Capital Forum on Pensions

May 25, 2015 - AGENDA

Thank you for joining us for our Annual Conference!
We have a great day planned for you. If you need any help, find Kathy Cannon (Conference director), Keith Walker (Co-Director) or Rebecca Giannini (Kathy's assistant.)
Enjoy!

Time		**Description**	**Location**
7:30 – 8:15	CFOP Begins	Registration & Breakfast	Gold Room
8:15 – 8:30		Welcome and Announcements	Gold Room
8:30 – 9:45	Sal Tripodi	**Pension Updates** – Topics include: Safe Harbor Mid-Year Amendments, Testing relief for closed DB plans and combo DB/DC plans, proposed changes to testing	Gold Room
9:45 – 10:00	BREAK	**Prize drawing #1**	Sponsors Alley
10:00–11:15	Sal Tripodi	**Pension Updates** – Topics include: Fiduciary update and DL process	Gold Room
11:15–11:30	BREAK	**Prize drawing #2**	Sponsors Alley
11:30-12:30	Sal Tripodi	**Pension Updates** – Topics include: Ethics	Gold Room
12:30–1:30	LUNCH	Lunch on the Patio	Patio & East Terrace
1:30 – 2:30	**General Session** Ilene H. Ferenczy Beth Harrington James C. Paul (Jim)	**The State of Retirement Plans Panel Discussion** The retirement plan industry is changing rapidly. We face challenges, threats and competition from many directions. How do we cover more people? What competition should we expect from state-run retirement plans, MyRAs or other sources? What might Social Security look like in the future and what changes have been made to benefits? Join us for a lively discussion about the current state of retirement plans!	Gold Room
2:30 – 2:45	BREAK	**Prize Drawing #3**	Sponsors Alley

Time		**Description**	**Location**
2:45 – 3:45	**WORKSHOPS**	We have three concurrent workshops for you to choose from. Read the intro for each session below and select which session you would like to attend. Find the corresponding room in the location column.	
2:45 – 3:45	**Session 1 –** Ilene H. Ferenczy	**Cash Balance Plans** Cash balance plans offer a unique opportunity, particularly for business owners to save significant amounts for retirement. However, these plans have had a somewhat checkered past, so many advisors and administrators hesitate to consider them for their clients. But, cash balance plans are alive and well, will be able to be documented on prototypes and volume submitter plans in the future, and – with wise actuarial work and administration – can avoid the pitfalls that are of concern.	Gold Room
2:45 – 3:45	**Session 2** – Kevin Thelen	**Increasing Retirement Income with Courageous Leadership** Participants in a typical retirement program are asked to answer two important questions: how much to save and how to invest their money. The problem is most participants are not empowered with the knowledge to make great saving and investment decisions as they prepare for retirement. Financial Advisors, TPAs, and other consultants can change the quality of decisions participants are making, it just requires an understanding of the problem, a solution, and the courage to make it happen	East Terrace
2:45 – 3:45	**Session 3** Scott E. Galbreath & Marcel Weiland	**Mission Possible - Correcting Common and Not-So-Common Plan Failures** Employee Plans Compliance Resolution System (EPCRS), and Voluntary Closing Agreement (VCA) with a particular focus on, but not limited to, participant loans, hardship withdrawals and requirement minimum distribution failures. We will provide an overview of the possibilities under the newest program, VCA, and an update on the changes in EPCRS's Voluntary Correction Program. We will use a case study approach to analyze how changes in facts will require using different programs. This presentation will self-destruct one minute after its conclusion.	Heritage Room
3:45 – 4:00	BREAK	**Prize Drawing #4-**	Sponsors Alley
4:00 – 5:00	Panel Discussion and Q&A	**Ilene Ferenczy, Beth Harrington, Scott Galbreath Jim Paul, Kevin Thelen, Sal Tripodi & Marcel Weiland** Here is your chance to ask the experts! Submit questions throughout the day and get them answered in this session.	Gold Room

Thank you for attending!

Capital Forum On Pensions

May 25, 2016

This event is only possible with the generosity of our sponsors!

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May 25, 2016

Capital Forum On Pensions

Arden Hills Resort & Spa
Sacramento, CA

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Mid-year changes to Safe Harbor 401(k) Plans

THE INFORMAL POSITION:
No mid-year amendments unless we say so

Mid-Year Amendment (p.7)
- Effective on date other than 1st day of PY
- Effective at *beginning* of PY but adopted after 1st day of PY

THE OFFICIAL POSITION:
Amend away, except where we say you can't

Amendments without strings attached
- Not in the prohibited list of changes
- Not a change that affects required information in the SH notice
- Not a change that is subject to regulatory conditions
- Examples: Eligibility conditions affecting EEs not already eligible (Ex 7), expansion of coverage (Ex 8), change of investment options (other than default in QACA – Ex 5)

Mid-year changes to Safe Harbor 401(k) Plans

Permissible changes subject to regulatory conditions (p.7)

Change of PY
Short year must be sandwiched between 2 SH years

Suspension of Reduction of SH contribution (Ex 2)
- Plan amendment and timely notice required
- ER must: (1) have provided "Maybe Not" Notice, OR (2) ER is operating at an economic loss
- Election opportunity must be provided

Adding a SH 401k during a PY
- Not permissible if plan is already a 401k
- For non-401k PS may add up to 1st day of 10th month

Mid-year changes to Safe Harbor 401(k) Plans

Permissible changes that affect required SH notice content (p.8)

REQUIRED NOTICE CONTENT: REQUIRED UNDER IRC §401(K)(12) OR (13), IRC §401(M), OR SH REGULATIONS (1.401(K)-3 OR 1.401(M)-3)

- ✓ Give updated SH notice
  - 30-90 days before change becomes effective
  - If not practical (e.g., retroactive change), ASAP but no later than 30 days after change is adopted
- ✓ Opportunity to change deferral election
  - 30-day period before change becomes effective
  - If not practical (e.g., retroactive change), ASAP but starting not later than 30 days after change is adopted
- ✓ Examples (1), (4), (5), (9)

Mid-year changes to Safe Harbor 401(k) Plans

Prohibited Changes (p.8)

- May NOT increase # of years required to fully vest in QACA SH contributions
- May NOT narrow eligibility for receiving SH contributions
  . . . BUT, may change for EEs who are not already eligible
- May NOT INCREASE amount of match (or compensation used to compute match), or add discretionary match
  . . . BUT, see next slide for exception
- May not change TYPE of SH plan (e.g., 401(k)(12) to QACA (see Example 6)

Mid-year changes to Safe Harbor 401(k) Plans

Retroactive Increase In Matching Contributions

Retroactive increase in match (SH or otherwise) is OK only if . . . (p.9)

- Change is adopted AT LEAST 3 months BEFORE the end of the PY (e.g., by October 1 for CY plan)
- Updated notice and election opportunity is provided
- Retroactive to first day of PY and applies to entire PY
- May need to change to PY method of calculating match and make "true up" contributions if necessary
- Example 3

Mid-year changes to Safe Harbor 401(k) Plans . . . A few more things

Anti-Cutback Rule can affect timing of a mid-year amendment
Example. Change in allocation method of PS contribution after employees have met allocation conditions (1,000 hours satisfied and plan doesn't have last day rule)

403(b) Plans that use ACP safe harbor may rely on this notice

Announcement 2007-59 is superseded (no longer necessary)

What about changes made before January 29, 2016?
Hopefully IRS will adopt nonenforcement policy

Comments requested (especially on mergers, EACAs)

CCA 201615013

p.12

Identifying Otherwise Excludable Employees

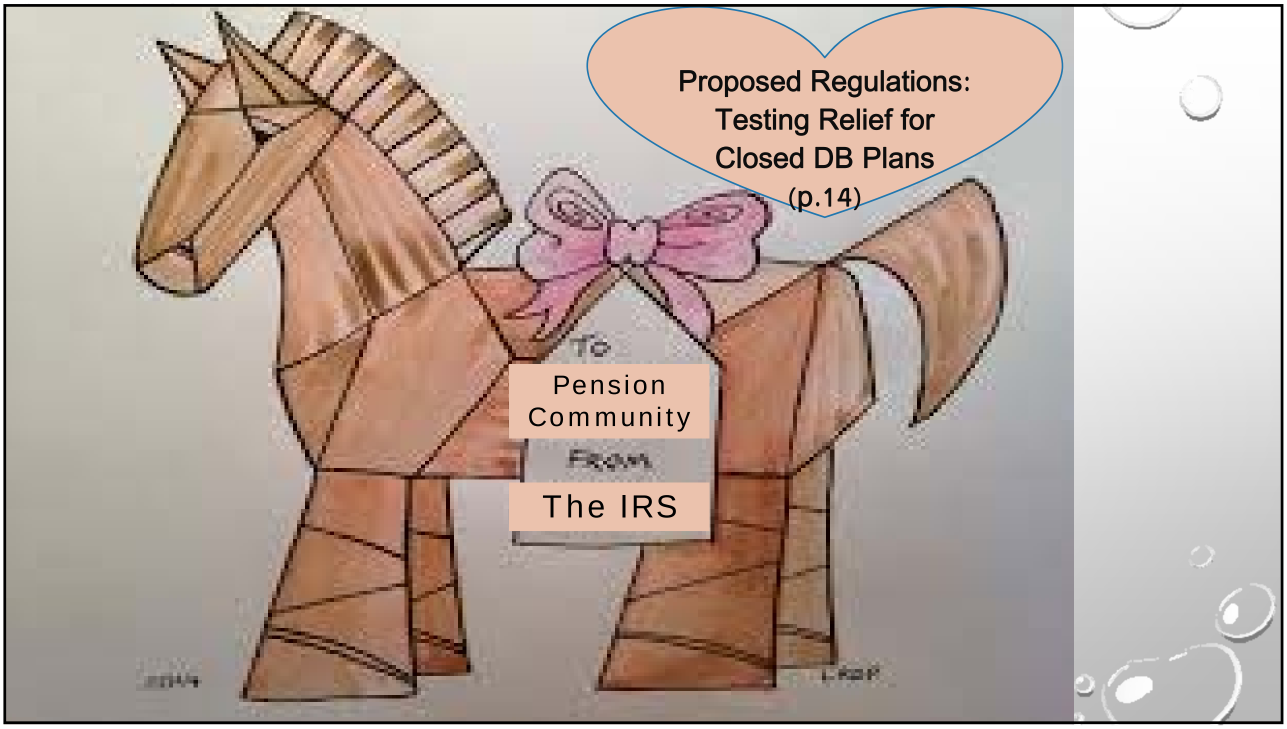
- Approach #1: assume statutory entry dates (earlier of 1st day of next PY or 6 months after completing statutory age & service requirements
- Approach #2: assume plan's entry dates
- Approach #3: assume no waiting period

KEEP CALM AND LISTEN TO EXAMPLE

CY plan; 3 months/no minimum age; monthly entry
Tegan starts July 10, 2016, entry 11/1/2016
Sara starts December 13, 2016, entry 4/1/2017

2016: Only Tegan is eligible
Otherwise excludable EE under all 3 approaches

2017: Both are eligible
Approach #1: Both are otherwise excludable EEs
Approach #2: Tegan is statutory EE, Sara otherwise excludable
Approach #3: Both are statutory EEs


Proposed Regulations:
Testing Relief for
Closed DB Plans
(p.14)
To
Pension
Community
From
The IRS

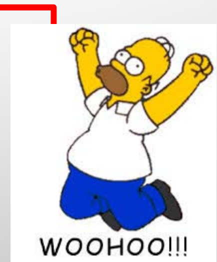

Proposed Regulations Under IRC §401(a)(4)
CLOSED DB PLANS
Relief for testing DB/DC combos that include Closed DB Plans; BRF testing relief for grandfathered group
Other combo-testing changes
Rate group testing changes

Proposed Changes to Rate Group Testing

✓Each rate group must pass either ratio test or average benefits test
✓If average benefits test used, reasonable classification test doesn't apply

Current law

✓If average benefits test used, reasonable classification test **WOULD APPLY** (p.14)
✓Classification test would apply to formula used to determine DC allocation or DB accrual
✓WILL BE WITHDRAWN!



Proposed

Anti-Abuse Standard Short-Service Employees & Targeted Lowest Paid NHCs

p.26

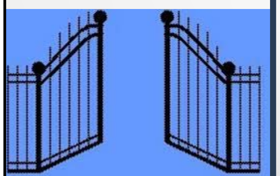
Focus is on:

- Allocations to very low-paid NHCs or those who work very few hours
- Bulk of NHC allocation goes to these employees
- Skews mathematical testing results
- Not a set group (i.e., plucked from "individual allocation groups"

Examples
- Suspect job classification
- Never vests
- High NHC allocation rates

Proposed Proposed Changes to DB/DC testing

MODIFIED GATEWAY



FOR BENEFITS-TESTING DB/DC PLAN

Gateway tests that are currently eligible (p.15)

- ✓ DB/DC plan is PRIMARILY DB in character
  - More than 50% of NHCs have NAR under DB > EBR under DC plan
- ✓ DB/DC plan consists of BROADLY AVAILABLE PLANS if DB side and DC side were looked at as separate plans
  - Nondiscriminatory classification test passed on each side
- ✓ Aggregate normal allocation rate for NHCs is no less than the gateway contribution requirement (usually 7-1/2%)
  - Normal equivalent allocation rate under DB + allocation rate under DC plan ≥ gateway contribution requirement
  - Equivalent allocation rates for the NHCs may be averaged

Proposed Proposed Changes to DB/DC testing

MODIFIED GATEWAY

FOR BENEFITS-TESTING DB/DC PLAN

- ✓ Allow averaging of allocation rates for NHCs in DC plan to determine if gateway contribution test is satisfied (p.16)
  - Current law only allows avg of NHC accrual rates on DB side
  - 15% cap on individual rates to compute average (25% if rates are a function of age or service)
- ✓ NHC's aggregate allocation rate could include match (lesser of 3% of comp or ACP of eligible NHCs, disregarding EE contributions)
- ✓ DB/DC plan that includes a closed DB plan deemed to meet gateway if certain conditions met (p.17)
- ✓ Plan that can meet rate group test if DC plan uses a 6% interest rate assumption deemed to meet gateway (p.18)

Definitions Re: Closed DB Plans (p.15)

Closed DB Plan

* Ceases accruals for some or all P's, OR

* Bars new P's after a closure date

Closure Date: When accruals freeze or participation is limited by a Closure Amendment

Grandfathered Group: accrues benefits or gets DB replacement allocations under a DC plan after the DB plan is closed

Special Gateway for Closed DB

- 1st day of PY must fall AFTER the 5th anniversary of the closure date
- Plan in effect at least 5 years ending on closure date
- From 5 years before closure date to end of current PY, no significant change to coverage or benefit formula (certain amendments excepted)

No gateway!

DB/DC plan may test on benefits basis for such PY

For each PY beginning after closure date and before 5th anniversary of closure date, the plan must have passed 401(a)(4) under 1 of 3 tests

- Each DB plan passes w/o aggregation
- DB/DC plan passes on a CONTRIBUTIONS basis
- DB/DC plan satisfies "primarily DB" test or the "broadly available" test

Proposed Regulations: Effective Date

Plan years beginning after publication date of final regulations

Early application: Plan years beginning on or after 1/1/2014

Does not apply to:
- ✓Averaging of DC allocation rates to meet DB/DC plan gateway
- ✓Option to include match in aggregate normal allocation rates
- ✓6% interest rate exception to gateway

fi·du·ci·ar·y
[fi-doo-shee-er-ee]

Definition of a fiduciary, p.29

CURRENT LAW	PROPOSAL
• Performed On Regular Basis	• May Be One-off Advice
• Mutual Understanding Advice Will Be Used As Primary Basis For Investment Decision	• Primary Basis For Investment Decision Not Required
• N/A To Rollovers/Distribs	• Applies To Rollovers/Distribs
• N/A To Appraisals	• Still N/A To Appraisals

Effective 6/7/16; Applicable 4/10/17; Transition Rules 4/10/17-1/1/18

Elements of being an investment advice fiduciary under proposal

Investment Advice is provided

To a Recipient

In a fiduciary capacity

For a fee or compensation

Elements of being an investment advice fiduciary under proposal

Investment Advice is provided

Recommendation (p.32) on:

- Sale, purchase or holding of securities or other investment property, or
- Recommendations with respect to rollovers, transfers, or distributions (what amount, in what form, to what destination, and type of investments after assets are rolled over, transferred or distribution (supersedes Advisory Opinion 2005-23A)
- Management of securities or other investment property, including investment policies or strategies, portfolio, selection of other persons to provide investment advice or investment mgmt services, selection of account arrangement (e.g., brokerage or advisory)

Elements of being an investment advice fiduciary under proposal

Investment Advice is provided

What is a Recommendation?

- Communication initiated by a person or software program
- Based on content, context, and presentation
- Would reasonably be viewed as a suggestion that the advice recipient take a specific course of action
- The more individually-tailed, the more likely it is a recommendation
- Consistent with FINRA Policy Statement 01-23

What is Investment Property?

- Does not include health insurance, disability insurance, term life insurance, or other property w/o an investment component

Elements of being an investment advice fiduciary under proposal

Investment Advice is provided

To a recipient

Plan
Plan fiduciary
Plan participant
Plan beneficiary
IRA
IRA owner

Elements of being an investment advice fiduciary under proposal

Investment Advice is provided

To a recipient

In a fiduciary capacity

- **Representation of fiduciary status with respect to advice, or**
- **Functional analysis**
  - **Based on particular investment needs**
  - **Directed to specific advice recipient regarding advisability of a particular investment or management decision**

Elements of being an investment advice fiduciary under proposal

- Explicit fee or compensation received by fiduciary or affiliate from any source
- Any other fee or comp from any source in connection with purchase or sale, or the provision of investment advice services
- Includes brokerage fee, mutual fund and insurance commissions, finders fees, revenue sharing, payments for shelf space, gifts and gratuities, expense reimbursements
- In connection with if wouldn't be paid but for transaction or service, or eligibility for fee/comp based in whole or part on the transaction or service

For a fee or compensation

Platform Providers

EXCEPTIONS (NOT CONSIDERED TO BE INVESTMENT ADVICE)

- Marketing material; must state not providing advice (p.36)
- Identifies investment options that meet objective criteria specified by plan fiduciary
- Provides objective financial data and comparisons with independent benchmark
- Can't advise on individual needs
- Plan fiduciary is independent of provider

General Communications

EXCEPTIONS (NOT CONSIDERED TO BE INVESTMENT ADVICE)

- Reasonable person would not view as an investment recommendation
  - ✓ Newsletters
  - ✓ Talk shows
  - ✓ Speeches, conferences
  - ✓ News reports
  - ✓ Marketing materials
  - ✓ General market data, price quotes
  - ✓ Performance reports
  - ✓ Prospectuses

EXCEPTIONS (NOT CONSIDERED TO BE INVESTMENT ADVICE)

Investment Education

- Replaces IB 96-1 (p.37)
- Plan Information (incl. investment alternatives
- General financial, investment, retirement information
- Asset allocation models and interactive materials
- Reference to specific DIAs in model or materials if independent fiduciary has oversight; identify other DIAs with similar risk and return characteristics

EXCEPTIONS (NOT CONSIDERED TO BE FIDUCIARY IN NATURE)

Employees

- Advising plan fiduciary, EE, indep contractor; no comp other than normal comp as an EE; more ltd if participant

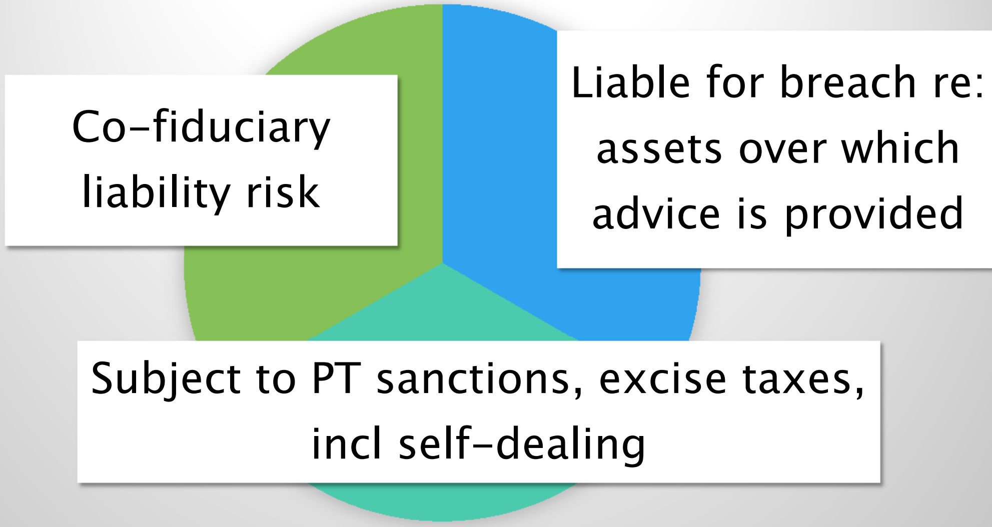
Financial expertise

Advice provided to bank, insurance co, investment adviser, broker-dealer or idependent fiduciary with $50 million or more under management or control; no direct comp from recipient for advice

Swaps

Recommendations made by swap dealer, swap participant or swap clearing firm to indep fiduciary who acknowledges it understands advice is not impartial

SCOPE OF FIDUCIARY DUTY FOR INVESTMENT ADVICE FIDUCIARY OF ERISA PLAN



HOW ARE IRAS & NON-ERISA PLANS AFFECTED?

- Broadens potential excise tax situations through self-dealing application
- Create enforcement mechanism through Best Interest Contract Exemption
- No DOL enforcement
- No co-fiduciary liability risk

BEST INTEREST CONTRACT EXEMPTION (P.49)

Contract
- Written Contract (IRAs/non-ERISA only)
  - Parties: Financial Insitution (F.I.) + Retirement Investor

Conduct
- Statement of fiduciary status
- Impartial Conduct Standards

Oversight
- Policies and Procedures
- Focus on Materials Conflicts of Interest
- Warranty (if contract applies)

Disclosure
- Best Interest Standard, services
- Material Conflicts of Interest
- Proprietary Products/3rd party pymts

DEFINITIONS

Financial Institution
- Registered Investment Adviser
- Bank
- Insurance Company
- Broker-dealer
- Entity approved in Individual Exemption

Adviser
- EE, contractor, agent, or rep of Financial Institution
- Satisfies applicable licensing requirements
- Fiduciary solely b/c of investment advice

DEFINITIONS

Retirement Investor

- Plan participant or beneficiary (with right to direct investments)
- IRA owner
- Retail Fiduciary: fiduciary of Plan or IRA, without financial expertise

Affiliate

- Controlled by, controlling, or under common control with, Adviser or F.I.
- Officer, director, partner, EE, relative
- Entity of which Adviser or F.I. is officer, director or partner

Contract

Must incorporate conditions of the Exemption (fiduciary status, Impartial Conduct Standards, Warranties)

- Must be executed for contracts after 1/1/18
- Existing contracts can use negative consent procedure
- No exculpatory provisions
- No limiting liability of Adviser of Financial Inst
- No bar to class actions
- May require arbitration of individual claims (but not in distant venues)
- May waive punitive damages & right to rescission of recommended transactions
- ERISA plans comply in operation; can't enter into contract that would include any prohibited provisions

Conduct

Impartial Conduct Standards, Fiduciary Statement

- Affirmative statement that Advisers act as fiduciaries under ERISA or tax code
- Best Interest standard (ERISA's prudence rule)
- Reasonable comp (ERISA sec 408(b)(2))
- No materially misleading statements
- Material Conflict of Interest: what reasonable person would conclude could affect best judgment

Oversight

Policies and Procedures Warranties

- Financial Institution adopts written policies and procedures designed to ensure compliance
- Identify Material Conflicts
- Adopt measures designed to prevent Material Conflicts
- No reliance on incentives that are intended to cause Advisers to make recommendations not meeting Best Interest Standard
- Warrantied (IRAs and non-ERISA plans)

Disclosure

Affirmative disclosures by Financial Institution

- Single written disclosure
- IRA/non-ERISA plan: in contract instead
- Clearly and prominently displayed
- Best Interest standard
- Services that will be provided
- How Retirement Investor will pay
- Material Conflicts of Interest
- Fees or charges
- Right to copies
- Proprietary Products/3rd Party Payments
- Monitoring services (if applicable)
- Contact info

OPERATIONAL DISCLOSURE REQUIREMENTS UNDER BIC EXEMPTION

See page 66

Financial Institution

Transaction:

Best Interest standard, Material Conflicts

Costs, fees, comp relating to recommended transaction

Description of policies and procedures

Right to copies

No more than once per year

OPERATIONAL DISCLOSURE REQUIREMENTS UNDER BIC EXEMPTION

See page 67

Financial Institution

Public webpage (freely accessible)

Business Model

Fee Schedule

Model contract

Policies and Procedures

Third Party Payment Arrangements

Adviser comp/incentive arrangements

May post Form ADV or other regulatory disclosures

PROPRIETARY PRODUCTS AND THIRD PARTY PAYMENTS

Compliance with policies & procedures; reasonable comp; prudent advice

Clearly disclosed (incl limitations and Material Conflicts

Documentation and reasonableness determination

Additional BIC requirements

See page 71

- Pre-notice to DOL
- 6-year recordkeeping requirement for F.I.
- RIGHT TO INSPECTION: DOL/IRS, FIDUCIARY, ER, PARTICIPANTS, IRA OWNERS

Level-To-Level Rollovers (ERISA plan to IRA) p.72

- **Still must comply with Fiduciary Statement and Impartial Conduct Standards**
- **Documentation:**
  - Alternatives to rollover (incl leaving $ in plan)
  - Fees associated with both Plan andIRA
  - Whether ER pays for all or part of plan administrative expenses
  - Different levels of services and investments
- **Adviser & Financial Institution must be Level Fiduciaries**

Other Special Rules For Level Fiduciaries

- **IRA to IRA**
  - Document reasons why in Best Interest, including services to be provided for the fee)
- **Switch from Commission-Based Account to Level Fee**
  - Document why switch is in Best Interest and services to be provided with fee
- **Robo-advice: covered only if provider of robo-advice is a Level Fee Fiduciary**

Additional Relief in BIC Exemption

Page 75

Sales & Purchases (not Principal Transactions, except Riskless)

- Ordinary course of business
- Arm's length
- Reasonable comp
- Satisfies BIC Exemption

Page 76

Pre-existing transactions

- Occurred prior to April 10, 2017 (or systematic program est before then)
- Covers all forms of comp
- Was not otherwise a PT

Additional Relief in BIC Exemption

Page 77

Transition Period

(4/10/17–1/1/18)

- Best interest standard
- More limited disclosures
- Reasonable comp
- Responsible compliance person
- Recordkeeping

Page 69

Good faith errors; reliance on others

- Disclosure failures
- Covers transition period disclosures
- 30-day correction period

How Will BIC Exemption Be Enforced?

IRA Owner or Non-ERISA Plan

- Breach of Contract action

Participant/ beneficiary

- 502(a)(2) breach action
- 502(a)(3) equitable relief action

DOL/IRS

- ERISA (DOL)
- Excise taxes (IRS)

Extension of Impartial Conduct Standards to other PTEs

PTE 86-128 (Fiduciary transactions) Page 88

PTE 75-1 (non-fiduciary broker transactions) Page 94

PTE 77-4 (mutual fund transactions) Page 99

PTEs 80-83/81-3 (reduction of indebtedness transactions; mortgage pool certificates)

PTE 84-24 (insurance, fixed rate annuity & mutual fund purchases) Page 100

Announcement 2015-19 (p.104)

IDPs: DL only for new & terminated plans, eff 1-1-17

Regular remedial amendment rules apply

Blanket extension planned by IRS ending no earlier than 12/31/17

IRS may announce special submission periods for amendments (or other reasons)

No off-cycle submissions accepted effective July 1, 2015 (exception for new plans)

DL Update

Last IDP Cycle: 2/1/16-1/31/17 (p.109)

4/30/16 deadline for DC pre-approved plans (umbrella closing agreement program – p.108)

No more expiration dates on DLs; expiration dates on existing DLs no longer operative

Related Group cannot elect Cycle A for 3rd cycle unless elected it for 2nd cycle (p.105)

Migrating IDPs to Pre-Approved Plan Cycle (p.105)

Extension to April 30, 2017, to adopt a Pre-Approved Plan

Opportunity to apply for Form5307 DL (if applicable) by April 30, 2017

Existing IDP that hasn't adopted Pre-Approved Plan before 1/1/16

New IDPs established on or after 1/1/16

Does NOT extend 4/30/16 deadline for Pre-Approved Plan adopters (what about 8905 adopters?)

Rollovers to SIMPLE-IRAs (p.109)
Effective after 12/18/15

SIMPLE-IRA may received rollover from
* Qualified plan
* 403(b) plan
*Governmental 457(b) plan

2-year period under IRC §72(t)(6) must have passed (1st 2 taxable yrs that EE participated in the SIMPLE-IRA

Obergefell v. Hodges: States must recognize same-sex marriage

Impact on plans?

Minor. *Windsor* case established Federal law rights (Notice 2015-86, p.109)

Important effective dates

June 26, 2013 (*Windsor*)
September 16, 2013 (RR 2013-17)

Prop Reg adding *Windsor* definition for all code purposes

Caution!

Avoid discriminatory rules for proof of marriage;
Domestic partners are NOT spouses
Required amendment? (Notice 2014-19)
Optional amendments? Notice 2015-86

IRS "Soft" Guidance On Documentation (p.111)

Hardships	Participant Loans
➤ Request, review and approval. ➤ Substantiates financial need (P self-certification NOT ok) ➤ In accordance with applicable law and plan provisions. ➤ Proof of the actual distribution; Form 1099-R	➤ Application, review and approval process ➤ Executed plan loan note. ➤ Verifying purchase or construction of primary residence (no self-certification) ➤ Loan repayments. ➤ Collection activities after default and related 1099-R

IRS Shuts Down De-Risking Lump Sum Programs For Retirees Under DB Plans (Notice 2015-49, p.112)

What is it?

- ✓ **Retirees in pay status get a one-time lump sum election**
- ✓ **Eliminates plan's future risk to fund benefit**

How Did They Stop It?

- ✓ **Prohibit plan amendments that allow lump sum to be elected by retiree after annuity starting date**
- ✓ **May amend to increase annuity payments**
- ✓ **Effective July 9, 2015**
- ✓ **Pre-Notice Accelerations permitted**

➢EBSA Interpretive Bulletin on State Run Plans (Eff. 11-18-15) (p.114)

- ERISA preemption issues for State programs open to private sector ERs
  - Program must be voluntary
  - ERISA requirements, liability provisions & enforcement rules FULLY APPLY
- Endorsement of Washington State Small Business Retirement Savings Marketplace (Marketplace Approach)
  - State connects eligible ERs with qualifying savings plans (ERISA & non-ERISA)
- State-sponsored prototype plan
  - Adopting ER assumes ERISA responsibility
  - State or 3rd party could be named fiduciary or plan administrator
  - Primary fiduciary responsibility for administrative and asset management functions could be moved away from the adopting ER
  - State could designate low-cost investment options and a TPA for prototype

EBSA Interpretive Bulletin on State Run Plans (Eff. 11-18-15)

State-run open MEPs (p.115)

- Would be subject to ERISA
- State is plan sponsor, named fiduciary & plan administrator (may use contracted 3rd party private sector providers)
- Treated as a single plan (one 5500, one audit)
- Grants advantage over private sector MEPs: deems state to sufficient nexus to ERs (interest in welfare of citizens)
- Could be DB plan
- ER could have very limited fiduciary responsibility (i.e., duty to prudently select arrangement and monitor its operation)
  - State could get Advisory Opinion on shifting of fiduciary roles
- State would be market participant rather than regulator, so no preemption

State sovereignty laws protecting EEs from suit could create ERISA preemption issue

Surface Transportation and Veterans Health Care Choice Improvement Act of 2015

- C corporation returns (post-2015): 15th day of 4th month (e.g., April 15); 6-mo ext available (5 mos before 2026) (p.118)
- Special rule for June 30 C corporations: not effective until 2026 (stay on 15th day of 3rd month – Sept 15); 7-month extension rule before 2026)
- Partnerships & S corporations: 15th day of 3rd month; 6-mo extension (instead of 5) for partnerships
- Would have changed CY Form 5500 auto extension to 3-1/2 months (Nov 15) starting w/ 2016 returns, but repealed by later legislation

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No more ERPAs (p.120)

Last testing window ends 2/12/2016

CE requirements continue

IRS Compliance Questions (Do NOT complete for 2015)		
Question (p.120)	**5500/5500-SF Line**	**5500-EZ Line**
Is plan a 401k plan?	Sch R, Part VII, Line 20a	N/A
Is 401k SH or ADP-tested?	Sch R, Part VII, Line 20b	N/A
Current-year testing?	Sch R, Part VII, Line 20c	N/A
Ratio test or Avg Ben Test?	Sch R, Part VII, Line 21a	N/A
Permissive aggregation?	Sch R, Part VII, Line 21b	N/A
Timely amendments?*	Sch R, Part VII, Line 22a	Part V, Line 13a
Last amendment/restatement date (insert code)*	Sch R, Part VII, Line 22b	Part V, Line 13b

IRS Compliance Questions (Do NOT complete for 2015)		
Question	**5500/5500-SF Line**	**5500-EZ Line**
Opinion/Advisory ltr & S/N (if applicable)	Sch R, Part VII, Line 22c	Part V, Line 13c
DL date & S/N (if applicable)	Sch R, Part VII, Line 22d	Part V, Line 13d
Maintenance in US territory?*	Sch R, Part VII, Line 23	N/A
Did plan have UBTI?*	Sch H or Sch I, Line 4o	Part V, Line 15
In-service distributions?	Sch H or Sch I, Line 4p	Part V, Line 16
Trust name, trust EIN, trustee	Sch H or Sch I, Lines 6a-6c	Part II, Lines 4a-4c
Trustee's/custodian/s phone #	Sch H or Sch I Line 6d	Part II, Line 4d

Page 123

Joint Employment Relationships
Interpretation of DOL's Wage & Hour Division

Application of FLSA
- ✓ Broader than ERISA's "common law EE" standard
- ✓ Horizontal joint employment
- ✓ Vertical joint employment
- ✓ Could be helpful with shared EE situations

Horizontal
- Focus on ERs
- 9 factors identified
- Compare to 2 jobs with separate ERs
  - Example with shared restaurant employment

Vertical
- Intermediary between EE and potential joint ER
- Is EE economically dependent?
  - Subcontractor example

p.128

Changes for Church Plans

CG Test
- 80% operating funds test
- Direct involvement in day-to-day ops
- NQCC
- Permissive aggregation
- Permissive Disaggregation

Grand-fathered 403(b) DB plan

▶ ***415(b) limits do NOT apply***

Auto-Enrollment
- ERISA preemption
- Uniformity
- Notice & election requirements
- Default investment
- Similar to ACA

Mergers/ Transfers
- QP and 403(b) maintained by same church
- Merger OK
- Transfer OK

81-100 Group Trust
- Church plan assets
- Assets of CCO

Definition of a Church Plan

Advocate case
(p.132)
7^{th} Cir. (IL, IN, WI)
3^{rd} Cir. agrees (DE, NJ, PA, VI)

Who can **establish** a church plan?
- Church
- Convention or association of churches

Who can **maintain** a church plan?
- Church
- Convention/association
- Principal purpose entity (e.g., church pension board)

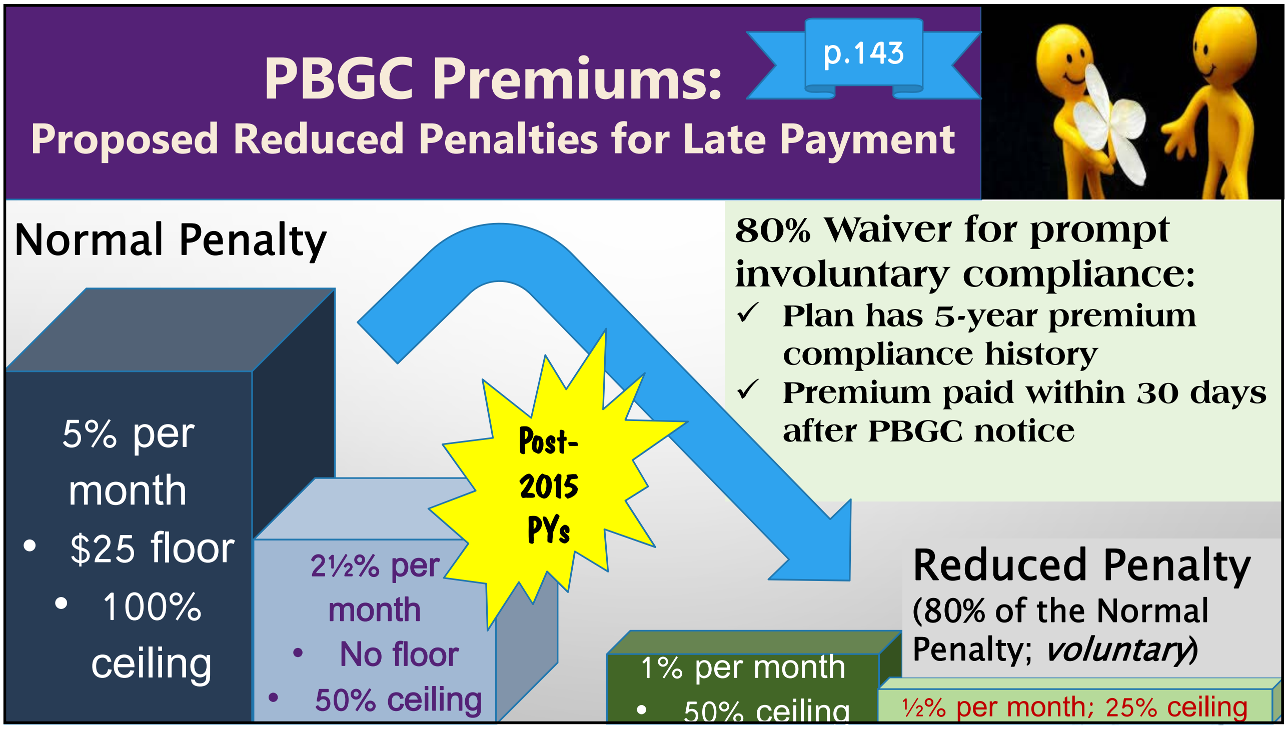
Plan may **cover** EEs of:
- Church
- Convention/association
- Principal purpose entity
- Ministers
- Church controlled or affiliated org

Cash Balance Regulations:
Anti-cutback Relief/Effective Dates

MAY ROUND INTEREST RATES (P.168)

Regs finalized to specify how noncompliant rate should be amended (p. 135)
- ✓ Based on why rate is noncompliant
- ✓ Multiple noncompliant features: address each one separately
- ✓ Additional guidance on noncompliant cumulative floors
- ✓ Participant-directed crediting rates
- ✓ Added more options to change to third segment rate

Regulations delayed to 2017 PY; amendments due by end of 2016 PY



PBGC Premiums:
Proposed Reduced Penalties for Late Payment
p.143
Normal Penalty
5% per month
• $25 floor
• 100% ceiling
2½% per month
• No floor
• 50% ceiling
Post-2015 PYs
80% Waiver for prompt involuntary compliance:
✓ Plan has 5-year premium compliance history
✓ Premium paid within 30 days after PBGC notice
Reduced Penalty
(80% of the Normal Penalty; voluntary)
1% per month
• 50% ceiling
½% per month; 25% ceiling

Reportable Event Regulations
Effective for events occurring in 2016 or later (p.144)
PBGC
Small plan waiver: flat-rate premiums in prior year for 100 or fewer participants (see Table 3, p.160)
Public company waiver: subject to SEC reporting; event reported on SEC Form 8-K
Foreign entity waiver: not contributing sponsor, no US tax return, no reportable income other than passive income of $1,000 or less, not foreign parent, & no substantial assets in US


PBGC

Reportable Event Regulations

Financial soundness waivers:

- **Company Low-Default-Risk (p.148)**
  - Event falls within safe harbor period
    - Begins on financial information date
    - Ends no later than 13 months later
  - Financial info date based on 10-K, financial statement closing date or filing of tax return, whichever applies
  - Must meet low-default-risk standard as of financial info date


PBGC

Reportable Event Regulations

- **Company Low-Default-Risk**
  - **Low-default-risk standard**
    1. Probability of default test
    2. Debt test
    3. Retained earnings test
    4. EBITDA test
    5. Income test
    6. Loan default test
    7. Plan obligations test
- **Well-funded plan (no VRP for prior PY)**

Must satisfy 1 & 2 or four of the 7

Reportable Event Regulations

p.145 (Deadlines)
p.159 (Tables)

Post-event notice:
Within 30 days after person knows or has reason to know
Table 1: Waivers
Table 2: Categories

Obligation:
- P.A. & each contrib sponsor (post-event)
- Each contrib sponsor (advance)

Advance notice:
At least 30 days before effective date of the event
Table 2: Categories

ERISA claims:
Burden of Proof

Barton **case – 9th Cir** (p.161) (AL, AZ, CA, HI, ID, MT, OR, NV, WA)

- ✓ Burden of proof shifts to defendant if plaintiff makes prima facie case of benefit entitlement
- ✓ Plan administrator was require plaintiff to submit documentation to show that his service was with the requisite companies w/i related group that participated in the plan, prove 1,000-hour test was met in the requisite years
- ✓ Dissent: conflicts with deferential review standard

Equitable Relief

Dissent!
Supremes have read "equitable" too narrowly

Effect on pension overpayments?

