee Plans Compliance Resolution System (EPCRS), allows plan sponsors to bring their plans back into compliance without losing the tax benefits provided to qualified retirement plans. Many errors can be corrected with either no penalty or at a significantly reduced cost as compared to corrections made after an IRS audit.

THE EPCRS CONSISTS OF THREE SUBCOMPONENTS:

THE SELF-CORRECTION PROGRAM (SCP)

The Self-Correction Program permits plan sponsors to self-correct operational problems, such as not following the terms of the plan. There is no IRS application form and no fee for this program. Insignificant errors may be corrected at any time. You should correct significant errors within two years of the failure.

THE VOLUNTARY CORRECTION PROGRAM (VCP)

The Voluntary Correction Program allows plan sponsors to correct a qualification error if they discover the problem before the plan

THE AUDIT CLOSING AGREEMENT PROGRAM (AUDIT CAP)

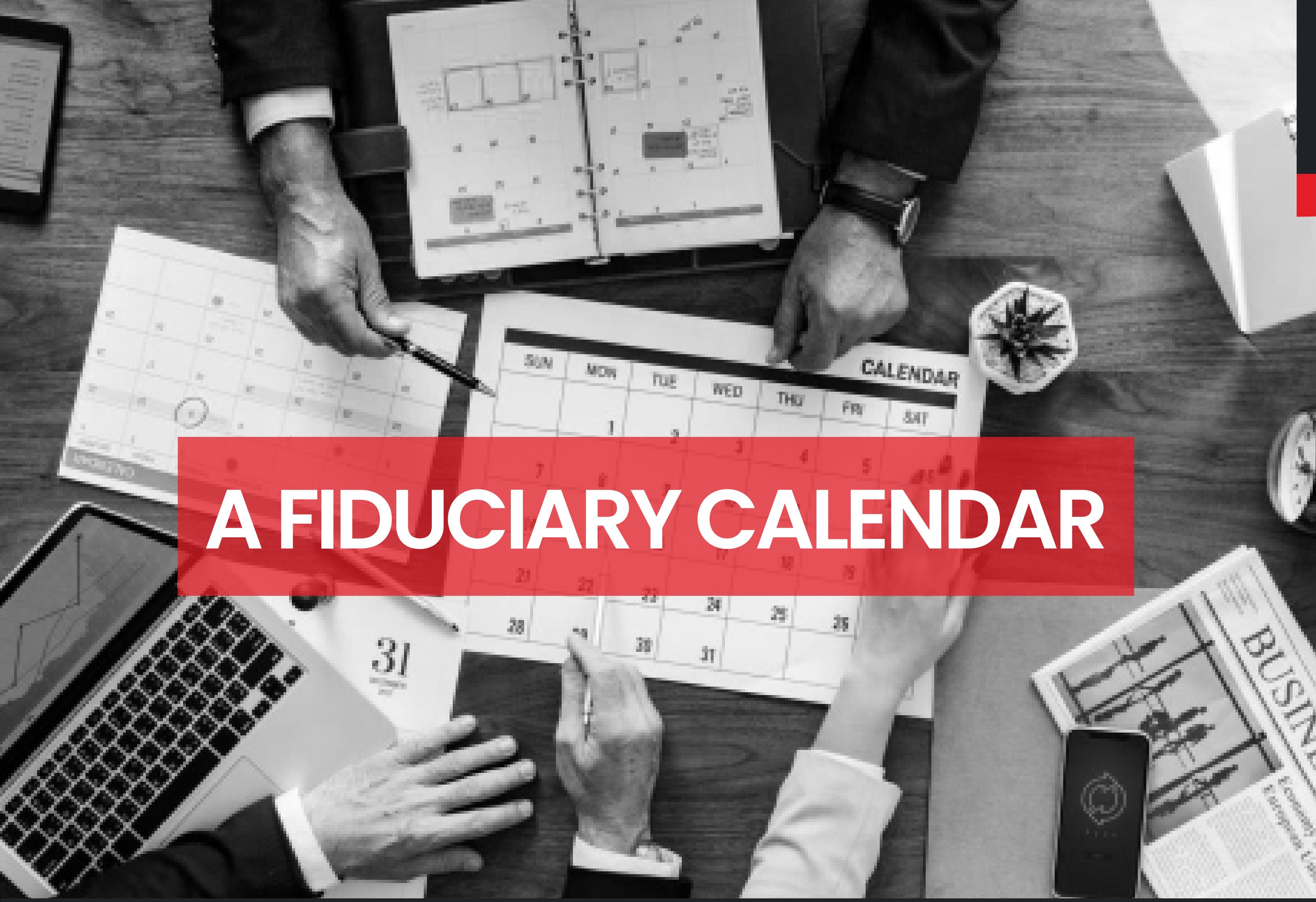
The Audit Closing Agreement Program is used if a failure is discovered during an IRS plan audit. This will involve a much higher sanction based on the extent and severity of the failure than if the plan sponsor corrected the error prior to the audit.