Montanile **case, Sup Ct** (162)

Recovery by health plan of third-party payments

- ✓ Enforcement of subrogation claim (equitable lien by agreement)
- ✓ Participant had dissipated funds before suit was brought by plan
- ✓ Can't go after P's general assets
- ✓ Must go against indentifiable funds attributable to settlement proceeds (*Sereboff* clarified)

Preemption

Gobielle **case, Sup Ct** (p.163)

- ✓ VT law required reporting of coverage & approved claims
- ✓ Conflicted with ERISA's R&D regime: impermissible connection

Dissent!
Supremes have read preemption too broadly

Ethics Case Studies

Ethics Case Study #1

New referral source

50 new plans in Feb 2017

Wants 2016 PY work done
Top administrator just quit

76

Ethics Case Study #1

Mike from Seaver Pensions
- 10 yrs experience
- Can bring some "loyal" clients
- Non-compete agreement
- Bright. Does things "own way"
- Fired by Seaver ("too many shortcuts"). Customer complaints.

Carol, recent grad
- Interned at CPA firm
- No QP experience
- Will need training but excellent candidate
- Enthusiastic; will "read 5500 instructions from cover to cover"

Ethics Case Study #1

Mike from Seaver Pensions
- 10 yrs experience
- Can bring some "loyal" clients
- Non-compete agreement
- Bright. Does things "own way"
- Fired by Seaver ("too many shortcuts"). Customer complaints.

- Is Mike competent?
- What info concerns you?
- What if Mike says Seaver Pensions was unscrupulous & didn't like him following the rules?
- Would you allow Mike to bring clients over?
  - Contact the clients Mike has relationships with?

Ethics Case Study #1

- Does Carol have the necessary competence?
- What weight should you give to her being a good candidate?
- What other options would you consider besides hiring Mike and/or Carol?

Carol, recent grad
- Interned at CPA firm
- No QP experience
- Will need training but excellent candidate
- Enthusiastic; will "read 5500 instructions from cover to cover"

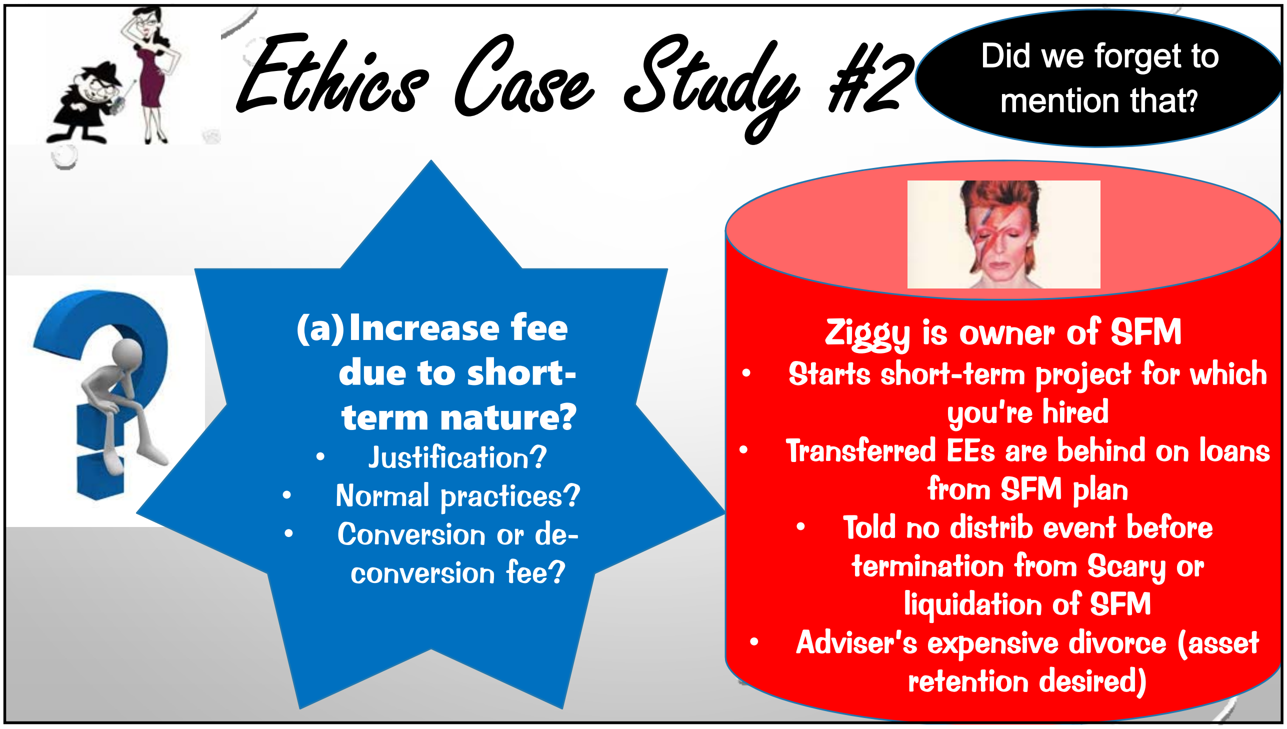
Ethics Case Study #2

Did we forget to mention that?

Scary Monsters, Inc.
- Buys assets in March
- Hires 100s of SFM EEs
- Doesn't take over SFM plan

SFM, Inc.
- Sale of assets
- Continues plan
- Hires you as TPA (in Nov)
- No mention of prior sale
- Advisor referral

Ziggy is owner of SFM
- Starts short-term project for which you're hired
- Transferred EEs are behind on loans from SFM plan
- Told no distrib event before termination from Scary or liquidation of SFM
- Adviser's expensive divorce (asset retention desired)


Ethics Case Study #2
Did we forget to mention that?
(a) Increase fee due to short-term nature?
• Justification?
• Normal practices?
• Conversion or de-conversion fee?
Ziggy is owner of SFM
• Starts short-term project for which you're hired
• Transferred EEs are behind on loans from SFM plan
• Told no distrib event before termination from Scary or liquidation of SFM
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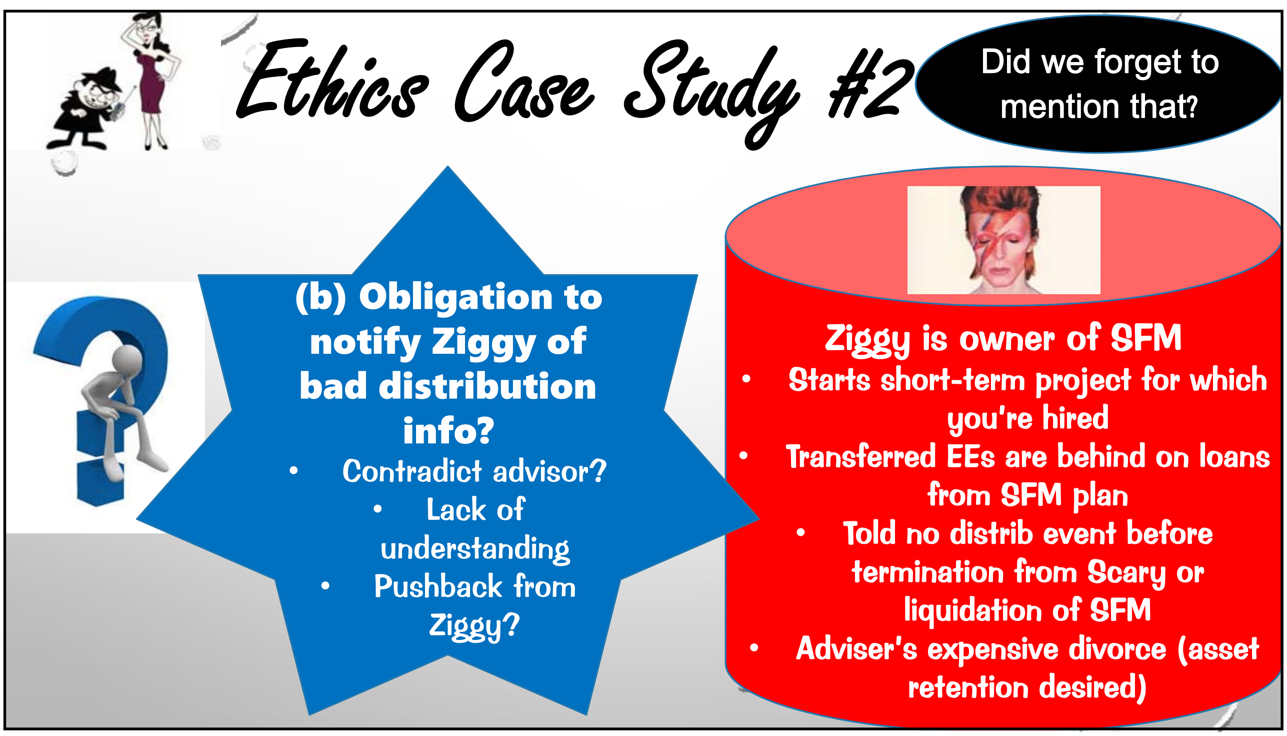
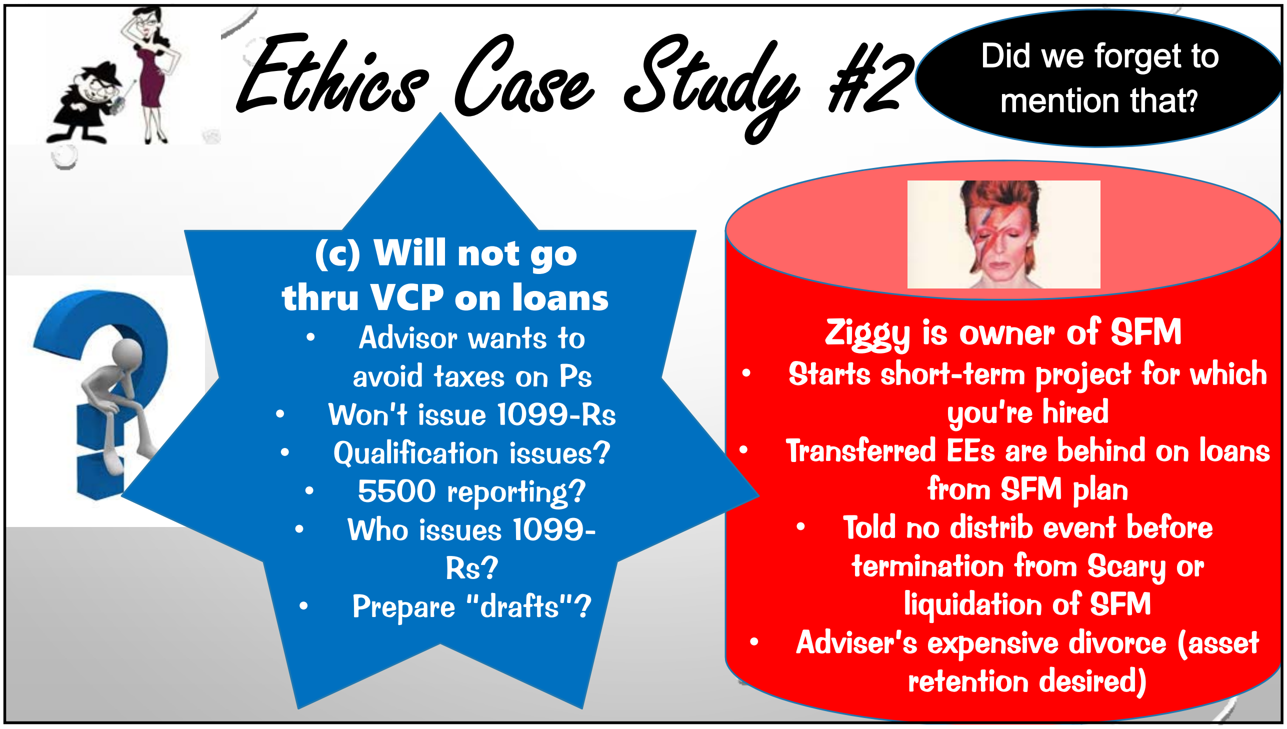
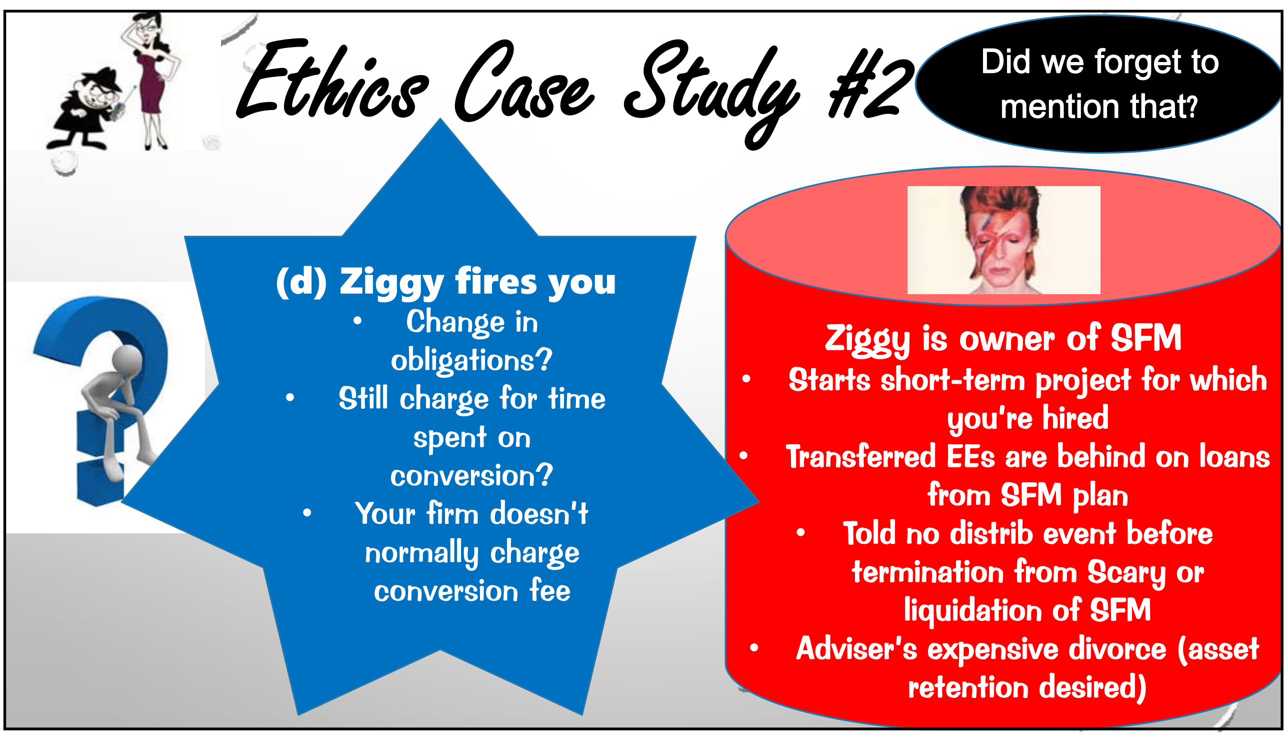
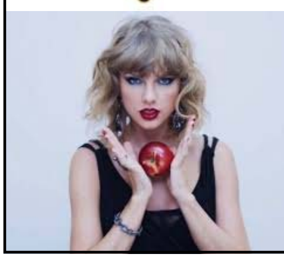

Ethics Case Study #2
Did we forget to mention that?
(b) Obligation to notify Ziggy of bad distribution info?
• Contradict advisor?
• Lack of understanding
• Pushback from Ziggy?
Ziggy is owner of SFM
• Starts short-term project for which you're hired
• Transferred EEs are behind on loans from SFM plan
• Told no distrib event before termination from Scary or liquidation of SFM
• Adviser's expensive divorce (asset retention desired)


Ethics Case Study #2
Did we forget to mention that?
(c) Will not go thru VCP on loans
• Advisor wants to avoid taxes on Ps
• Won't issue 1099-Rs
• Qualification issues?
• 5500 reporting?
• Who issues 1099-Rs?
• Prepare "drafts"?
Ziggy is owner of SFM
• Starts short-term project for which you're hired
• Transferred EEs are behind on loans from SFM plan
• Told no distrib event before termination from Scary or liquidation of SFM
• Adviser's expensive divorce (asset retention desired)


Ethics Case Study #2
Did we forget to mention that?
(d) Ziggy fires you
• Change in obligations?
• Still charge for time spent on conversion?
• Your firm doesn't normally charge conversion fee
Ziggy is owner of SFM
• Starts short-term project for which you're hired
• Transferred EEs are behind on loans from SFM plan
• Told no distrib event before termination from Scary or liquidation of SFM
• Adviser's expensive divorce (asset retention desired)

Ethics Case Study #3



Suspicious activity

- No 2014 allocation to Bob (Term. Early 2015)
  - Confusion with last day rule?
- Taylor promises to fix; she has loan payment due
- Taylor asks 2015 year-end work to be expedited
- Bob's 2014 allocation was deposited to Taylor's account
  - Still not fixed when you check in 2016
- 2 terminees in early 2016 didn't get 2015 allocations
  - Taylor's loan from her acct is now paid off
  - You have not yet notified Tom, the owner

Ethics Case Study #3

(a) Should you bring your concerns to someone in authority?

- Who is your client?

Suspicious activity

- No 2014 allocation to Bob (Term. Early 2015)
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(b) Sufficient to tell record-keeper or advisor rather than Tom?

Ethics Case Study #3

Suspicious activity

- No 2014 allocation to Bob (Term. Early 2015)
  - Confusion with last day rule?
- Taylor promises to fix; she has loan payment due
- Taylor asks 2015 year-end work to be expedited
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- 2 terminees in early 2016 didn't get 2015 allocations
  - Taylor's loan from her acct is now paid off
  - You have not yet notified Tom, the owner

(c) You tell Tom

- Asks for investigation
- Refuses to pay additional fee
- "You should have paid better attention"
- Assist without payment?

Ethics Case Study #3

Suspicious activity

- No 2014 allocation to Bob (Term. Early 2015)
- Confusion with last day rule?
- Taylor promises to fix; she has loan payment due
- Taylor asks 2015 year-end work to be expedited
- Bob's 2014 allocation was deposited to Taylor's account
- Still not fixed when you check in 2016
- 2 terminees in early 2016 didn't get 2015 allocations
- Taylor's loan from her acct is now paid off
- You have not yet notified Tom, the owner

(d) Have recordkeeper freeze Taylor's account?
- Fiduciary action?
- Reallocation?

Ethics Case Study #4

Crusher & McCoy, P.C. (Medical Practice)

- Key referral source brings them to you
- You will work 401k
- DB plan
- Actuarial firm mistakes
- CPA has done DB 5500s
- Advisor wants you to take over 5500 for DB

(a) Should you accept engagement?
- Competence to prepare DB 5500?
- Reliance on information provided by actuarial firm?

(b) Special circumstances or caveats?
- Engage an independent actuary?
- Charge C&M for extra review?

(c) Suppose actuarial firm has not made mistakes that anyone knows of?

May 25, 2016

Capital Forum On Pensions

Arden Hills Resort & Spa
Sacramento, CA

Presented by Sal Tripodi
(Sal, The Pension Pal)

Sal,
the Pension Pal
PensionPal@twitter.com

http://www.linkedin.com/in/saltripodi

Mid-year changes to Safe Harbor 401(k) Plans

REASONABLE AND NECESSARY

THE INFORMAL POSITION:
No mid-year amendments unless we say so

Mid-Year Amendment (p.7)
- Effective on date other than 1st day of PY
- Effective at *beginning* of PY but adopted after 1st day of PY

THE OFFICIAL POSITION:
Amend away, except where we say you can't

Amendments without strings attached
- Not in the prohibited list of changes
- Not a change that affects required information in the SH notice
- Not a change that is subject to regulatory conditions
- Examples: Eligibility conditions affecting EEs not already eligible (Ex 7), expansion of coverage (Ex 8), change of investment options (other than default in QACA – Ex 5)

Mid-year changes to Safe Harbor 401(k) Plans

Permissible changes subject to regulatory conditions (p.7)

Change of PY
Short year must be sandwiched between 2 SH years

Suspension of Reduction of SH contribution [Ex 2]
- Plan amendment and timely notice required
- ER must: (1) have provided "Maybe Not" Notice, OR (2) ER is operating at an economic loss
- Election opportunity must be provided

Adding a SH 401k during a PY
- Not permissible if plan is already a 401k
- For non-401k PS may add up to 1st day of 10th month

Mid-year changes to Safe Harbor 401(k) Plans

Permissible changes that affect required SH notice content (p.8)

Required Notice Content: Required under IRC §401(k)(12) or (13), IRC §401(m), or SH regulations (1.401(k)-3 or 1.401(m)-3)

✓ Give updated SH notice
- 30-90 days before change becomes effective
- If not practical (e.g., retroactive change), ASAP but no later than 30 days after change is adopted

✓ Opportunity to change deferral election
- 30-day period before change becomes effective
- If not practical (e.g., retroactive change), ASAP but starting not later than 30 days after change is adopted

✓ Examples (1), (4), (5), (9)

Mid-year changes to Safe Harbor 401(k) Plans

Prohibited Changes (p.8)

- May NOT increase # of years required to fully vest in QACA SH contributions
- May NOT narrow eligibility for receiving SH contributions
  . . . BUT, may change for EEs who are not already eligible
- May NOT INCREASE amount of match (or compensation used to compute match), or add discretionary match
  . . . BUT, see next slide for exception
- May not change TYPE of SH plan (e.g., 401(k)(12) to QACA (see Example 6)

Mid-year changes to Safe Harbor 401(k) Plans

Retroactive Increase In Matching Contributions

Retroactive increase in match (SH or otherwise) is OK only if . . . (p.9)

- Change is adopted AT LEAST 3 months BEFORE the end of the PY (e.g., by October 1 for CY plan)
- Updated notice and election opportunity is provided
- Retroactive to first day of PY and applies to entire PY
- May need to change to PY method of calculating match and make "true up" contributions if necessary
- Example 3

Mid-year changes to Safe Harbor 401(k) Plans . . . A few more things

Anti-Cutback Rule can affect timing of a mid-year amendment
Example. Change in allocation method of PS contribution after employees have met allocation conditions (1,000 hours satisfied and plan doesn't have last day rule)

403(b) Plans that use ACP safe harbor may rely on this notice

Announcement 2007-59 is superseded (no longer necessary)

What about changes made before January 29, 2016?
Hopefully IRS will adopt nonenforcement policy

Comments requested (especially on mergers, EACAs)

CCA 201615013

p.12

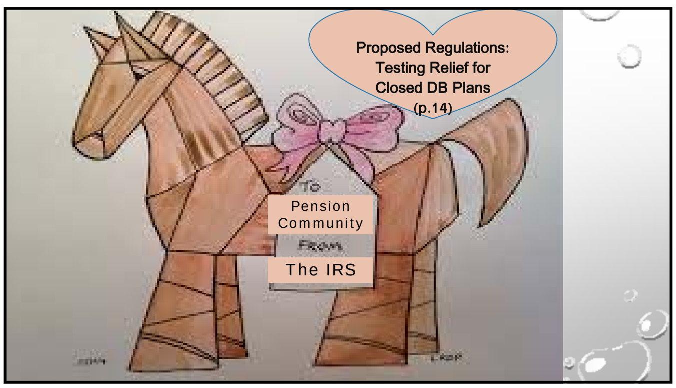
Identifying Otherwise Excludable Employees

- Approach #1: assume statutory entry dates (earlier of 1st day of next PY or 6 months after completing statutory age & service requirements
- Approach #2: assume plan's entry dates
- Approach #3: assume no waiting period

CY plan; 3 months/no minimum age; monthly entry
Tegan starts July 10, 2016, entry 11/1/2016
Sara starts December 13, 2016, entry 4/1/2017

2016: Only Tegan is eligible
Otherwise excludable EE under all 3 approaches

2017: Both are eligible
Approach #1: Both are otherwise excludable EEs
Approach #2: Tegan is statutory EE, Sara otherwise excludable
Approach #3: Both are statutory EEs



Proposed Regulations Under IRC §401(a)(4)

Proposed Changes to Rate Group Testing

Current law

- ✓Each rate group must pass either ratio test or average benefits test
- ✓If average benefits test used, reasonable classification test doesn't apply

Proposed

- ✓If average benefits test used, reasonable classification test **WOULD APPLY** (p.14)
- ✓Classification test would apply to formula used to determine DC allocation or DB accrual
- ✓WILL BE WITHDRAWN!

Anti-Abuse Standard Short-Service Employees & Targeted Lowest Paid NHCs

p.26

Focus is on:

- *Allocations to very low-paid NHCs or those who work very few hours*
- *Bulk of NHC allocation goes to these employees*
- *Skews mathematical testing results*
- *Not a set group (i.e., plucked from "individual allocation groups"*

Examples

- Suspect job classification
- Never vests
- High NHC allocation rates

Proposed Proposed Changes to DB/DC testing

MODIFIED GATEWAY

FOR BENEFITS-TESTING DB/DC PLAN

Gateway tests that are currently eligible (p.15)

- ✓ DB/DC plan is PRIMARILY DB in character
  - More than 50% of NHCs have NAR under DB > EBR under DC plan
- ✓ DB/DC plan consists of BROADLY AVAILABLE PLANS if DB side and DC side were looked at as separate plans
  - Nondiscriminatory classification test passed on each side
- ✓ Aggregate normal allocation rate for NHCs is no less than the gateway contribution requirement (usually 7-1/2%)
  - Normal equivalent allocation rate under DB + allocation rate under DC plan ≥ gateway contribution requirement
  - Equivalent allocation rates for the NHCs may be averaged

Proposed Proposed Changes to DB/DC testing

MODIFIED GATEWAY

FOR BENEFITS-TESTING DB/DC PLAN

- ✓ Allow averaging of allocation rates for NHCs in DC plan to determine if gateway contribution test is satisfied (p.16)
  - Current law only allows avg of NHC accrual rates on DB side
  - 15% cap on individual rates to compute average (25% if rates are a function of age or service)
- ✓ NHC's aggregate allocation rate could include match (lesser of 3% of comp or ACP of eligible NHCs, disregarding EE contributions)
- ✓ DB/DC plan that includes a closed DB plan deemed to meet gateway if certain conditions met (p.17)
- ✓ Plan that can meet rate group test if DC plan uses a 6% interest rate assumption deemed to meet gateway (p.18)

Definitions Re: Closed DB Plans (p.15)

Closed DB Plan

* Ceases accruals for some or all P's, OR
* Bars new P's after a closure date

Closure Date: When accruals freeze or participation is limited by a Closure Amendment

Grandfathered Group: accrues benefits or gets DB replacement allocations under a DC plan after the DB plan is closed

Special Gateway for Closed DB

- 1st day of PY must fall AFTER the 5th anniversary of the closure date
- Plan in effect at least 5 years ending on closure date
- From 5 years before closure date to end of current PY, no significant change to coverage or benefit formula (certain amendments excepted)

No gateway!

DB/DC plan may test on benefits basis for such PY

For each PY beginning after closure date and before 5th anniversary of closure date, the plan must have passed 401(a)(4) under 1 of 3 tests

- Each DB plan passes w/o aggregation
- DB/DC plan passes on a CONTRIBUTIONS basis
- DB/DC plan satisfies "primarily DB" test or the "broadly available" test

Proposed Regulations: Effective Date

Plan years beginning after publication date of final regulations

Early application: Plan years beginning on or after 1/1/2014

Does not apply to:
- ✓Averaging of DC allocation rates to meet DB/DC plan gateway
- ✓Option to include match in aggregate normal allocation rates
- ✓6% interest rate exception to gateway

fi·du·ci·ar·y [fi-doo-shee-er-ee]

Definition of a fiduciary, p.29

CURRENT LAW	PROPOSAL
• Performed On Regular Basis • Mutual Understanding Advice Will Be Used As Primary Basis For Investment Decision • N/A To Rollovers/Distribs • N/A To Appraisals	• May Be One-off Advice • Primary Basis For Investment Decision Not Required • Applies To Rollovers/Distribs • Still N/A To Appraisals

Effective 6/7/16; Applicable 4/10/17; Transition Rules 4/10/17-1/1/18

Elements of being an investment advice fiduciary under proposal

Investment Advice is provided

To a Recipient

In a fiduciary capacity

For a fee or compensation

Elements of being an investment advice fiduciary under proposal

Investment Advice is provided

Recommendation (p.32) on:
- Sale, purchase or holding of securities or other investment property, or
- Recommendations with respect to rollovers, transfers, or distributions (what amount, in what form, to what destination, and type of investments after assets are rolled over, transferred or distribution (supersedes Advisory Opinion 2005-23A)
- Management of securities or other investment property, including investment policies or strategies, portfolio, selection of other persons to provide investment advice or investment mgmt services, selection of account arrangement (e.g., brokerage or advisory)

Elements of being an investment advice fiduciary under proposal

Investment Advice is provided

What is a Recommendation?
- Communication initiated by a person or software program
- Based on content, context, and presentation
- Would reasonably be viewed as a suggestion that the advice recipient take a specific course of action
- The more individually-tailed, the more likely it is a recommendation
- Consistent with FINRA Policy Statement 01-23

What is Investment Property?
- Does not include health insurance, disability insurance, term life insurance, or other property w/o an investment component

Elements of being an investment advice fiduciary under proposal

Investment Advice is provided

To a recipient

Plan
Plan fiduciary
Plan participant
Plan beneficiary
IRA
IRA owner

Elements of being an investment advice fiduciary under proposal

Investment Advice is provided

To a recipient

In a fiduciary capacity

- **Representation of fiduciary status with respect to advice, or**
- **Functional analysis**
  - **Based on particular investment needs**
  - **Directed to specific advice recipient regarding advisability of a particular investment or management decision**

Elements of being an investment advice fiduciary under proposal

- Explicit fee or compensation received by fiduciary or affiliate from any source
- Any other fee or comp from any source in connection with purchase or sale, or the provision of investment advice services
- Includes brokerage fee, mutual fund and insurance commissions, finders fees, revenue sharing, payments for shelf space, gifts and gratuities, expense reimbursements
- In connection with if wouldn't be paid but for transaction or service, or eligibility for fee/comp based in whole or part on the transaction or service

For a fee or compensation

Platform Providers

EXCEPTIONS (NOT CONSIDERED TO BE INVESTMENT ADVICE)

- Marketing material; must state not providing advice (p.36)
- Identifies investment options that meet objective criteria specified by plan fiduciary
- Provides objective financial data and comparisons with independent benchmark
- Can't advise on individual needs
- Plan fiduciary is independent of provider

General Communications

EXCEPTIONS (NOT CONSIDERED TO BE INVESTMENT ADVICE)

- Reasonable person would not view as an investment recommendation
  - ✓ Newsletters
  - ✓ Talk shows
  - ✓ Speeches, conferences
  - ✓ News reports
  - ✓ Marketing materials
  - ✓ General market data, price quotes
  - ✓ Performance reports
  - ✓ Prospectuses

Investment Education

EXCEPTIONS (NOT CONSIDERED TO BE INVESTMENT ADVICE)

- Replaces IB 96-1 (p.37)
- Plan Information (incl. investment alternatives
- General financial, investment, retirement information
- Asset allocation models and interactive materials
- Reference to specific DIAs in model or materials if independent fiduciary has oversight; identify other DIAs with similar risk and return characteristics

EXCEPTIONS (NOT CONSIDERED TO BE FIDUCIARY IN NATURE)

Employees

- Advising plan fiduciary, EE, indep contractor; no comp other than normal comp as an EE; more ltd if participant

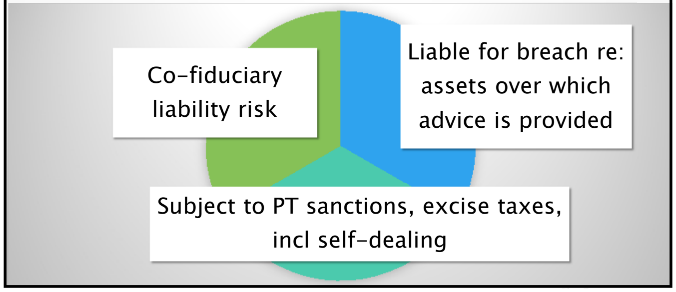
Financial expertise

Advice provided to bank, insurance co, investment adviser, broker-dealer or idependent fiduciary with $50 million or more under management or control; no direct comp from recipient for advice

Swaps

Recommendations made by swap dealer, swap participant or swap clearing firm to indep fiduciary who acknowledges it understands advice is not impartial

SCOPE OF FIDUCIARY DUTY FOR INVESTMENT ADVICE FIDUCIARY OF ERISA PLAN



HOW ARE IRAS & NON-ERISA PLANS AFFECTED?

- Broadens potential excise tax situations through self-dealing application
- Create enforcement mechanism through Best Interest Contract Exemption
- No DOL enforcement
- No co-fiduciary liability risk

BEST INTEREST CONTRACT EXEMPTION (P.49)

Contract
- Written Contract (IRAs/non-ERISA only)
  - Parties: Financial Insitution (F.I.) + Retirement Investor

Conduct
- Statement of fiduciary status
- Impartial Conduct Standards

Oversight
- Policies and Procedures
- Focus on Materials Conflicts of Interest
- Warranty (if contract applies)

Disclosure
- Best Interest Standard, services
- Material Conflicts of Interest
- Proprietary Products/3rd party pymts

DEFINITIONS

Financial Institution

- Registered Investment Adviser
- Bank
- Insurance Company
- Broker-dealer
- Entity approved in Individual Exemption

Adviser

- EE, contractor, agent, or rep of Financial Institution
- Satisfies applicable licensing requirements
- Fiduciary solely b/c of investment advice

DEFINITIONS

Retirement Investor

- Plan participant or beneficiary (with right to direct investments)
- IRA owner
- Retail Fiduciary: fiduciary of Plan or IRA, without financial expertise

Affiliate

- Controlled by, controlling, or under common control with, Adviser or F.I.
- Officer, director, partner, EE, relative
- Entity of which Adviser or F.I. is officer, director or partner

Contract

Must incorporate conditions of the Exemption (fiduciary status, Impartial Conduct Standards, Warranties)

- Must be executed for contracts after 1/1/18
- Existing contracts can use negative consent procedure
- No exculpatory provisions
- No limiting liability of Adviser of Financial Inst
- No bar to class actions
- May require arbitration of individual claims (but not in distant venues)
- May waive punitive damages & right to rescission of recommended transactions
- ERISA plans comply in operation; can't enter into contract that would include any prohibited provisions

Conduct

Impartial Conduct Standards, Fiduciary Statement

- Affirmative statement that Advisers act as fiduciaries under ERISA or tax code
- Best Interest standard (ERISA's prudence rule)
- Reasonable comp (ERISA sec 408(b)(2))
- No materially misleading statements
- Material Conflict of Interest: what reasonable person would conclude could affect best judgment

Oversight

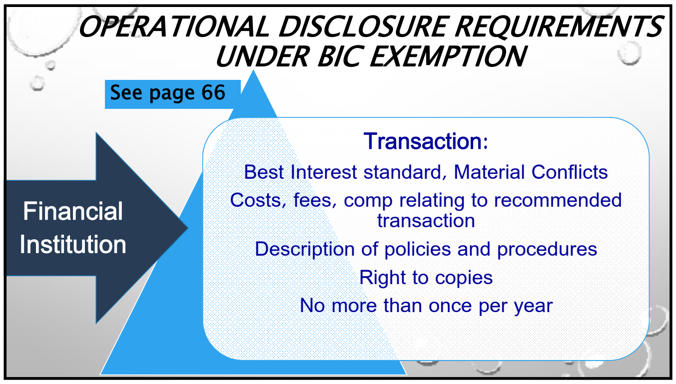
Policies and Procedures Warranties

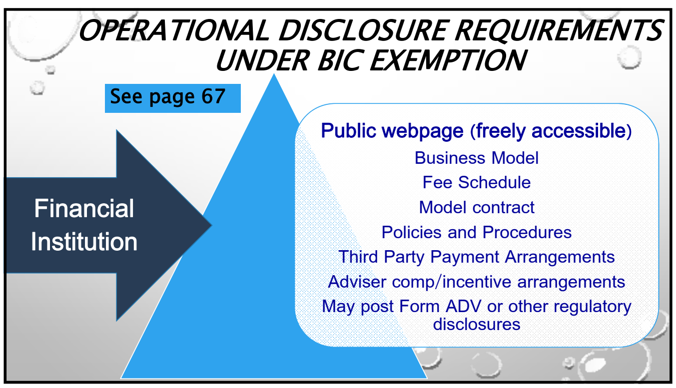
- Financial Institution adopts written policies and procedures designed to ensure compliance
- Identify Material Conflicts
- Adopt measures designed to prevent Material Conflicts
- No reliance on incentives that are intended to cause Advisers to make recommendations not meeting Best Interest Standard
- Warrantied (IRAs and non-ERISA plans)

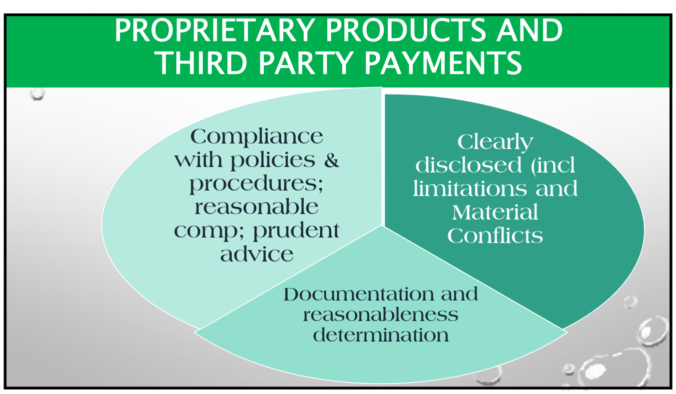
Disclosure

Affirmative disclosures by Financial Institution

- Single written disclosure
- IRA/non-ERISA plan: in contract instead
- Clearly and prominently displayed
- Best Interest standard
- Services that will be provided
- How Retirement Investor will pay
- Material Conflicts of Interest
- Fees or charges
- Right to copies
- Proprietary Products/3rd Party Payments
- Monitoring services (if applicable)
- Contact info


OPERATIONAL DISCLOSURE REQUIREMENTS UNDER BIC EXEMPTION
See page 66
Financial Institution
Transaction:
Best Interest standard, Material Conflicts
Costs, fees, comp relating to recommended transaction
Description of policies and procedures
Right to copies
No more than once per year


OPERATIONAL DISCLOSURE REQUIREMENTS UNDER BIC EXEMPTION
See page 67
Financial Institution
Public webpage (freely accessible)
Business Model
Fee Schedule
Model contract
Policies and Procedures
Third Party Payment Arrangements
Adviser comp/incentive arrangements
May post Form ADV or other regulatory disclosures


PROPRIETARY PRODUCTS AND THIRD PARTY PAYMENTS
Compliance with policies & procedures; reasonable comp; prudent advice
Clearly disclosed (incl limitations and Material Conflicts
Documentation and reasonableness determination

Additional BIC requirements

See page 71

- Pre-notice to DOL
- 6-year recordkeeping requirement for F.I.
- Right to inspection: DOL/IRS, fiduciary, ER, participants, IRA owners

Level-To-Level Rollovers (ERISA plan to IRA) p.72

- Still must comply with Fiduciary Statement and Impartial Conduct Standards
- Documentation:
  - Alternatives to rollover (incl leaving $ in plan)
  - Fees associated with both Plan andIRA
  - Whether ER pays for all or part of plan administrative expenses
  - Different levels of services and investments
- Adviser & Financial Institution must be Level Fiduciaries

Other Special Rules For Level Fiduciaries

- IRA to IRA
  - Document reasons why in Best Interest, including services to be provided for the fee)
- Switch from Commission-Based Account to Level Fee
  - Document why switch is in Best Interest and services to be provided with fee
- Robo-advice: covered only if provider of robo-advice is a Level Fee Fiduciary

Additional Relief in BIC Exemption

Page 75	Sales & Purchases (not Principal Transactions, except Riskless)	• Ordinary course of business • Arm's length • Reasonable comp • Satisfies BIC Exemption
Page 76	Pre-existing transactions	• Occurred prior to April 10, 2017 (or systematic program est before then) • Covers all forms of comp • Was not otherwise a PT

Additional Relief in BIC Exemption

Page 77	Transition Period (4/10/17-1/1/18)	• Best interest standard • More limited disclosures • Reasonable comp • Responsible compliance person • Recordkeeping
Page 69	Good faith errors; reliance on others	• Disclosure failures • Covers transition period disclosures • 30-day correction period

How Will BIC Exemption Be Enforced?

IRA Owner or Non-ERISA Plan	• Breach of Contract action
Participant/ beneficiary	• 502(a)(2) breach action • 502(a)(3) equitable relief action
DOL/IRS	• ERISA (DOL) • Excise taxes (IRS)

Extension of Impartial Conduct Standards to other PTEs

- PTE 86-128 (Fiduciary transactions) Page 88
- PTE 75-1 (Non-fiduciary broker transactions) Page 94
- PTE 77-4 (Mutual fund transactions) Page 99
- PTEs 80-83/81-3 (Reduction of indebtedness transactions; mortgage pool certificates)
- PTE 84-24 (Insurance, fixed rate annuity & mutual fund purchases) Page 100

Announcement 2015-19 (p.104)

- IDPs: DL only for new & terminated plans, eff 1-1-17
- Regular remedial amendment rules apply
  Blanket extension planned by IRS ending no earlier than 12/31/17
- IRS may announce special submission periods for amendments (or other reasons)
- No off-cycle submissions accepted effective July 1, 2015 (exception for new plans)

DL Update

- Last IDP Cycle: 2/1/16-1/31/17 (p.109)
  4/30/16 deadline for DC pre-approved plans (umbrella closing agreement program – p.108)
- No more expiration dates on DLs; expiration dates on existing DLs no longer operative
- Related Group cannot elect Cycle A for 3rd cycle unless elected it for 2nd cycle (p.105)

Migrating IDPs to Pre-Approved Plan Cycle (p.105)

Extension to April 30, 2017, to adopt a Pre-Approved Plan

- Opportunity to apply for Form5307 DL (if applicable) by April 30, 2017
- Existing IDP that hasn't adopted Pre-Approved Plan before 1/1/16
- New IDPs established on or after 1/1/16

Does NOT extend 4/30/16 deadline for Pre-Approved Plan adopters (what about 8905 adopters?)

Rollovers to SIMPLE-IRAs (p.109) Effective after 12/18/15

SIMPLE-IRA may received rollover from

* Qualified plan
* 403(b) plan
* Governmental 457(b) plan

2-year period under IRC §72(t)(6) must have passed (1st 2 taxable yrs that EE participated in the SIMPLE-IRA

Obergefell v. Hodges: States must recognize same-sex marriage

Impact on plans?

Minor. *Windsor* case established Federal law rights (Notice 2015-86, p.109)

Important effective dates

June 26, 2013 (*Windsor*)
September 16, 2013 (RR 2013-17)

Prop Reg adding *Windsor* definition for all code purposes

Caution!

Avoid discriminatory rules for proof of marriage;
Domestic partners are NOT spouses
Required amendment? (Notice 2014-19)
Optional amendments? Notice 2015-86

IRS "Soft" Guidance On Documentation (p.111)

Hardships	Participant Loans
➤ Request, review and approval. ➤ Substantiates financial need (P self-certification NOT ok) ➤ In accordance with applicable law and plan provisions. ➤ Proof of the actual distribution; Form 1099-R	➤ Application, review and approval process ➤ Executed plan loan note. ➤ Verifying purchase or construction of primary residence (no self-certification) ➤ Loan repayments. ➤ Collection activities after default and related 1099-R

IRS Shuts Down De-Risking Lump Sum Programs For Retirees Under DB Plans (Notice 2015-49, p.112)

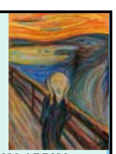
What is it?

- ✓**Retirees in pay status get a one-time lump sum election**
- ✓**Eliminates plan's future risk to fund benefit**

How Did They Stop It?

- ✓**Prohibit plan amendments that allow lump sum to be elected by retiree after annuity starting date**
- ✓**May amend to increase annuity payments**
- ✓**Effective July 9, 2015**
- ✓**Pre-Notice Accelerations permitted**

➢EBSA Interpretive Bulletin on State Run Plans (Eff. 11-18-15) (p.114)



- ERISA preemption issues for State programs open to private sector ERs
  - Program must be voluntary
  - ERISA requirements, liability provisions & enforcement rules FULLY APPLY
- Endorsement of Washington State Small Business Retirement Savings Marketplace (Marketplace Approach)
  - State connects eligible ERs with qualifying savings plans (ERISA & non-ERISA)
- State-sponsored prototype plan
  - Adopting ER assumes ERISA responsibility
  - State or 3rd party could be named fiduciary or plan administrator
  - Primary fiduciary responsibility for administrative and asset management functions could be moved away from the adopting ER
  - State could designate low-cost investment options and a TPA for prototype

EBSA Interpretive Bulletin on State Run Plans (Eff. 11-18-15)

State-run open MEPs (p.115)

- Would be subject to ERISA
- State is plan sponsor, named fiduciary & plan administrator (may use contracted 3rd party private sector providers)
- Treated as a single plan (one 5500, one audit)
- Grants advantage over private sector MEPs: deems state to sufficient nexus to ERs (interest in welfare of citizens)
- Could be DB plan
- ER could have very limited fiduciary responsibility (i.e., duty to prudently select arrangement and monitor its operation)
  - State could get Advisory Opinion on shifting of fiduciary roles
- State would be market participant rather than regulator, so no preemption

State sovereignty laws protecting EEs from suit could create ERISA preemption issue

Surface Transportation and Veterans Health Care Choice Improvement Act of 2015

C corporation returns (post-2015): 15th day of 4th month (e.g., April 15); 6-mo ext available (5 mos before 2026) (p.118)

Special rule for June 30 C corporations: not effective until 2026 (stay on 15th day of 3rd month – Sept 15); 7-month extension rule before 2026)

Partnerships & S corporations: 15th day of 3rd month; 6-mo extension (instead of 5) for partnerships

Would have changed CY Form 5500 auto extension to 3-1/2 months (Nov 15) starting w/ 2016 returns, but repealed by later legislation

No more ERPAs (p.120)

Last testing window ends 2/12/2016

CE requirements continue

IRS Compliance Questions (Do NOT complete for 2015)

Question (p.120)	5500/5500-SF Line	5500-EZ Line
Is plan a 401k plan?	Sch R, Part VII, Line 20a	N/A
Is 401k SH or ADP-tested?	Sch R, Part VII, Line 20b	N/A
Current-year testing?	Sch R, Part VII, Line 20c	N/A
Ratio test or Avg Ben Test?	Sch R, Part VII, Line 21a	N/A
Permissive aggregation?	Sch R, Part VII, Line 21b	N/A
Timely amendments?*	Sch R, Part VII, Line 22a	Part V, Line 13a
Last amendment/restatement date (insert code)*	Sch R, Part VII, Line 22b	Part V, Line 13b

IRS Compliance Questions (Do NOT complete for 2015)

Question	5500/5500-SF Line	5500-EZ Line
Opinion/Advisory ltr & S/N (if applicable)	Sch R, Part VII, Line 22c	Part V, Line 13c
DL date & S/N (if applicable)	Sch R, Part VII, Line 22d	Part V, Line 13d
Maintenance in US territory?*	Sch R, Part VII, Line 23	N/A
Did plan have UBTI?*	Sch H or Sch I, Line 4o	Part V, Line 15
In-service distributions?	Sch H or Sch I, Line 4p	Part V, Line 16
Trust name, trust EIN, trustee	Sch H or Sch I, Lines 6a-6c	Part II, Lines 4a-4c
Trustee's/custodian/s phone #	Sch H or Sch I Line 6d	Part II, Line 4d

Joint Employment Relationships Interpretation of DOL's Wage & Hour Division

Application of FLSA
- ✓ Broader than ERISA's "common law EE" standard
- ✓ Horizontal joint employment
- ✓ Vertical joint employment
- ✓ Could be helpful with shared EE situations

Horizontal
- Focus on ERs
- 9 factors identified
- Compare to 2 jobs with separate ERs
  - Example with shared restaurant employment

Vertical
- Intermediary between EE and potential joint ER
- Is EE economically dependent?
  - Subcontractor example

p.128

Changes for Church Plans

CG Test
- 80% operating funds test
- Direct involvement in day-to-day ops
- NQCC
- Permissive aggregation
- Permissive Disaggregation

Grand-fathered 403(b) DB plan

▶ *415(b) limits do NOT apply*

Auto-Enrollment
- ERISA preemption
- Uniformity
- Notice & election requirements
- Default investment
- Similar to ACA

Mergers/ Transfers
- QP and 403(b) maintained by same church
- Merger OK
- Transfer OK

81-100 Group Trust
- Church plan assets
- Assets of CCO

Definition of a Church Plan

Advocate case (p.132)
7th Cir. (IL, IN, WI)
3rd Cir. agrees (DE, NJ, PA, VI)

Who can **establish** a church plan?
- Church
- Convention or association of churches

Who can **maintain** a church plan?
- Church
- Convention/ association
- Principal purpose entity (e.g., church pension board)

Plan may **cover** EEs of:
- Church
- Convention/ association
- Principal purpose entity
- Ministers
- Church controlled or affiliated org

Cash Balance Regulations: Anti-cutback Relief/Effective Dates

May round interest rates (p.168)

Regs finalized to specify how noncompliant rate should be amended (p. 135)
- ✓ Based on why rate is noncompliant
- ✓ Multiple noncompliant features: address each one separately
- ✓ Additional guidance on noncompliant cumulative floors
- ✓ Participant-directed crediting rates
- ✓ Added more options to change to third segment rate

Regulations delayed to 2017 PY; amendments due by end of 2016 PY

PBGC Premiums: Proposed Reduced Penalties for Late Payment

p.143

Normal Penalty

- 5% per month
  - $25 floor
  - 100% ceiling
- 2½% per month
  - No floor
  - 50% ceiling

Post-2015 PYs

- 1% per month
  - 50% ceiling

80% Waiver for prompt involuntary compliance:

- ✓ Plan has 5-year premium compliance history
- ✓ Premium paid within 30 days after PBGC notice

Reduced Penalty (80% of the Normal Penalty; *voluntary*)

- ½% per month; 25% ceiling

Reportable Event Regulations

PBGC

Effective for events occurring in 2016 or later (p.144)

- Small plan waiver: flat-rate premiums in prior year for 100 or fewer participants (see Table 3, p.160)
- Public company waiver: subject to SEC reporting; event reported on SEC Form 8-K
- Foreign entity waiver: not contributing sponsor, no US tax return, no reportable income other than passive income of $1,000 or less, not foreign parent, & no substantial assets in US

Reportable Event Regulations

PBGC

Financial soundness waivers:

- ❑ **Company Low-Default-Risk (p.148)**
  - ❖ Event falls within safe harbor period
    - Begins on financial information date
    - Ends no later than 13 months later
  - ❖ Financial info date based on 10-K, financial statement closing date or filing of tax return, whichever applies
  - ❖ Must meet low-default-risk standard as of financial info date

Reportable Event Regulations

- Company Low-Default-Risk
  - Low-default-risk standard
    1. Probability of default test
    2. Debt test
    3. Retained earnings test
    4. EBITDA test
    5. Income test
    6. Loan default test
    7. Plan obligations test
- Well-funded plan (no VRP for prior PY)

Must satisfy 1 & 2 or four of the 7

Reportable Event Regulations

p.145 (Deadlines) p.159 (Tables)

Post-event notice: Within 30 days after person knows or has reason to know
Table 1: Waivers
Table 2: Categories

Obligation:
- P.A. & each contrib sponsor (post-event)
- Each contrib sponsor (advance)

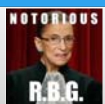
Advance notice: At least 30 days before effective date of the event
Table 2: Categories

ERISA claims: Burden of Proof

Barton case – 9th Cir (p.161) (AL, AZ, CA, HI, ID, MT, OR, NV, WA)

- ✓ Burden of proof shifts to defendant if plaintiff makes prima facie case of benefit entitlement
- ✓ Plan administrator was require plaintiff to submit documentation to show that his service was with the requisite companies w/i related group that participated in the plan, prove 1,000-hour test was met in the requisite years
- ✓ Dissent: conflicts with deferential review standard

Equitable Relief



Dissent!
Supremes have read "equitable" too narrowly

Effect on pension overpayments?

***Montanile* case, Sup Ct** (162)

Recovery by health plan of third-party payments

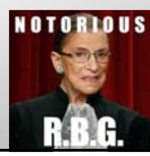
- ✓ Enforcement of subrogation claim (equitable lien by agreement)
- ✓ Participant had dissipated funds before suit was brought by plan
- ✓ Can't go after P's general assets
- ✓ Must go against indentifiable funds attributable to settlement proceeds (*Sereboff* clarified)

Preemption

***Gobielle* case, Sup Ct** (p.163)

- ✓ VT law required reporting of coverage & approved claims
- ✓ Conflicted with ERISA's R&D regime: impermissible connection

Dissent!
Supremes have read preemption too broadly



Ethics Case Studies

Ethics Case Study #1

New referral source → 50 new plans in Feb 2017 → Wants 2016 PY work done Top administrator just quit

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Ethics Case Study #1

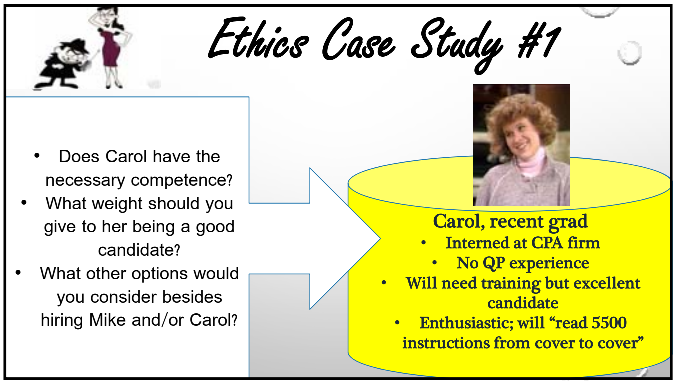
Mike from Seaver Pensions
- 10 yrs experience
- Can bring some "loyal" clients
- Non-compete agreement
- Bright. Does things "own way"
- Fired by Seaver ("too many shortcuts"). Customer complaints.

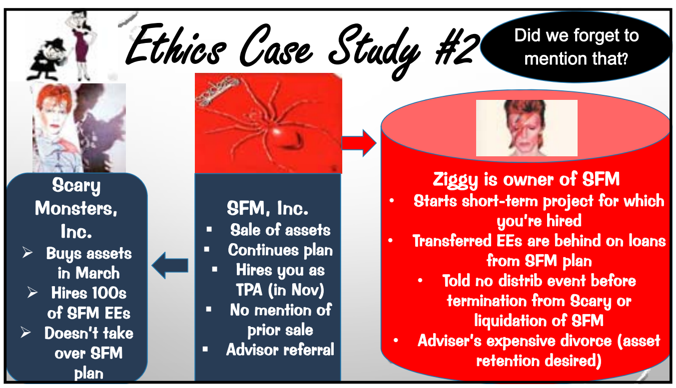
Carol, recent grad
- Interned at CPA firm
- No QP experience
- Will need training but excellent candidate
- Enthusiastic; will "read 5500 instructions from cover to cover"

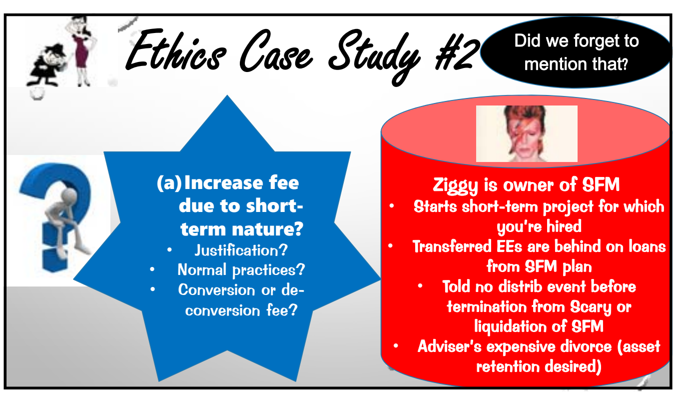
Ethics Case Study #1

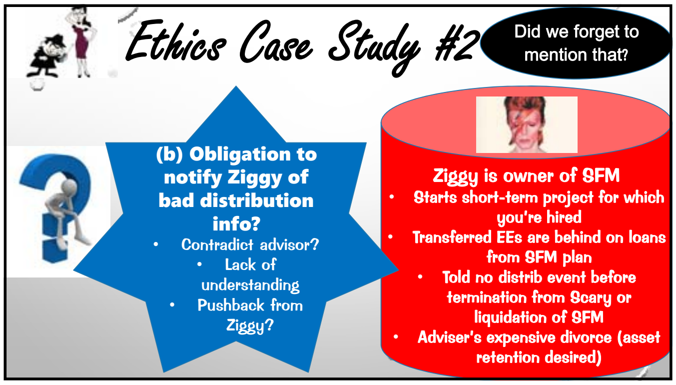
Mike from Seaver Pensions
- 10 yrs experience
- Can bring some "loyal" clients
- Non-compete agreement
- Bright. Does things "own way"
- Fired by Seaver ("too many shortcuts"). Customer complaints.

- Is Mike competent?
- What info concerns you?
- What if Mike says Seaver Pensions was unscrupulous & didn't like him following the rules?
- Would you allow Mike to bring clients over?
  - Contact the clients Mike has relationships with?

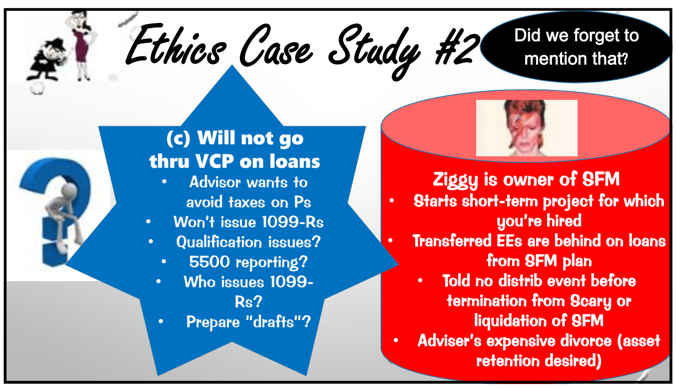

Ethics Case Study #1
• Does Carol have the necessary competence?
• What weight should you give to her being a good candidate?
• What other options would you consider besides hiring Mike and/or Carol?
Carol, recent grad
• Interned at CPA firm
• No QP experience
• Will need training but excellent candidate
• Enthusiastic; will "read 5500 instructions from cover to cover"


Ethics Case Study #2
Did we forget to mention that?
Scary Monsters, Inc.
➢ Buys assets in March
➢ Hires 100s of SFM EEs
➢ Doesn't take over SFM plan
SFM, Inc.
▪ Sale of assets
▪ Continues plan
▪ Hires you as TPA (in Nov)
▪ No mention of prior sale
▪ Advisor referral
Ziggy is owner of SFM
• Starts short-term project for which you're hired
• Transferred EEs are behind on loans from SFM plan
• Told no distrib event before termination from Scary or liquidation of SFM
• Adviser's expensive divorce (asset retention desired)

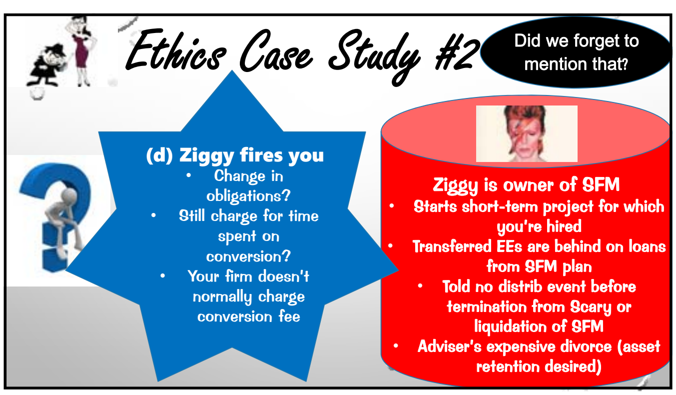

Ethics Case Study #2
Did we forget to mention that?
(a) Increase fee due to short-term nature?
• Justification?
• Normal practices?
• Conversion or de-conversion fee?
Ziggy is owner of SFM
• Starts short-term project for which you're hired
• Transferred EEs are behind on loans from SFM plan
• Told no distrib event before termination from Scary or liquidation of SFM
• Adviser's expensive divorce (asset retention desired)



Ethics Case Study #2
Did we forget to mention that?
(b) Obligation to notify Ziggy of bad distribution info?
• Contradict advisor?
• Lack of understanding
• Pushback from Ziggy?
Ziggy is owner of SFM
• Starts short-term project for which you're hired
• Transferred EEs are behind on loans from SFM plan
• Told no distrib event before termination from Scary or liquidation of SFM
• Adviser's expensive divorce (asset retention desired)



Ethics Case Study #2
Did we forget to mention that?
(c) Will not go thru VCP on loans
• Advisor wants to avoid taxes on Ps
• Won't issue 1099-Rs
• Qualification issues?
• 5500 reporting?
• Who issues 1099-Rs?
• Prepare "drafts"?
Ziggy is owner of SFM
• Starts short-term project for which you're hired
• Transferred EEs are behind on loans from SFM plan
• Told no distrib event before termination from Scary or liquidation of SFM
• Adviser's expensive divorce (asset retention desired)



Ethics Case Study #2
Did we forget to mention that?
(d) Ziggy fires you
• Change in obligations?
• Still charge for time spent on conversion?
• Your firm doesn't normally charge conversion fee
Ziggy is owner of SFM
• Starts short-term project for which you're hired
• Transferred EEs are behind on loans from SFM plan
• Told no distrib event before termination from Scary or liquidation of SFM
• Adviser's expensive divorce (asset retention desired)

Ethics Case Study #3

SHAKE IT OFF

Suspicious activity

- No 2014 allocation to Bob (Term. Early 2015)
  - Confusion with last day rule?
- Taylor promises to fix; she has loan payment due
- Taylor asks 2015 year-end work to be expedited
- Bob's 2014 allocation was deposited to Taylor's account
  - Still not fixed when you check in 2016
- 2 terminees in early 2016 didn't get 2015 allocations
  - Taylor's loan from her acct is now paid off
  - You have not yet notified Tom, the owner

Ethics Case Study #3

SHAKE IT OFF

(a) Should you bring your concerns to someone in authority?
- Who is your client?

Suspicious activity

- No 2014 allocation to Bob (Term. Early 2015)
  - Confusion with last day rule?
- Taylor promises to fix; she has loan payment due
- Taylor asks 2015 year-end work to be expedited
- Bob's 2014 allocation was deposited to Taylor's account
  - Still not fixed when you check in 2016
- 2 terminees in early 2016 didn't get 2015 allocations
  - Taylor's loan from her acct is now paid off
  - You have not yet notified Tom, the owner

Ethics Case Study #3

SHAKE IT OFF

(b) Sufficient to tell record-keeper or advisor rather than Tom?

Suspicious activity

- No 2014 allocation to Bob (Term. Early 2015)
  - Confusion with last day rule?
- Taylor promises to fix; she has loan payment due
- Taylor asks 2015 year-end work to be expedited
- Bob's 2014 allocation was deposited to Taylor's account
  - Still not fixed when you check in 2016
- 2 terminees in early 2016 didn't get 2015 allocations
  - Taylor's loan from her acct is now paid off
  - You have not yet notified Tom, the owner

Ethics Case Study #3

Suspicious activity

(c) You tell Tom

- Asks for investigation
- Refuses to pay additional fee
- "You should have paid better attention"
- Assist without payment?

- No 2014 allocation to Bob (Term. Early 2015)
  - Confusion with last day rule?
- Taylor promises to fix; she has loan payment due
- Taylor asks 2015 year-end work to be expedited
- Bob's 2014 allocation was deposited to Taylor's account
  - Still not fixed when you check in 2016
- 2 terminees in early 2016 didn't get 2015 allocations
  - Taylor's loan from her acct is now paid off
  - You have not yet notified Tom, the owner

Ethics Case Study #3

Suspicious activity

(d) Have recordkeeper freeze Taylor's account?

- Fiduciary action?
- Reallocation?

- No 2014 allocation to Bob (Term. Early 2015)
  - Confusion with last day rule?
- Taylor promises to fix; she has loan payment due
- Taylor asks 2015 year-end work to be expedited
- Bob's 2014 allocation was deposited to Taylor's account
  - Still not fixed when you check in 2016
- 2 terminees in early 2016 didn't get 2015 allocations
  - Taylor's loan from her acct is now paid off
  - You have not yet notified Tom, the owner

Ethics Case Study #4

Crusher & McCoy, P.C.
(Medical Practice)

- Key referral source brings them to you
- You will work 401k
  - DB plan
- Actuarial firm mistakes
  - CPA has done DB 5500s
- Advisor wants you to take over 5500 for DB

(a) Should you accept engagement?

- Competence to prepare DB 5500?
- Reliance on information provided by actuarial firm?

(b) Special circumstances or caveats?

- Engage an independent actuary?
- Charge C&M for extra review?

(c) Suppose actuarial firm has not made mistakes that anyone knows of?

2016 CAPITAL FORUM ON PENSIONS

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Table of Contents

Table of Federal Circuit Court Jurisdictions

In many of the court citations provided in this book, reference is made to a Federal judicial circuit, which is the federal appellate court. The U.S. States and territories are divided among thirteen federal circuits. The following table identifies the jurisdiction of each circuit.

Circuit	Jurisdiction
First (abbreviated 1st Cir.)	Maine, Massachusetts, New Hampshire, Puerto Rico, Rhode Island
Second (abbreviated 2nd or 2d Cir.)	Connecticut, New York, Vermont
Third (abbreviated 3rd or 3d Cir.)	Delaware, New Jersey, Pennsylvania, Virgin Islands
Fourth (abbreviated 4th Cir.)	Maryland, North Carolina, South Carolina, Virginia, West Virginia
Fifth (abbreviated 5th Cir.)	Mississippi, Louisiana, Texas
Sixth (abbreviated 6th Cir.)	Kentucky, Michigan, Ohio, Tennessee
Seventh (abbreviated 7th Cir.)	Illinois, Indiana, Wisconsin
Eighth (abbreviated 8th Cir.)	Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota, South Dakota
Ninth (abbreviated 9th Cir.)	Alaska, Arizona, California, Hawaii, Idaho, Montana, Oregon, Nevada, Washington
Tenth (abbreviated 10th Cir.)	Colorado, Kansas, New Mexico, Oklahoma, Utah, Wyoming
Eleventh (abbreviated 11th Cir.)	Alabama, Florida, Georgia
District of Columbia (abbreviated D.C. Cir.)	Washington, D.C.
Federal (abbreviated Fed. Cir.)	Washington, D.C.

CURRENT DEVELOPMENTS

Safe Harbor 401(k) Plans

IRS provides guidance on mid-year changes to safe harbor plans and safe harbor notices [Citation: *Notice 2016-16*, I.R.B. 2016-7 (February 16, 2016)]
Text available at http://1.usa.gov/1PJU76SEO

The IRS has finally issued guidance on what types of mid-year changes to safe harbor plans are permissible, as well as what changes can be made during the plan year to the safe harbor notice that has already been provided to employees. Notice 2016-16 is effective for mid-year changes made on or after January 29, 2016. The guidance is very flexible and practical. The approach taken by the IRS is to start with the assumption that all mid-year amendments are permissible, and then set forth specific types of amendments that are not permissible. This approach is actually more consistent with the regulatory language than the previous approach of warning against all mid-year amendments except as specifically authorized by the IRS. Treas. Reg. §1.401(k)-3(e)(1) provides that: (1) the plan provisions that satisfy the safe harbor requirements must be adopted before the first day of the plan year and remain in effect for the entire 12-month plan year, and (2) amendments may not be adopted to change those provisions during the plan year. The reference to "those provisions" indicates that the regulatory intent was not to preclude mid-year amendments on a broad scale, but rather to ensure that the amendments that are needed to make the plan a safe harbor are generally not changed during the plan year.

* **Definition of a mid-year change.** For purposes of this guidance, a mid-year change is either: (1) a change that is first effective *during* a plan year, but not effective at the beginning of the plan year, or (2) a change that is effective as of the beginning of the plan year, but adopted after the beginning of the plan year. See Section III.A. of Notice 2016-16.

* **General rule for mid-year changes.** A mid-year change made to a safe harbor 401(k) plan or to the plan's safe harbor notice content is permissible if: (1) the notice and election opportunity requirements described in Section III.C. of Notice 2016-16 are satisfied (explained later in this summary), in the case of a mid-year change to the plan's required safe harbor notice content, and (2) the mid-year change is not described in the list of prohibited mid-year changes in Section III.D. of Notice 2016-16. See Section III.B. of Notice 2016-16.

✪ *Exemption for mid-year changes permitted by the regulations.* Any of the mid-year changes listed below are authorized by the regulations. Accordingly such mid-year changes need not satisfy the conditions of Section III.B. of Notice 2016-16, as described above, but rather must meet the applicable regulatory conditions.

➤ The adoption of a short plan year or any change to the plan year, as permitted under Treas. Reg. §§1.401(k)-3(e)(2), (3) and (4), and 1.401(m)-3(f)(2), (3) and (4).

➤ The adoption of safe harbor plan status on or after the beginning of the plan year (e.g., adding a safe harbor 401(k) arrangement to an existing profit sharing plan that does not contain a 401(k) arrangement), as permitted under Treas. Reg. §§1.401(k)-3(f) and 1.401(m)-3(g).

➤ The reduction or suspension of safe harbor contributions, as permitted under Treas. Reg. §§1.401(k)-3(g) and 1.401(m)-3(h) (which usually takes the plan out of safe harbor status, unless an exception is satisfied).

✪ *Other possible restrictions.* The IRS also notes that the anti-cutback restrictions under IRC §411(d)(6), the nondiscrimination testing requirements under IRC §401(a)(4), and the anti-abuse provisions under Treas. Reg. §1.401(k)-1(b)(3) could affect the permissibility of mid-year changes.

* **Notice and election requirements for mid-year changes to required safe harbor notice content.** If a mid-year change affects the required safe harbor notice content, the requirements described in (1) and (2) below must be met in order for the mid-year change to be permissible. See Section III.C. of Notice 2016-16. "Required safe harbor notice content" means information that is required to be in the safe harbor notice by reason of IRC §§401(k)(12)(D) and (13)(E) and 401(m)(11)(A)(ii), and Treas. Reg. §§1.401(k)-3(d) and (k) and 1.401(m)-3(e). See Section II.C. of Notice 2016-16.

(1) Updated notice. Within a reasonable period before the effective date of the change, each employee otherwise required to be provided a safe harbor notice must be provided with an updated safe harbor notice that describes the mid-year change and its effective date. Providing the updated safe harbor notice within 30 to 90 days before the mid-year change becomes effective is deemed to be reasonable. However, where this is not practical (e.g., a retroactive amendment), the notice is treated as provided timely if it is provided as soon as practicable, but not later than 30 days after the change is adopted. Also, if the mid-year change was already reflected in the annual safe harbor notice provided before the beginning of the plan year, no updated notice is required.

(2) Election opportunity. Each employee who is required to receive the updated notice described in (1) above, must have a reasonable opportunity (including a reasonable period after receipt of the updated notice) to change his or her deferral election before the effective date of the mid-year change. A 30-day election period is deemed to be reasonable for this purpose. However, where this is not practical (e.g., a retroactive change), the employee is treated as having a reasonable opportunity to change his or her deferral election if the election opportunity begins as soon as practicable after the date the updated notice is provided, but not later than 30 days after the date the change is adopted.

* **Prohibited mid-year changes.** The following mid-year charges are prohibited, unless it is required by applicable law to be made mid-year (e.g., a change mandated by a statutory law change or a court decision).

(1) QACA vesting requirements. A mid-year change may not increase the number of completed years of service for an employee to have a vested right to the account balance attributable to safe harbor contributions under a QACA. A QACA can require up to two years of service before an employee vests in safe harbor contributions. For example, a mid-year change could not change a QACA's vesting rule from one year of service to two years of service.

(2) Narrowing group eligible for safe harbor contribution. A mid-year change may not reduce the number or otherwise narrow the group of employees eligible to receive safe harbor contributions. For example, the plan could not be amended to provide that, effective July 1 of a calendar year plan, hourly-paid employees may no longer participate in the safe harbor 401(k) plan.

(a) Changes affecting employees not yet eligible *are* permissible. This prohibition does not apply to an otherwise permissible change under eligibility service crediting rules or entry date rules made with respect to employees who are not already eligible as of the date the change is either adopted or effective to receive safe harbor contributions. For example, a mid-year amendment could change a safe harbor 401(k) plan's eligibility conditions from immediate entry to a one-year of service requirement, effective as of a date during the plan year, provided that the amendment applied to employees hired after such date.

(3) Type of safe harbor plan. A mid-year amendment may not change the type of safe harbor plan. For example, the mid-year amendment cannot change a 401(k)(12) safe harbor plan into a QACA.

(4) Certain changes to the matching formula. As a general rule, a mid-year change may not: (i) add or modify the formula used to determine matching contributions (or the definition of compensation used to determine matching contributions) if the change increases the amount of matching contributions, or (ii) add a discretionary match formula.

✪ Note that this restriction does not apply to increasing safe harbor nonelective contributions under a mid-year amendment. See Example (1) below.

(a) Exception for certain retroactive amendments. A mid-year change to increase the match is permissible if: (i) the mid-year change is adopted at least 3 months before the end of the plan year (e.g., before October 1 under a calendar-year plan), (ii) the updated safe harbor notice and election opportunity described above are provided, and (iii) the change is made retroactively effective to the beginning of the plan year and applies to the entire plan year. If the plan was making payroll-based matching contributions, as described in Treas. Reg. §1.401(k)-3(c)(5)(ii), the retroactive effective date may require an amendment to provide for matching contributions based on the entire plan year (resulting in a "true up" in some cases) in order to satisfy the nondiscriminatory matching formula requirements under Treas. Reg. §§1.401(k)-3(c)(4) and 1.401(m)(d)(4).

*** Examples.** The following examples illustrate the guidance described above. The first 7 examples are provided in Section III.E. of Notice 2016-16.

(1) Example - increase in safe harbor nonelective contribution. An employer adopts a mid-year amendment to its safe harbor 401(k) plan that increases future safe harbor *nonelective* contributions from 3% to 4% for all eligible employees. Employees otherwise required to be provided a safe harbor notice are provided both an updated notice that describes the increased contribution percentage and an additional election opportunity in accordance with the notice and election requirements described above. The mid-year change is permissible.

✪ This change would not be permissible if the amendment increased future matching contributions. However, a retroactive increase in match is permitted if the other conditions described above are satisfied. See Example (3) below.

(2) Example - reduction of safe harbor nonelective contribution. An employer adopts a mid-year plan amendment to its safe harbor 401(k) plan to decrease safe harbor nonelective contributions from 4% to 3% for all eligible employees. This type of amendment is permitted under Treas. Reg. § 1.401(k)-3(g), and the requirements of that regulation, rather than Notice 2016-16, must be satisfied. The decrease will cause the plan to no longer be a safe harbor plan and it will be required to satisfy ADP testing.

(3) Example - retroactive change to increase safe harbor matching contributions. A safe harbor 401(k) plan provides for a match calculated on a payroll-period basis. A mid-year amendment adopted on August 31 increases the safe harbor matching contribution from 4% to 5%, retroactive to January 1. The amendment also changes from a payroll-period match calculation to an entire-plan-year match

calculation. Due to the retroactive effective date of the change, it is not practicable for the plan to provide an updated safe harbor notice and additional election opportunity to employees prior to the January 1 effective date. On September 3, the first date that an updated notice and additional election opportunity can practicably be provided, employees otherwise required to be provided a safe harbor notice are provided an updated notice that describes the increased contribution percentage and given an additional 30-day election period starting September 3, which complies with the notice and election requirements described above. The mid-year amendment is permissible.

(4) Example - addition of in-service withdrawal provision. A mid-year amendment is made to a safe harbor 401(k) plan to add an age 59 ½ in-service withdrawal feature. Employees otherwise required to be provided a safe harbor notice are provided both an updated notice that describes the withdrawal feature and an additional election opportunity in accordance with notice and election requirements described above. The amendment is permissible. Note that the notice and election requirements were necessary because distribution provisions are included in the required content of the safe harbor notice.

(5) Example - change in investment options. A mid-year amendment to a QACA changes the default investment fund from Fund X to Fund Y. Employees otherwise required to be provided a safe harbor notice are provided both an updated notice that describes Fund Y as the default investment fund and an additional election opportunity, in accordance with the notice and election requirements described above. The mid-year change is permissible. Note that the notice and election requirements were necessary because information about the default investment is required in a safe harbor notice for a QACA.

(6) Example - change in type of safe harbor plan. A mid-year amendment changes a 401(k)(12) safe harbor plan into a QACA. This is an impermissible type of change. However, the employer could add an auto-enrollment feature under the 401(k)(12) safe harbor plan that takes effect during the plan year, as long as the notice and election requirements described above are satisfied.

(7) Example - change of entry date. A mid-year amendment changes the entry date for commencement of participation under a safe harbor 401(k) plan from monthly to quarterly. The amendment also changes plan rules regarding arbitration of disputes. The amendment is effective with respect to employees who are not already eligible to participate in the safe harbor plan. The mid-year amendment is permissible. Furthermore, since the safe harbor notice is not required to include the plan entry date or information on arbitration procedures, an updated safe harbor notice and additional election opportunity are not required.

(8) Example - expansion of coverage. A safe harbor 401(k) plan covers only salaried employees. The plan year is the calendar year. In June, the employer adopts an amendment to allow hourly-paid employees to participate in the plan, effective July 1. This mid-year change is permissible. The notice and election requirements described above do not apply because the exclusion of hourly-paid employees was not part of the required safe harbor notice content. Of course, the hourly-paid employees must receive a timely safe harbor notice (e.g., by July 1 for those who become newly eligible as of that date).

(9) Example - change in allocation method for profit sharing contributions. A safe harbor 401(k) plan also provides for a discretionary profit sharing contribution, which is allocated under a permitted disparity formula. Only participants employed on the last day of the plan year share in the profit sharing allocation. A mid-year amendment is adopted that changes the allocation method to a new comparability formula. This amendment doesn't violate the ant-cutback rule under IRC §411(d)(6) because the last day

employment rule means that no participants have accrued a protected right to the permitted disparity allocation at the time the amendment is adopted and made effective. Since information about other contributions is part of the required safe harbor notice content, the notice and election requirements described above are applicable. If those requirements are satisfied, the mid-year amendment is permissible.

* **Section 403(b) plans.** The same principles apply to mid-year changes to section 403(b) plans that apply the ACP safe harbor rules pursuant to IRC §403(b)(12). See Section IV of Notice 2016-16.

* **Announcement 2007-59.** Announcement 2007-59 had allowed for certain mid-year changes to be made to add a designated Roth contribution arrangement or to change certain hardship withdrawal changes). Announcement 2007-59 is revoked by Notice 2016-16. Notice 2016-16 would allow any of the changes described in Announcement 2007-59.

* **Comments.** In Section V of Notice 2016-16, the IRS asks for comments as to whether additional guidance is needed to address mid-year changes. In particular, the IRS is interested in mid-year changes that arise with respect to mergers and acquisitions or to plans that have eligible automatic contribution arrangements (EACAs) under IRC §414(w).

* **What is the status of changes made before January 29, 2016?** Some practitioners made a practical decision to advise employers to make certain mid-year amendments that not modify the safe harbor provisions under the plan. If these amendments would otherwise be permissible under Notice 2016-16, will the IRS nonetheless take the position that the amendments were not permissible unless they were permitted under the regulations or other guidance issued by the IRS? It is anticipated that the IRS will not take any adverse action under these circumstances, but it would helpful for them to formally say so. The IRS' previous "position" that mid-year amendments were generally not permissible was never formally stated in guidance. Furthermore, those practitioners and plan sponsors who decided to make mid-year amendments that didn't change the safe harbor provisions in the plan were reasonably interpreting the language in Treas. Reg. §1.401(k)-3(e)(1), which is cited in Notice 2016-16 as the basis of the guidance provided in the notice.

Disaggregation of Otherwise Excludable Employees

Chief Counsel of IRS confirms use of statutory entry dates for determining otherwise excludable employees; recognizes acceptability of other identification methods [Citation: *CCA 201615013* (April 8, 2016)]
Text available at http://1.usa.gov/1WV366r

The IRS Chief Counsel for Tax Exempt & Government Entities was asked its position on whether "otherwise excludable employees" can be determined by taking into account the maximum entry date rule under IR §410(a)(4). IRC §410(a)(4) provides that, unless excluded for reasons other than age or service, an employee who has satisfied the statutory minimum age and service requirements (i.e., one year of service and attainment of age 21) must become a participant no later than the *earlier* of: (1) 6 months after completing the statutory minimum age and service requirements, or (2) the first day of the plan year following the plan year in which such requirements are satisfied.

IRC §410(b)(4)(B) allows for the disaggregation of "otherwise excludable employees" (i.e., employees who have not satisfied the statutory minimum age and service requirements) when determining compliance with the coverage rules under IRC §410(b). Plans electing this testing method must perform separate coverage tests with respect to both groups: (1) the employees who are not otherwise excludable employees ("statutory employees") and (2) the otherwise excludable employees. See Treas. Reg. §§1.410(b)-6(b)(3) and 1.410(b)-7(c)(3). IRC §401(k)(3)(F) also permits an ADP test to be un by disregarding the NHCs who have not met the minimum age and service requirements of IRC §410(a)(1)(A), but only if the plan elects to disaggregate otherwise excludable employees for coverage testing, pursuant to IRC §410(b)(4)(B). IRC §401(m)(5)(C) provides a parallel rule for ACP testing.

The regulations do not provide specific guidance on how otherwise excludable employees should be identified. In particular, it has been unclear whether an employee can be treated as an otherwise excludable employee beyond the date as of which he or she has completed the statutory minimum age and service requirements, until either the plan's entry date or the statutory entry dates under IRC §410(a)(4). There also has been an issue as to the special testing rule under IRC §401(k)(3)(F) and IRC §401(m)(5)(C) regarding whether the NHCs excluded from the ADP and ACP tests under such rule can include NHCs who have completed the statutory age and service requirements but have not reached the plan entry date or the statutory entry date prior to the end of the plan year. CCA 201615013 addresses these issues.

Based on the language in the statute and the regulations, the TEGE Chief Counsel's Office concludes that there is room for three interpretations: (1) recognition of the statutory entry dates under IRC §401(a)(4) (regardless of the plan's entry date system), (2) recognition of the plan's entry date rules, or (3) no waiting period beyond the date on which the employee attains age 21 and completes the one year of service requirement (regardless of the plan's entry date system). These interpretations are acceptable both for applying the separate coverage tests under IRC §410(b)(4)(B) and the ADP and ACP tests under IRC §§401(k)(3)(F) and 401(m)(5)(C). (The memo doesn't specifically mention IRC §401(m)(5)(C), but since IRC §401(m)(5)(C) contains the same language that is found in IRC §401(k)(3)(F) there is no reason why the same analysis wouldn't apply.)

Example. A 401(k) plan requires 3 months of service and no age requirement to participate. The same eligibility conditions apply to the allocation of profit sharing contributions. The plan year is the calendar year. Under the plan's entry date system, an employee becomes a participant as of the first day of the month following completion of the 3-month requirement. Tegan is hired on July 10, 2016, and Sara is hired on December 13, 2016. They are both NHCs and they are both over age 21. They each complete 1,000 hours as of the end of their first eligibility computation period (July 9, 2017, for Tegan, and December 12, 2017, for Sara). Under the plan's eligibility conditions, Tegan becomes eligible for the plan on November 1, 2016 (i.e., the first day of the month following her completion of 3 months of service on October 9, 2017), and Sara becomes eligible for the plan on April 1, 2017 (i.e., the first day of the month following her completion of 3 months of service on March 12, 2017). The plan elects to disaggregate otherwise excludable employees for coverage testing purposes, pursuant to IRC §410(b)(4)(B). The plan also elects to apply the special ADP and ACP testing rule under IRC §§401(k)(3)(F) and 401(m)(5)(C), thereby excluding NHCs from the test if they haven't completed the statutory minimum age and service requirements.