START HERE

Plan sponsors can use the IRS's self-audit tools as part of their periodic plan check-ups to ensure the plan is up-to-date and operating in compliance with the plan documents and the current regulations. Plan sponsors may want to work through the checklist with their financial advisor or their recordkeeper or third party administrator to understand the full scope of plan operations.

These service providers can also introduce corrections resources to help plan sponsors correct any compliance mistakes.

401(k) Plan Checklist: https://www.irs.gov/pub/irs-pdf/p4531.pdf
401(k) Plan Fix-it Guide: https://www.irs.gov/retirement-plans/401k-plan-fix-it-guide



A FIDUCIARY CALENDAR

FIVE FIDUCIARY RESPONSIBILITIES

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A FIDUCIARY CALENDAR

USE A CALENDAR TO STAY ON TRACK

So, to help ensure that fiduciary plan governance practices are comprehensive and consistent from year to year, many plan sponsors use a fiduciary calendar. Therefore, by assigning certain tasks to specific times of the year in a plan, plan sponsors can make certain they are addressing all critical items each year.

Benefit Trust is a great resource for helping plan sponsors understand their fiduciary responsibilities and develop a plan governance strategy. Many plan sponsors find it beneficial to divide fiduciary tasks into items to address every quarter and items they should complete just once per year, and then assigning the tasks to a specific quarter. Even more, plan sponsors should work with their financial advisors to craft a fiduciary calendar to follow consistently year to year. The calendar should take into account the timing of reports and testing results received from service providers, open enrollment periods, and critical deadlines (e.g., contributions, disclosures). After they review and discuss each calendar item, plan sponsors should document their decisions and identify any further actions or deadlines. For example, plan amendments, participant notices, discussions with service providers.

Furthermore, the following fiduciary task list identifies some of the actions plan sponsors may want to include in their fiduciary calendars, broken down by quarterly or annual tasks.

QUARTERLY

FIDUCIARY TASKS

MONITOR LEGISLATIVE AND REGULATORY DEVELOPMENTS AFFECTING RETIREMENT PLANS

Tap into the expertise of service providers and financial advisors. Understand how new retirement plan rules will affect plan operations. Or, to determine whether a document amendment is required.

REVIEW PLAN INVESTMENT PERFORMANCE

Compare to criteria in Investment Policy Statement (IPS), if applicable, and evaluate if investments should be on a watch list for possible removal from the plan.

EVALUATE SERVICE PROVIDER PERFORMANCE

Confirm service providers are meeting all service standards. Then, identify any plan operations issues and develop procedures to avoid similar issues in the future.

REVIEW COMMUNICATIONS FROM SERVICE PROVIDERS AND RESPOND PROMPTLY

Accurate and timely participant disclosures, compliance testing, and government reporting depend on good data and timely communications between service providers and plan sponsors.

ADDRESS PARTICIPANT CONCERNS

In addition to resolving any concerns, determine whether the problem could apply to other participants and whether additional procedures should be adopted to prevent future problems.

IDENTIFY UPCOMING DEADLINES AND ANY TASKS THAT MUST BE COMPLETED TO ENSURE COMPLIANCE

As plan fiduciaries, plan sponsors must ensure the plan meets all compliance deadlines – even if a service provider generally assumes responsibility for the event (e.g., delivering quarterly participant statements).

ANNUALLY

FIDUCIARY TASKS

CONSIDER THE PLAN OBJECTIVES AND PLAN DESIGN FEATURES

Evaluate whether there have been any significant changes in the business or employee demographics that warrant changes in the objectives for the plan or plan design features.

CONFIRM TIMELY DEPOSITS OF ALL EMPLOYEE CONTRIBUTIONS AND LOAN REPAYMENTS

Also, if any late deposits occur, work with service providers to make corrective contributions and determine what actions are needed to prevent late contributions in the future.

EVALUATE PLAN PERFORMANCE

Compare plan performance to the objectives set for the plan (e.g., participation rate, contribution rate, average plan balance, allocation across investments, rate of distributions and loans, including loan defaults) and benchmark performance against other plans of a similar size.

STUDY THE PLAN DOCUMENT

Check various plan transactions (e.g., definition of compensation used for contributions, hardship distributions) to make sure the plan is operating according to the terms of the plan document. Confirm any necessary amendments to keep the plan document up to date.

REVIEW INVESTMENT POLICY STATEMENT (IPS)

Determine whether the IPS still aligns with the plan's investment objectives and the investment products available to the plan.

ENSURE PARTICIPANT NOTICES AND GOVERNMENT REPORTING WERE DELIVERED

Make sure all required notices and disclosures were delivered timely to participants (and beneficiaries). Confirm the annual Form 5500 filing was accurate and on time. Discuss any issues with the appropriate service providers.