✪ *2016 plan year.* Only Tegan is eligible for the plan in the 2016 plan year (October 1 through December 31, 2016). She is in the otherwise excludable group for 2016, regardless of which method the plan uses, because she doesn't complete the year of service until July 9, 2017.

✪ *2017 plan year.* For the 2017 plan year, both Tegan and Sara are eligible for the plan. Whether they are in the otherwise excludable group for the 2017 plan year depends on which approach the plan takes to identify otherwise excludable employees.

✓ If the plan takes into account the statutory entry dates under IRC §410(a)(4), both Tegan and Sara are also otherwise excludable employees for the 2017 plan year. Under the statutory entry date rules, both of them would not become eligible for the plan until January 1, 2018.

✓ If the plan takes into account the plan's entry date system, *only Sara is an otherwise excludable employee* for the 2017 plan year. Under the plan's entry date system, Tegan would become eligible on August 1, 2017, if the plan required her to earn a year of service to become eligible, but Sara wouldn't become eligible until January 1, 2018 (i.e., the month following her completion of a year of service on December 12, 2017).

✓ If the plan takes into account no waiting period, they both are in the *statutory employee group* and neither is an otherwise excludable employee for the 2017 plan year. Under this approach, neither the statutory entry dates nor the plan's entry date system is taken into account. Since both of them complete a year of service during the 2017 plan year (Tegan on July 9, 2017, and Sara on December 12, 2017), they are not disaggregated under the otherwise excludable employee rule.

The three methods illustrated above may be used in applying the disaggregated coverage testing rule under IRC §410(b)(4)(B) as well as the special ADP and ACP testing rule under IRC §§401(k)(3)(F) and 401(m)(5)(C).

Nondiscrimination Testing Under IRC §401(a)(4)

Proposed regulations provide testing relief for certain closed DB plans, and modify testing rules for DB/DC plans; proposed regulations that would require allocation formulas or benefit formulas to reflect reasonable classification will be withdrawn [Citation: *Prop. Treas. Reg. §§1.401(a)(4)-2(c), 1.401(a)(4)-3(c), 1.401(a)(4)-4(d)(8), 1.401(a)(4)-8(b)(1), 1.401(a)(4)-9(b)(2), 1.401(a)(4)-12, and 1.401(a)(4)-13(a)(4)*, 81 F.R. 4976-4986 (January 29, 2016); *Announcement 2016-16* (April 14, 2016)]
Text available at http://1.usa.gov/1Sg03VO (proposed regulations), http://1.usa.gov/1VYXvLw (Announcement 2016-16)
EOB2015 sections affected: Chapter 9, Section IV, Part B.4.b., Part C and Part E, Section IX, Part B.5., and Section X, Part D

The primary purpose of these proposed regulations is to provide relief from certain nondiscrimination testing requirements with respect to a closed defined benefit (DB) plan, where additional benefits are provided to a grandfathered group of employees. However, the IRS also has included some other changes to the 401(a)(4) regulations, including a proposal to require compliance with the reasonable classification test when a rate group is relying on the average benefits test, and to provide some additional flexibility in testing DB/DC plans on a benefits basis. Fortunately, Announcement 2016-16 announces that the IRS will withdraw the portion of these proposed regulations the would require compliance with the reasonable classification test. These new rules generally would apply to plan years beginning after the publication of final regulations in the Federal Register, but some exceptions would apply. See ¶6 below for details on the effective date.

¶1. Rate group testing under the average benefits test. Under current regulations, if a rate group under Treas. Reg. §1.401(a)(4)-2(c) or §1.401(a)(4)-3(c) relies on the average benefits test to show compliance with IRC §410(b), the coverage ratio for that rate group is not required to pass the reasonable classification test. Under Prop. Treas. Reg. §1.401(a)(4)-2(c)(3)(ii)(A), the formula that is used to determine the allocation for the HCE with respect to whom the rate group is established would have to apply to a group of employees that satisfies the reasonable classification requirement of Treas. Reg. §1.410(b)-4(b) in order for the rate group to be able to rely on the average benefits test. The same rule would apply to the benefit formula applicable to the HCE with respect to whom the rate group is established under a defined benefit plan. See Prop. Treas. Reg. §1.401(a)(4)-3(c)(2). If the allocation formula or benefit formula could not satisfy the reasonable classification test, the rate group would have to satisfy IRC §410(b) by using the ratio percentage test (i.e., a ratio percentage of 70% would be required).

> ***Will be withdrawn.*** **In Announcement 2016-16, the IRS announced that it will withdraw this part of the regulations. This will avoid uncertainty in designing new comparability plans and other similar programs where certain allocation rates or benefit accrual rates are provided to a select group of employees. This would have been especially difficult in the context of plans maintained by small employers, and plans covering multiple owners with different retirement savings objectives.**

¶2. Definitions relating to closed DB plans. The following definitions would be added to Treas. Reg. §1.401(a)(4)-12 for purposes of applying the special testing rules described in ¶3, ¶4 and ¶5 below that relate to closed DB plans.

(1) Closed DB plan. A closed DB plan means a defined benefit plan that has been amended to: (1) cease accruals under a benefit formula provided by the plan for some or all employees whose benefits were previously determined under that formula, or (2) limit participation in the plan to a group of employees that consists of some or all of the plan participants who participated in the plan as of the closure date (as defined in (2) below). See Treas. Reg. §1.401(a)(4)-12, *Closed defined benefit plan*.

(2) Closure date/closure amendment. The closure date means the day before accruals cease or participation is limited pursuant to a closure amendment (i.e., the amendment that results in a closed DB plan). See Treas. Reg. §1.401(a)(4)-12, *Closure amendment* and *Closure date*. Also see the note at the end of ¶4(3)(b) below regarding a deemed closure date for a defined benefit plan maintained by a former employer that is maintained by an employer pursuant to a merger or acquisition.

(3) Grandfathered group of employees. A grandfathered group of employees with respect to a closure amendment is the group of employees who, after the closure date, either: (i) continue accruals under the closed DB plan, or (ii) are entitled to an allocation formula under a defined contribution plan because those employees previously participated in the closed DB plan (e.g., employees who receive a DB replacement allocation, as discussed in ¶4 below). See Treas. Reg. §1.401(a)(4)-12, *Grandfathered group of employees*.

¶3. Modified gateway rules for DB/DC plans to test on a benefits basis. When permissively aggregated plans include at least 1 DB plan and at least 1 DC plan, the aggregated plans are referred to as a "DB/DC plan" under the coverage and nondiscrimination testing regulations. Treas. Reg. §1.401(a)(4)-9(b)(2)(v) addresses when a DB/DC plan is eligible to be tested on a benefits basis. Normally, the DB/DC plan must satisfy one of the following three tests in order to test on a benefits basis: (1) the DB/DC plan is primarily DB in character, as prescribed by Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(B)), (2) the DB/DC plan consists of broadly available separate plans if the DB portion and the DC portion were looked at as separate plans, in accordance with the rules under Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(C)), or (3) the aggregate normal allocation rate of the NHCs satisfies the gateway requirements under Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(D). See Treas. Reg. §1.401(a)(4)-9(b)(2)(v). The proposal would modify the manner in which the aggregate normal allocation rates of the NHCs are determined (see (1) below), and would allow benefits testing by a DB/DC plan that can meet one of two additional testing options, one for closed DB plans (see (2) below), and one for plans that can satisfy an alternative nondiscrimination test using a lower interest rate assumption (see (3) below).

(1) Modifications to the determination of aggregate normal allocation rates. The proposed regulations would expand the options available for averaging the rates of the NHCs (see (1)(a) below) and to permit the inclusion of matching contributions (see (1)(b) below) to demonstrate compliance with the gateway test.

(1)(a) Averaging the rates of NHCs. The gateway test imposes a minimum percentage for each NHC's aggregate normal allocation rate (i.e., the sum of the equivalent allocation rate of the benefits, if any, accrued by the NHC under the DB plan and the normal allocation rate, if any, of such NHC under the DC plan). To determine an NHC's aggregate normal allocation rate, the current regulations allow the plan to treat each NHC who benefits under the DB plan that is part of the DB/DC plan as having an equivalent allocation rate equal to the average equivalent allocation rate of all NHCs who benefit under the DB plan. This makes it simpler to calculate each NHC's aggregate normal allocation rate, because the same equivalent allocation rate can be added to the allocation rate for each NHC who also benefits under the DC plan that is part of the DB/DC plan. Prop. Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(D)(3) would be amended to add more flexibility here. Prop. Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(D)(3)(ii) would allow the aggregate normal allocation rate of the NHCs who benefit under the DC plan that is part of the DB/DC plan to reflect the average of the allocation rates for all NHCs who benefiting under that DC plan. Coupled with the averaging rule for equivalent allocation rates under the DB plan, this would enable the plan to demonstrate compliance with the gateway test by computing an average equivalent allocation rate under the DB plan and an average allocation rate under the DC plan, resulting in just three possible aggregate normal allocation rates for gateway purposes: (1) the average equivalent allocation rate under the DB plan for NHCs who benefit solely under the DB plan, (2) the average allocation rate under the DC plan for NHCs who benefit solely under the DB plan, and (3) the sum of the rates in (1) and (2) for NHCs who benefit under both plans. As long as (1), (2) and (3) were all at least equal to the gateway requirement, the gateway test would be satisfied.

(1)(a)(i) Cap on average rates. For purposes of the averaging rules discussed in (1)(a) above, the proposed regulations would require any equivalent allocation rate under the DB plan or allocation rate under the DC plan to be capped at 15% to determine the average of such rates for all NHCs. For example, if there is a group of 15 NHCs who benefit under the DB plan that is part of the DB/DC plan, and 4 of those 15 have equivalent allocation rates in excess of 15%, those 4 would be deemed to have an equivalent allocation rate of 15% to compute the average for the NHCs. However, if the equivalent allocation rates under the DB plan or the allocation rates under the DC plan are a function of age or service, where higher rates apply to older employees or longer-service employees, a 25% cap, rather than a 15% cap, would apply. See Prop. Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(D)(3)(iii). This 25% exception is designed to encourage employers to provide higher rates for longer-term employees and for employees who are closer to retirement.

(1)(b) Recognition of matching contributions. As a general rule, matching contributions may not used to assist IRC §401(a)(4) testing for other employer-provided benefits, except to the extent that matching contributions have to be taken into account in compute the average benefit ratio under the average benefits test under Treas. Reg. §1.410(b)-5. Under the proposed regulations, if an NHC is eligible for a matching contribution under the DC plan that is part of the DB/DC plan, the allocation rate of such NHC may be increased by the lesser of: (1) 3%, or (2) the average matching contribution percentage for the group of eligible NHCs in that plan. The average matching contribution percentage is the ACP for that group, as determined under Treas. Reg. §1.401(m)-5, but determined with taking into account any employee contributions. See Prop. Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(D)(4). This increase for matching contributions would apply uniformly to all of the NHCs who are eligible for the matching contribution (even if the NHC received no match because he or she didn't make an elective deferral for that plan year).

(1)(b)(i) Example - inclusion of average matching contribution percentage. A DC plan that is part of a DB/DC plan for testing purposes includes a 401(k) arrangement with a match. The plan does not allow for after tax employee contributions that would be subject to the ACP test under IRC §401(m). The ACP of the eligible NHCs for the plan year is 3.8%. The gateway test applicable for the plan year requires that each eligible NHC under the DB/DC plan have an aggregate normal allocation rate of at least 7%. The plan could treat each NHC who is eligible for a match under the DC plan as receiving a 3% allocation attributable to the match (i.e., the lesser of 3% or the ACP), regardless of the actual match received by any individual NHC. By taking into account the 3% matching contribution, the NHCs would only have to receive an additional 4% to meet the gateway, which could come from allocation of nonelective contributions under the DC plan, an equivalent normal allocation rate derived from benefits accrued under the DB plan, or a combination of the two.

✪ If the ACP of the eligible NHCs had only been 2.8%, instead of 3.8%, then the NHCs who are eligible for a match under the DC plan would be treated as receiving a 2.8% (rather than 3%) allocation attributable to match. Also, if the 3.8% ACP reflected after-tax employee contributions as well, the percentage would have to be recalculated by taking into account only the matching contributions for that year.

(2) Special testing option for DB/DC plans that include a closed DB plan. If a DB/DC plan includes a closed DB plan (as defined in ¶2(1) above) that cannot meet one of normal three tests under Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(A), the plan would still be able to test on a benefits basis if the requirements under Prop. Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(F) are satisfied, as described in (2)(a) and (2)(b) below. This special rule would apply only if the plan year for which benefits testing is being used begins on or after the fifth anniversary of the closure date (as defined in ¶2(2) above) with respect to the closed DB plan.

(2)(a) Eligibility to use this special rule. The closed DB plan would be eligible for this special rule if: (1) the plan was in effect for at least 5 years ending on the closure date, (2) for each plan year that begins after the closure date and before the 5th anniversary of the closure date, the DB/DC plan meets one of the requirements described in (2)(b) below, and (3) neither the benefit formula nor the coverage of the plan has significantly changed by plan amendment (other than the closure amendment (as defined in ¶2(2) above) with an effective date during the period that begins 5 years before the closure date and ends on the last of the plan year for which benefits testing is being used. See Prop. Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(F)(1). Certain amendments (see (2)(a)(i) below) would be disregarded to determine if the significant amendment test is satisfied. If the significant amendment test cannot be met for a plan year, then the plan would have to demonstrate that it can use benefits testing under one of the other rules prescribed by Treas. Reg. §1.401(a)(4)-9(b)(2)(v).

(2)(a)(i) Disregarded amendments. The following types of amendments would be disregarded to determine if the benefit formula or coverage under the closed DB plan has been significantly changed by plan amendment during the relevant period described in (2)(a) above: (1) an amendment adopted during the 5-year period ending on the closure date that does not increase the accrued benefit or future accruals for any employee, which does not expand coverage, and is not discriminatory within the meaning of Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(6) (discussed in ¶4(3)(b)(ii) below), (2) an amendment adopted during the 5-year period ending on the closure date that expands the benefit formula with respect to the closed DB plan to an acquired group of employees, provided that all similarly situated employees within such acquired group are treated in a consistent manner, (3) any amendment to the closed DB plan that is adopted after the closure date that would satisfy the nondiscriminatory rule under Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(6) (see ¶4(3)(b)(ii) below), (4) any *de minimis* change to the benefit formula under the closed DB plan, or (5) any amendment that is permitted in subsequently published guidance by the IRS (e.g., a notice or revenue ruling). See Prop. Treas. Reg. §1.401(a)(4)-8(b)(2)(v)(F)(3).

(2)(b) Manner of passing nondiscrimination tests. The DB/DC plan must be able to show that for each of the plan years beginning after the closure date and before the 5th anniversary of the closure date, one of the following three tests is satisfied: (1) each DB plan that is part of the DB/DC plan satisfies IRC §401(a)(4) on the basis of benefits without being aggregated with any DC plan, (2) the DB/DC plan satisfies IRC §401(a)(4) on a contributions basis, or (3) the DB/DC plan satisfies the primarily DB in character test under Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(B) or the broadly available separate plans test under Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(C). See Prop. Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(F)(2). The IRS notes in the preamble to the proposed regulations that this rule is intended to be comparable to the requirement that the group of employees who receive defined benefit replacement allocations (DBRAs) satisfies IRC §410(b). Note that this requirement is applied only for the post-closure plan years that precede the first plan year that the special rule in (2) above can be used. Think of it as a threshold testing test that must be first in order for the plan to be eligible to use this special testing rule.

(3) 6% testing rate exception. The proposed regulations provide that, if the benefits test can be satisfied by the DB/DC plan by normalizing benefits under the DC plan using a 6% interest rate assumption, rather than a standard interest rate of 7½%-8½% (as normally prescribed by Treas. Reg. §1.401(a)(4)-8(b)(2)(ii)(B)), the DB/DC plan would be entitled to pass IRC §401(a)(4) on a benefits basis. See Prop. Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(G). In other words, by being able to pass on a benefits basis using a 6% interest rate assumption, the DB/DC plan would not have to satisfy any of the other tests under Treas. Reg. §1.401(a)(4)-9(b)(2)(v) to be eligible to use benefits testing. As a general rule, when a lower interest is used, the discrepancy between equivalent benefit rates for older employees as compared to equivalent benefit rates for younger employees increases. Since HCEs usually are older in these plans, particularly in small or medium sized employers, using a 6% interest rate will tend to narrow the allocation rate differences between HCEs and NHCs to account for that increased discrepancy in equivalent benefit rates.

¶4. **Modifications to DBRA rules.** Treas. Reg. §1.401(a)(4)-8(b) prescribes rules for testing defined contribution (DC) plans on the basis of benefits to demonstrate compliance with IRC §401(a)(4). To be eligible to use benefits testing, the DC plan must meet one of the three tests: (1) have broadly available allocation rates (as defined in Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)), (2) have age-based allocation rates that are based on either a gradual age or service schedule (as defined in Treas. Reg. §1.401(a)(4)-8(b)(1)(iv)) or uniform target benefit allocations (as defined in Treas. Reg. §1.401(a)(4)-8(b)(1)(v)), or (3) a gateway contribution test applicable to the NHCs who benefit under the plan (as prescribed by Treas. Reg. §1.401(a)(4)-8(b)(1)(vi)). (Note that if the DC plan is part of a DB/DC plan for testing purposes, additional gateway requirements need to be met to test on a benefits basis, as described in ¶3 above.) Currently, Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(B) through (E) allows plans to disregard certain transitional allocations to determine if the plan meets the "broadly available allocation rates" test. These transitional allocations have to provide either a defined benefit replacement allocation (DBRA) or a pre-existing transition allocations under plan provisions adopted before June 29, 2001, or that apply to employees acquired before August 28, 2001. The proposed regulations would replace these rules with revised rules that would provide for a permanent rule and more flexibility in dealing with closed DB plans and transitional allocations provided to a grandfathered group of employees.

(1) Disregarded replacement allocations. The proposed regulations would allow a DC plan to determine whether it provides for broadly available allocation rates to apply the following two rules with respect to a DBRA (as defined in (3) below). In order to use these rules, the plan provisions would have to satisfy the requirements described in (2) below. An example of such a DBRA is shown in the example in ¶5(3)(b) below, which also illustrates the special testing rule for the DBRA under the current and effective availability tests under Prop. Treas. Reg. §1.401(a)(4)-4(d)(8) for benefits, rights and features.

(1)(a) Add-on DBRAs. For a DBRA that is provided in addition to an employee's otherwise applicable allocation under the plan, the employee's allocation rate would be determined by disregarding the DBRA. See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(B)(1).

(1)(b) Greater-of formulas. For an employee whose allocation for the plan year is the greater of the allocation for which the employee otherwise would be eligible or the DBRA, the allocation for which the employee otherwise would be eligible would be treated as the allocation currently available to the employee, even if the DBRA is the greater amount. See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(B)(2). This type of greater-of formula would be permissible by reason of Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(C)(2).

(2) Required plan provisions/design options. Plan provisions relating to DBRAs would have to specify *both* the group of employees who are eligible for the DBRAs, and the amount of the DBRAs. See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(C)(1). In addition, except as permitted under (3)(b)(i) below, these plan provisions could not be amended after the date they are both adopted and effective. See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(C)(3). (The reference to adopted *and* effective would allow a prospective DBRA provision to be amended before it becomes effective without violating this limitation.)

(3) Definition of a DBRA. In order to be a DBRA eligible for these special testing rules, the DBRA would have to apply only to a grandfathered group of employees with respect to a closed DB plan. In addition: (i) the allocation would have to be a replacement allocation, as described in (3)(a) below, (ii) the closed DB plan would have to meet the conditions in (3)(b) below, and (iii) for each plan that begins *before* the fifth anniversary of the closure date of the closed DB plan, the grandfathered group of employees must be a nondiscriminatory group. See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(1). A "nondiscriminatory group" for this purpose means a group that would satisfy IRC §410(b) if the average benefit ratio test under Treas. Reg. §1.410(b)-5 didn't have to be satisfied (i.e., the grandfathered group represents a coverage ratio that would satisfy the nondiscriminatory classification test under Treas. Reg. §1.410(b)-4). See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(4). For plan years beginning after the fifth anniversary of the closure date, the grandfathered group would not have to meet the nondiscriminatory group test in order for these special rules under (1) above to apply.

(3)(a) Requirements for a replacement allocation. A replacement allocation under a DBRA would have to meet the requirements in (3)(a)(i) and (3)(a)(ii) below. See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(2).

(3)(a)(i) Replacement value. The allocation would have to be designed so that it is reasonably expected to replace some or all of the benefit accruals that each employee in the grandfathered group would have been provided under the closed DB plan in the absence of the closure amendment. This determination is made on the basis of the terms of the plan and the IRC §415(b)(1)(A) dollar limit in effect immediately prior to the closure date. See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(2)(i).

(3)(a)(ii) Consistent treatment. The allocation would have to be provided in a consistent manner to all similarly situated employees. See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(2)(ii).

(3)(b) Requirements for the closed DB plan. The closed DB plan with respect to which the DBRA is provided would have to meet the following three conditions.

✪ *Condition #1.* The benefit formula under the closed DB that is applicable to the grandfathered group of employees must have generated equivalent normal allocation rates that increased from year to year as employees attained higher ages or were credited with additional years of service.

✪ *Condition #2.* For the plan year preceding the closure date, the plan must have satisfied the coverage and nondiscrimination testing requirements under IRC §§410(b) and 401(a)(4) without using the merger/acquisition/disposition transition rule under IRC §410(b)(6)(C), and without aggregating with another plan.

✪ *Condition #3.* The closed DB plan was in effect for the 5-year period ending on the closure date and neither the benefit formula nor the coverage of the plan was significantly changed by plan amendment with an effective date during such period (except as permitted under (3)(b)(i) below).

See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(3).

***Closed plan sponsored by a former employer.* In the case of a closed DB plan that was sponsored by a former employer (e.g., employer took over the former employer's DB plan), Condition #2 does not apply, and Condition #3 must be met only for the 1-year period ending on the closure date. See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(7)(i). Furthermore, if the employees of the former employer became the employees of the new employer as a result of a merger, acquisition or similar event, then**

the transaction is treated as a closure amendment with respect to the former employer's plan. See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(7)(iii).

(3)(b)(i) Permissible amendments. Any of the following amendments would be permissible without violating the amendment restrictions prescribed in (2) and (3)(b) above.

(3)(b)(i)(A) Amendments that don't increase benefits. An amendment to a closed DB plan that is adopted during the 5-year period ending on the closure date which: (1) does not increase the accrued benefit or future accruals for any employee, (2) does not expand coverage, and (3) is nondiscriminatory (as defined in (3)(b)(ii) below). See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(5)(i).

(3)(b)(i)(B) *De minimis* changes to DBRA. An amendment to the DC plan under which the DBRA is provided that makes *de minimis* changes to the calculation of the DBRA (e.g., a change in the definition of compensation to include IRC §132(f) elective reductions for qualified transportation fringe benefits). See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(5)(ii).

(3)(b)(i)(C) Addition or removal of a greater-of formula. An amendment to the DC plan under which the DBRA is provided that adds or removes a greater-of provision described in (1)(b) above. See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(5)(iii).

(3)(b)(i)(D) Other nondiscriminatory change. Any amendment to the DBRA under the DC plan that changes the allocation in a manner that is nondiscriminatory (as described in (3)(b)(ii) below). See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(5)(iv).

(3)(b)(i)(E) Other permissible amendments announced by IRS. Any amendment that is permitted under published guidance from the IRS (e.g., notice or revenue ruling). See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(5)(v).

(3)(b)(i)(F) Acquired employees. An amendment adopted during the 5-year period ending on the closure date that extends the coverage or benefit formula of the closed DB plan to an acquired group of employees, provided that all similarly situated employees within that group are treated in a consistent manner. See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(7)(ii).

(3)(b)(ii) Nondiscriminatory amendment. An amendment is not discriminatory if: (1) the ratio percentage *of the plan* is not decreased as a result of the amendment, and (2) in the case of a plan that does not use one of the safe harbor tests (i.e., Treas. Reg. §1.401(a)(4)-2(b) (DC design-based safe harbor), §1.401(a)(4)-3(b) (DB design-based safe harbor), §1.401(a)(4)-8(b)(3) (target benefit plan safe harbor) or §1.401(a)(4)-8(c)(3) (cash balance plan safe harbor)), the ratio percentage for the *rate group* with respect to any HCE is not decreased as a result of the amendment. See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iii)(D)(6)(i).

(4) Gradual age or service schedule. To determine if a plan meets the gateway exception for age-based allocation formulas that provide for a gradual age or service schedule, as prescribed by Treas. Reg. §1.401(a)(4)-8(b)(1)(i)(B)(2), the plan's schedule is determined without regard to a DBRA (as described

in (3) above), applying the rules described in (1) above to determine the amount to disregard. See Prop. Treas. Reg. §1.401(a)(4)-8(b)(1)(iv)(E).

¶5. Special BRF testing rule for grandfathered group under a closed DB plan. The proposed regulations would create a special testing rule for benefits, rights and features (BRFs) made available just to a grandfathered group of employees with respect to a closed DB plan. If the conditions of the regulation are met, the BRF would be treated as satisfying both the current availability test under Treas. Reg. §1.401(a)(4)-4(b) and the effective availability test under Treas. Reg. §1.401(a)(4)-4(c). See Prop. Treas. Reg. §1.401(a)(4)-4(d)(8). This exception would be in addition to the existing exceptions for BRFs available solely to an acquired group of employees, as provided in Treas. Reg. §1.401(a)(4)-4(d)(1), and for BRFs available to frozen participants (i.e., nonexcludable employees with accrued benefits who are not currently benefiting under the plan), as provided in Treas. Reg. §1.401(a)(4)-4(d)(2).

(1) General rule. For a plan year that begins on or after the 5th anniversary of the closure date with respect to a closed DB plan, a BRF under a DB plan or DC plan that is available *only* to a grandfathered group of employees with respect to the closed plan, would be deemed to satisfy the current availability and effective availability rule if: (i) no plan amendment (except as permitted under (4) below) that affects the availability of the BRF has an applicable amendment date that begins on the closure date and ends on the last day of such plan year (i.e., the amendment prohibition is an ongoing requirement that must be met continuously during the period for which this relief is sought), and (ii) meets the requirements under (2) below, if the plan is a defined benefit plan, or the requirements under (3) below, if the plan is a defined contribution plan. See Prop. Treas. Reg. §1.401(a)(4)-4(d)(8)(i). The "applicable amendment date" is determined under the Treas. Reg. §1.411(d)-3(g)(4) (i.e., the later of the effective date of the amendment or the date the amendment is adopted).

(2) Additional requirements for BRFs provided under a DB plan. If the BRF is provided under a DB plan, the following additional requirements must be satisfied: (i) the plan providing the BRF must be the closed DB plan, (ii) no plan amendment that affects the availability of the BRF has an applicable amendment date that is within the 5-year period ending on the closure date (except as permitted under (4) below), and (iii) the closure amendment that restricted the availability of the BRF, making it available only to the grandfathered employees, must also have made a significant change in the type of benefit formula under the plan (e.g., a change from a traditional benefit formula to a cash balance formula). See Prop. Treas. Reg. §1.401(a)(4)-4(d)(8)(ii). See the example in 5(a) below.

(3) Additional requirements for BRFs provided under a DC plan. If the BRF is provided under a DC plan, the BRF must be a right to a rate of matching contributions, and the following conditions are met with respect to such BRF: (i) the rate of match is designed so that the matching contributions will replace some or all of the value of the benefit accruals that each employee in the grandfathered group would have been provided under the closed plan in the absence of a closure amendment (based on the terms of that plan and the IRC §415(b)(1)(A) dollar limit in effect immediately prior to the closure date), (ii) the closed DB plan meets the requirements described in ¶4(3)(b) above, and (iii) the rate of match is provided in a consistent manner to all similarly situated employees. See the example in (5)(b) below.

(4) Permissible amendments. Any of the following amendments are disregarded in determining whether the requirements described in (1), (2) and (3) above are satisfied. If any such amendment is adopted, the requirements under (2) and (3) above are applied as if the BRF provided after the amendment was the BRF provided before the amendment. See Prop. Treas. Reg. §1.401(a)(4)-4(d)(8)(iv).

(4)(a) Extending eligibility for the BRF prior to closure date. An amendment adopted during the 5-year period ending on the closure date that extends eligibility for the BRF to an acquired group of employees provided that all similarly situated employees within that group are treated in a consistent manner. See Prop. Treas. Reg. §1.401(a)(4)-4(d)(8)(iv)(A).

(4)(b) Changes to eligibility for the BRF after closure date. An amendment adopted after the closure date that expands or restricts the eligibility for the BRF, provided that, as of the applicable amendment date, the ratio percentage of the group of employees eligible for the BRF (taking into account the plan amendment) is not less than the ratio percentage of the group of employees eligible for the BRF provided before the amendment. See Prop. Treas. Reg. §1.401(a)(4)-4(d)(8)(iv)(B).

(4)(c) Replacement of BRF with a BRF of lesser value. An amendment adopted after the closure date that results in a replacement of the BRF with BRF that is available to the same group of employees as the original BRF, provided that the original BRF is of inherently equal or greater value (as determined under Treas. Reg. §1.401(a)(4)-4(d)(4)(i)(A)) than the BRF that replaces it. See Prop. Treas. Reg. §1.401(a)(4)-4(d)(8)(iv)(C).

(4)(d) *De minimis* amendment. An amendment adopted after the closure date that results in a replacement of the BRF with another BRF that is available to the same group of employees as the original BRF, provided that there is only a *de minimis* difference between the amount payable under the original BRF and the amount payable under the BRF that replaces it. See Prop. Treas. Reg. §1.401(a)(4)-4(d)(8)(iv)(D).

(4)(e) Other permissible amendments announced by IRS. Any amendment that is permitted under published guidance from the IRS (e.g., notice or revenue ruling). See Prop. Treas. Reg. §1.401(a)(4)-4(d)(8)(iv)(E).

(5) Examples provided in the regulations. The examples below illustrate how this BRF testing relief works.

(5)(a) Example - subsidized early retirement benefit for grandfathered group of employees. Plan P, established in 2003, provides for a traditional benefit formula equal to 2% of average annual compensation multiplied by years of service. It also provides a subsidized early retirement benefit for employees who retire between the ages of 55 and 65 with at least 20 years of service. The plan satisfied coverage and nondiscrimination testing for the 2015 plan year without being permissively aggregated with another plan. The plan is amended to provide future accruals under a cash balance formula effective for the 2016 plan year. No early retirement subsidy applies with respect to the cash balance formula benefits. The cash balance formula provides for pay credits equal to 5% of compensation and an interest crediting rate of 6%. Benefits after the conversion are generally determined as the sum of the pre-2016 accrued benefit plus the post-2015 cash balance benefit. However, an employee who had attained age 50 and had completed 15 years of service before 2016, is entitled to the greater of the benefit determined under the pre-amendment formula (as if that formula continued to apply) or the "sum of" formula. No other significant amendments changing the plan's coverage or benefit formula were made during the 5-year period ending on the closure date (January 1, 2011, through December 31, 2015).

➤ The conversion amendment is a closure amendment with a closure date of December 31, 2015.

➤ The subsidized early retirement benefit is a BRF available only to the grandfathered group of employees (i.e., the employees who have benefits under the old formula that are eligible for the subsidy).

➤ For a plan year that begins after December 31, 2015 (i.e., the 5th anniversary of the closure date), is eligible for the special testing rule because the conditions described in (1) and (2) above are satisfied: (i) no other amendment that affects the availability of the early retirement subsidy is adopted after the closure date, (ii) the early retirement subsidy is provided under a closed DB plan, (iii) no amendment that affected the availability of the early retirement subsidy was adopted during the 5-year period ending on the closure date, and (iv) the plan has undergone a significant change in the benefit formula in connection with the closure amendment that resulted in the restriction of the availability of the subsidized early retirement benefit.

This is *Example 1* under Prop. Treas. Reg. §1.401(a)(4)-4(d)(8)(v).

(5)(b) Example - replacement match provided under DC plan. Assume the same facts as in (5)(a) above except that, instead of adopting a conversion amendment under the DB plan, Plan P is amended to cease future accruals for all employees. In addition, on November 1, 2015, the employer amends its 401(k) plan to provide, effective January 1, 2016, for additional matching contributions of up to an additional 4% of compensation solely for employees who were previously covered by the closed DB plan, and had attained age 50 and had at least 15 years of service on or before December 31, 2015. The matching formula is reasonably designed so that it replaces some or all of the value of the benefit accruals that would have otherwise been accrued by these employees had the DB plan not been frozen.

➤ The plan amendment freezing the DB plan is a closure amendment with a closure date of December 31, 2015.

➤ The enhanced rate of match in the 401(k) plan is available solely to the grandfathered group of employees.

➤ For a plan year that begins after December 31, 2015 (i.e., the 5th anniversary of the closure date), the enhanced rate of match is a BRF eligible for relief because it meets the requirements of (1) and (2) above: (i) no change was made to the enhanced rate of match with an applicable amendment date that is after the closure date, (ii) the BRF is a rate of match provided under a DC plan, (iii) the enhanced rate of match is reasonably designed to replace some of the value of the benefit accruals that would have been earned under the closed DB plan, and (iv) the rate of match is provided in a consistent manner to all similarly situated employees.

➤ The conditions are also met for the special DBRA rule under Treas. Reg. §1.401(a)(4)-8(b)(1)(d)(iii), as described in ¶4 above, because: (i) the prior benefit formula under closed DB plan generated equivalent normal allocation rates that increased as employees attained higher ages, (ii) the closed DB plan met coverage and nondiscrimination testing for the plan year preceding the closure date without using permissive aggregation, and (iii) the closed DB plan was in effect for the 5-year period ending on the closure date, and neither the benefit formula nor the coverage of the plan was significantly changed during this period.

This is *Example 2* under Prop. Treas. Reg. §1.401(a)(4)-4(d)(8)(v).

¶6. Effective date. The proposed regulations would become effective for plan years beginning after the publication of final regulations in the Federal Register. See Prop. Treas. Reg. §1.401(a)(4)-13(a)(4)(i) and, with respect to the rules discussed in ¶5 above, Prop. Treas. Reg. §1.401(a)(4)-4(d)(8)(vi).

(1) Earlier application. The rules described in ¶1, ¶3, ¶4 and ¶5 above may be applied to plan years that begin on or after January 1, 2014, and before the effective date. See Prop. Treas. Reg. §1.401(a)(4)-13(a)(4)(ii) and, with respect to the rules discussed in ¶5 above, Prop. Treas. Reg. §1.401(a)(4)-4(d)(8)(vi). This option is designed primarily for the benefit of closed DB plans that might prefer to use the rules in these proposed regulations rather than those that were provided on a temporary basis by Notices 2014-5 and 2015-28.

(1)(a) Early application date precluded for certain changes. The option to average allocation rates of NHCs under a DC plan included in a DB/DC plan, pursuant to Prop. Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(D)(3)(ii) (see ¶3(1)(a) above), the option to take into account matching contributions to determine the aggregate normal allocation rate under a DB/DC plan, pursuant to Prop. Treas. Reg. §1.401(a)(4)-9(b)(2)(v)(D)(4) (see ¶3(1)(b) above), and the 6% interest rate testing exception to the gateway requirement for DB/DC plans, as prescribed by Prop. Treas. Reg. §1.401(a)(4)-1(b)(2)(v)(G) (see ¶3(3) above), may not be applied before the regulations are finalized. See Prop. Treas. Reg. §1.401(a)(4)-13(a)(4)(iii).

IRS concerns about plan designs involving short service employees resurfaces; regulations must be "reasonably interpreted" to prevent discrimination in favor of HCEs [Citation: *Discriminatory Plan Designs Using Short Service*, IRS Employee Plan News, Issue No. 2016-5 (April 4, 2016)]
Text available at http://1.usa.gov/1MOF9Lr

Treas. Reg. §1.401(a)(4)-1(c)(2) (sometimes referred to as the "anti-abuse" regulation) states that the provisions of Treas. Reg. §§1.401(a)(4)-1 through 1.401(a)(4)-13 must be interpreted in a reasonable manner consistent with the purpose of preventing discrimination in favor of highly compensated employees (HCEs). October 22, 2004, the IRS headquarters in Washington, DC, issued a directive to the field which provided examples of abuses in the coverage and nondiscrimination testing area. See *Short Service Employees and Other Meaningful Benefit Schemes and Abuses*, Memorandum for Director, EP Examinations and Director, EP Determinations Redesign from Carol Gold, Director, Employee Plans (October 22, 2004), http://www.irs.gov/pub/irs-tege/directive.pdf. The directive concluded that those examples violated Treas. Reg. §1.401(a)(4)-1(c)(2). Thus, a plan "which uses plan formulas and/or hiring practices to provide substantial amounts to HCEs while severely limiting amounts payable to nonhighly compensated employees (NHCs) by targeting coverage to nonhighly compensated employees with short periods of service does not satisfy the nondiscrimination rules of section 401(a)(4) or the regulations."

✪ *Clarification.* In a letter dated February 5, 2005, the IRS clarified the intent of the 2004 directive. That letter is available at http://www.irs.gov/pub/irs-tege/shortservice_letter.pdf. In the 2005 letter, the IRS said the following (italics added for emphasis).

> "The memo of October 22, 2004, focuses primarily on plan designs which are intended to satisfy the nondiscrimination tests of section 401(a)(4) only by allocating amounts to the sponsor's lowest paid employees who may have very short periods of service. Generally, we are *focused on designs that provide allocations to the lowest paid employees who also happen to be short service employees*. It is this combination of characteristics — *lowest paid employees with short service* — that we believe has the potential to be abusive. Under this plan design, and as reflected in the two examples in the memo, the amounts allocated to the sponsor's lowest paid employees can be expected to provide minimal actual benefits to these employees.
>
> The language you quote from the memo was *not intended to set forth a separate rule where short service employees are not an issue*. Instead, the language was intended to indicate that questionable hiring practices are not a required element to a finding of discrimination. As the memo's discussion and examples demonstrate, the intent of the October 22, 2004 memorandum is to focus upon plans that attempt to satisfy the nondiscrimination tests by using nominal contributions or benefits for the lowest paid non-highly compensated employees where the nominal contributions or benefits *result from very short periods of service*. We believe that attempts to satisfy the nondiscrimination tests should and will fail where virtually all of the plan contributions or benefits, except for nominal contributions or benefits for these lowest-paid employees, are accrued by the highly compensated employees. The memo should be construed in light of this intent. We understand that some may question whether we are reversing positions on certain plan designs that the Service may previously have looked at favorably. However, the memorandum of October 22, 2004, is not intended to suggest that plan designs that have been consistently and repeatedly approved by the Service are now in question. That memorandum is

> also not intended to address any possible concerns raised by this plan design under section 401(a)(26).
> I hope this letter resolves any questions you may have regarding our memorandum of October 22, 2004."

* **Revisit of issue in EP News.** In Issue No. 2016-5 of the Employee Plans News, the IRS revisits the issue of "short service" employees. In its article, the IRS notes that qualified retirement plans must ensure "the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees," consistent with the anti-abuse standard of Treas. Reg. §1.401(a)(4)-1(c)(2). A plan that meets statutory or regulatory checklists, but primarily or exclusively benefits HCEs with little to no benefits for NHCs, may still discriminate and violate IRC §401(a)(4).

* **Design attributes.** The IRS notes that these plan designs: (1) provide significant benefits to the HCEs and a specified group of NHCs, who work very few hours or receive very little compensation, and exclude other NHCs from plan participation, (2) in the case of a DC plan, allocate employer contributions to this limited group of NHCs so this group receives the minimum to satisfy the mathematical portion of the nondiscrimination requirements of IRC §401(a)(4) (e.g., the plan might use a group of NHCs who have at least one hour of service and received the least amount of compensation for the plan year), and (3) the actual number of NHCs included in the plan described above isn't a set group, but instead is defined as the minimum number required to satisfy the requirements of IRC §§401(a)(4) and 410(b). Issue (3) seems to be focused on plans that define each eligible participant as a separate "allocation group" where the employer is cherry-picking the least paid NHCs to receive all or most of the employer allocation that has been targeted to the NHC group.

* **Examples of discriminatory plan designs.** The IRS goes on to identify certain plan designs as discriminatory plan designs in DB, DC and DB/DC combo plans.

- Some plans limit NHC benefits to a specific job classification, where the classification includes only the lowest paid or shortest service group of NHCs.
- Another variation on this plan design provides coverage to NHCs who work on an as-needed basis and earn very little each year.
- Some plan designs require 1,000 hours to earn a year of service for vesting but *not for allocation purposes*. In these plans, the low paid or short service NHCs receive an accrual or allocation but don't vest in the benefit because they never complete a year of vesting service.
- A flip side of the previous example is a plan that defines a year of vesting service as the employee's completion of 12-consecutive months of employment. Through this more liberal vesting design, these NHCs become vested in the very small plan benefit that enables the plan to pass the mathematical tests.
- Plans may discriminate even though they allocate a larger percentage of compensation to NHCs. With this design, NHCs, on average, may seem to receive a misleadingly large accrual or allocation level. For example, an NHC participant with $200 of annual compensation may receive a profit sharing allocation of $200 (a benefit equal to 100% of compensation), while an HCE with compensation of $200,000 may receive a benefit of only 25% of compensation or $50,000.

Although these designs may allow the plan to satisfy the vesting or numeric general tests for nondiscrimination, the IRS does not believe they satisfy the "anti-abuse" standard of Treas. Reg. §1.401(a)(4)-1(c)(2).

* **How to respond.** Although there may be some validity to the IRS' concerns, this latest pronouncement injects some uncertainty in an area that is largely objective. How should the practitioner respond? The most practical approach would be to adjust for some of the "red flags"identified by the IRS when designing the plan, or at least when demonstrating compliance with IRC §401(a)(4).

- If the plan has liberal eligibility requirements that enable part-time employees to participate, but who will not earn vesting in the plan, consider testing for IRC §401(a)(4) compliance without taking into account the allocations or benefit accruals of such employees. Alternatively, consider an alternative vesting rule that would enable these employees to vest over time. For example, the plan might state that a year of service is awarded for every period of two consecutive vesting computation periods during which the employee is employed but fails to earn enough service to receive credit for a year of service in either computation period.
- If low-paid employees are receiving allocations equal to or near 100% compensation, consider demonstrating IRC §401(a)(4) compliance by taking into account only a portion of their allocation (e.g., cap the allocation to no more than 2 times the highest allocation rate of any HCE).
- Disaggregate otherwise excludable employees for testing purposes so that many of these short-service will be disregarded when testing the statutory employees for IRC §401(a)(4) compliance. Remember, an election to disaggregate otherwise excludable employees may be made with respect to the portion of the plan that is subject to IRC §401(a)(4) testing (i.e., the employer's nonelective contributions under a 401(k) plan) without having to make the same election for ADP and ACP testing. This is because the 401(k) and 401(m) arrangements consisting of the elective deferrals and matching contributions are considered to be a separate plan from the nonelective contribution for coverage and nondiscrimination testing purposes.

Although the regulations don't incorporate these types of testing approaches it certainly wouldn't violate the IRC §401(a)(4) testing rules. Rather, they would provide a cushion for testing purposes that will minimize the plan's exposure to attack under the anti-abuse standard of Treas. Reg. §1.401(a)(4)-1(c)(2).

Fiduciary Requirements: Definition of a Fiduciary

Final regulations expand the definition of a fiduciary with respect to persons who provide investment advice for a fee [Citation: *DOL Reg. §2510.3-21*, 81 F.R. 20946-21002 (April 8, 2016)]
Text available at http://1.usa.gov/1Whtl6P
EOB2016 sections affected: Chapter 13B, Section II, Part A.2.

These regulations broaden the definition of a fiduciary who provides investment advice for a fee. ERISA §3(21)(A)(ii) treats a person as a fiduciary if such person renders investment advice for a fee or other compensation, direct or indirect, with respect to any assets of the plan, or has any authority or responsibility to render such advice even if not actually rendered. The regulations finalize a proposal that had been published on April 20, 2015, and reflect significant modifications to the proposal to address concerns and suggestions made during the public comment period.

* **Overview of changes to proposal.** The final regulations make significant revisions to the proposed regulations, mostly in response to public comments. In many cases the revisions clarify the scope of the investment advice fiduciary definition, and make the prohibited transaction exemptions issued along with the new regulations more workable. Regarding the definition of an investment advice fiduciary, the final regulations make the following significant changes.

- Eliminate appraisals from the definition of investment advice (reserved for a future regulations project)
- Allow educational materials under ERISA plans to use specific investment options under the plan in asset allocation models and interactive investment materials without those models and materials being treated as investment advice
- Clarify the definition of a recommendation and when referrals might fall into the category of investment advice
- Provide a broader exception for advice given to plan or IRA fiduciaries with financial expertise
- Better distinguish between requirements for ERISA plans and requirements for IRAs and non-ERISA plans, recognizing that the disclosure and enforcement regime already in place for ERISA plans inherently provide more protection to participants and beneficiaries of these plans

* **Related class exemptions.** In companion with the final regulation on the fiduciary definition, the DOL has issued two new class exemptions that were necessitated by the new rules, included the Best Interest Contract Exemption, and modifies several existing class exemptions to make them consistent with the expanded investment advice fiduciary definition and the Best Interest Contract Exemption. Like with the regulations on the definition of an investment advice fiduciary, significant modifications were made to the Best Interest Contract Exemption in response to public comments. The new and modified class exemptions are discussed in a separate summary. See ¶8.362.

* **Effective date/applicability date.** The new regulations become applicable on April 10, 2017 (the Monday following the one-year anniversary of the publication of the final regulations in the Federal Register). See DOL Reg. §2510.3-21(h)(2). However, an effective date of June 7, 2016 (60 days after the publication date) is also imposed to provide certainty that the rules will go into effect. See DOL Reg. §2510.3-21(h)(1). By having an earlier effective date, financial service providers and potential advice recipients will have certainty that the regulations are final and not subject to further amendment or modification without additional public comment, and potential advice recipients (i.e., plans, plan fiduciaries, participants and beneficiaries of plans, and IRA owners) will have assurance that the new protections under these regulations are now officially part

of the law and regulations governing their investment advice providers. Additional time is provided for complying with certain requirements of some of the new exemptions (e.g., Best Interest Contract Exemption). For details on these additional compliance deadlines, see the separate summary on the exemptions at ¶8.362.

> ✪ *DOL offers assistance.* The DOL is aware that there will be a learning curve to fully comprehend the scope of the regulation and the related prohibited transaction exemptions. In addition, there will inevitably be a need for clarification of certain provisions of the regulation and the exemptions. In the preamble to the regulations, the DOL notes its full intention to support advisers, plan sponsors and fiduciaries, and other affected parties with extensive compliance assistance activities. It is likely that the DOL will make use of FAQs and other tools on its website to assist with compliance.

* **Prior regulations.** The prior regulations, which remain in effect until the applicability date described above, were issued in 1975. They are restated in DOL Reg. §2510.3-21(j) of the new regulations, so they are preserved for the period between the effective date and the applicability date of the new regulations. In these regulations, the DOL interpreted the investment advice rule to mean that, for a person to be an investment advice fiduciary, three requirements had to be met.[1] First, the person had to render advice about the value of particular investments and make recommendations as to the advisability of investing in, purchasing, or selling particular investments. Second: (1) there had to be discretionary authority or control over whether to buy or sell the investment, or (2) the person had to render advice on a regular basis pursuant to a mutual agreement or understanding that the investment advice services will be the primary basis for investment decisions made by the recipient of the advice. Third, the person had to be compensated for such investment advice, either directly or indirectly. The modifications to these regulations focus primarily on the second condition in the regulations. In particular, the new regulations eliminate the concepts of "mutual agreement" and "primary basis" and "regular basis" to clarify that a person can be a fiduciary by reason of rendering investment advice merely on the basis of the nature of the relationship, without having to determine if the advice being rendered will be the primary basis for investment decisions, or that services are rendered on a regular basis (even a one-off provision of investment advice could come within the scope of the regulation). A great deal of litigation has occurred over this element of the prior regulations because of the subjectivity of the terms, so the elimination of these inquiries will be a welcome change, although the new regulations will no doubt trigger a whole new set of issues that will need to be litigated. The new regulations also clarify that the rendering of investment advice to a participant or beneficiary under the plan is a type of investment advice that can trigger fiduciary status.

> ***Addresses enforcement frustrations experienced by the DOL/change in plan environment.* The DOL expressed frustrations it has experienced in the enforcement of ERISA §3(21)(A) due to the limitations under prior Reg. §2510.3-21(c) with respect to the rendering of investment advice for a fee. For example, where a plan has relied upon abusive investment advice from a self-dealing consultant concerning an investment product on a single occasion, the DOL has been unable to bring an action for fiduciary breach against the consultant because the "regular basis" rule was not satisfied. Similarly, the "regular basis" rule prevented enforcement against an insurance brokerage company for accepting kickbacks from an annuity carrier while advising plans for a fee regarding the selection of annuity contracts (e.g., the annuity contracts are purchased only in connection with the termination of a plan). The DOL also notes the different investment landscape applicable to ERISA plans and IRAs since the issuance of the current regulations in 1975. In particular, the**

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[1] The DOL refers in the preamble to the regulations to a "five-part test" which takes into account that the second requirement described in the text actually consists of three components: (1) a discretionary control component, (2) a "regular basis" component, and (3) a "primary basis" component. Under that second requirement, the investment advice fiduciary is meeting component (1) or is meeting both components (2) and (3).

DOL is concerned about the increased investment responsibilities transferred to participants in ERISA plans, and the trillions of dollars being transferred to IRAs through the rollover process. These new regulations will expand the definition of a fiduciary for purposes of applying the prohibited transaction rules to IRA, thereby necessitating use of the "best interest" standard by a person advising an IRA owner if such person has a potential conflict of interest because of the compensation arrangement or the relationship such person has with the investment provider.

¶1. Revised definition of rendering investment advice for a fee. DOL Reg. §2510.3-21(a) prescribes four elements for determining whether a person is an investment advice fiduciary.

☞ First, there has to be investment advice services (see ¶1.a. below).

☞ Second, there has to be a plan-related recipient of the advice (see ¶1.b. below).

☞ Third, there has to be a fiduciary relationship, determined either by a functional fiduciary analysis or a self-proclaimed fiduciary status (see ¶1.c. below).

☞ Fourth, the person must be receiving a fee or other compensation, direct or indirect, for such services (see ¶1.d. below).

¶1.a. Investment advice services. A person is providing investment advice services if such person provides:

(1) a recommendation (see ¶1.a.1) below) as to the advisability of acquiring, holding, disposing of or exchanging securities or other investment property (see ¶1.a.2) below), including a recommendation as to how securities or other investment property should be invested after they are rolled over, transferred, or distributed from the plan or IRA, or

(2) a recommendation as to the management of securities[2] or other investment property, including, among other things, (i) recommendations on investment policies or strategies, portfolio composition, selection of other persons to provide investment advice or investment management services, selection of investment account arrangements (e.g., brokerage versus advisory), or (ii) recommendations with respect to rollovers, transfers, or distributions[3] from a plan or IRA, including whether, in what amount, in what form, and to what destination such a rollover, transfer, or distribution should be made.

See DOL Reg. §2510.3-21(a)(1)(i) and (ii). Note that only one of these activities is required to meet this first element.

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[2] Advice regarding the management of securities or other property within the term investment advice covers recommendations as to proxy voting and the management of retirement assets. As with other types of investment advice, guidelines or other information on voting policies for proxies that are provided to a broad class of investors without regard to a client's individual interests or investment policy, and which are not directed or presented as a recommended policy for the plan or IRA to adopt, would not rise to the level of fiduciary investment advice. Similarly, a recommendation addressed to all shareholders in an SEC-required proxy statement in connection with a shareholder meeting of a company whose securities are registered under Section 12 of the Securities Exchange Act of 1934, for example soliciting a shareholder vote on the election of directors and the approval of other corporate action, would not constitute fiduciary investment advice under the rule from the person who creates or distributes the proxy statement. See the preamble to the final regulations at 81 F.R. 20967 (April 8, 2016).

[3] The DOL notes in the preamble to the final regulations that with respect to tax code provisions regarding required minimum distributions, merely advising a participant or IRA owner that certain distributions are required by law would not constitute investment advice. Whether such "tax" advice is accompanied by a recommendation that constitutes "investment advice" would depend on the particular facts and circumstances involved. See the preamble to the final regulations, 81 F.R. 20966 (April 8, 2016).

Appraisals dropped. **The final regulation dropped the inclusion of appraisals, fairness opinions or similar statement in the scope of investment advice services. The DOL believes it is more appropriate to deal with issues relating to appraisals in a separate regulatory project. The 2015 proposal had provided for an exception relating to ESOP appraisals only.**

¶1.a.1) Definition of a recommendation. The term "recommendation" means a communication, regardless of whether it is initiated by a person or a computer software program, that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action. See DOL Reg. §2510.3-21(b)(1). The determination of whether a recommendation has been made is an objective rather than subjective inquiry. The more individually-tailored the communication is to a specific investment advice recipient about a security, investment property or investment strategy, the more likely it will be viewed as a recommendation. Providing a selective list of securities to a recipient as appropriate for that investor *is* a recommendation as to the advisability of acquiring securities, even if no recommendation is made with respect to any one security on the list. Information, activities or materials described in ¶2.a.1) through ¶2.a.4) below are considered not to be recommendations and, therefore, the provision of such information would not cause a person delivering that information to be an investment advice fiduciary. Any information, activities or materials not described in ¶2.a.1) through ¶2.a.4) must be evaluated under the general definition of a recommendation to determine if such information, activities or materials constitute an investment recommendation.

✪ ***FINRA guidance.*** **The DOL decided not to adopt FINRA guidelines (e.g., FINRA Policy Statement 01-23) as the basis for determining whether a communication is a recommendation. However, the approach taken to define a recommendation for purpose of the regulation is consistent with and based on FINRA's approach.**

✪ ***"Carve-out" terminology dropped.*** **The 2015 Proposal had identified "carve-outs" that would allow for certain information to be provided by platform providers and for the delivery of investment education materials. The final regulations eliminate the "carve-out" terminology. Instead, the exceptions discussed in ¶1.a.2) through ¶1.a.4) were adopted by the final regulations.**

¶1.a.1)a) Series of actions. The regulation specifically states that a series of actions, directly or indirectly (e.g., through or together with any affiliate), that may not constitute a recommendation when viewed individually may amount to a recommendation when considered in the aggregate. See DOL Reg. §2510.3-21(b)(1).

¶1.a.2) Definition of investment property. The regulations define an investment property by stating what it is not. Thus, the term ''investment property'' for purposes of these regulations does not include health insurance policies, disability insurance policies, term life insurance policies, and other property to the extent the policies or property do not contain an investment component. See DOL Reg. §2510.3-21(g)(4). For example, a person advising on the purchase of a life insurance policy is not providing investment advise if the policy is a term insurance policy. However, a whole life policy or a universal life policy, which has an investment component, would be an investment property with respect investment advice within the scope of these regulations could be given.

¶1.a.3) Selection of persons to provide investment advice or investment management services. Category (2) of investment advice services described in ¶1.a. above includes recommendations on the selection of other persons to provide investment advice or investment management services. The proposed regulations had listed this as a separate category of investment advice, but the final regulations moved it to be one component listed in category (2). The DOL explains in the preamble to the final regulations that listing such recommendations as a separate category of investment advice might have contributed to some commenters' uncertainty about the breadth of the proposal, and whether it covered recommendations of persons providing investment management services rather than as merely one example of a recommendation on investment management. It is common practice for some service providers, such as recordkeepers, to be asked by customers to provide a list of names of investment advisers with whom the recordkeepers have existing relationships (e.g., systems interfaces). In the DOL's view, the issue is whether a ''referral'' rises to the level of a ''recommendation,'' and whether the recommendation was given for a fee or other compensation as the rule requires. This in turn depends on the content, context, and manner of presentation. If, in context, the investor would reasonably believe that the service provider is recommending that the plan base its hiring decision on the specific list provided by the adviser, and the service provider receives compensation or referral fees for providing the list, the communication would be fiduciary in nature. See the preamble to the final regulations at 81 F.R. 20968 (April 8, 2016).

¶1.a.4) Advisory Opinion 2005-23A superseded. In Advisory Opinion 2005-23A, the DOL took the position that, as a general matter, a recommendation to a plan participant to take an otherwise permissible plan distribution does not constitute investment advice within the meaning of current DOL Reg. §2510.3-21(c), even when that advice is combined with a recommendation as to how the distribution should be invested. The definition of investment advice in the new regulations, as shown above, expressly includes these types of recommendations in the definition of investment advice and, so, would supersede Advisory Opinion 2005-23A.

¶1.b. Recipient. The recipient of the investment advice services described in ¶1.a. above must be a plan (see ¶1.b.1) below), plan fiduciary (see ¶1.b.2) below), plan participant (see ¶1.b.3) below) or beneficiary, an IRA (see ¶1.b.1) below) or an IRA owner. See DOL Reg. §2510.3-21(a)(1).

¶1.b.1) Definition of a plan/IRA. For purposes of the regulation, the term "plan" includes any employee benefit plan described in ERISA §3(3) and any plan described in IRC §4975(e)(1)(A) (i.e., a qualified plan under IRC §401(a) or 403(a)). See DOL Reg. §2510.3-21(g)(6)(i). A "qualified plan" would not include a governmental plan or a nonelecting church plan, which are exempt from IRC §4975 by reason of IRC §4975(g). The term "IRA" includes any trust, account or annuity described in IRC §4975(e)(1)(B) through (F) (i.e., an IRA under IRC §408(a) or (b), Archer medical savings accounts described in IRC §220(d), health savings accounts (HSAs) described in IRC §223(d), and Coverdell education savings accounts described in IRC §530). See DOL Reg. §2510.3-21(g)(6)(ii).

***SEPs and SIMPLE-IRAs.* The term "IRA" includes a SEP or SIMPLE-IRA, as defined in IRC §408(k) and §408(p), respectively, because they are IRAs under IRC §408(a) or (b), but they satisfy additional requirements to be treated as a SEP or SIMPLE-IRA.**

***Roth IRAs.* IRC §408A provides that, except as provided in that section, a Roth IRA is treated for all purposes of the tax code in the same manner as an IRA. Thus, the reference to IRAs in IRC §4975(e)(1)(B) and (C) would include Roth IRAs.**

***403(b) plans.* Note that if a 403(b) plan is covered by ERISA, then it would satisfy the definition of an employee benefit plan under ERISA §3(3) and, so, would be subject to this regulation. The DOL**

confirms this in the preamble to the final regulations and notes, for example, that a platform provider to 403(b) plans could utilize the exceptions available to platform providers, as discussed in ¶2.b.1) and ¶2.b.2) below. However, a non-ERISA 403(b) plan is not listed in IRC §4975(e)(1). Thus, a person providing investment advice to a non-ERISA 403(b) participant would not be subject to the regulation.

¶1.b.2) Definition of plan fiduciary. A "plan fiduciary" means a person who is a fiduciary under ERISA §3(21)(A) or IRC §4975(e)(3). See DOL Reg. §2510.3-21(g)(7). For this purpose, a participant or beneficiary of the plan or a relative of either is not a ''plan fiduciary'' with respect to the plan, and the IRA owner or a relative (see ¶1.b.2)a) below) is not a ''plan fiduciary'' with respect to the IRA.

¶1.b.2)a) Definition of a relative. A "relative" of an individual includes any person described in ERISA §3(15) or IRC §4975(e)(6) (i.e., spouse, ancestor, lineal descendant, and any spouse of a lineal descendant), and a brother, a sister, or a spouse of a brother or sister. See DOL Reg. §2510.3-21(g)(8)

¶1.b.3) Definition of plan participant. The term ''plan participant'' or ''participant'' means a person described in ERISA §3(7) (i.e., any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit). Thus, once an employee's or former employee's benefit is fully paid out and the employee or former employee is no longer eligible for benefits, the individual is no longer a plan participant. This means that, once plan benefits have been distributed and are no longer held in a plan or IRA via a rollover, investment advice with respect to those distributed funds would not be subject to these regulations.

¶1.c. Fiduciary relationship. This third element is satisfied if the person who is performing the investment advice services described in ¶1.a. above falls into either of the two categories described in ¶1.c.1) and ¶1.c.2) below. See DOL Reg. §2510.3-21(a)(2). The requisite investment relationship can be either direct or indirect (e.g., through or together with an affiliate). An "affiliate" of a person means: (1) any person who is, directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with such person, (2) any officer, director, partner, employee or relative (as defined in ¶1.b.2)a) above) of such person, and (3) any corporation or partnership of which such person is an officer, director or partner. See DOL Reg. §2510.3-21(g)(1). "Control" means the power to exercise a controlling influence over the management or policies of a person other than an individual (e.g., an entity). See DOL Reg. §2510.3-21(g)(2).

Exceptions. **The regulations include exceptions, under which a fiduciary relationship is deemed not to exist, for certain transactions with independent fiduciaries who have financial expertise, swap transactions, and employee-provided investment advice. These are discussed in ¶2.b. below.**

No broad carve-out for call center employees. **The DOL declined to create a broad carve-out for call center employees. If, in the performance of their jobs, call center employees make specific investment recommendations to plan participants or IRA owners under the circumstances described in the regulations, the DOL believes it is appropriate to treat them, and possibly their employers, as fiduciaries unless they meet the conditions of one of the exceptions set forth in ¶2. below.**

¶1.c.1) Representation of fiduciary status. A person falls into this category if the person represents or acknowledges that he/she is acting as a fiduciary within the meaning of ERISA or the tax code. See DOL Reg. §2510.3-21(a)(2)(i).

✪ **The DOL believes that explicitly claiming ERISA fiduciary status, orally or in writing, enhances the adviser's influence, and gives the advice recipient a reasonable expectation that the advice will be impartial and prudent, so that such a representation or acknowledgment in connection with the provision of the advice should result in fiduciary status if provided for a fee or other compensation.**

¶1.c.2) Functional fiduciary status regarding the provision of investment advice. A person falls into this category if the person has not otherwise represented or acknowledged ERISA fiduciary status, but who: (1) renders the advice pursuant to a *written or verbal* agreement, arrangement or understanding that the advice is based on the particular investment needs of the advice recipient, or (2) directs the advice to a specific advice recipient regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the plan or IRA. See DOL Reg. §2510.3-21(a)(2)(ii) and (iii). As long as this standard is met, a fiduciary relationship can exist even though the recipient of the advice might not use it as the primary basis for those decisions, and even if the advice is rendered only once (e.g., a fiduciary might retain a person to provide advice on a particular real estate investment in the plan's portfolio and never have reason to use the adviser again).

¶1.d. Fee or other compensation. The term "fee or other compensation, direct or indirect" means: (1) any explicit fee or compensation for the advice received by the person (or by an affiliate) from any source, and (2) any other fee or compensation received from any source in connection with or as a result of the purchase or sale of a security or the provision of investment advice services. See ¶1.d.1) below for the determination of whether a fee or other compensation is "in connection with or as a result of" a transaction or service. Fee or other compensation under this definition includes, but is not limited to, commissions, loads, finder's fees, revenue sharing payments, shareholder servicing fees, marketing or distribution fees, underwriting compensation, payments to brokerage firms in return for shelf space, recruitment compensation paid in connection with transfers of accounts to a registered representative's new broker-dealer firm, gifts and gratuities, and expense reimbursements. See DOL Reg. §2510.3-21(g)(3).

¶1.d.1) In connection with or as a result of. A fee or compensation is paid ''in connection with or as a result of'' a purchase or sale transaction or an investment advice service if: (1) the fee or compensation would not have been paid but for the transaction or service, or (2) if eligibility for or the amount of the fee or compensation is based in whole or in part on the transaction or service. See DOL Reg. §2510.3-21(g)(3).

¶2. Exceptions. Due to the potential broadness of the definition in ¶1 above, the regulations contain exceptions to elements of the investment advice fiduciary definition. In ¶2.a. below are exceptions to the definition of a recommendation, as described in ¶1.a.1) above. In ¶2.b. below are exceptions with respect to activities that will not be treated as fiduciary in nature for purposes of the fiduciary relationship described in ¶1.c. above. If any of these exceptions applies to a person, the person will not be treated as an investment advice fiduciary solely by reason of the activity described. Thus, any of the prohibited transaction exemptions also issued with the regulations, which are aimed at providing exemptive relief for certain transactions entered into by an investment advice fiduciary, wouldn't need to be followed with respect to such activities.

¶2.a. Exceptions relating to the definition of a recommendation. DOL Reg. §2510.3-21(b)(2) contains a list of activities that are not treated as recommendations for purposes of ¶1.a.1) above. Thus, a person would not be an investment advice fiduciary by reason of engaging in such activities, even if the person receiving compensation for such activities.

¶2.a.1) Investment platform providers. A person is not making a recommendation described in ¶1.a.1) above if the person markets or makes available to a plan fiduciary without regard to the *individualized needs* of the plan, its participants, or beneficiaries, a platform or similar mechanism from which a plan fiduciary may select or monitor investment alternatives, including qualified default investment alternatives (QDIAs), into which plan participants or beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. See DOL Reg. §2510.3-21(b)(2)(i). This exception is available only if: (1) the plan fiduciary is independent of the person who markets or makes available the platform or similar mechanism, and (2) the person discloses in writing to the plan fiduciary that the person is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity. A "plan fiduciary" for this purpose is not a participant or beneficiary or relative of either.

¶2.a.1)a) Use of objective criteria in recommending platforms. The DOL notes that the marketing and making available of platforms that are segmented based on objective criteria would not result in providing fiduciary advice solely by virtue of the segmentation. Thus, for example, a platform provider who offers different platforms for small, medium, and large plans would not be providing investment advice merely because of such segmentation. This "type of activity is more akin to product development and is within the provider's discretion as a matter of business judgment, the same as if the provider decided not to offer platforms at all." See the preamble to the regulations at 81 F.R. 20973 (April 8, 2016).

¶2.a.2) General financial information provided in connection with investment platform. In connection with the activities described in ¶2.a.1) above, the following information will not be treated as a covered recommendation: (1) identifying investment alternatives that meet objective criteria *specified by the plan fiduciary* (e.g., stated parameters concerning expense ratios, size of fund, type of asset, or credit quality), but only if the person identifying the investment alternatives discloses in writing whether the person has a financial interest in any of the identified investment alternatives (and, if so, the precise nature of that interest), (2) in response to a request for information (RFI) or request for proposal (RFP), or similar solicitation by or on behalf of a plan, identifying a limited or sample set of investment alternatives based on only the size of the employer or plan, the current investment alternatives designated under the plan, or both, but only if the response to the RFI, RFP or similar solicitation is in writing and discloses whether the person identifying the limited or sample set of investment alternatives has a financial interest in any of the alternatives (and, if so, the precise nature of such interest), or (3) providing objective financial data and comparisons with independent benchmarks to the plan fiduciary. See DOL Reg. §2510.3-21(b)(2)(ii). For example, this exception enables platform providers to assist with compiling data necessary to comply with the DOL's regulations on fee disclosures to participant-directed plans (DOL Reg. §2550.404a-5) without being treated as making recommendations that fall within the scope of the regulation.

¶2.a.3) General communications. A recommendation does not include general communications that a reasonable person would not view as an investment recommendation. This includes: (1) general circulation newsletters, (2) commentary in publicly broadcast talk shows, (3) remarks and presentations in widely attended speeches and conferences, (4) research or news reports prepared for general distribution, (5) general marketing materials, (6) general market data (including data on market performance, market indices, or trading volumes), (7) price quotes, (8) performance reports, and (9) prospectuses. See DOL Reg. §2510.3-21(b)(2)(iii). This exception was added by the final regulations to alleviate concerns expressed by commenters.

¶2.a.4) Investment education exception. An investment recommendation does not include information and materials described in ¶2.a.4)a) through ¶2.a.4)d) below that is provided to a plan, plan fiduciary, participant or beneficiary, IRA or IRA owner. See DOL Reg. §2510.3-21(b)(2)(iv). It doesn't matter: (1) who provides or makes available this information and materials (e.g., a plan sponsor, a fiduciary, a service provider), (2) the frequency with which the information and materials are provided, (3) the form in which the information and materials are provided (e.g., on an individual or group basis, in writing or orally, or via a call center, video or computer software), or (4) whether an identified category of information and materials is furnished or made available alone or in combination with other categories of information and materials. However, the information and materials, standing or alone or in combination with other materials, may not include recommendations with respect to specific investment products or specific plan or IRA alternatives, or recommendations with respect to investment or management of a particular security or securities or other investment property, except as noted in ¶2.a.4)c) and ¶2.a.4)d) below. This exception incorporates (with modification) the investment education guidelines that are in DOL Reg. §2509.96-1 (also known as "Interpretive Bulletin (IB) 96-1") and, as of the applicability date, IB 96-1 is removed.

✪ ***Consequences of providing investment materials that do not satisfy the investment education exception.*** **The investment education exception provides a safe harbor under which the furnished material is deemed not to be an investment recommendation. Whether materials that go beyond these guidelines rise to the level of an investment recommendation would be based on the applicable facts and circumstances. Even if the materials constituted investment recommendations, they wouldn't cause the person providing such materials to be an investment advice fiduciary unless the other elements of an investment advice fiduciary are satisfied. For example, an employer who provides materials that do not comply with the investment education exception is unlikely to be an investment advice fiduciary by reason of providing such materials, because it is unlikely that the employer is receiving a fee or other compensation for furnishing such materials, which, as explained in ¶1.d. above, is a necessary element of being an investment advice fiduciary. In fact, the DOL notes in the preamble to the final regulations (81 F.R. 20976) that "incidental economic advantages" that may accrue to the employer by reason of sponsorship of an employee benefit plan do not constitute fees or compensation within the meaning of the regulation (e.g., the employer would not be receiving a fee or compensation under the regulation merely because the plan is structured so the employer**

does not pay plan expenses that are paid out of an ERISA budget account funded with revenue sharing generated by investments under the plan).

¶2.a.4)a) Plan information. Information and materials that, without reference to the appropriateness of any individual investment alternative or any individual benefit distribution option for the plan or IRA, or a particular participant or beneficiary or IRA owner, describe: (1) the terms or operation of the plan or IRA, (2) inform a plan fiduciary, participant, beneficiary, or IRA owner about the benefits of plan or IRA participation, the benefits of increasing plan or IRA contributions, the impact of preretirement withdrawals on retirement income, retirement income needs, varying forms of distributions, including rollovers, annuitization and other forms of lifetime income payment options (e.g., immediate annuity, deferred annuity, or incremental purchase of deferred annuity), advantages, disadvantages and risks of different forms of distributions, or (3) describe product features, investor rights and obligations, fee and expense information, applicable trading restrictions, investment objectives and philosophies, risk and return characteristics, historical return information, or related prospectuses of investment alternatives under the plan or IRA. See DOL Reg. §2510.3-21(b)(2)(iv)(A).

¶2.a.4)b) General financial, investment and retirement information. Information and materials on financial, investment and retirement matters that inform the plan fiduciary, participant or beneficiary, or IRA owner about: (1) general financial and investment concepts (e.g., risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investments), (2) historic differences in rates of return between different asset classes (e.g., equities, bonds, cash) based on standard market indices, (3) the effect of fees and expenses on rates of return, (4) the effects of inflation, (5) estimating future retirement income needs, (6) determining investment time horizons, (7) assessing risk tolerance, (8) retirement-related risks (e.g., longevity risks, market/interest rates, inflation, health care and other expenses), and (9) general methods and strategies for managing assets in retirement (e.g., systematic withdrawal payments, annuitization, guaranteed minimum withdrawal benefits), including those offered outside the plan or IRA. See DOL Reg. §2510.3-21(b)(2)(iv)(B). Information described in (3), (8) and (9) were not referenced in IB 96-1. This exception for general financial or investment information is not met if it addresses: (1) specific investment products, (2) specific plan or IRA alternatives or distribution options available to the plan or IRA or to participants, beneficiaries and IRA owners, or (3) specific alternatives or services offered *outside* the plan or IRA.

¶2.a.4)c) Asset allocation models. Information and materials (e.g., pie charts, graphs, or case studies) that provide a plan fiduciary, plan participant or beneficiary, or IRA owner with models of asset allocation portfolios of *hypothetical* individuals with different time horizons (which may extend beyond an individual's retirement date) and risk profiles, where: (1) such models are based on generally accepted investment theories that take into account the historic returns of different asset classes (e.g., equities, bonds, or cash) over defined periods of time, (2) all material facts and assumptions on which such models are based (e.g., retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, and rates of return), accompany the models, (3) such models do not include or identify any specific investment product or specific alternative available under the plan or IRA, except as permitted in ¶2.a.4)c)i) below, and (4) a statement accompanies the model explaining that, in applying particular asset allocation models to their individual situations, participants, beneficiaries, or IRA owners should consider their other assets, income, and investments (e.g., equity in a home, Social Security benefits, individual retirement plan investments, savings accounts and interests in other qualified and non-qualified plans) in addition to their interests in the plan or IRA, to the extent those items are not taken into account in the model or estimate. See DOL Reg. §2510.3-21(b)(2)(iv)(C).

¶2.a.4)c)i) Limited use of specific investment options. In the case of an ERISA plan, asset allocation models may identify a specific investment alternative available under the plan, but only if it is a designated investment alternative (DIA) within the meaning of DOL Reg. §2550.404a-5(h)(4) under the plan, and the DIA is subject to oversight by a plan fiduciary who is independent from the person who developed or markets the DIA and the model. In addition, the model must: (1) identify all the other DIAs available under the plan that have similar risk and return characteristics (if any), and (2) be accompanied by a statement indicating that those other DIAs have similar risk and return characteristics and identifying where information on those DIAs may be obtained (including information described in ¶2.a.4)a) above and, if applicable, the investment-related fee disclosures under DOL Reg. §2550.404a-5(d)). See DOL Reg. §2510.3-21(b)(2)(iv)(C)(4). Since this exception applies only to DIAs, it would not cover asset model allocations that are provided with respect to the investment of a brokerage account. This option is not available to IRAs because there isn't an ERISA fiduciary with oversight authority over investment alternatives.

✪ ***Fiduciary oversight.*** **The DOL notes in the preamble to the final regulations that, as part of the ERISA obligation to monitor plan service providers, a responsible plan fiduciary would have an obligation to evaluate and periodically monitor the asset allocation models being made available to the plan participants and beneficiaries as part of any education program. "That evaluation should include an evaluation of whether the models and materials are in fact unbiased and not designed to influence investment decisions towards particular investments that result in higher fees or compensation being paid to parties that provide investments or investment-related services to the plan." See 81 F.R. 20978 (April 8, 2016).**

¶2.a.4)d) Interactive investment materials. Questionnaires, worksheets, software and similar materials which meet the criteria described in ¶2.a.4)d)i) through ¶2.a.4)d)iv) below and provide a plan fiduciary, a participant or beneficiary, or IRA owners the means to: (1) estimate future retirement income needs, and assess the impact of different asset allocations on retirement income, (2) evaluate distribution options, products or vehicles by providing information described in ¶2.a.4)a) and ¶2.a.4)b) above, or (3) estimate a retirement income stream that could be generated by an actual or hypothetical account balance. See DOL Reg. §2510.3-21(b)(2)(ii)(D).

¶2.a.4)d)i) Criteria for interactive materials. The materials described in ¶2.a.4)d) above: (1) must be based on generally accepted investment theories that take into account the historic returns of different asset classes (e.g., equities, bonds, cash) over defined periods of time, and (2) must have an objective correlation between the asset allocations or income streams generated by the material and the information and data supplied by the participant, beneficiary or IRA owner. See DOL Reg. §2510.3-21(b)(2)(iv)(D)(1), (2), and (3).

¶2.a.4)d)ii) Material facts and assumptions. All material facts and assumptions (e.g., retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, rates of return and other features and rates specific to income annuities or systematic withdrawal plan) that may affect a plan participant's, beneficiary's or IRA owner's assessment of the different asset allocations or different income streams either must: (1) accompany the material, or (2) be specified by the participant, beneficiary or IRA owner. See DOL Reg. §2510.3-21(b)(2)(ii)(D)(4).

¶2.a.4)d)iii) Other relevant information. The materials either must: (1) take into account other assets, income and investments (e.g., equity in a home, Social Security benefits, individual retirement account/ annuity investments, savings accounts, and interests in other qualified and non-qualified plans), *or* (2) be accompanied by a statement indicating that, in applying particular asset allocations to their individual situations, or in assessing the adequacy of an estimated income stream, plan participants, beneficiaries or IRA owners should consider their other assets, income, and investments in addition to their interests in the plan or IRA. See DOL Reg. §2510.3-21(b)(2)(ii)(D)(5).

¶2.a.4)d)iv) Identification of specific investment alternative or distribution option. As a general rule, the materials may not include or identify any specific investment alternative or distribution option available under the plan or IRA. However, the interactive materials may include an investment alternative or distribution option that is identified by the plan participant, beneficiary, or IRA owner. In the case of a plan, the interactive materials also may include a specific investment alternative that is a designated investment alternative (DIA) within the meaning of DOL Reg. §2550.404a-5(h)(4) under the plan, if the DIA is subject to oversight by a plan fiduciary who is independent from the person who developed or markets the DIA and the model. In addition, the model must: (1) identify all the other DIAs available under the plan that have similar risk and return characteristics (if any), and (2) be accompanied by a statement indicating that those other DIAs have similar risk and return characteristics and identifying where information on those DIAs may be obtained (including information described in ¶2.a.4)a) above and, if applicable, the investment-related fee disclosures under DOL Reg. §2550.404a-5(d)). See DOL Reg. §2510.3-21(b)(2)(iv)(D)(6). The exception for specified DIAs does not apply to an IRA, but the IRA owner is permitted to specify investment alternatives or distribution options that he or she would like the interactive materials to consider.

✪ *Fiduciary oversight.* See the comment at the end of ¶2.a.4)c)i) above regarding the DOL's view on a responsible plan fiduciary's obligation to review asset allocation models. The same would apply to interactive investment materials furnished by a service provider.

¶2.b. Exceptions to fiduciary relationship definition. A person engaging in any of the activities described in ¶2.b.1) through ¶2.b.3) below is not treated as having a fiduciary relationship with the other party in the transaction and, thus, would not be an investment advice fiduciary by reason of such activity.

¶2.b.1) Transactions with independent fiduciaries who have financial expertise. This exception applies to the provision of advice (including the provision of asset allocation models or other financial analysis tools), with respect to an arm's length sale, purchase, loan, exchange, or other transaction related to the investment of securities or other investment property, to a plan fiduciary or IRA who is independent of such person providing the advice. See DOL Reg. §2510.3-21(c)(1). In order for this exception to apply, the conditions described in ¶2.b.1)a) through ¶2.b.1)d) must be satisfied. This expertise is based on the premise that the plan fiduciary has sufficient expertise and sophistication to warrant exemptive relief for the provider of the advice. Note that this exception was expanded by the final regulations to cover non-ERISA plans and IRAs, as well as ERISA-covered plans, provided that the conditions of the exception are satisfied.

¶2.b.1)a) Not representing self as fiduciary. A person relying on this exception cannot be representing or acknowledging that he or she is acting as a fiduciary within the meaning of ERISA or the tax code. See DOL Reg. §2510.3-21(c).

¶2.b.1)b) Categories of eligible independent fiduciaries. The person relying on this exception must know or reasonably believe that the independent fiduciary of the plan or IRA is: (1) a bank (as defined in the Investment Advisers Act of 1940) or similar institution that is regulated and supervised and subject to periodic examination by a State or Federal agency, (2) an insurance carrier which is qualified under the laws of more than one State to perform the services of managing, acquiring or disposing of assets of a plan, (3) an investment adviser registered under the Investment Advisers Act of 1940 or, if not so registered by reason of paragraph (1) of section 203A of such Act, is registered as an investment adviser under the laws of the State in which it maintains its principal office and place of business, (4) a broker-dealer registered under the Securities Exchange Act of 1934, or (5) any independent fiduciary that holds, or has under management or control, total assets of at least $50 million. See DOL Reg. §2510.3-21(c)(1)(i). Note that only category (5) has a minimum asset requirement. The person giving the advice may rely on a written representation from the plan or independent fiduciary that the asset minimum in category (5) has been satisfied.

¶2.b.1)b)i) Determination of whether a fiduciary is independent. In the preamble to the final regulations, the DOL notes that the issue of whether a fiduciary is "independent" will generally involve a determination as to whether there exists a financial interest (e.g., compensation, fees), ownership interest, or other relationship, agreement or understanding that would limit the ability of the fiduciary to carry out its fiduciary responsibility to the plan or IRA beyond the control, direction or influence of other persons involved in the transaction. Consideration must be given to all relevant facts and circumstances, including evidence bearing on all relationships between the fiduciary and the other party. The DOL cites the following examples in its discussion.

- If a fiduciary has an interest in or relationship with another party that may conflict with the interests of the plan for which the fiduciary acts or which may otherwise affect the fiduciary's best judgment as a fiduciary, the DOL would not regard the person as independent.

- Parties belonging to controlled group, as defined in IRC §414(b) or (c), or in an affiliated services group, as defined in IRC §414(m), would be "sufficiently affiliated so that such relationships would affect the fiduciary's best judgment."
- If the transaction includes an agreement, arrangement, or understanding with other parties involved in the transaction that is designed to relieve the fiduciary from any responsibility, obligation or duty to the plan or IRA, the fiduciary would not be independent.
- A showing of substantial control and close supervision by a common parent may be evidence of a lack of independence.
- A fiduciary would not be independent if the fiduciary received compensation or fees in connection with the transaction that involved a violation of the self-dealing provisions of ERISA §406.

¶2.b.1)c) Qualifications of the independent fiduciary. The person relying on this exception must know or reasonably believe that the independent fiduciary: (1) is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies, and (2) is a fiduciary under ERISA or the tax code, or both, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction. See DOL Reg. §2510.3-21(c)(1)(ii) and (iv). The person giving the advice may rely on a written representation from the plan or independent fiduciary that either or both of these qualifications are satisfied.

¶2.b.1)d) Representation to independent fiduciary. The person providing the advice must fairly inform the independent fiduciary: (1) that the person is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the transaction, and (2) of the existence and nature of the person's financial interests in the transaction. See DOL Reg. §2510.3-21(c)(1)(iii).

¶2.b.1)e) No compensation for advice. The person providing the advice must not receive a fee or other compensation directly from the plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner for the provision of investment advice (as opposed to other services) in connection with the transaction. See DOL Reg. §2510.3-21(c)(1)(v).

¶2.b.2) Swaps. This exception applies to the provision of advice to an ERISA plan by a person who is a swap dealer, security-based swap dealer, major swap participant, or major security-based swap participant, or a swap clearing firm, as defined in section 1a of the Commodity Exchange Act and section 3(a) of the Securities Exchange Act, if: (1) the plan is represented by an ERISA fiduciary who is independent of the person giving the advice, (2) in the case of a person who is a swap dealer or security-based swap dealer, the person is not acting as an advisor to the plan (within the meaning of section 4s(h) of the Commodity Exchange Act or section 15F(h) of the Securities Exchange Act of 1934) in connection with the transaction, (3) the person does not receive a fee or other compensation directly from the plan or plan fiduciary for the provision of investment advice (as opposed to other services) in connection with the transaction, *and* (4) in advance of providing any recommendations with respect to the transaction, or series of transactions, the person obtains a written representation from the independent plan fiduciary, that the fiduciary understands that the person is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the transaction and that the independent fiduciary is exercising independent judgment in evaluating the recommendation. See DOL Reg. §2510.3-21(c)(2). Also see the discussion in ¶2.b.1)b)i) above regarding the determination of whether a fiduciary is independent. The same principles would apply here.