REVIEW NONDISCRIMINATION TESTING RESULTS AND CONTRIBUTION LIMITS

Likewise, ensure you correct any excesses in a timely manner. Consequently, determine whether plan design changes are necessary to address multiple years of testing failures.

ASSESS AND BENCHMARK ADMINISTRATIVE SERVICE PROVIDER FEES

Make sure any fees paid from plan assets are reasonable (and for services necessary for the administration of the plan). Do this by benchmarking them against fees charged by other providers for comparable services.

ASSESS FIDELITY BOND

Determine whether fidelity bonds are adequate for each plan official who handles plan assets. Individuals are required to be bonded for at least 10% of plan assets ($1,000 minimum bond, $500,000 maximum bond, $1 million if plan holds company stock).

START HERE

Even more, talk to Benefit Trust about developing a plan governance strategy to address all aspects of your fiduciary responsibilities including building a calendar of fiduciary tasks. Finally, you can find out more about your fiduciary responsibilities with this free publication from the Department of Labor:

Meeting Your Fiduciary Responsibilities: https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/publications/meeting-your-fiduciary-responsibilities.pdf

FEES AND FEE DISCLOSURES

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UNDERSTAND PLAN FEES

Especially important for a plan sponsor is selecting and monitoring service providers and investments for the plan. As a plan fiduciary, they must ensure that quality services are provided to the plan and that fees are reasonable and necessary if paid from plan assets. In order to make prudent, informed decisions about plan fees, plan sponsors must have a solid understanding of the types of expenses that their plan can incur.

Three categories of expenses typically arise in a retirement plan, such as a 401(k) plan:

SETTLOR FEES

Certain services are viewed as primarily benefiting the plan sponsor rather than the plan participants and cannot be paid from plan assets. These "settlor functions" include services related to plan establishment, plan design and plan termination.

PLAN ADMINISTRATION FEES

Service providers assess fees for recordkeeping and third party administration costs for the day-to-day operations of the plan. This can include processing transactions, performing compliance testing, and generating plan reporting. They can assess additional fees if the plan uses an outside trustee or custodian. These fees may be paid by the plan sponsor, from plan assets, or through revenue sharing arrangements. Fees for services performed for an individual participant (e.g., loan processing) are typically debited from the affected participant's plan account balance.

INVESTMENT FEES

Investment providers charge fees to cover the costs of investment management, administration, and account maintenance, along with distribution and sales charges. They deduct these fees from the participant's investment account. Investment fees and revenue sharing arrangements between service providers and investment managers can be complex. Most plan sponsors tap into the expertise of an investment advisor to better understand their plan's investment fees.

MAKE SURE FEES ARE REASONABLE

In recent years, there have been an increasing number of lawsuits brought by retirement plan participants alleging that plan sponsors breached their fiduciary duties by paying excessive fees for services or investments. Plan sponsors are not required to choose the least expensive service providers and investments. However, they should make sure the fees are "reasonable." According to the Department of Labor, cost is just one of multiple factors that plan sponsors should consider in making this determination. Even more, plan sponsors should have a methodical approach for weighing the value of the services received and the benefit to the plan against the cost for those services. They should document their decision-making process and the basis for determining a plan fee is reasonable.

To ensure plan sponsors have the information they need to evaluate whether fees are reasonable, the ERISA Section 408(b)(2) disclosure regulations require service providers to provide fee disclosures to plan sponsors. Plan sponsors must collect and review this fee information prior to contracting with providers. Furthermore, Benefit Trust can provide benchmarking support and help plan sponsors identify and evaluate competitive service arrangements and investment options.

A PRUDENT PROCESS

In addition to reviewing fee disclosures before engaging with a service provider or including an investment option on the plan menu, plan sponsors should develop and document a prudent process for monitoring fees on an ongoing basis. This will ensure that the fees paid by the plan continue to be reasonable. If the services, the marketplace, or the plan's needs change, plan sponsors must determine whether to modify or terminate the arrangements based on their new circumstances. Plan sponsors should conduct fee reviews on a regular schedule. Benchmarking fees against other service providers who deliver comparable services or similar investments is critical to determining whether fees continue to be reasonable. So, as with other fiduciary functions, plan sponsors should maintain records of the steps they took to satisfy their responsibilities and the reasons for their decisions.

START HERE

A plan sponsor has a fiduciary obligation under ERISA to make prudent choices regarding plan-related fees and expenses. This will ensure that only reasonable fees are paid from plan assets. Advisors can provide valuable assistance in helping plan sponsors understand the fees associated with their plan. They can also design a due diligence process to help satisfy their fiduciary requirements.

Fiduciary best practices include working with a financial advisor to:

- Establish a due diligence process for evaluating both service provider and investment fees.
- Benchmark fees to determine reasonableness.
- Document the review processes
- Review plan fees on a regular schedule (e.g., annually)