✪ **The DOL developed this exception in coordination with the SEC and the Commodity Futures Trading Commission (CFTC).**

¶2.b.3) Employees providing advice to a plan fiduciary, employee or independent contractor. This exception applies to a person who, in his or her capacity as an employee of the plan sponsor (or of an affiliate of such sponsor), an employee of an employee benefit plan, an employee of an employee organization, or an employee of a plan fiduciary: (1) provides advice to a plan fiduciary, an employee (other than in his or her capacity as a participant or beneficiary of an employee benefit plan - see ¶2.b.3)a) below) or an independent contractor of such plan sponsor, affiliate, or employee benefit plan, and (2) receives no fee or other compensation, direct or indirect, in connection with the advice beyond the employee's normal compensation for work performed for the employer. See DOL Reg. §2510.3-21(c)(3)(i). In the preamble to the regulations, the DOL notes that this exception recognizes that internal employees, such as members of a company's human resources department, routinely develop reports and recommendations for investment committees and other named fiduciaries of the sponsors' plans without acting as paid fiduciary advisers.

✪ **The proposal had limited this exception to advice provided by an employee to a plan fiduciary, but the final regulations expanded the exception to include advice provided by the employee to another employee or to an independent contractor.**

¶2.b.3)a) More limited exception for advice provided by employee to a plan participant or beneficiary. An exception also applies to a person who, in his or her capacity as an employee of the plan sponsor (or of an affiliate of such plan sponsor), provides advice to another employee of the plan sponsor in his or her capacity as a participant or beneficiary of the plan, but only if: (1) the person's job responsibilities do not involve the provision of investment advice or investment recommendations, (2) the person is not registered or licensed under federal or state securities or insurance law, (3) the advice he or she provides does not require the person to be registered or licensed under federal or state securities or insurance laws, and (4) the person receives no fee or other compensation, direct or indirect, in connection with the advice beyond the employee's normal compensation for work performed for the employer. See DOL Reg. §2510.3-21(c)(3)(ii).

¶3. Scope of fiduciary duty for an investment advice fiduciary. An investment advice fiduciary is not deemed to be a fiduciary regarding any assets of the plan or IRA with respect to which such person does not: (1) have any discretionary authority, discretionary control or discretionary responsibility, (2) exercise any authority or control, (3) render investment advice (as defined in ¶1 above) for a fee or other compensation, and (4) have any authority or responsibility to render such investment advice. See DOL Reg. §2510.3-21(d). In other words, if the activities or authority that makes a person a fiduciary is limited solely to the provision of investment advice for a fee over only a portion of the assets of the plan, the person is not a fiduciary with respect to the rest of the plan.

¶3.a. Co-fiduciary liability. The limitation described in ¶3 above does not exempt such person from the co-fiduciary liability provisions of ERISA §405(a) concerning liability for fiduciary breaches by other fiduciaries with respect to any assets of the plan, assuming the conditions for co-fiduciary liability exist. See DOL Reg. §2510.3-21(d)(1).

¶3.b. Party-in-interest status. The limitation described in ¶3 above does not exclude such person from being a party-in-interest in the capacity of a service provider (as described in ERISA §3(14)(B) and IRC §4975(e)(2)) with respect to any assets of the employee benefit plan or IRA. See DOL Reg. §2510.3-21(d)(2).

¶3.c. Continued applicable of certain State law. These regulations should not be construed to affect or modify the preemption provisions of ERISA §514, including the savings clause in ERISA §514(b)(2)(A) for State laws that regulate insurance, banking, or securities. See DOL Reg. §2510.3-21(i).

¶3.d. ERISA §404(c) relief not available to investment advice fiduciary. The fact that an investment advice fiduciary might be providing advice to a plan participant or beneficiary, who in turn acts on the advice by directing an investment action with respect to his or her account, does not mean that the fiduciary can seek protection under ERISA §404(c) for imprudence advice or a self-dealing violation. See the preamble to the final regulations, 81 F.R. 20965 (April 8, 2016).

¶3.e. Cannot contract away fiduciary status. Parties cannot by contract or disclaimer alter the application of the final regulation as to whether fiduciary investment advice has occurred in the first instance or will occur during the course of a relationship. See the preamble to the final regulations at 81 F.R. 20987 (April 8, 2016).

¶3.f. Ongoing duties with respect to advice given. If the investment advice recommendations relate to the advisability of acquiring or exchanging securities or other investment property in a particular transaction, the DOL does not believe that the regulation imposes on the person providing such advice an automatic fiduciary obligation to continue to monitor the investment or the advice recipient's activities to ensure that the recommendations remain prudent and appropriate. Rather, the obligation to monitor the investment on an ongoing basis would be a function of the reasonable expectations, understandings, arrangements, or agreements of the parties. See the preamble to the final regulations at 81 F.R. 20987 (April 8, 2016). The DOL also addresses this issue in the Best Interest Contract Exemption (separately summarized), where monitoring services may be a factor in determining whether a particular investment is in the advice recipient's best interest.

¶4. Execution of securities transactions. DOL Reg. §2510.3-21(e), which is essentially the same as former §2510.3-21(d), sets forth the conditions under which the execution of securities transactions does not cause fiduciary status for a person who is: (1) a broker or dealer registered under the Securities Exchange Act of 1934, (2) a reporting dealer who makes primary markets in securities of the United States Government or of an agency of the United States Government and reports daily to the Federal Reserve Bank of New York its positions with respect to such securities and borrowings thereon, or (3) a bank supervised by the United States or a State. Such person is not a fiduciary with respect to an employee benefit plan or IRA solely because the person executes transactions for the purchase or sale of securities on behalf of such plan in the ordinary course of its business as a broker, dealer, or bank, pursuant to instructions of a fiduciary with respect to such plan or IRA, if neither the fiduciary nor any affiliate of such fiduciary is such broker, dealer, or bank, and the instructions from the fiduciary meet the conditions in ¶4.a. below. See DOL Reg. §2510.3-21(e)(1).

¶4.a. Conditions for instructions regarding the execution of securities transactions. The fiduciary's instructions to the broker-dealer, reporting dealer or bank that is executing the securities transaction must specify: (1) the security to be purchased or sold, (2) a price range within which the security is to be purchased or sold if the security is issued by an open-end investment company registered under the Investment Company Act of 1940 (mutual fund), a price which is determined in accordance with Rule 22c1 under the Investment Company Act of 1940, (3) a time span during which such security may be purchased or sold (not to exceed five business days), and (4) the minimum or maximum quantity of such security which may be purchased or sold within such price range, or, in the case of a mutual fund, the minimum or maximum quantity of such security which may be purchased or sold, or the value of such security in dollar amount which may be purchased or sold, at the price referred to in (2). See DOL Reg. §2510.3-21(e)(1)(ii).

¶4.b. Scope of fiduciary status if exception conditions not met. A broker-dealer, reporting dealer or bank who is a fiduciary with respect to an employee benefit plan or IRA solely by reason of ERISA §3(21)(A)(i) or IRC §4975(e)(3)(A) in connection with the execution of a securities transaction which fails to comply with the exception described in ¶4. above, is not deemed to be a fiduciary regarding any other assets of the plan or IRA with respect to which such person does not: (1) have any discretionary authority, discretionary control or discretionary responsibility, (2) exercise any such authority or control, (3) render investment advice for a fee or other compensation, and (4) have any authority or responsibility to render such investment advice. See DOL Reg. §2510.3-21(e)(2)..

¶4.b.1) Co-fiduciary liability. The limitation in ¶4.b. above does not exempt such person from the co-fiduciary liability provisions of ERISA §405(a) concerning liability for fiduciary breaches by other fiduciaries with respect to any assets of the plan, assuming the conditions for co-fiduciary liability exist. See DOL Reg. §2510.3-21(e)(2)(i).

¶4.b.2) Party-in-interest status. The limitation described in ¶4.b. above does not exclude such person from being a party-in-interest in the capacity of a service provider (as described in ERISA §3(14)(B) and IRC §4975(e)(2)) with respect to any assets of the plan or IRA. See DOL Reg. §2510.3-21(d)(e)(ii).

¶5. Application of regulations to non-ERISA qualified plans and IRAs. IRC §4975(e)(3), which defines a fiduciary for purposes of the prohibited transaction provisions under IRC §4975, parallels the ERISA definition of a fiduciary under ERISA §3(21)(A). Effective December 31, 1978, section 102 of the Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 237 transferred the authority of the Secretary of the Treasury to promulgate regulations regarding the definition of a fiduciary to the Secretary of Labor. Accordingly, all references to ERISA §3(21)(A) in the regulation should be read as a reference to IRC §4975(e)(3) as well, and the provisions of DOL Reg. §2510.3-21 apply for purposes of IRC §4975 with respect to any plan described in IRC §4975(e)(1), including an IRA. See DOL Reg. §2510.3-21(f). Accordingly, investment advice fiduciaries can be subject to excise taxes under IRC §4975 and can be required by the IRS to correct the prohibited transaction in order to avoid the 100% second tier tax under IRC §4975(b).

✪ *Does the regulation impose ERISA fiduciary standards on non-ERISA qualified plans and IRAs?* No, not directly. However, the DOL is indirectly imposing standards similar to those under ERISA §404 through the Best Interest Contract Exemption (separately summarized) and corresponding modifications to some of the existing class exemptions applicable to various financial transactions.

✪ *Is there a co-fiduciary liability risk for non-ERISA qualified plans and IRAs?* No. The co-fiduciary liability rules are found in ERISA §405, and these plans are not subject to those statutory rules, even if the investment advice fiduciary is relying on the Best Interest Contract Exemption.

✪ *Can an investment advice fiduciary to an IRA or non-ERISA qualified plan be sued under ERISA?* No. However, the DOL included a written contract requirement under the Best Practice Contract Exemption that applies to IRAs and non-ERISA plans. This was deliberate so that, even though the fiduciary would not face an ERISA suit for failure to satisfy the ERISA fiduciary standards, the fiduciary could face a breach-of-contract action (including a possible class action) for not putting the client's best interests first or otherwise complying with such exemption.

¶6. Non-fiduciary activities not affected. The DOL notes in the preamble to the final regulations that DOL Reg. §2510.3-21 would not cause attorneys, accountants, and actuaries to be treated as fiduciaries merely because they provide professional assistance in connection with a particular investment transaction. Only when these professionals act outside their normal roles and recommend specific investments or otherwise engage in the provision of fiduciary investment advice would they be subject to the investment advice fiduciary definition. In addition, the regulation would not affect the principle articulated in Interpretative Bulletin 75-8, D-2 (see DOL Reg. §2509.75-8), which provides that the plan sponsor's human resources personnel or plan service providers who have no power to make decisions as to plan policy, interpretations, practices or procedures, but who perform purely administrative functions for an employee benefit plan, within a framework of policies, interpretations, rules, practices and procedures made by other persons, are not fiduciaries with respect to the plan. This is commonly referred to as the "ministerial activities" exception to fiduciary status.

¶7. Selection of persons to provide investment education or investment advice. The designation of a person to provide investment educational services or investment advice to plan participants and beneficiaries is, like any designation of a service provider, an exercise of discretionary authority or control with respect to management of the plan. Therefore, persons making the designation must act prudently and solely in the interest of the plan participants and beneficiaries, both in making the designation and in continuing such designation. In addition, the designation of an investment adviser to serve as a fiduciary may give rise to co-fiduciary liability if the person making and continuing such designation in doing so fails to act prudently and solely in the interest of plan participants and beneficiaries; or knowingly participates in, conceals or fails to make reasonable efforts to correct a known breach by the investment advisor. Although this information was provided in IB 96-1 (see DOL Reg. §2509.96-1(e), before its removal by these new regulations), DOL Reg. §2510.3-21 does not incorporate this discussion. Instead, the DOL refers in the preamble to the general principles under ERISA §§404 and 405 which support this concept of fiduciary responsibility with respect to appointed service providers.

✪ *Investment advice fiduciary status not conferred on plan sponsor merely by making appointment.* In the case of an employer or other plan sponsor, an employer or plan sponsor would not become an investment advice fiduciary merely because the employer or plan sponsor engaged a service provider to provide investment advice, or because a service provider engaged to provide investment education crossed the line and provided investment advice in a particular case. However, if the employer does not prudently monitor the service provider, there could be liability on the employer as a result of such imprudent conduct under the general principles of ERISA §§404 and 405. See the preamble to the final regulations at 81 F.R. 20965 (April 8, 2016).

✪ *Employer not liable for participant's designation of an investment advice fiduciary.* A plan sponsor or fiduciary would have no fiduciary responsibility or liability with respect to the actions of a third party selected by a participant or beneficiary to provide education or investment advice where the plan sponsor or fiduciary neither selects nor endorses the educator or adviser, nor otherwise makes arrangements with the educator or adviser to provide such services. See the preamble to the final regulations at 81 F.R. 20965 (April 8, 2016). In footnote 25 of the preamble, the DOl acknowledged that a plan sponsor may wish to provide office space or make computer terminals available for use by a service provider that has been selected by a participant or beneficiary to provide investment education using interactive materials. Whether a plan sponsor or fiduciary has effectively endorse or made an arrangement with a particular service provider is an inherently factual inquiry. However, a uniformly applied policy of providing office space or computer terminals for service providers independently selected by plan participants or beneficiaries would not, in of it itself, constitute an endorsement of or an arrangement with a service provider.

Prohibited Transaction Exemptions Relating to Investment Transactions

New class exemptions and modifications to existing exemptions coordinate with final investment advice fiduciary regulations [Citation: *Best Interest Contract Exemption*, 81 F.R. 21002-21089 (April 8, 2016), *Class Exemption for Principal Transactions in Certain Assets between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs*, 81 F.R. 21089-21139 (April 8, 2016), *Amendments to Class Exemptions 75–1, 77–4, 80–83 and 83–1*, 81 F.R. 21208-21221 (April 8, 2016), *Amendment to and Partial Revocation of PTE 86–128 and Amendment to and Proposed Partial Revocation of PTE 75–1*, 81 F.R. 21181-21208 (April 8, 2016), *Amendment to PTE 75-1, Part V*, 81 F.R. 21139-21147 (April 8, 2016), and Amendment to and Partial Revocation of PTE 84-24, 81 F.R. 21147-21181 (April 8, 2016)]
Text available at http://1.usa.gov/1PYn2NS (Best Interest Contract Exemption), http://1.usa.gov/1oIwjDG (Principal Transactions Exemption), http://1.usa.gov/1PYmHe6 (Modifications to PTE 75-1, PTE 77-4, PTE 80-83 and PTE 83-1), http://1.usa.gov/1S1cEcF (Modifications to PTE 86-128 and PTE 75-1), http://1.usa.gov/1S1cAtD (Modifications to PTE 75-1, Part V), and http://1.usa.gov/1qxO1vc (Modifications to PTE 84-24)
EOB2016 sections affected: Chapter 14, Section II, Part E

On April 8, 2016, the DOL issued final regulations defining an investment advice fiduciary. See separate summary at ¶3.320(1). In conjunction with those regulations, the DOL issued two new class exemptions, and modified several existing class exemptions involving investment transactions. These exemptions are:

- ➤ Best Interest Contract Exemption (see ¶1, ¶2 and ¶3 below)
- ➤ Principal Transactions Exemption (see ¶4 below)
- ➤ Modifications to PTE 86-128 (see ¶5 below)
- ➤ Modifications to PTE 75-1, PTE 77-4, PTE 80-83 and PTE 83-1 (see ¶6 below)
- ➤ Modifications to PTE 84-24 (see ¶7 below)

These exemptions seek to impose impartial advice standards on investment advice fiduciaries who would avail themselves of these exemptions in order to be compensated for investment advice without engaging in a prohibited transaction. The exemptions also restrict how these exemptions are used by investment advice fiduciaries to IRAs and IRA owners.

✪ *Significant changes from the proposed exemptions.* The DOL has substantially modified the Best Interest Contract Exemption and has expanded the reach of the Principal Transactions Exemption. The final version of the Best Interest Contract Exemption is more workable, particularly for investment advice fiduciaries who provide services to ERISA plans. The key changes to the Best Interest Contract Exemption are the following.

- Elimination of the written contract requirement when the Exemption is applied to advice provided to ERISA plans (IRAs and non-ERISA plans are still subject to the written contract requirement, although contract need not be executed prior to the adviser's recommendations)
- Requiring only the Financial Institution (and not the Adviser(s) associated with that institution) to execute the contract with the advice recipient
- Required contract terms can be incorporated into account-opening documents
- Addition of a negative consent process for existing clients (at the time the Exemption becomes fully applicable)
- Streamlined compliance for rollover advice where level fees are paid (the so-called "level-to-level" rule)
- Simplification of the disclosure requirements and elimination of most of the proposed data collection requirements

- Requirement to provide the most detailed disclosures only upon request
- Elimination of the limited asset list, so that all investment types can be covered by the Exemption
- Expansion of the application of the Exemption to advice provided to small plans
- Clarification of how the Exemption is satisfied by institutions that limit offerings to proprietary products
- Addition of a mechanism to correct good faith violations of the disclosure conditions without losing the benefit of the Exemption

¶1. <u>Best Interest Contract Exemption</u>. In response to comments that its investment advice fiduciary regulation will negatively affect the availability of investment advice for retail investors, the DOL has issued this class exemption on its own motion. According to the preamble to the Exemption, the Exemption will promote the provision of investment advice that is in the best interest of "retail investors" such as plan participants and beneficiaries, IRA owners, and small plans. Certain types of fees and compensation common in the retail market, such as brokerage or insurance commissions, 12b-1 fees and revenue sharing payments, result in prohibition transactions when received by fiduciaries as a result of investment advice transactions. The exemption would allow certain investment advice fiduciaries, including broker-dealers and insurance agents, to receive these various forms of compensation if certain conditions are met. Although level-fee advisers in many cases will not need the Exemption because the manner of compensation does not result in a prohibited transaction, the Exemption is available if there are potential conflicts of interest in the delivery of that advice (e.g., additional compensation to an affiliate arising from the investments selected as a result of the advice). The DOL views the Best Interest Contract Exemption as taking a "standards-based approach" to the conditions for exemption, rather than imposing a highly prescriptive approach to specifying conditions. This statement certainly carries more weight in the final reversion of the Exemption, where the DOL has substantially simplified the compliance requirements. The DOL believes its approach will provide sufficient flexibility to accommodate a wide range of business practices and to allow current compensation practices to remain in effect while minimizing the harmful impact of conflicts of interest on the quality of advice. Nonetheless, it will result in a significant change to "business as usual" in the investment advice arena.

> ✪ *Applicability date.* Although the Best Interest Contract Exemption, as well as the supplemental exemptions referenced in the next paragraph, is considered to be issued on June 7, 2016 (the effective date of revised DOL Reg. §2510.3-21), it is applicable to transactions occurring <u>on or after April 10, 2017</u>, consistent with the applicability date of DOL Reg. §2510.3-21. However, certain conditions of the Exemption are postponed until <u>January 1, 2018</u>. During the period from April 10, 2017, through January 1, 2018 (referred to as the Transition Period" in Section IX of the Exemption - see ¶3.b. below), full relief is available for Financial Institutions and Advisers even though they will be subject to more limited conditions. This period is intended to give Financial Institutions and Advisers time to prepare for compliance with the conditions of Sections II through V of the Exemption, as described in ¶1.c., ¶1.d., ¶.e. and ¶1.f. below, while safeguarding the interests of Retirement Investors.
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> ✪ *Two additional exemptions.* As part of the Best Interest Contract Exemption, the DOL also provides an exemption for the purchase or sale of an investment product (including insurance and annuity contracts) involving a service provider. See ¶2. below. This exemption for purchases and sales does <u>not</u> apply to Principal Transactions, which are subject to the conditions of a separate Class Exemption (separately summarized in ¶4 below). The DOL also is providing provide broad exemptive relief for transactions by Advisers and Financial Institutions occurring before April 10, 2017, including the

continued holding of investments that were acquired before April 10, 2017, or were acquired after such date, but pursuant to a recommendation given before April 10, 2017. See ¶3. below.

¶1.a. Covered transactions under the Best Interest Contract Exemption ("Exemption"). The Best Interest Contract Exemption ("Exemption") would permit Advisers, Financial Institutions, and their Affiliates and Related Entities to receive compensation as a result of their provision of investment advice (within the meaning of ERISA §3(21)(A)(ii) or IRC §4975(e)(3)(B)) to a Retirement Investor without being treated as engaging in a prohibited transaction. See Section I(b) of the Exemption. The terms Retirement Investor, Adviser, Financial Institution, Affiliate, and Related Entity are defined in ¶1.a.1) below. For the exemption to be available: (1) the Financial Institution and the Adviser must satisfy impartiality standards, acknowledge fiduciary status and provide disclosures, and, in the case of an IRA or non-ERISA plan, enter into a written contract with the Retirement Investor (see ¶1.c. below), (2) certain disclosures must be provided on a transactional basis, and on a periodically-updated web basis (see ¶1.d. below), (3) certain additional conditions must be met with respect to Proprietary Products and Third Party Payments (see ¶1.e. below), and (4) disclosures must be furnished to the DOL and certain recordkeeping requirements must be satisfied (see ¶1.f. below).

Limitation on assets dropped. **The proposed version of the Exemption limited the relief to advice on only certain types of assets. The final version removes that limitation, so that the adviser may provide investment recommendations relating to all types of assets, including limited partnerships, REITs, and all types of annuity contracts. However, the DOL intends to pay "special attention" to recommendations involving investments that are complex, illiquid, risky, lack transparency, bear high fees or commissions, or provide tax benefit that are generally unnecessary in a tax-exempt account, to ensure that any recommendations on such products made after April 10, 2017, adhere to the Impartial Conduct Standards described in ¶1.c.3) below. Financial Institutions and Advisers should take special care in recommending such investments, and Financial Institutions should ensure that their policies and procedures are designed to ensure compliance by its Advisers with the Impartial Conduct Standards, and provide Advisers with information and training to fully understand all investment products being sold. See the preamble to the Exemption, 81 F.R. 21015 (April 8, 2016).**

¶1.a.1) Defined terms.

¶1.a.1)a) Retirement Investor. The following persons qualify as Retirement Investors for purposes of the Exemption: (1) a participant or beneficiary of a Plan (defined in ¶1.a.1)b) below) with authority to direct the investment of assets in his or her Plan account or to take a distribution, (2) the beneficial owner of an IRA acting on behalf of the IRA, and (3) a Retail Fiduciary (defined in ¶1.a.1)a)i) below). See Section VIII(o) of the Exemption.

¶1.a.1)a)i) Retail Fiduciary. A Retail Fiduciary is a fiduciary of a Plan or IRA, other than a fiduciary with financial expertise, as determined under DOL Reg. §2510.3-21(c)(1)(i). See Section VIII(n) of the Exemption.

¶1.a.1)b) Plan/IRA. The Exemption defines a Plan as an employee benefit plan under ERISA §3(3) or a qualified plan described in IRC §4975(e)(1)(A). See Section VIII(j) of the Exemption. An IRA for purposes of the Exemption means any account or annuity described in IRC §4975(e)(1)(B) through (F), which includes not only IRAs and Roth IRAs described in IRC §§408(a) and (b) and 408A, and SEPs and SIMPLE-IRAs, but also HSAs, Archer medical savings accounts, and Coverdell education savings accounts. See Section VIII(g) of the

Exemption. These definitions of plan and IRA coordinate with the definitions also used in the investment advice fiduciary regulation (DOL Reg. §2510.3-21).

¶1.a.1)c) Adviser. An adviser is an individual who: (1) is a fiduciary of a Plan or IRA solely by reason of the provision of investment advice (as described in ERISA §3(21)(A)(ii) or IRC §4975(e)3)(B), or both, and the applicable regulations) with respect to assets of the Plan or IRA involved in the transaction, (2) is an employee independent contractor, agent, or registered representative of a Financial Institution (see ¶1.a.1)d) below), and (3) satisfies the applicable federal and state regulatory and licensing requirements of insurance, banking, and securities laws with respect to the covered transaction. See Section VIII(a) of the Exemption. Note that all three conditions must be satisfied. See ¶1.a.1)e) below for the definition of an Affiliate of the Adviser.

Discretionary fiduciaries. **The DOL noted in the preamble that it confined the Best Interest Contract Exemption to investment advice fiduciaries because a fiduciary who has full investment discretion with respect to plan or IRA assets or who has discretionary authority over the administration of the plan or IRA (a "discretionary fiduciary") is not affected by DOL Reg. §2510.3-21 and thus, not the subject of the Exemption. This is *not* to say the discretionary fiduciary could engage in conflicted advice without ramifications. Rather, the discretionary fiduciary must look to other prohibited transaction exemptions that may apply to a particular transaction engaged in by such fiduciary.**

¶1.a.1)d) Financial Institution. The Financial Institution for purposes of this Exemption is the entity that employs the Adviser or otherwise retains such individual as an independent contractor, agent or registered representative. The Financial Institution must fall into one of the five following categories.

(1) Registered as an investment adviser under the Investment Advisers Act of 1940 or under the laws of the State in which the Adviser maintains its principal office and place of business.

(2) Bank or similar financial institution supervised by the United States or State, or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 USC 1813(b)(1)) (regardless of whether the advice is provided through a trust department).

(3) Insurance company qualified to do business under the laws of a State, provided that the insurance company (a) has obtained a Certificate of Authority from the insurance commissioner of its domiciliary State which has neither been revoked nor suspended, (b) has undergone and shall continue to undergo an examination by an independent certified public accountant for its last completed taxable year or has undergone a financial examination (within the meaning of the law of its domiciliary State) by the state's insurance commissioner within the preceding 5 years, and (c) is domiciled in a State whose law requires that actuarial review of reserves be conducted annually by an independent firm of actuaries and reported to the appropriate regulatory authority (see ¶1.a.1)g) below for the criteria for determining a person is "independent").

(4) Broker or dealer registered under the Securities Exchange Act of 1934.

(5) Entity that is described in the definition of Financial Institution in an individual exemption granted by the DOL under ERISA §408(a) and IRC §4975(c), after June 7, 2016 (the issuance date of this Exemption), that provides relief for the receipt of compensation in connection with investment advice provided by an investment advice fiduciary, under the same conditions as the Best Interest Contract Exemption.

See Section VIII(e) of the Exemption. Also see ¶1.a.1)e) below for the definition of an Affiliate of a Financial Institution.

¶1.a.1)e) Affiliate. An Affiliate of an Adviser or Financial Institution is: (1) any person, directly or indirectly through one or more intermediaries, who is controlling, controlled by, or under common control with the Adviser or Financial Institution, where "control'' means the power to exercise a controlling influence over the management or policies of a person other than an individual, (2) any officer, director, partner, employee, or relative (as defined in ERISA §3(15) - a spouse, ancestor, lineal descendant, or spouse of a lineal descendant) of the Adviser or Financial Institution, and (3) any corporation or partnership of which the Adviser or Financial Institution is an officer, director or partner. See Section VIII(b) of the Exemption.

¶1.a.1)f) Related Entity. The Exemption broadly defines a Related Entity as any entity other than an Affiliate in which the Adviser or Financial Institution has an interest which may affect the exercise of its best judgment as a fiduciary. See Section VIII(m) of the Exemption. This places the burden on the investment advice fiduciary to analyze relationships that might potentially create a conflict of interest or otherwise affect the best judgment of such person.

¶1.a.1)g) Independent person. A person is Independent for purposes of this Exemption if that person: (1) is *not* the Adviser, the Financial Institution or any Affiliate relying on the Exemption, (2) does not receive, *or is not projected to receive within the current Federal income tax year*, compensation or other consideration for his or her own account from the Adviser, the Financial Institution or Affiliate in excess of 2% of the person's annual revenues based upon its prior income tax year, and (3) does not have a relationship to or an interest in the Adviser, the Financial Institution or Affiliate that might affect the exercise of the person's best judgment in connection with transactions described in the Exemption. See Section VIII(f) of the Exemption.

¶1.a.2) Relief. The Exemption provides relief from the restrictions of ERISA §406(a)(1)(D) and §408(b), and the excise taxes under IRC §4975(a) and (b) by reason of IRC §4975(c)(1)(D), (E) and (F), as long as the conditions described in ¶1.c. through ¶1.f. below are satisfied. These statutory provisions preclude the use of plan assets by a party-in-interest/disqualified person (ERISA §406(a)(1)(D) and IRC §4975(c)(1)(D)) and self-dealing by a fiduciary (ERISA §406(b) and IRC §49975(c)(1)(E) and (F)). See Section I(b) of the Exemption. Note that relief from ERISA §406(a)(1)(C) and IRC §4975(c)(1)(C), which generally prohibits compensation for services rendered to a plan or IRA, is not provided. Since investment advice is a service rendered to plans, the Adviser and Financial Institution are not relieved of the need to comply with the services exemption under ERISA §408(b)(2) and IRC §4975(d)(2), including the fee disclosure requirements under DOL Reg. §2550.408b-2, in order to receive compensation for their services, even if the Adviser and the Financial Institution meet the conditions of the Best Interest Contract Exemption.

¶1.a.3) Effect of failing to comply with the conditions of the Best Interest Contract Exemption. Satisfaction of the conditions of the Exemption is determined on a transaction by transaction basis. Thus, the effect of noncompliance with a condition depends on whether the condition applies to a single transaction or multiple transactions. For example, if an Adviser fails to provide a transaction disclosure in accordance with Section III(a) (see ¶1.d.1) below) with respect to a particular asset purchased by a plan, account, or IRA, the relief provided by the Best Interest Contract Exemption would be unavailable to the Adviser and Financial Institution only for the otherwise prohibited compensation received in connection with the investment in that specific asset. More broadly, if an Adviser and Financial Institution fail to meet the Impartial Conduct Standard described in ¶1.c. below, relief under the Best Interest Contract Exemption would be unavailable solely with respect to the investments made by that Retirement Investor, not all Retirement Investors to which the Adviser and Financial Institution provide advice. However, if a Financial Institution fails to comply with a condition that is necessary for all transactions involving investment advice to Retirement Investors, such as the maintenance of the webpage, as described in ¶1.d. below, the Financial Institution will not be eligible for the relief under the Best Interest Contract Exemption for all prohibited transactions entered into during the period in which the failure to comply existed.

¶1.a.4) Why would an Adviser need this Exemption if his or her compensation is level? As a general principle, a person who receives truly level compensation (e.g., fixed percentage of assets) is not engaging in a prohibited transaction with respect to such advice and wouldn't need the Best Interest Contract Exemption. The DOL agrees with such assessment, noting in the preamble to the Exemption that, by itself, the ongoing receipt of compensation calculated as a fixed percentage of the value of assets under manager, where such values are determined by readily available independent sources or independent valuations, typically would not raise prohibited transaction concerns. However, a particular relationship or compensation structure could result in an Adviser having an interest that may affect the exercise of its best judgment as a fiduciary when providing a recommendation, which would violate the self-dealing rules. For example, self-valuation by the Adviser of assets under management, that could affect the Adviser's compensation, may raise prohibited transaction issues. A prohibited transaction also could arise with respect to a discrete investment advice transaction, such as a recommendation to take a distribution (or effect a rollover) that could generate a fee for the Adviser that he or she would not otherwise receive. Remember, a primary objective of the Best Interest Contract Exemption and the revised exemptions also being released by the DOL is to neutralize the impact of conflicts of interest. See the preamble to the investment advice regulation (DOL Reg. §2510.3-21) at 81 F.R. 20992 (April 8, 2016). When in doubt, the Adviser should either comply with the Best Interest Contract Exemption, or rely on a statutory exemption or another class exemption, to ensure that he or she is not engaging in a prohibited transaction. The Adviser also might comply with the Best Interest Contract Exemption only in a rollover transaction, for example, but not with respect to ongoing advice provided under a level compensation arrangement, if the Adviser determines the ongoing relationship does not raise prohibited transaction issues (including conflicts of interest). Ultimately, the burden will be on the Adviser to show that he or she did not engage in a prohibited transaction, either because of the structure of the relationship or because of compliance with the Best Interest Contract Exemption or other exemption.

¶1.b. Exclusions. The Exemption does not apply if any of the circumstances described in ¶1.b.1) through ¶1.b.4) apply.

¶1.b.1) Certain plan roles prohibited. If the Plan is covered by Title I of ERISA, the Exemption does not apply if: (1) the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the Plan, or (2) the Adviser or Financial Institution (or an Affiliate) is named fiduciary or plan administrator (as defined in ERISA §3(16)(A)) with respect to the Plan, and was selected to provide advice to the Plan by a fiduciary who is not Independent. See Section I(c)(1) of the Exemption. Regarding (1), the employer/employee restriction does not apply in the case of an IRA.

Accordingly, an Adviser or Financial Institution may provide advice to the beneficial owner of an IRA who is employed by the Adviser, its Financial Institution or an Affiliate, and receive prohibited compensation as a result. The prohibition in (2) is intended to disallow selection of Advisers and Financial Institutions by named fiduciaries or plan administrators that have an interest in them.

¶1.b.2) Must not be a Principal Transaction. The Exemption does not apply if the compensation is received as a result of a Principal Transaction. See Section I(c)(2) of the Exemption. A "Principal Transaction" is a purchase or sale of an investment product in which the Adviser or Financial Institution is purchasing from or selling to a Plan, participant or beneficiary, or IRA on behalf of: (1) the Financial Institution's own account, or (2) the account of a person who is directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the Financial Institution. See Section VIII(k) of the Exemption. But see ¶4 below for a separate Principal Transaction Class Exemption covering certain principal transactions. Given the more direct potential conflict between the Adviser or Financial Institution and the Retirement Investor in a Principal Transaction, special conditions need to be satisfied, which are set forth in that separate exemption.

¶1.b.2)a) Certain transactions *not* treated as Principal Transactions. A Principal Transaction does not include: (1) the sale of an insurance or annuity contract, (2) a mutual fund transaction, or (3) a Riskless Principal Transaction. A Riskless Principal Transaction is a transaction in which a Financial Institution, after having received an order from a Retirement Investor to buy or sell an investment product, purchases or sells the same investment product for the Financial Institution's own account to offset the contemporaneous transaction with the Retirement Investor. See Section VIII(p). The DOL has determined that these Principal Transactions do not need special conditions and, therefore, are covered by the Best Interest Contract Exemption.

***Transactional relief for sales or purchases not treated as Principal Transactions.* See ¶2 below for relief from ERISA §406(a)(1)(A) through (D) and IRC §4975(c)(1)(A) through (D) provided by Section VI of the Exemption for certain investment transactions that are not included in the definition of a Principal Transaction, including Riskless Principal Transactions. Depending on business practices, a Financial Institution might confine use of the Principal Transactions Exemption described in ¶4 below for all Principal Transactions (including Riskless Principal Transactions), or satisfy the Principal Transaction Exemption described in ¶4 below only when the transaction is not a Riskless Principal Transaction and use the Best Interest Contract Exemption for Riskless Principal Transactions.**

¶1.b.3) Robo-advice provider that is not a Level Fee Fiduciary. The Exemption generally does not apply if the compensation is received as a result of investment advice to a Retirement Investor generated solely by an interactive website in which computer software-based models or applications provide investment advice based on personal information each investor supplies through the website without any personal interaction or advice from an individual Adviser (usually referred to as robo-advice). However, the Exemption is available if the robo-advice provider is a Level Fee Fiduciary that complies with the conditions in Section II of the Exemption that apply to a Level Fee Fiduciary, as explained in ¶1.g.1) below. See Section I(c)(3) of the Exemption.

***Rationale.* The DOL is of the opinion that, since the marketplace for such advice is still evolving in ways that both appear to avoid conflicts of interest that would violate the prohibited transaction rules, and minimize cost, a general inclusion of robo-advice in the Best Interest Contract Exemption could adversely modify the incentives currently shaping the market for robo-advice. The DOL also points to the statutory prohibited transaction exemption under IRC §408(g) which covers**

computer-generated investment advice for conflicted fiduciary advisers, as set forth in DOL Reg §2550.408g-1. However, to provide an alternative to the statutory exemption for Level Fee Fiduciaries that provide robo-advice, the limited exception for such robo-advice is eligible for the Best Interest Contract Exemption.

¶1.b.4) Fiduciary status relating to plan management or administration. The Exemption does not apply if the Adviser has or exercises any discretionary authority or discretionary control with respect to the recommended transaction. See Section I(c)(4) of the Exemption. In such case, the fiduciary engaging in the transaction would need to rely on another prohibited transaction exemption (e.g., the statutory exemption under ERISA §408(b)(14) and IRC §4975(d)(17) for certain conflicted investment advice, or PTE 86-128, if applicable). Note that in the definition of an Adviser, as described in ¶1.a.1)c) above, the Adviser must be a fiduciary solely by reason of being an investment advice fiduciary. So, this exclusion is technically redundant, since the discretionary authority or control would render the person a fiduciary for other reasons, thereby making the Exemption unavailable anyway.

¶1.c. Contract, Impartial Conduct, and other requirements. Section II of the Exemption prescribes the "guts" of the Best Interest Contract Exemption, i.e., the formalities of the investment advice transactions, standards of conduct, warranties, and disclosures. These conditions are described in ¶1.c.1) through ¶1.c.5) below. More limited conditions are imposed on certain transactions engaged in by Level Fee Fiduciaries. See ¶1.g.1) below.

¶1.c.1) Written contract requirement (IRAs and non-ERISA plans only). If the investment advice concerns an IRA or non-ERISA Plan, the Financial Institution must enter into an enforceable[4] written contract that meets the conditions specified in Section II(a) of the Exemption. The contract must incorporate the requirements described in ¶1.c.2) through ¶1.c.4) below regarding acknowledgment of fiduciary status, Impartial Conduct Standards, Warranties. The contract requirement is the cornerstone of the Exemption for IRAs and non-ERISA Plans because it creates a mechanism under which a Retirement Investor is alerted to the Adviser's and Financial Institution's obligations and is provided with a basis upon which its rights can be enforced. ERISA plans are not subject to the written contract requirement because the enforcement mechanisms of ERISA (which also authorizes enforcement activity by the DOL) are available.

***Advisers need not be parties to the contract.* Note that it is the Financial Institution that must enter into the contract, not the individual Advisers that will be providing investment advice with respect to the contract.**

***No effect on transactions not otherwise subject to prohibited transaction rules.* Compliance with the Best Interest Contract Exemption would be necessary only with respect to transactions that otherwise would constitute prohibited transactions under ERISA and the tax code. Certain compensation arrangements can be structured by a fiduciary without engaging in a prohibited transaction. See, for example, Advisory Opinion 97-15A (the so-called "Frost opinion") (illustrated in the example at ¶1.c.4)b)iii) below. However, to the extent a compensation arrangement cannot be fully outside of the prohibited transaction net, an exemption is needed, which may be obtained either through the Best Interest Contract Exemption or another available statutory or administrative exemption.**

[4] As long as the contract is enforceable, the Financial Institution is not required to sign the contract. See the preamble to the Exemption at 81 F.R. 21024 (April 8, 2016).

¶1.c.1)a) Contract execution and assent. Section II(a)(1) prescribes rules for formalizing the contract requirements, which differ for new contract and existing contracts (pre-2018 contracts).

¶1.c.1)a)i) New contracts. A new contract (i.e., on entered into on or after January 1, 2018), which includes the terms required by Section II(b)-(d) of the Exemption (see ¶1.c.2) through ¶1.c.4) below), must be entered into no later than the time as the execution of the recommended transaction (but, in order to cover prior recommendations, the contract's terms must cover such recommendations). The contract is between the Financial Institution and the Retirement Investor acting on behalf of the Plan, participant or beneficiary account, or IRA. The contract may (but is not required to be) a standalone document. It also can be incorporated into an investment advisory agreement, investment program agreement, account opening agreement, insurance or annuity contract or application, or similar document (or amendment thereto). The contract must be enforceable against the Financial Institution. The Retirement Investor's assent may be evidenced by either handwritten or electronic signatures (but telephonic consent is not permissible). See Section II(a)(1)(i) of the Exemption.

¶1.c.1)a)i)A) Relief for new contracts not executed by Retirement Investor where compensation is received for investment advice. For a Retirement Investor who does not have an existing contract, and must enter in a new contract with the Financial Institution, as described in ¶1.c.1)a)i) above, relief is provided if the contract is not entered into, but the Financial Institution, or any Adviser, Affiliate or Related Entity thereof, receives compensation (except as prohibited in relief conditions (1) and (2), as described later in this paragraph) as a result of the Adviser's or Financial Institution's investment advice to the Retirement Investor regarding an IRA or non-ERISA plan. This relief is necessitated because the contract does not have to be executed before advice is provided, only before any transaction is executed pursuant to such advice. For the relief to apply: (1) the individual Adviser making the recommendation cannot receive compensation, directly or indirectly, that is reasonably attributable to the Retirement Investor's purchase, holding, exchange or sale of the investment (e.g., a commission or 12b-1 fee), (2) the Financial Institution's policies and procedures prohibit the Financial Institution and its Affiliates and Related Entities from compensating their Advisers in lieu of compensation described in (1) (including bonuses, prizes or other incentives) and the Financial Institution reasonably monitors such policies and procedures, (3) the Adviser and the Financial Institution, with respect to the recommendation, comply with the Impartial Conduct Standards set forth in ¶1.c.3) below (except the warranty requirement), the web disclosure requirement described in ¶1.d.4) below, and the conditions (if applicable) on Proprietary Products or investments that generate Third Party Payments that are described in ¶1.e.3) through ¶1.e.6) below, and (4) the failure by the Financial Institution to enter into the contract is not part of an effort, attempt, agreement, arrangement or understanding by the Adviser or Financial Institution designed to avoid compliance with the exemption or enforcement of its conditions. See Section II(a)(1)(iii) of the Exemption. Note that condition (1) prohibits compensation to the Adviser that is attributable to the investment transaction to the Advisor, but not to the Financial Institution or its Affiliates or Related Entities.

¶1.c.1)a)ii) Amendment of existing contracts by negative consent. For existing contracts (i.e., an investment advisory agreement, investment program agreement, account opening agreement, insurance contract, annuity contract, or similar agreement or contract that was executed before January 1, 2018, and remains in effect), either a new contract can be executed, in accordance with ¶1.c.1)a)i) above, or a negative consent approach can be utilized. Under the negative consent approach, proposed amendments to the existing contract (which must include the terms required under Section III(b)-(d) of the Exemption, as explained in ¶1.c.2) through ¶1.c.4) below) and the disclosure required by Section II(e) (see ¶1.c.5) below) must be delivered (by mail or electronically) to the Retirement Investor prior to January 1, 2018. The amended contract is then deemed to go into effect unless the amended contract is terminated within 30 days after delivery. See Section II(a)(1)(ii) of the Exemption. The proposed amendment may not impose any new contractual obligations, restrictions, or liabilities on the Retirement Investor by negative consent.

¶1.c.1)b) Master contract covering multiple recommendations. A separate written contract is not required for each recommendation. Thus, the contract may cover all of the recommendations made to the Retirement Investor by the Financial Institution and its associated Advisers as long as the contract is entered into no later than the first time a transaction is executed pursuant to any recommendation that is covered by the contract. See Section II(a) of the Exemption.

¶1.c.1)c) Availability of contract at website. The Financial Institution must maintain an electronic copy of the Retirement Investor's contract on its website that is accessible by the Retirement Investor. See Section II(a)(2) of the Exemption.

¶1.c.1)d) Prohibited contractual provisions. The written contract may not contain: (1) exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms, (2) a provision under which the Plan, IRA or Retirement Investor waives or qualifies its right to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution, or in an individual or class claim agrees to an amount representing liquidated damages for breach of the contract, or (3) agreements to arbitrate or mediate individual claims in venues that are distant or otherwise unreasonably limit the ability of the Retirement Investors to asset the claims safeguarded by the Exemption (but otherwise, requiring pre-dispute binding arbitration of individual disputes is permissible). See Section II(f)(1) through (3) of the Exemption.

¶1.c.1)d)i) Waiver of punitive damages or rescission is permissible. The contract may includes a waive of the Retirement Investor's right to obtain punitive damages or rescission of recommended transactions to the extent such waiver is: (1) knowingly agreed to by the parties, and (2) permissible under applicable State or Federal law. See Section II(f)(3) of the Exemption.

¶1.c.1)d)ii) Severability of prohibition on arbitration agreements for class claims. One of the prohibited contractual provisions shown in ¶1.c.1)d) protects the right to bring a class action or other representative claim, which would include a prohibition on arbitrary agreement for class claims. To ensure that the remainder of the requirements remain in effect should a court rule this prohibition to be invalid, the Exemption provides that, until such court's decision is reversed, all other terms of the Exemption remain in effect with respect to contracts subject to that court's jurisdiction. See Section II(f)(4) of the Exemption.

¶1.c.1)e) Compliance for ERISA Plans. For recommendations to Retirement Investors regarding investments in ERISA Plans, where the contract requirement does not apply, the operational requirements of Section II of the Exemption apply. Specifically: (1) no later than the time of execution of the recommended transaction, the Financial Institution must comply with the fiduciary statement requirement described in ¶1.c.2) below, (2) the Financial Institution and the Adviser must comply with the Impartial Conduct Standards described in ¶1.c.3) below, (3) the Financial Institution must adopt policies and procedures incorporating the requirements and prohibitions described in ¶1.c.4) below (but is not required to make a warranty that it will comply with the policy and procedures requirement since ERISA already provides an enforcement mechanism), and (4) provide the disclosures described in ¶1.c.5) below. See Section II(g) of the Exemption. The difference is that, in the context of the IRA or non-ERISA plan, these requirements will also be reflected in the written contract, in order to create a enforcement mechanism to fill the void of no ERISA coverage.

¶1.c.1)e)i) Prohibition on entering into contracts with certain provisions. To ensure that in the case of an ERISA-covered plan proper ERISA enforcement is not compromised, the Financial Institution and the Adviser may not enter into any contract, instrument, or communication that would be precluded in a written contract in the IRA or non-ERISA plan context, as described in ¶1.c.1)d) above. With respect to prohibition (1) in ¶1.c.1)d) above, the prohibition is reworded to be consistent with ERISA. Thus, the contract, instrument or communication may not purport to disclaim any responsibility or liability for any responsibility, obligation, or duty under Title I of ERISA to the extent the disclaimer would be prohibited by ERISA §410. See Section II(g)(5) of the Exemption.

¶1.c.2) Statement of fiduciary status. The Exemption requires the Financial Institution to affirmatively states in writing that it and the Adviser(s) act as fiduciaries under ERISA or the tax code, or both, with respect to any investment advice provided by the Financial Institution or the Adviser subject to the contract or, in the case of an ERISA plan, with respect to any investment recommendations regarding the Plan or participant or beneficiary account. See Section II(b) of the Exemption. Note that the statement is made by the Financial Institution on behalf of all of its Advisers.

Not intended to conflict with securities law. **The DOL notes in the preamble to the Exemption that it is not requiring the Adviser or Financial Institution to acknowledge fiduciary status under securities laws, but rather under ERISA or the tax code, or both. Thus, in its opinion, such acknowledgment would not trigger an automatic loss of the broker-dealer exception under the Investment Advisers Act of 1940. Having to act in the customer's best interest, receive no more than reasonable compensation, and refrain from making misleading statements, as required of a broker who is fiduciary investment adviser under DOL Reg. §2510.3-21 does not cause the broker to violate the securities laws, nor do the securities laws forbid such brokers from working for firms that implement appropriate polices and procedures to ensure that these standards in the Exemption are satisfied. See 81 F.R. 21026 (April 8, 2016).**

Additional comments on fiduciary acknowledgment. **The Exemption does not condition relief on acknowledgment of fiduciary status by more than one Financial Institution. The Exemption only require a Financial Institution acknowledge fiduciary status. For example, where there is a product**

manufacturer (e.g., insurance company), and a broker-dealer or RIA recommending the product to clients, either one could be the Financial Institution acknowledging fiduciary status. However, the Financial Institution exercising supervisory authority (e.g., the broker-dealer in this example) must adhere to the conditions of the Exemption, including the policies and procedures requirement and the obligation to insulate the Adviser from incentives to violate the Best Interest Standard, as discussed in ¶1.c.4) below. In addition, if the product manufacturer is the only entity that satisfies the Financial Institution definition with respect to a particular transaction (e.g., advice is provided by agents of the manufacturer), then the product manufacturer must acknowledge fiduciary status and exercise the require supervisory authority with respect to the Exemption, including entering into the contract in the case of an IRA or non-ERISA plan. See the preamble to the Exemption at 81 F.R. 21067 (April 8, 2016).

¶1.c.3) Impartial Conduct Standards. The Impartial Conduct Standards are: (1) investment advice will be provided to the Retirement Investor that, at the time of the recommendation, is in the Best Interest of the Retirement Investor (see ¶1.c.3)a) below for more details), (2) the recommended transaction will not cause the Adviser, Financial Institution, or their Affiliates or Related Entities to receive, directly or indirectly, compensation[5] for their services that is in excess of reasonable compensation within the meaning of ERISA §408(b)(2) and IRC §4975(d)(2), and (3) statements by the Financial Institution and its Advisers to the Retirement Investor about the recommend transaction, fees and compensation, Material Conflicts of Interest (see ¶1.c.3)b) below), and any other matters relevant to a Retirement Investor's investment decisions, will *not* be materially misleading at the time they are made.[6] See Section II(c) of the Exemption. The reasonableness standard for the compensation is consistent with the compensation requirement for service providers under ERISA §408(b)(2) and is dependent on the particular facts and circumstances. In the case of an IRA or a non-ERISA plan, the written contract, as described in ¶1.c.1) above must state that the Financial Institution and its Advisers will comply with these standards.

Compliance is a condition of the Exemption. **Note that actual compliance with Impartial Conduct Standards is a condition for the relief. For example, if the investment advice does not meet the Best Interest standard, the exemption is not available, even if the Retirement Institution or the Adviser has stated, in a written contract or otherwise, that it would comply with that standard.**

¶1.c.3)a) Best Interest of the Retirement Investor. Investment advice is in the Best Interest of the Retirement Investor when the Advisor and Financial Institution providing the advice act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like manner and familiar with such matters would use in the conduct of an enterprise of like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the

[5] Footnote 57 of the preamble to the Exemption provides that such compensation includes, for example, charges against the investment, such as commissions, sales loads, sales charges, redemption fees, surrender charges, exchange fees, account fees and purchase fees, as well as compensation included in operating expenses and other ongoing charges, such as wrap fees, mortality, and expense fees. However, "spread" is not treated as compensation. For example, in the case of a fixed annuity, or the fixed component of a variable annuity, the spread would be the difference between the fixed return credited to the contract holder and the insurer's general account investment experience.

[6] Whether the Retirement Investor relied on the misleading statements is irrelevant in determining whether the fiduciary has violated the Exemption. However, reliance could be relevant in the question of damages in subsequent arbitration or court proceedings. See the preamble to the Exemption at 81 F.R. 21031 (April 8, 2016).

financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party (e.g, the manufacturer of the investment product). See Sections II(c)(1) and VIII(d) of the Exemption. A Financial Institution that limits investment recommendations, in whole or in part, to Proprietary Products or investments that generate Third Party Payments, and Advisers making recommendations subject to such limitations are deemed to satisfy the Best Interest standard when they comply with the conditions set forth in ¶1.e.2) below.

Intent of Best Interest standard. **The DOL notes in the preamble to the Exemption that the Best Interest standard is structured in same fashion as the duty of loyalty under ERISA §404(a)(1)(A) and trust law. In this regard, the DOL would expect the standard to be interpreted in light of forty years of judicial experience with ERISA's fiduciary standards and hundreds more with the duties imposed on trustees under the common law of trusts. In general, courts focus on the process the fiduciary used to reach its determination or recommendation, i.e., whether the fiduciaries, ''at the time they engaged in the challenged transactions, employed the proper procedures to investigate the merits of the investment and to structure the investment.'' See *Donovan v. Mazzola*, 716 F.2d 1226, 1232 (9th Cir. 1983). Moreover, a fiduciary's investment recommendation is measured based on the circumstances prevailing at the time of the transaction, not on how the investment turned out with the benefit of hindsight.**

Enforcement through written contract. **By also applying the Best Interest standard to the written contract requirement described in ¶1.c.1) above, in the case of investment advice provided with respect to an IRA or non-ERISA plan, failure to comply with the Best Interest standard also is susceptible to a private breach-of-contract suit (including class actions), providing an enforcement mechanism not available through ERISA's enforcement mechanisms.**

¶1.c.3)b) Material Conflicts of Interest. A Material Conflict of Interest exists when an Adviser or Financial Institution has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor. See Section VIII(i) of the Exemption.

¶1.c.4) Policies and procedures requirement/warranty. Section II(d) of the Exemption sets forth policies and procedures requirements, and requires that, in the case of an IRA or non-ERISA plan, the Financial Institution make affirmative warranties that it will adopt these policies and procedures, and in fact comply with such warranties. For an ERISA plan, the Financial Institution must comply with these requirements, but are not required to make a formal warranty to the Retirement Investor that it will comply. The DOL believes that, for these plans, ERISA also provides an adequate enforcement mechanism (i.e., actions for fiduciary breach and prohibited transaction enforcement), making a separate warranty unnecessary. The required policies and procedures are that: (1) the Financial Institution adopts and complies with written policies and procedures reasonably and prudently designed to ensure that its Advisers adhere to the Impartial Conduct Standards described in ¶1.c.3) above, (2) in formulating its policies and procedures, the Financial Institution (a) specifically identifies and documents its Material Conflicts of Interest (as defined in ¶1.c.3)b) above), (b) adopts measures reasonably and prudently designed to prevent Material Conflicts of Interest from causing a violation of the Impartial Conduct Standards, and (c) designates a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring their Advisers' adherence to such standards, and (3) subject to the exception described in ¶1.c.4)a) below, neither the Financial Institution nor (to the best of its knowledge) any Affiliate or Related Entity, uses or relies upon quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are intended to (or reasonably would be expected to) cause Advisers to make recommendations that are not in the Best Interest of the Retirement Investor.

DOL may request. **These written policies and procedures must be provided to the DOL upon request. See Section III(b)(4) of the Exemption.**

¶1.c.4)a) Permissible differential compensation. A Financial Institution, its Affiliates or Related Entities may provide Advisers with differential compensation (whether in type or amounts including commissions), based on investment decisions by Plans, participant or beneficiary accounts, or IRAs, to the extent that the Financial Institution's policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of Advisers with the interests of the Retirement Investors they serve as fiduciaries. Such compensation practices can include differential compensation based on neutral factors tied to the differences in the services delivered to the Retirement Investor with respect to different types of investments, as opposed to the differences in the amounts of Third Party Payments the Financial Institution receives in connection with particular investment recommendations. See Section II(d)(3) of the Exemption. The DOL notes in the preamble to the Exemption that particular attention should be paid to incentives provided to branch managers and supervisors, which could cause such managers or supervisors to incentive Advisers in a way that violates the standards. For example, branch managers and other supervisors should not be awarded bonuses or trips based on sales of certain investments, if such awards could not be made directly to Advisers under the Exemption. See 81 F.R. 21037-21038 (April 8, 2016).

¶1.c.4)b) Policies and procedures/examples. The Exemption does not mandate the specific content of the policies and procedures, nor prescribes how such policies and procedures would not encourage investment advice that is not in the Best Interest of the Retirement Investors. The Exemption does not mandate level fees or require any particular compensation structure, as long as the Financial Institution complies with the standards of the Exemption. The examples in ¶1.c.4)b)i) through ¶1.c.4)b)v) below are provided in the preamble to the Exemption. See 81 F.R. 21038-21039 (April 8, 2016). The examples are not intended to be an exhaustive list of proper compensation and employment arrangements that warranty requirement. They range from examples that eliminate or nearly eliminate compensation differentials, to examples that permit, but police, differentials. The Financial Institution retains the latitude necessary to design its compensation and employment arrangements, provided that those arrangements promote, rather than undermine, the Best Interest and Impartial Conduct Standards. The DOL expects that the Financial Institution will engage in a good faith process to prudently establish and oversee policies and procedures that will effectively mitigate conflicts of interest and ensure adherence to the Impartial Conduct Standards. To this end, Financial Institutions may also want to consider designating an individual or group (e.g., internal compliance officer or a committee) responsible for addressing material conflicts of interest issues.

¶1.c.4)b)i) Example #1: independently certified computer models. The Adviser interacts directly with the Retirement Adviser, but makes investment recommendations in accordance with an unbiased computer model created by an independent third party. Under this example, the Adviser can receive any form or amount of compensation so long as the advice is rendered in strict accordance with the model. Footnote 65 of the preamble to the Exemption notes that this example is not intended to retract the view of the DOL previously expressed in Advisory Opinion 2001-02A, (commonly referred to as the "SunAmerica opinion,"), where the DOL concluded that the provision of fiduciary investment advice would not result in prohibited transactions under circumstances where the advice provided by the fiduciary is the result of the application of methodologies developed, maintained and overseen by a party independent of the fiduciary in accordance with the conditions set forth in the Advisory Opinion. A computer model also can be used as part of an advice arrangement that satisfies the conditions under the prohibited transaction exemption in ERISA §408(b)(14) and (g). Footnote 31 of the preamble notes that this example is not intended to override the exclusion from exemptive relief for robo advice (see ¶1.b.3) above), but rather is intended to cover live advice that is rendered with the help of unbiased computer models.

¶1.c.4)b)ii) Example #2: asset-based compensation. The Financial Institution accepts differential compensation but pays the Adviser a percentage, which does not vary based on the types of investments, of the dollar amount of assets invested by the Plans, participant and beneficiary accounts, and IRAs with the Adviser. The Adviser earns the same percentage on the same payment schedule, regardless of how the Retirement Investor's assets are allocated between different investments (e.g., equity securities, proprietary mutual funds, and bonds underwritten by non-Related Entities), and the Financial Institution gives particular attention to recommendations that increase the Adviser's base (e.g., advice to roll money out of a plan into IRA investments that generate fees for the Adviser).

¶1.c.4)b)iii) Example #3: fee offset. The Financial Institution establishes a fee schedule for its services and the services of its Advisers. The fees are competitive and reasonable in relation to the services provided to the Retirement Investor and are not themselves intended to nor would they reasonably be expected to cause Advisers to violate the Impartial Conduct Standards. The Financial Institution accepts transaction-based payments directly from the Plan, participant or beneficiary account, or IRA, and/or from third party investment providers. To the extent the payments from third party investment providers exceed the established fee, the additional amounts are rebated to the Plan, participant or beneficiary account, or IRA. To the extent Third Party Payments do not satisfy the established fee, the Plan, participant or beneficiary account, or IRA is charged directly for the remaining amount due. Regardless of the investment chosen, the Financial Institution and the Adviser retain only the compensation set forth in the fee schedule, which is not in excess of reasonable compensation.

Fee offset for Third Party Payments. **Footnote 66 of the preamble to the Exemption notes that certain types of fee-offset arrangements may result in avoidance of prohibited transactions altogether. For example, in Advisory Opinions 97-15A and 2005-10A, the DOL explained that a fiduciary investment adviser could provide investment advice to a plan with respect to investment funds that pay it or an affiliate additional fees without engaging in a prohibited transaction if those fees are offset against fees that the plan otherwise is obligated to pay to the fiduciary.**

¶1.c.4)b)iv) Example #4: commissioner and stringent supervisory structure. The Financial Institution establishes a commission-based compensation schedule for Advisers in which all variation in commissions is eliminated for recommendations of investments within reasonably designed categories. The Financial Institution establishes supervisory mechanisms to protect against conflicts of interest created by the transaction-based model and takes special care to ensure that any differentials that are retained are based on neutral factors (e.g., time or complexity of the work involved), and that the differentials do not incentivize Advisers to violate the Impartial Conduct Standards or operate to transmit firm-level conflicts of interest to the Adviser (e.g., by increasing compensation based on how much revenue or profits the investment products generate for the Financial Institution). Accordingly, the Financial Institution does not provide an incentive for the Adviser to recommend one mutual fund over another, or to recommend one category of investments over another, based on the greater compensation the Financial Institution would receive. But it might, for example, draw a distinction between variable annuities and mutual funds based on the additional time it has determined is necessary for client communications and Financial Institution adopts a stringent supervisory structure to ensure that Advisers' recommendations are based on the customer's financial interest, and not on the additional compensation the Adviser stands to make by recommending, for example, more frequent transactions or products for which greater compensation is provided.

✪ *Prudent supervisory structure.* This example goes on to give some examples of components of a prudent supervisory structure: (1) comprehensive monitoring system, which evaluates qualify for advice, corrects identified problems, and pays particular attention to recommendations associated with higher compensation and recommendations at key liquidity events (e.g., rollovers), (2) a system to evaluate whether Advisers recommend imprudent reliance on investment products sole by or through the Financial Institution, (3) use of metrics for behavior and basing compensation in part on them (e.g., measures aimed at preventing churning), (4) penalizing advisers and supervisors (including branch managers) by reducing compensation (or utilizing clawback provisions) based on receipt of customer complaints or indications that conflicts are not being carefully managed, (5) appointment of a committee to assess the risks and conflicts associated with new investment products, (6) ensure that no Adviser or supervisor earns more for a sale of a product issues by a "preferred provider" or for a Proprietary Product over other comparable products, and (7) periodic review and revision (if necessary) of the Financial Institution's policies and procedures, including evaluation of whether compensation differentials remain appropriate and are based on neutral factors.

¶1.c.4)b)v) Example #5: Rewards for Best Interest Advice. The Financial Institution's policies and procedures establish a compensation structure that is reasonably designed reward Advisers for giving advice that adheres to the Impartial Conduct Standards. For example, this might include compensation that is primarily asset-based, as discussed in the example in ¶1.c.4)b)ii) above, with the addition of bonuses and other incentives paid to promote advice that is in the Best Interest of the Retirement Investor. While the compensation would be variable, it would align with the customer's best interest.

¶1.c.4)c) Insurance company statutory employees. IRC §3121 allows an insurance company to treat an independent contractor as a full-time employee if that individual is "'is devoted to the solicitation of life insurance or annuity contracts, or both, primarily for one life insurance company." See Treas. Reg. §31.3121(d)-1(d)(3)(ii). The DOL confirms in the preamble to the regulations that the provision of employee benefits (e.g., customary deferred compensation or subsidized health or pension benefits) based on a person's status as a statutory employee, which may involve evaluation of the amount of Proprietary Products sold, in and of itself would not violate the practices and procedures requirement described in ¶1.c.4) above. However, the Financial Institution must still view its polices and procedures and incentive practices as a whole to determine if they are reasonably designed to avoid a misalignment of the interest of Advisers with the interests of the Retirement Investors they serve as fiduciaries. See 81 F.R. 21036 (April 8, 2016).

¶1.c.5) Affirmative disclosures. The Financial Institution must satisfy the disclosure requirements set forth in Section II(e) of the Exemption, as described in ¶1.c.5)a) below. In the case of an ERISA plan, these disclosures must be made in a single written disclosure. The case of an IRA or non-ERISA plan, these disclosures must be provided in either the written contract described in ¶1.c.1) above, or in a separate single written document. By a single written disclosure, the DOL means that the information is in a document that contains only this information, or is in a specific section of a contract so that the Retirement Investor is not required to locate the relevant information in several places through a larger document or series of disclosures. See the preamble to the Exemption at 81 F.R. 21046 (April 8, 2016). These disclosures must be made no later than the time of the execution of the recommended transaction.

¶1.c.5)a) Content of disclosures. The disclosure must clearly and prominently provide the information described in ¶1.c.5)a)i) through ¶1.c.5)a)vii) below.

¶1.c.5)a)i) Delivery of services and compensation. The disclosure must: (1) state the Best Interest standard, (2) inform the Retirement Investor of the services provided by the Financial Institution and the Adviser, and (3) describe how the Retirement Investor will pay for services, either directly or through Third Party Payments (e.g., applicable commissions or other forms of transaction-based payments). See Section II(e)(1) of the Exemption.

¶1.c.5)a)ii) Conflicts of interest. The disclosure must: (1) describe the Material Conflicts of Interest, (2) disclose any fees or charges the Financial Institution, its Affiliates, or the Adviser imposes upon the Retirement Investor or the Retirement Investor's account, and (3) state the types of compensation that the Financial Institution, its Affiliates, and the Adviser expect to receive from third parties in connection with recommended investments. See Section II(e)(2) of the Exemption.

¶1.c.5)a)iii) Right to copies. The disclosure must inform the Retirement Investor that the Investor has the right to obtain copies of: (1) the Financial Institution's written description of its policies and procedures (as described in ¶1.c.4) above), and (2) the specific disclosure of costs, fees, and compensation, including Third Party Payments, regarding recommended transactions (i.e., the transaction disclosures described in ¶1.d. below), described in dollar amounts, percentages, formulas, or other means reasonably designed to present materially accurate disclosure of their scope, magnitude, and nature in sufficient detail to permit the

Retirement Investor to make an informed judgment about the costs of the transaction and about the significance and severity of the Material Conflicts of Interest. The disclosure also must describe how the Retirement Investor can get this information, free of charge. Iff the Retirement Investor's request is made prior to the transaction, then this information also must be provided prior to the transaction. If the request is made after the transaction, then the information must be provided within 30 business days after the request. See Section II(e)(3) of the Exemption.

¶1.c.5)a)iv) Web-based information. The disclosure must include a link to the Financial Institution's website (as required by the rules described in ¶1.d.2) below), and must inform the Retirement Investor that the following is available free of charge on the website: (1) model contract disclosures updated as necessary on a quarterly basis, and (2) the Financial Institution's written description of its policies and procedures (as described in ¶1.c.4) above). See Section II(e)(4) of the Exemption.

¶1.c.5)a)v) Proprietary Products/Third Party Payments. The disclosure must disclose to the Retirement Investment: (1) whether the Financial Institution offers Proprietary Products or receives Third Party Payments with respect to any recommended investments, (2) the extent the Financial Institution or Adviser limits investment recommendations, in whole or part, to Proprietary Products or investments that generate Third Party Payments, and (3) the limitations placed on the universe of investments that the Adviser may offer for purchase, sale, exchange, or holding by the Retirement Investor. The information is insufficient if it merely states that the Financial Institution or Adviser ''may'' limit investment recommendations based on whether the investments are Proprietary Products or generate Third Party Payments, without specific disclosure of the extent to which recommendations are, in fact, limited on that basis. See Section II(e)(5) of the Exemption.

¶1.c.5)a)vi) Contact information. The disclosure must provide contact information (telephone *and* email) for a representative of the Financial Institution that the Retirement Investor can use to contact the Financial Institution with any concerns about the advice or service they have received. If applicable, this part of the disclosure must include a statement explaining that the Retirement Investor can research the Financial Institution and its Advisers using FINRA's BrokerCheck database or the Investment Adviser Registration Depository (IARD), or other database maintained by a governmental agency or instrumentality, or self-regulatory organization. See Section II(e)(6) of the Exemption.

¶1.c.5)a)vii) Monitoring services. The disclosure must describe whether or not the Adviser and Financial Institution will monitor the Retirement Investor's investments and alert the Retirement Investor to any recommended change to those investments, and, if so monitoring, the frequency with which the monitoring will occur and the reasons for which the Retirement Investor will be alerted. See Section II(e)(7) of the Exemption.

***Risky investments.* With respect to recommendations involving assets that are hard to value, illiquid, complex, or particularly risky, the DOL cautions that the Financial Institution should consider carefully whether such investment can be prudently recommended to a particular Retirement Investor without a mechanism in place for the ongoing monitoring of the investment (whether that be done by the Financial Institution or Adviser or another person), and the added cost of monitoring should be considered in determining whether the**

recommended investments meet the Best Interest standard. See the preamble to the Exemption at 81 F.R. 21016 (April 8, 2016).

¶1.c.5)b) Correction of good faith errors. The Financial Institution will not fail to satisfy these disclosure requirements, or violate a contractual provision based thereon, solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, provided the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. See Section II(e)(8) of the Exemption.

¶1.c.5)b)i) Reliance on information provided by others. To the extent compliance with these disclosure rules requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is: (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution, or (2) any officer, director, employee, agent, registered representative, relative or family member (as defined in ERISA §3(15) and IRC §4975(e)(6) - a spouse, ancestor, lineal descendant, or spouse of a lineal descendant) of, or partner in, the Adviser or Financial Institution. See Section II(e)(8) of the Exemption.

¶1.d. Disclosure requirements. Section III of the Exemption prescribes transaction disclosures (see ¶1.d.1) below) and web disclosures (see ¶1.d.2) below) that must be met by the Financial Institution. Annual disclosures that had been proposed under Section III of the Proposed Exemption were eliminated in the final version. The Exemption does not provide any model disclosures. The Financial Institution is not required to disclose information the disclosure of which would be otherwise prohibited by law. See Section III(b)(3).

¶1.d.1) Transaction disclosures. Prior to or at the same time as execution of a recommended transaction in an investment product, the Financial Institution must provide the Retirement Investment Investor a disclosure that, clearly and prominently in a single written document: (1) states the Best Interest standard of care (as described in ¶1.c.3)a) above) owed by the Adviser and Financial Institution to the Retirement Investor, (2) described any Material Conflicts of Interest (as described in ¶1.c.3)b) above), (3) informs the Retirement Investor of the right to obtain copies of the information described in ¶1.d.1)a) below, and (4) includes a link to the Financial Institution's website (as described in ¶1.d.2) below) and informs the Retirement Investor that model contract disclosures or other model notices (updated as necessary on a quarterly basis) are maintained at the website, and the Financial Institution's written description of its policies and procedures (as described in ¶1.d.2)a)iv) below) are available free of charge. See Section III(a) of the Exemption.

¶1.d.1)a) Copies furnished upon request. The Retirement Investor may request copies of: (1) the Financial Institution's written description of its polices and procedures adopted in accordance with the warranty requirements described in ¶1.c.4) above, and (2) specific disclosures of costs, fees and other compensation, including Third Party Payments regarding recommend transactions. The costs, fees, and other compensation may be described in dollar amounts, percentages, formulas, or other means reasonably designed to present materially accurate disclosure of their scope, magnitude, and nature in sufficient detail to permit the Retirement Investor to make an informed judgment about the costs of the transaction and about the significance and severity of the Material Conflicts of Interest. The copies requested must be furnished before the transaction occurs, if the request is made prior to the transaction, or otherwise within 30 business days after the request is made. See Section III(a)(2) of the Exemption.

¶1.d.1)b) Reliance on prior disclosures. The disclosures described in ¶1.d.1) above do not have to be repeated for subsequent recommendations of the same investment product within one year of the provision of a contract disclosure described in ¶1.c.5) above, or a previous disclosure described in ¶1.d.1) above, unless there are *material changes* in the subject of the disclosure.

¶1.d.2) Web disclosures. For relief to be available for any investment recommendation, the Financial Institution must maintain a website, updated at least quarterly, which is freely accessible to the public, and which shows the information described in ¶1.d.2)a) below. Note that the requirement for the website to be "freely accessible" to the public is intended to promote comparison shopping and the overall transparency of the marketplace. See the preamble to the Exemption at 81 F.R. 21046 (April 8, 2016). A website would not fail to be freely accessible because it requires a visitor to create a user name and password to gain access. See 81 F.R. 21052 (April 8, 2016).

¶1.d.2)a) Information that must be available at the website. The website must contain the information described in ¶1.d.2)a)i) through ¶1.d.2)a)vi) below. See Section III(b)(1) of the Exemption.

¶1.d.2)a)i) Business model. A discussion of the Financial Institution's business model and the Material Conflicts of Interest associated with that model. See Section III(b)(1)(i) of the Exemption.

¶1.d.2)a)ii) Fee schedule. A schedule of the typical account or contract fees and service charges. See Section III(b)(1)(ii) of the Exemption.

¶1.d.2)a)iii) Model contract. A model contract or other model notice of the contractual terms (if applicable) and required disclosures described in ¶1.c.2) through ¶1.c.5) above. which are reviewed for accuracy no less frequently than quarterly and updated within 30 days if necessary. See Section III(b)(1)(iii) of the Exemption.

¶1.d.2)a)iv) Policies and procedures. A written description of the Financial Institution's policies and procedures that accurately describes or summarizes key components of the policies and procedures relating to conflict-mitigation and incentive practices in a manner that permits Retirement Investors to make an informed judgment about the stringency of the Financial Institution's protections against conflicts of interest. See Section III(b)(1)(iv) of the Exemption.

¶1.d.2)a)v) Third Party Payment arrangements. To the extent applicable: (1) a list of all product manufacturers and other parties with whom the Financial Institution maintains arrangements that provide Third Party Payments to either the Adviser or the Financial Institution with respect to specific investment products or classes of investments recommended to Retirement Investors, and (2) a description of the arrangements, including a statement on whether and how these arrangements impact Adviser compensation, and a statement on any benefits the Financial Institution provides to the product manufacturers or other parties in exchange for the Third Party Payments. See Section III(b)(1)(v) of the Exemption.

¶1.d.2)a)vi) Adviser compensation and incentive arrangements. Disclosure of the Financial Institution's compensation and incentive arrangements with Advisers including, if applicable: (1) any incentives (including both cash and non-cash compensation or awards) to Advisers for recommending particular product manufacturers, investments or categories of investments to Retirement Investors, or for Advisers to move to the Financial Institution from another firm or to stay at the Financial Institution, and (2) a full and fair description of any payout or compensation grids, but not including information that is specific to any individual Adviser's compensation or compensation arrangement. Section III(b)(1)(vi) of the Exemption.

¶1.d.2)b) Manner of disclosure. The arrangements with product manufacturers, Advisers, and others, as described in ¶1.d.2)a) above, may be described by reference to dollar amounts, percentages, formulas, or other means reasonably calculated to present a materially accurate description of the arrangements. The website also may group disclosures based on reasonably-defined categories of investment products or classes, product manufacturers, Advisers, and arrangements, and it may disclose reasonable ranges of values, rather than specific values, as appropriate. However constructed, the website must fairly disclose the scope, magnitude, and nature of the compensation arrangements and Material Conflicts of Interest in sufficient detail to permit visitors to the website to make an informed judgment about the significance of the compensation practices and Material Conflicts of Interest with respect to transactions recommended by the Financial Institution and its Advisers. Section III(b)(1)(vii) of the Exemption.

¶1.d.2)b)i) Supporting document. If disclosures are grouped, as described in ¶1.d.2)b) above, the Financial Institution must retain the data and documentation supporting the group disclosure during the time that it is applicable to the disclosure on the website, and for six years after that. The data and documentation must be made available to the DOL within 90 days of the DOL's request. See Section III(b)(5) of the Exemption. With respect to these data and documentation requirements, as well as the requirement to make such data and documentation available to the DOL: (1) the good faith relief described in ¶1.d.4) and ¶1.d.5) below apply, (2) if such records are lost or destroyed, due to circumstances beyond the Financial Institution's control, no prohibited transaction will be considered to have occurred solely on the basis of the unavailability of those records, and (3) no party other the Financial Institution responsible for these requirements will be subject to a civil penalty under ERISA §502(i) or excise taxes under IRC §4975(a) and (b) if the records are not maintained or provided to the DOL within the required timeframes. See Section III(c)(3) of the Exemption.

¶1.d.3) Alternative methods of disclosure. To the extent the information described in ¶1.d.1) or ¶1.d.2) above is provided in other disclosures which are made public (e.g., disclosures required by the SEC and/or the DOL such as a Form ADV, Part II), the Financial Institution may satisfy these requirements by posting such disclosures to its website with an explanation that the information can be found in the disclosures and a link to where it can be found. See Section III(b)(2) of the Exemption.

¶1.d.4) Relief for good faith errors. The Financial Institution is deemed not to fail the disclosure requirements described above (nor to violate a contractual provision) solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, or if the website is temporarily inaccessible. In order for this relief to apply: (1) in the case of an error or omission on the website, the Financial Institution discloses the correct information as soon as practicable, but not later than seven (7) days after the date on which it discovers or reasonably should have discovered the error or omission, and (2) in the case of an error or omission with respect to a transaction disclosure (as described in ¶1.d.1) above), the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. See Section III(c)(1) of the Exemption.

¶1.d.5) Reliance on others. If the above disclosures require Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This relief is not available if the entity is: (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution, or (2) any officer, director, employee, agent, registered representative, relative/family member (as defined in ERISA §3(15), and IRC §4975(e)(6) - a spouse, ancestor, lineal descendant, or spouse of a lineal descendant) of, or partner in, the Adviser or Financial Institution. See Section III(c)(2) of the Exemption.

¶1.e. Proprietary Products and Third Party Payments. Section IV of the Exemption expressly permits reliance on the Exemption even though at the time of a covered transaction, the Financial Institution restricts Advisers' investment recommendations, in whole or in part, to Proprietary Products or to investments that generate Third Party Payments, so long as all of the applicable conditions of the Exemption are satisfied. See ¶1.e.1) below for the definitions of Proprietary Products and Third Party Payments. See ¶1.e.2) below for the manner in which the Financial Institution and the Advisers meet the Best Interest standard described in ¶1.c.3)a) above where the investment advice is subject to these limitations.

¶1.e.1) Definitions of Proprietary Products and Third Party Payments. A Proprietary Product is a product that is managed, issued or sponsored by the Financial Institution or any of its Affiliates. See Section VIII(l) of the Exemption. Third Party Payments include: (1) sales charges when not paid directly by the Plan, participant or beneficiary account, or IRA, (2) gross dealer concessions, (3) revenue sharing payments, (4) 12b–1 fees, (5) distribution, (6) solicitation or referral fees, (7) volume-based fees, (8) fees for seminars and educational programs, and (9) any other compensation, consideration or financial benefit provided to the Financial Institution or an Affiliate or Related Entity by a third party as a result of a transaction involving a Plan, participant or beneficiary account, or IRA. See Section VIII(q) of the Exemption.

¶1.e.2) Satisfaction of the Best Interest standard. A Financial Institution that limits investment recommendations in the manner described in ¶1.e. above, and an Adviser making recommendations subject to these limitations, are deemed to satisfy the Best Interest standard described in ¶1.c.3)a) above if the conditions in ¶1.e.2)a) through ¶1.e.2)f) below are satisfied. See Section IV(b) of the Exemption.

¶1.e.2)a) Disclosure of limitations and payments. The Retirement Investor must be clearly and prominently informed in writing that: (1) the Financial Institution offers Proprietary Products or receives Third Party Payments with respect to the purchase, sale, exchange, or holding of recommended investments, and (2) the limitations placed on the universe of investments that the Adviser may recommend to the Retirement Investor. The notice is insufficient if it merely states that the Financial Institution or Adviser ''may'' limit investment recommendations based on whether the investments are Proprietary Products or generate Third Party Payments, without specific disclosure of the extent to which recommendations are, in fact, limited on that basis. See Section IV(b)(1) of the Exemption. This information must be provided no later than the time of execution of the recommend transaction.

¶1.e.2)b) Conflict disclosure. The Retirement Investor must be fully and fairly informed in writing of any Material Conflicts of Interest that the Financial Institution or Adviser have with respect to the recommended transaction. In addition, the Adviser and Financial Institution must comply with the disclosure requirements set forth in ¶1.d. above. See Section IV(b)(2) of the Exemption.

¶1.e.2)c) Documentation and reasonableness determinations. The Financial Institution must: (1) document in writing its limitations on the universe of recommended investments, the Material Conflicts of Interest associated with any contract, agreement, or arrangement providing for its receipt of Third Party Payments or associated with the sale or promotion of Proprietary Products, any services it will provide to Retirement Investors in exchange for Third Party Payments, and any services or consideration it will furnish to any other party, including the payor, in exchange for the Third Party Payments, (2) reasonably conclude that the limitations on the universe of recommended investments and Material Conflicts of Interest will not cause the Financial Institution or its Advisers to receive compensation in excess of reasonable compensation for Retirement Investors (within the meaning of ERISA §408(b)(2) and IRC §4975(d)(2)), and (3) reasonably determine, after consideration of the policies and procedures established pursuant to the warranty requirements described in ¶1.c.4) above, that these limitations and Material Conflicts of Interest will not cause the Financial Institution or its Advisers to recommend imprudent investments. The Financial Institution must document in writing the bases for its conclusions. See Section IV(b)(3) of the Exemption.

¶1.e.2)d) Compliance with policies and procedures. The Financial Institution must adopt, monitor, implement and adhere to policies and procedures and incentive practices described in ¶1.c.4) above. In addition, neither the Financial Institution nor (to the best of its knowledge) any Affiliate or Related Entity, uses or relies upon quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are intended or would reasonably be expected to cause the Adviser to make imprudent investment recommendations, to subordinate the interests of the Retirement Investor to the Adviser's own interests, or to make recommendations based on the Adviser's considerations of factors or interests other than the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor. See Section IV(b)(4) of the Exemption. Particular care should be taken that differential payments to Advisers do not demonstrate that they are based on what is more lucrative to the Financial Institution.

¶1.e.2)e) Reasonable compensation anticipated at time of recommendation. At the time of the recommendation, the amount of compensation and other consideration must, at the time of the recommendation, reasonably be anticipated to be paid, directly or indirectly, to the Adviser, Financial Institution, or their Affiliates or Related Entities for their services in connection with the recommended transaction is not in excess of reasonable compensation within the meaning of ERISA §408(b)(2) and IRC §4975(d)(2). See Section IV(b)(5) of the Exemption.

¶1.e.2)f) Compliance with prudence standard. The Adviser's recommendation musts reflect the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor. In addition, the Adviser's recommendation must not be based on the financial or other interests of the Adviser or on the Adviser's consideration of any factors or interests other than the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor. See Section IV(b)(6) of the Exemption.

¶1.f. Disclosure to the DOL and recordkeeping requirements. Section V of the Exemption prescribes requirements for disclosure to the DOL (see ¶1.f.1) below) and recordkeeping requirements (see ¶1.f.2) below).

¶1.f.1) Disclosure to DOL. Before receiving any compensation in reliance on the Exemption, the Financial Institution must notify the DOL of the intention to rely on this class exemption. The notice is made by email to e-BICE@dol.gov. The notice will remain in effect until revoked in writing by the Financial Institution. The notice need not identify any specific plan or IRA. See Section V(a) of the Exemption. This is a notice provision only and does not require any approval or finding by the DOL that the Financial Institution is eligible for the exemption. Once a Financial Institution has sent the notice, it can immediately begin to rely on the exemption provided the conditions are satisfied.

¶1.f.2) Recordkeeping requirements. The Financial Institution must maintain for a period of six years, in a manner that is accessible for examination, the records necessary to enable the persons described in ¶1.f.2)a) below to determine whether the conditions of the Exemption have been met. Records would include, for example, records concerning the Financial Institution's incentive and compensation practices for its Advisers, the Financial Institution's policies and procedures, and documentation governing the application of the policies and procedures, the documents prepared with respect to Proprietary Products and Third Party Payments, as described in ¶1.e. above, contracts entered into with Retirement Investors, and disclosure documentation. No party other than the Financial Institution responsible for meeting these recordkeeping requirements will be subject to sanctions under ERISA §502(i) or IRC §4975 if such records are not properly maintained or not available for examination. In addition, if records are lost or destroyed due to circumstances beyond the Financial Institution's control, no prohibited transaction will have occurred merely because of the unavailability of such records. See Section V(b) of the Exemption.

¶1.f.2)a) Persons with right of inspection. The records described in ¶1.f.2) above must be reasonably available at their customary location for examination during normal business hours by: (1) an authorized employee or representative of the IRS or DOL, (2) any fiduciary of a plan that engaged in a covered transaction (or authorized employee or representative of the fiduciary), (3) any contributing employer and any employee organization whose members are covered by a Plan that is involved in a covered transaction (or any employee or representative of these entities), and (4) any participant or beneficiary of a Plan, or an IRA owner, involved in a covered transaction (or authorized representative of such participant, beneficiary or IRA owner). See Section V(c)(1) of the Exemption.

¶1.f.2)b) Exception for privileged information. A person described in ¶1.f.2)a) above (other than the DOL or IRS) may not examine records regarding a recommended transaction involving: (1) another Retirement Investor, (2) privileged trade secrets or privileged commercial or financial information of the Financial Institution, or (3) information identifying other individuals. See Section V(c)(2) of the Exemption.

¶1.f.2)c) Refusal to disclose exempt information. If the Financial Information refuses to disclose any information on the basis that the information is exempt from disclosure, the Financial Institution must, by the close of the 30th day following the request, provide a written notice advising the requestor of the reasons for the refusal, and that the DOL may request such information. See Section V(c)(3) of the Exemption.

¶1.f.2)d) Scope of recordkeeping failures. Failure to maintain the required records necessary to determine whether the conditions of this Exemption have been met will result in the loss of the exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions. See Section V(c)(4) of the Exemption.

¶1.g. Limited compliance requirements for Level Fee Fiduciaries and Bank Networking Arrangements. The final Exemption adds special rules for Level Fee Fiduciaries, which are described in ¶1.g.1) below, and for Bank Networking Arrangements, as described in ¶1.g.2) below.

¶1.g.1) Special rules for Level Fee Fiduciaries. A number of Exemption requirements are waived (see ¶1.g.1)a) below) for a Level Fee Fiduciary, including rollover advice or arrangement switches described in ¶1.g.2) and ¶1.g.3) below that are recommended by the Level Fee Fiduciary. A Financial Institution and Adviser are Level Fee Fiduciaries if the only fee received by the Financial Institution, Adviser, and Affiliate in connection with advisory or investment management services to the Plan or IRA is a Level Fee that is disclosed *in advance* to the Retirement Investor. A Level Fee is a fee or compensation provided: (1) on the basis of a fixed percentage of the value of the assets, or (2) a set fee that does not vary with the particular investment recommended. A commission or other-transaction based fee is not a Level Fee. See Section VIII(h) of the Exemption.

***In connection with.* A fee or compensation is paid ''in connection with or as a result of" a purchase or sale transaction or an investment advice service if: (1) the fee or compensation would not have been paid but for the transaction or service, or (2) if eligibility for or the amount of the fee or**

compensation is based in whole or in part on the transaction or service. See DOL Reg. §2510.3-21(g)(3).

Leveling examined at both Financial Institution and Adviser level. **This special rule for Level Fee Fiduciaries is not available if either the Financial Institution or the Adviser (or their Affiliates) receive any other remuneration (e.g., commissions, 12b-1 fees or revenue sharing), beyond the Level Fee in connection with investment management or advisory services with respect to the Plan or IRA. However, in such case, the Best Interest Contract Exemption could be relied on by complying with the full requirements of the Exemption.**

Offset of nonuniform compensation. **Note that it is possible for a person to receive Third Party Payments but still be considered receiving a level fee if the contract or arrangement provides for a level fee that is offset by any Third Party Payments, provided that any such payments in excess of the level fee are rebated to the Retirement Investor. The DOL alludes to this in footnote 23 of the preamble to the Exemption by referring to Advisory Opinion 97-15A (known as the "Frost Letter"), which concluded that a fiduciary who received Third Party Payments was not engaging in self-dealing if such payments offset the level fees the fiduciary otherwise would collect and did not cause the fiduciary's compensation to exceed the level fee. The Frost Letter approach is illustrated in the example at ¶1.c.4)b)iii) above.**

Rollovers. **The relief for rollovers described in ¶1.g.1)b) and ¶1.g.1)c) below are generally relying on the Exemption just for the rollover itself, which is a discrete transaction. The DOL acknowledges in footnote 18 of the preamble to the Exemption that, after the rollover, the ongoing receipt of level compensation will generally not require a prohibited transaction exemption.**

¶1.g.1)a) Waived from many Exemption requirements. Recommendations provided by Financial Institutions and Advisers that are Level Fee Fiduciaries are not subject to: (1) the contract requirement described in ¶1.c.1) above, (2) the practices and procedures and warranty requirements described in ¶1.c.4) above, (3) the disclosure requirements described in ¶1.c.5) and ¶1.d. above, and (4) the disclosure and recordkeeping requirements described in ¶1.f. above. See Section II(h) of the Exemption. However, the Financial Institution still must comply with the fiduciary statement requirement described in ¶1.c.2) above, and the Impartial Conduct Standards described in ¶1.c.3) above. See Section II(h)(1) and (2) of the Exemption. Note that there is no mention of compliance with the requirements described in ¶1.e. above because those requirements apply to recommendations involving Proprietary Products and Third Party Payments that result in potentially conflicted advice, which would not be present in a Level Fee situation that is subject to this special rule.

> ***Exemption may not be needed in the first place.*** **With an Level Fee situation, there is also the possibility that reliance on the Best Interest Contract Exemption is not necessary at all. See ¶1.a.4) above. However, rollover and arrangement switches described in ¶1.g.1)b) and ¶1.g.1)c) below present potential conflicts that will generally need relief under the Exempt, but can be eligible for relief by complying with the more limited requirements described in ¶1.g.1)a).**

¶1.g.1)b) Rollover from ERISA Plan to IRA. For the relief in ¶1.g.1)a) above to apply to a recommendation to roll over from an ERISA Plan to an IRA, the Financial Institution must document the specific reason or reasons why the recommendation was considered to be in the Best Interest of the Retirement Investor. This documentation must take into consideration or account the following: (1) the Retirement Investor's alternatives to a rollover, including leaving the money in his or her current employer's Plan, if permitted, (2) the fees and expenses associated with both the Plan and the IRA, (3) whether the employer pays for some or all of the plan's administrative expenses, and (4) the different levels of services and investments available under each option. See Section II(h)(3)(i) of the Exemption. Note that these consideration are consistent with those recommended by FINRA in its Regulatory Notice 13-45.

¶1.g.1)c) Rollover from one IRA to another IRA or to switch from commission-based account to level fee arrangement. For the relief in ¶1.g.1)a) above to apply in the case of a recommendation to rollover from one IRA to another IRA, or to switch from a commission-based account to a level fee arrangement, the Level Fee Fiduciary must document the reasons that the arrangement is considered to be in the Best Interest of the Retirement Investor, including, specifically, the services that will be provided for the fee. See Section II(h)(3)(ii) of the Exemption.

¶1.g.2) Bank Networking Arrangements. An Adviser who is a bank employee, and a Financial Institution that is a bank or similar financial institution supervised by the United States or a state, or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. §1813(b)(1)), may receive compensation pursuant to a Bank Networking Arrangement (as described in ¶1.g.2)a) below) in connection with their provision of investment advice to a Retirement Investor, provided the investment advice adheres to the Impartial Conduct Standards in ¶1.c.3) above. The remaining conditions of the exemption do not apply. See Section II(h)(i) of the Exemption. This exception allows the Adviser or Financial Institution to receive a referral fee for recommendations made under the Bank Networking Arrangement.

¶1.g.2)a) Definition of a Bank Networking Arrangement. A Bank Networking Arrangement is an arrangement for the referral of retail non-deposit investment products that satisfies applicable federal banking, securities and insurance regulations, under which employees of a bank refer bank customers to and unaffiliated: (1) investment adviser registered under the Investment Advisers Act of 1940 or under the laws of the State in which the adviser maintains its principal office and place of business, (2) insurance company qualified to do business under the laws of a State, or (3) broker or dealer registered under the Securities Exchange Act of 1934, as amended. For purposes of this definition, a ''bank'' is a bank or similar financial institution supervised by the United States or a state, or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. §1813(b)(1)). See Section VIII(c) of the Exemption.

¶1.h. Enforcement. The DOL discusses in the preamble to the Exemption the differences in the way the contractual requirement will be enforced by IRA owners, plan participants and beneficiaries and the DOL. Also see ¶1.c.4) above regarding exculpatory provisions and liability limiting provisions that may not be in the contract.

¶1.h.1) Enforcement by IRA owners. For an IRA owner, the primary relief will be through a contract claim for enforcement of the provisions of the contract, including the recommendation of an investment that is not in the Best Interest of the IRA owner, or failure to comply with the Impartial Conduct Standards or the warranties.

¶1.h.2) Enforcement by participants and beneficiaries. Plan participants and beneficiaries will be able to use ERISA §502(a)(2) and ERISA §502(a)(3) to enforce compliance with the Exemption. An Adviser's failure to comply with the conditions of the Best Interest Contract Exemption or the Impartial Conduct Standards would result in a non-exempt prohibited transaction, which would likely result in a fiduciary breach, enabling a plan participant or beneficiary to sue under ERISA §502(a)(2) or ERISA §502(a)(3) to recover any loss in value to the plan (including the loss in value to an individual account), or to obtain disgorgement of any wrongful profits or unjust enrichment. Additionally, plans, participants and beneficiaries could enforce their obligations in an action based on breach of the agreement.

¶1.h.3) Enforcement by DOL/IRS excise taxes. The DOL could enforce ERISA's prohibited transaction and fiduciary duty provisions with respect to employee benefit plans, but not IRAs, in the event that the Adviser or Financial Institution received compensation in a prohibited transaction but failed to comply with the Best Interest Contract Exemption or the Impartial Conduct Standards. For example, if the specific conditions of the Best Interest Contract Exemption are not met, the Adviser and Financial Institution will have engaged in a non-exempt prohibited transaction, and the DOL would be entitled to seek relief under ERISA §502(a)(2) and (5). Note that, in the case of IRAs, the IRS could enforce the excise tax provisions for a non-exempt transaction that result from failure to comply with the Best Interest Contract Exemption, but could not enforce the terms of the contract.

¶2. Exemption for certain purchases and sales (Section VI Exemption). Section VI of the Exemption provides an exemption for certain investment transactions between a Plan, participant or beneficiary account, or IRA and a Financial Institution that is a service provider or other party-in-interest or disqualified person. This Exemption provides relief from the restrictions of ERISA §406(a)(1)(A) or (D) and IRC §4975(e)(1)(A) or (D), if the conditions described in ¶2.a. below are satisfied. See Section VI(b) of the Exemption. Note that the relief provided by Section VI does not encompass the self-dealing rules under ERISA §406(b) and IRC §4975(c)(1)(E) and (F) that arise with respect to compensation received with respect to investment advice and recommended transactions. Relief from the self-dealing rules requires compliance with Sections II through V of the Exemption, as explained in ¶1 above.

Not limited to insurance and annuity contracts. **The proposal had limited the Section VI Exemption to purchases and sales of insurance and annuity contracts. The final Exemption covers all investment products that meet the conditions of Section VI.**

¶2.a. Conditions for the Section VI Exemption. For a transaction to be eligible for the Section VI Exemption: (1) the transaction must be effected by the Financial Institution in the ordinary course of its business, (2) the compensation, direct or indirect received for any services rendered by the Financial Institution and its Affiliates and Related Entities, is not in excess of reasonable compensation (within the meaning of ERISA §408(b)(2) and IRC §4975(d)(2)), and (3) the terms of the transaction must be at least as favorable to the Plan, participant or beneficiary account, or IRA as the terms generally available in an arm's length transaction with an unrelated party. See Section VI(c) of the Exemption.

Identified need for this exemption. **The DOL discusses in the preamble to the Exemption its reasoning in adding the relief provided in Section VI of the Exemption. See 81 F.R. 21064 (April 8, 2016). A number of transactions may occur as a result of an Adviser's or Financial Institution's advice that would involve a prohibited transaction under ERISA §406(a)(1)(A) or IRC §4975(c)(1)(A) as a result of the sale or purchase that is effectuated as a result of the Retirement Investor's acceptance of that advice. For example, a Plan's or IRA's purchase of an insurance or annuity product would otherwise be a prohibited transaction if the insurance company is a service provider to the Plan or IRA (and is particularly necessary in some of these transactions because revised PTE 84-24 (see ¶7 below) no longer provides relief for purchases of variable annuity contracts or indexed annuity contracts). Similarly, a Riskless Principal Transaction (see ¶2.b. below) could be a prohibited transaction if the Financial Institution also provides the underlying advice, and the purchase of a Proprietary Product from a Financial Institution also may involve this type of prohibited transaction.**

¶2.b. Exclusions. The exclusions described in ¶1.b. above, which includes exclusion of Principal Transactions (other than Riskless Principal Transactions), also apply to the Section VI Exemption, so that this exemptive relief is not available in such situations. See Section VI(d) of the exemption. However since a Riskless Principal Transaction is not within the exclusion for Principal Transactions, it would be covered by the Section VI Exemption if the conditions in ¶2.a. above are satisfied. For Principal Transactions that are not Riskless Principal Transactions, the transaction may qualify for relief under the Principal Transactions Exemption described in ¶4 below.

¶3. Pre-Existing Transactions Exemption and Transitional Relief. Section VII of the Exemption provides relief from Pre-Existing Transactions (see ¶3.a. below) and Section IX of the Exemption provides Transitional Relief for transactions occurring between April 10, 2017, and January 1, 2018 (see ¶3.b. below).

¶3.a. Pre-Existing Transactions Exemption. Advisers, Financial Institutions, and their Affiliates and Related Entities, may receive compensation, such as 12b–1 fees, in connection with the purchase, sale or holding of a security or other investment property by a Plan, participant or beneficiary account, or IRA if the conditions of the Pre-Existing Transactions Exemption are satisfied, as set forth in Section VII of the Exemption and described in ¶3.a.1) and ¶3.a.2) below. This Pre-Existing Transactions Exemption recognizes that some Advisers and Financial Institutions might not have considered themselves fiduciaries prior to the publication of the investment advice fiduciary regulation, or entered into a transaction in reliance of an class exemption that has since been amended. The Pre-Existing Transactions Exemption covers the self-dealing rules under ERISA §406(b) and IRC §4975(e)(1)(E) and (F), as well as the prohibition on sales and exchanges with a party-in-interest or disqualified person, and the use of plan assets by a party-in-interest or disqualified person, as described in ERISA §406(a)(1)(A) and (D) and IRC §4975(e)(1)(A) and (D).

¶3.a.1) Covered transactions under the Pre-Existing Transactions Exemption. The Pre-Existing Transactions Exemption covers the receipt of compensation by an Adviser, Financial Institution, and any Affiliate and Related Entity, as a result of investment advice (including advice to hold) provided to a Plan, participant or beneficiary or IRA owner in connection with the purchase, holding, sale or exchange of securities or other property: (1) that was acquired before April 10, 2017 (the Applicability Date), or (2) that was acquired pursuant to a recommendation to continue to adhere to a systematic purchase program established before April 10, 2017. See Section VII(b) of the Exemption. For the Pre-Existing Transactions Exemption to apply, the conditions described in ¶3.a.2) below must be satisfied.

¶3.a.2) Conditions of the Pre-Existing Transactions Exemption. To have the relief described in ¶3.a. above: (1) the compensation is received pursuant to an agreement, arrangement or understanding that was entered into prior to April 10, 2017, and that has not expired or come up for renewal after such date, (2) the purchase or sale of the Asset was not otherwise a non-exempt prohibited transaction pursuant to ERISA §406 and IRC §4975 on the date it occurred, (3) the compensation is not received in connection with the Plan's, participant or beneficiary account's or IRA's investment of additional amounts in the previously acquired investment vehicle, such as additional contributions to a variable annuity product or additional investments in a particular mutual fund (except in connection with a recommendation to exchange investments within a mutual fund family or variable annuity contract, pursuant to an exchange privilege or rebalancing program that was established before April 10, 2017, but only if the recommendation does not result in the Adviser and Financial Institution, or their Affiliates or Related Entities, receiving more compensation, either as a fixed dollar amount or a percentage of assets, than they were entitled to receive prior to April 10, 2017), (4) the amount of the compensation paid, directly or indirectly, to the Adviser, Financial Institution, or their Affiliates or Related Entities in connection with the transaction is not in excess of reasonable compensation within the meaning of ERISA §408(b)(2) and IRC §4975(d)(2), and (5) any investment recommendations made after April 10, 2017, by the Financial Institution or Adviser with respect to the securities or other investment property (a) reflect the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, and (b) are made without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party. See Section VII(b) of the Exemption.

¶3.b. Transition Period. Section IX sets forth limited compliance rules for the period from April 10, 2017, to January 1, 2018 (the Transition Period). The Transition Period relief permits Advisers, Financial Institutions, and their Affiliates and Related Entities to receive compensation as a result of the provision of investment advice during such period, provided that the conditions described in ¶3.b.1) through ¶3.b.4) are satisfied. Transition Period relief is not available to the persons or compensation excluded from the Best Interest Contract Exemption, as described in ¶1.b. above. See Section IX(c) of the Exemption. Through this Transition Period relief, more time is provided before the contract requirements described in ¶1.c.1) above and the warranty requirements described in ¶1.c.4) above are satisfied, and truncated versions of the other requirements are imposed.

¶3.b.1) Standards of care. This condition is met if: (1) when providing investment advice to the Retirement Investor, the Financial Institution and the Adviser(s) provide investment advice that is, at the time of the recommendation, in the Best Interest of the Retirement Investor (as described in ¶1.c.3)a) above), (2) the recommended transaction does not cause the Financial Institution, Adviser or their Affiliates or Related Entities to receive, directly or indirectly, compensation for their services that is in excess of reasonable compensation within the meaning of ERISA §408(b)(2) and IRC §4975(d)(2), and (3) and Statements by the Financial Institution and its Advisers to the Retirement Investor about the recommended transaction, fees and compensation, Material Conflicts of Interest, and any other matters relevant to a Retirement Investor's investment decisions, are not materially misleading at the time they are made. See Section IX(d)(1) of the Exemption.

¶3.b.2) Disclosures. This condition is met if, no later than the time the recommended transaction is executed, the following disclosures are provided to the Retirement Investor by the Financial Institution: (1) the fiduciary statement described in ¶1.c.2) above, (2) a description of the Impartial Conduct Standards and an affirmative statement that the Financial Institution and the Adviser(s) adhered to such standards in recommending the transaction, (3) a description of the Financial Institution's Material Conflicts of Interest, and (4) whether the Financial Institution offers Proprietary Products or receives Third Party Payments with respect to any investment recommendations, and to the extent the Financial Institution or Adviser limits investment recommendations, in whole or part, to Proprietary Products or investments that generate Third Party Payments, notifies the Retirement Investor of the limitations placed on the universe of investment recommendations (merely stating that the Financial Institution or Adviser ''may'' limit investment recommendations based on whether the investments are Proprietary Products or generate Third Party

Payments is insufficient without specific disclosure of the extent to which recommendations are, in fact, to limited). See Section IX(d)(2)(i) through (iv) of the Exemption.

¶3.b.2)a) Manner of disclosure. The disclosure must be a single written disclosure, which may cover multiple transactions or all transactions occurring within the Transition Period, and must be provided in a clear and prominent manner. See Section IX(d) of the Exemption. The disclosure may be provided in person, electronically, or by mail, and need not be repeated for any subsequent recommendations during the Transition Period. See Section IX(d)(2)(v) of the Exemption.

¶3.b.2)b) Good faith errors. The Financial Institution is deemed not to fail these disclosure requirements solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, provided the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. See Section IX(d)(2)(vi) of the Exemption.

¶3.b.2)c) Reliance on others. If these disclosures require the Financial Institution to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This relief is not available if the entity is: (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution, or (2) any officer, director, employee, agent, registered representative, relative/family member (as defined in ERISA §3(15), and IRC §4975(e)(6) - a spouse, ancestor, lineal descendant, or spouse of a lineal descendant) of, or partner in, the Adviser or Financial Institution. See Section IX(d)(2)(vi) of the Exemption.

¶3.b.3) Designation of responsible person for compliance. This condition is met if the Financial Institution designates a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards. See Section IX(d)(3) of the Exemption.

¶3.b.4) Recordkeeping. The Financial Institution must satisfy the recordkeeping requirements described in ¶1.f.2) above. See Section IX(d)(4) of the Exemption. Note that pre-transaction notification to the DOL, as described in ¶1.f.1) above is not required for reliance on the Transition Period relief.

¶4. Principal Transactions Exemption. As part of its regulatory package regarding investment advice fiduciaries, the DOL has issued this new exemption to cover relief for principal transactions between a plan, participant or beneficiary account, or an IRA, and an investment advice fiduciary. The Applicability Date for the Principal Transactions Exemption is April 10, 2017, which is the same Applicability Date as for the Best Interest Contract Exemption and the investment advice fiduciary regulation (DOL Reg. §2510.3-21). The final Principal Transactions Exemption contains revisions designed to facilitate implementation and compliance with the Exemption's terms. It also expands the coverage of the Exemption to include transactions in products other than debt securities, now referring to covered assets as Principal Traded Assets. Broader applicability is provided when the trade is a sale by the Plan, account or IRA, as opposed to a purchase by the Plan, account or IRA. See ¶4.a.1) below.

¶4.a. Definitions of Principal Transactions, Riskless Principal Transactions, Principal Traded Assets and debt securities covered by this Exemption. A Principal Transaction means a purchase or sale of a Principal Traded Asset (see ¶4.a.1) below), other than a Riskless Principal Transaction, in which an Adviser or Financial Institution is purchasing from or selling to the Plan, account or IRA on behalf of: (1) the Financial Institution's own account *or* (2) the account of a person who directly or indirectly, through one or more intermediaries, is controlling, controlled by, or under common control with the Financial Institution. See Section VI(k) of the Exemption. A Riskless Principal Transaction means a transaction in which a Financial Institution, after having received an order from a Retirement Investor to buy or sell a Principal Traded Asset, purchases or sells the asset for the Financial Institution's own account to offset the contemporaneous transaction with the Retirement Investor. See Section VI(m) of the Exemption. For other relevant definitions (Retirement Investor, Financial Institution, Affiliated, Independent), see ¶4.d. below.

***Definition of Plan and IRA.* The Exemption defines a Plan as an employee benefit plan under ERISA §3(3) or a qualified plan described in IRC §4975(e)(1)(A) (which includes a non-ERISA plan). See Section VI(i) of the Exemption. An IRA for purposes of the Exemption means any account or annuity described in IRC §4975(e)(1)(B) through (F), which includes not only IRAs and Roth IRAs described in IRC §§408(a) and (b) and 408A (including a SEP or SIMPLE-IRA), but also HSAs, Archer medical savings accounts, and Coverdell education savings accounts. See Section VI(g) of the Exemption. These definitions of Plan and IRA coordinate with the definitions also used in the investment advice fiduciary regulation (DOL Reg. §2510.3-21).**

¶4.a.1) Principal Traded Asset. A Principal Traded Asset is different depending on whether the transaction is a purchase (see ¶4.a.1)a) below) and a sale (see ¶4.a.1)b) below).

¶4.a.1)a) Purchases. If the Principal Transaction or Riskless Principal Transaction involves a purchase by the Plan, account, or IRA, the Principal Traded Asset must be: (1) a debt security (as defined in ¶4.a.2) below), (2) a certificate of deposit (CD), (3) an interest in a Unit Investment Trust (within the meaning of section 4(2) of the Investment Company Act of 1940), or (4) an investment that is permitted be purchased under an individual exemption granted by the DOL under ERISA §408(a) and/or IRC §4975(c), after the effective date of this exemption, that provides relief for investment advice fiduciaries to engage in the purchase of the investment in a Principal Transaction or a Riskless Principal Transaction with a Plan or IRA under the same conditions as Principal Transaction Exemption (creating an avenue to obtain DOL permission to expand coverage of the Exemption to other purchases). See Section VI(j)(1) of the Exemption.

¶4.a.1)b) Sales. If the Principal Transaction is a sale by the Plan, account or IRA, a Principal Traded Asset is any security or other investment property. See Section VI(j)(2) of the

Exemption. The DOL made this definition more flexible to give Retirement Investors maximum liquidity in disposing of investment property.

¶4.a.2) Debt security. A debt security means a "debt security" as defined by Rule 10b-10(d)(4) of the Securities Exchange Act of 1934 that is: (1) U.S. dollar denominated, issued by a U.S. corporation and offered pursuant to a registration statement under the Securities Act of 1933, (2) an Agency Debt Security (as defined in FINRA Rule 6710(l)), (3) and Asset Backed Security (as defined in FINRA rule 6710(m) or its successor) that is guaranteed by an Agency (as defined in FINRA rule 6710(k) or its successor), or a Government Sponsored Enterprise (as defined in FINRA rule 6710(n) or its successor), or (4) a U.S. Treasury Security (as defined in FINRA Rule 6710(p) or its successor). See Section VI(d) of the Exemption. The debt security must meet the conditions described in ¶4.a.2)a) and ¶4.a.2)b) below.

¶4.a.2)a) Restrictions on issuance/underwriting. With respect to the purchase of a debt security, the security may not have been issued by the Financial Institution or any Affiliate. See Section III(a)(1) of the Exemption. Additionally, the debt security may not be purchased by the Plan, account or IRA in an underwriting or underwriting syndicate in which the Financial Institution or any Affiliate is the underwriter or a member. See Section III(a)(2) of the Exemption. However, the DOL noted in the preamble to the proposed Exemption that, if a debt security was originally underwritten by the Financial Institution or an Affiliate, but was later obtained for sale in the secondary market, such debt security may be purchased by the Plan, account or IRA pursuant to the Principal Transaction Exemption. Presumably, this is still the view of the DOL as it is not discussed again in the final Exemption.

¶4.a.2)b) Creditworthiness/liquidity. The debt security must possess no greater than a moderate credit risk and be sufficiently liquid that the debt security could be sold at or near its carrying value within a reasonably short period of time. See Section III(a)(3) of the Exemption. Debt securities subject to a moderate credit risk should possess at least average credit-worthiness relative to other similar debt issues. Moderate credit risk would denote current low expectations of default risk, with an adequate capacity for payment of principal and interest. These securities have a level of creditworthiness similar to investment grade securities.

¶4.b. Scope of relief. The Principal Transactions Exemption permits an Adviser or Financial Institution to engage in the purchase or sale of a Principal Traded Asset in a Principal Transaction or Riskless Principal Transaction with a Plan, participant or beneficiary account ("account"), or IRA, and receive a mark-up, mark-down or other payment for themselves or any Affiliate, as a result of the Adviser's and Financial Institution's advice regarding the transaction, providing that the conditions described in ¶4.c. below are satisfied. See Section I(b) of the Exemption. Relief is limited to the self-dealing provisions under ERISA §406(b)(1) and (2) and IRC §4975(c)(1)(E), as well as the prohibitions on sales and exchanges involving plan assets, and transfer or use of plan assets, as described in ERISA §406(a)(1)(A) and (D) and IRC §4975(c)(1)(A) and (D). It does not provide relief from ERISA §406(b)(3) and IRC §4975(c)(1)(F), which prohibit a plan fiduciary from receiving any consideration for its own personal account from any party dealing with the Plan or IRA in connection with a transaction involving the assets of the Plan or IRA. As a result, the Exemption does not include relief for the receipt by a fiduciary of consideration from a trading venue in connection with the execution of purchases and sales thereon (e.g., payment for order flow), although the Best Interest Contract Exemption might cover such compensation. Note that relief from ERISA §406(a)(1)(C) and IRC

§4975(c)(1)(C), which generally prohibits compensation for services rendered to a plan or IRA, is not provided. Since investment advice is a service rendered to plans, the Adviser and Financial Institution are not relieved of the need to comply with the services exemption under ERISA §408(b)(2) and IRC §4975(d)(2), including the fee disclosure requirements under DOL Reg. §2550.408b-2.

¶4.b.1) Limitations on role of Adviser, Financial Institution, and Affiliates. The Adviser may not: (1) have or exercise any discretionary authority or discretionary control respecting management of the assets of the Plan, participant or beneficiary account, or IRA involved in the transaction or exercise any discretionary authority or control respecting management or the disposition of the assets, or (2) have any discretionary authority or discretionary responsibility in the administration of the Plan, participant or beneficiary account, or IRA. In addition, if the plan is an ERISA-covered plan: (1) the Adviser, the Financial Institution, and any Affiliate of either, may not be the employer of employees covered by the plan, and (2) the Adviser and the Financial Institution may not be a named fiduciary or plan administrator (as defined in ERISA §3(16)), or an affiliate of the named fiduciary or plan administrator, that was selected to provide advice to the plan by a fiduciary of the plan who is not Independent of the Adviser and the Financial Institution. See Section I(c) of the Exemption.

¶4.c. Conditions. The conditions for exemptive relief are set forth in ¶4.c.1) through ¶4.c.7) below.

¶4.c.1) Conditions to be met in written contract (IRAs or non-ERISA plans) or in operation (ERISA plans). In the case of an IRA or non-ERISA Plan, the Financial Institution must enter into a written contract with the Retirement Investor no later than time of the execution of the Principal Transaction or Riskless Principal Transaction. See Section II(a) of the Exemption. The written contract requirements parallel those that apply under the Best Interest Contract Exemption, including provision for the use of negative consent for contracts in existence before January 1, 2018. Those requirements are discussed in ¶1.c.1) above, and are not reproduced here. The contract provisions must set forth the requirements of Section II(b)-(e) of the Exemption, as discussed in ¶4.c.1)a) through ¶4.c.1)d) below. For an ERISA plans, the requirements below must be satisfied, but do not have to be reflected in a written contract, because ERISA provides an enforcement regime with respect to these activities. See Section II(g) of the Exemption.

¶4.c.1)a) Acknowledgment of fiduciary status. Both the Adviser and Financial Institution must acknowledge fiduciary status under ERISA or the tax code, or both, with respect to the investment recommendations to the Retirement Investor regarding the Principal Transactions. See Section II(b) of the Exemption. Refer to the discussion of the parallel requirement in the Best Interest Contract Exemption, in ¶1.c.2) above, for additional commentary on this requirement.

¶4.c.1)b) Impartial Conduct Standards. The Financial Institution must state that it and its Advisers agree to the following standards, and must in fact comply with such standards: (1) when providing investment advice to the Retirement Investor regarding a Principal Transaction or Riskless Principal Transaction, such advice, at the time of the recommendation, is in the Best Interest of the Retirement Investor (see ¶4.c.1)b)i) below), (2) the Adviser and Financial Institution seek to obtain the best execution reasonably available under the circumstances with respect to the Principal Transaction or Riskless Principal Transaction (see ¶4.c.1)b)ii) below), and (3) statements by the Financial Institution and its Advisers to the Retirement Investor about the Principal Transaction or Riskless Principal Transaction, fees and compensation related to the Principal Transaction or Riskless Principal Transaction, Material Conflicts of Interest, and any other matters relevant to a Retirement Investor's decision to engage in the Principal Transaction or Riskless Principal Transaction, will not be materially misleading at the time they are made. See Section II(c) of the Exemption. Many of these standards parallel those in the Best Interest Contract Exemption. Thus, the commentary in ¶1.c.3) above would apply in interpreting the similar provisions in this Exemption.

¶4.c.1)b)i) Best Interest standard. The Best Interest standard is met when the fiduciary acts with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the employee benefit plan or IRA, without regard to the financial or other interests of the fiduciary, any affiliate or other party. See Sections II(c)(1) and VI(c) of the Exemption. This is essentially the same language as used in the parallel provisions in the Best Interest Contract Exemption as discussed in ¶1.c.3) above).

¶4.c.1)b)ii) Best execution standard. Financial Institutions that are FINRA members satisfy the requirement to obtain the best execution reasonably available, as described in Section II(c)(2) of the Exemption, if they comply with the terms of FINRA rules 2121 (Fair Prices and Commissions) and 5310 (Best Execution and Interpositioning), or any successor rules in effect at the time of the transaction, as interpreted by FINRA, with respect to the Principal Transaction or Riskless Principal Transaction. See Section II(c)(2)(i) of the Exemption. For other Financial Institutions, meeting the standard of Section II(c)(2) of the Exemption will depend on facts and circumstances. However, the DOL may identify specific requirements regarding best execution and/or fair prices imposed by another regulator or self-regulatory organization relating to additional Principal Traded Assets in an individual exemption that may be satisfied as an alternative to the standard set forth in Section II(c)(2) above. See Section II(c)(2)(ii) of the Exemption.

¶4.c.1)c) Policies and procedures/warranties. Section II(d) of the Exemption sets forth requirements relating to policies and procedures reasonably designed to ensure that individual Advisers adhere to the Impartial Conduct Standards. See Section II(d) of the Exemption. These policies and procedures are essentially the same as those required under the Best Interest Contract Exemption, as discussed in ¶1.c.4) above, except the standards are focused on Principal Transactions and Riskless Prohibited Transactions, and Material Conflicts of Interest that may arise with respect to such transactions. In addition, the Financial Institution's written policies and procedures regarding Principal Transactions and Riskless Principal Transactions must address how credit risk and liquidity assessments for Debt Securities, as discussed in ¶4.a.2)b), will be made. As under the Best Interest Contract Exemption, in the case of an IRA or non-ERISA plan, warranties must be made in the written contract that these policies and procedures requirements will be adopted and complied with. For an ERISA plan, complies with these requirements are a condition of the Exemption, but do not have to be warrantied in a written contract.

¶4.c.1)d) Transaction disclosures. No later than the time of execution of the Principal Transaction or Riskless Principal Transaction, the Financial Institution must provide the following disclosures: (1) set forth in writing the circumstances under which the Adviser and Financial Institution may engage in Principal Transactions and Riskless Principal Transactions with the Plan, participant or beneficiary account or IRA and identify and disclose the Material Conflicts of Interest associated with Principal Transactions, (2) a description of the types of compensation that may be received by the Adviser and Financial Institution in connection with Principal Transactions and Riskless Principal Transactions (including types of compensation that may be received from third parties, and (3) identifies and discloses the Material Conflicts of Interest associated with Principal Transactions and Riskless Principal Transactions. See Section II(e)(1) of the Exemption. These disclosures must be clearly and prominently displayed in the written contract (if applicable) or in a separate single written statement disclosure. See the discussion in ¶1.c.5) above regarding the similar disclosure standard for the Best Interest Contract Exemption for additional commentary. The contract or separate disclosure also must comply with ¶4.c.1)d)i) through ¶4.d.1)d)iii) below.

¶4.c.1)d)i) Affirmative consent. Except in the case of existing contracts that use the negative consent approach (see ¶4.c.1) above), the contract or separate written disclosure, as applicable, must document the Retirement Investor's affirmative written consent, on a prospective basis, to Principal Transactions and Riskless Principal Transactions between the Adviser or Financial Institution and the Plan, account, or IRA. See Section II(e)(2) of the Exemption.

¶4.c.1)d)ii) Termination of consent, copies of information, availability of web disclosures. The contract or separate written disclosure also must inform the Retirement Investor: (1) that this consent is terminable at will upon written notice by the Retirement Investor at any time, without penalty to the Plan or IRA, (2) of the right to obtain, free of charge, copies of the Financial Institution's written description of its policies and procedures (as described in ¶4.c.1)c) above), as well as information about the Principal Traded Asset, including its purchase or sales price, and other salient attributes (including, as applicable, credit quality of the issuer, the effective yield, the call provisions, and the duration), (3) that model contract disclosures or other model notice of the contractual terms, which are reviewed for accuracy no less than quarterly and updated within 30 days as necessary, are maintained on the Financial Institution's website, and (4) that the Financial Institution's written description of its policies and procedures is available free of charge on the Financial Institution's website. See Section II(e)(3) of the Exemption. If a request for information described in (2) is made prior to the transaction, the information must be provided prior to the transaction, and if the request is made after the transaction, the information must be provided within 30 business days after the request.

¶4.c.1)d)iii) Monitoring services. The contract or separate disclosure must describe whether or not the Adviser and Financial Institution will monitor the Retirement Investor's investments that are acquired through Principal Transactions and Riskless Principal Transactions and alert the Retirement Investor to any recommended change to those investments. If such services will be provided, the frequency with which the monitoring will occur and the reasons for which the Retirement Investor will be alerted also must be disclosed. See Section II(e)(4) of the Exemption.

¶4.c.1)e) Good faith errors. The Financial Institution is deemed not to fail these disclosure requirements (nor to violate a contractual provision) solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, or if the website is temporarily inaccessible. In order for this relief to apply: (1) in the case of an error or omission on the website, the Financial Institution discloses the correct information as soon as practicable, but not later than seven (7) days after the date on which it discovers or reasonably should have discovered the error or omission, and (2) in the case of an error or omission with other disclosures, the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. See Section II(c)(4)(i) of the Exemption.

¶4.c.1)f) Reliance on others. If the above disclosures require Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This relief is not available if the entity is: (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution, or (2) any officer, director, employee, agent, registered representative, relative/family member (as defined in ERISA §3(15), and IRC §4975(e)(6) - a spouse, ancestor, lineal descendant, or spouse of a lineal descendant) of, or partner in, the Adviser or Financial Institution. See Section II(e)(5) of the Exemption.

¶4.c.2) Prohibited contractual provisions. As under the Best Interest Contract Exemption, the written contract under the Principal Transaction Exemption may not contain: (1) exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms, (2) a provision under which the Plan, IRA or Retirement Investor waives or qualifies its right to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution, and (3) agreements to arbitrate or mediate individual claims in venues that are distant or otherwise unreasonable. See Section II(f)(1)-(3) of the Exemption. A severability rule is also provided in the event a court rules the prohibition on arbitration of class or representative actions, as under the Best Interest Contract Exemption. See Section II(f)(4) of the Exemption. Since these rules parallel those in the Best Interest Contract Exemption, refer to the discussion in ¶1.c.1)d) above for additional commentary. In the case of an ERISA plans, that are not required to enter in a written contract, Section II(g)(5) precludes the Financial Institution and Adviser from including the same prohibited provisions in any contract, instrument or communication.

¶4.c.3) Cash transactions only. The purchase or sale of the Principal Traded asset must be in cash. No in-kind transactions are covered. See Section III(c) of the Exemption.

¶4.c.4) No evasion transactions. The Principal Transaction or Riskless Principal Transaction is not covered by the Exemption if it is part of an agreement, arrangement, or understanding designed to evade compliance with ERISA or the tax code, or to otherwise impact the value of the Principal Traded Asset. See Section III(b) of the Exemption.

¶4.c.5) Disclosures.

¶4.c.5)a) Pre-transaction disclosure. *No later than* the time of execution of the Principal Transaction or Riskless Principal Transaction, the Advisor or Financial Institution must inform the Retirement Investor, in writing or orally, of the capacity in which the Financial Institution may act with respect to such transaction. See Section IV(a) of the Exemption.

¶4.c.5)b) Confirmation. The Adviser or the Financial Institution must provide a written confirmation of the Principal Transaction or Riskless Principal Transaction. This confirmation requirement may be satisfied in accordance with Rule 10b-10 under the Securities Exchange Act of 1934 (or any successor rule in effect at the time of the transaction), or, for Advisers and Financial Institutions not subject to the Securities Exchange Act, similar requirements imposed by another regulator or self-regulatory organization. See Section IV(b) of the Exemption.

¶4.c.5)c) Annual disclosure. No less frequently than annually, the Adviser or Financial Institution must send to the Retirement Investor, in a *single* written disclosure: (1) a list identifying each Principal Transaction and Riskless Principal Transaction executed in the Retirement Investor's account in reliance on this Exemption during the applicable period, and the date and price at which the transaction occurred, and (2) a statement regarding the information described in ¶4.c.1)d)ii) above. See Section IV(c) of the Exemption.

¶4.c.5)d) Relief for good faith errors and reliance on third party information. Relief for good faith errors and reliance on third party information is also provided for these disclosures, which parallels the relief discussed in ¶4.c.1)e) and ¶4.c.1)f) above. See Section IV(d) of the Exemption.

¶4.c.5)e) Web disclosures. The Financial must prepare a written description of its policies and procedures and must make it available on its website and to Retirement Investors, free of charge, upon request. The description must accurately describe or summarize key components of the policies and procedures relating to conflict-mitigation and incentive practices in a manner that permits Retirement Investors to make an informed judgment about the stringency of the Financial Institution's protections against conflicts of interest. Additionally, Financial Institutions must provide their complete policies and procedures to the DOL upon request. See Section IV(e) of the Exemption.

¶4.c.6) Recordkeeping requirements. Section V of the Exemption prescribes recordkeeping requirements that are substantially the same as those required by the Best Interest Contract Exemption, as described in ¶1.f.2) above. Refer to that earlier discussion for additional commentary.

¶4.c.7) Relief during Transition Period. For a Principal Transaction or Riskless Principal Transaction involving the sale or purchase of a Principal Traded Asset that occurs between April 10, 2017, and January 1, 2018 (the "Transition Period"), more streamlined conditions apply, as set forth in Section VII of the Exemption. Specifically: (1) the Financial Institution and the Adviser(s) must adhere to the Impartial Conduct Standards described in ¶4.c.1)b) above, (2) statements by the Financial Institution and its Advisers to the Retirement Investor about the Principal Transaction or Riskless Principal Transaction, fees and compensation related to the Principal Transaction or Riskless Principal Transaction, Material Conflicts of Interest, and any other matters relevant to a

Retirement Investor's decision to engage in the Principal Transaction or Riskless Principal Transaction, must not be materially misleading at the time they are made, (3) the disclosure requirements described in ¶4.c.7)a) below must be satisfied, (4) the Financial Institution must designate a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards, and (5) comply with recordkeeping requirements described in ¶4.c.6) above. See Section VII(d) of the Exemption. However, the written contract requirement described in ¶4.c.1) above, some of the disclosure requirements in ¶4.c.1)e) above (e.g., disclosures regarding monitoring services), the general conditions in Section III of the Exemption, as discussed in ¶4.c.3) and ¶4.c.4) above, and the disclosures prescribed by Section IV of the Exemption, as discussed in ¶4.c.5) above, do not apply during the Transition Period.

¶4.c.7)a) Disclosures. The Financial Institution must provides to the Retirement Investor, no later than the time of execution of the recommended Principal Transaction or Riskless Principal Transaction, a single written disclosure, which may cover multiple transactions or all transactions occurring within the Transition Period, that clearly and prominently: (1) affirmatively states the fiduciary status of the Financial Institution and the Advisers, (2) sets forth the policies and procedures requirement, and (3) discloses the circumstances under which the Adviser and Financial Institution may engage in Principal Transactions and Riskless Principal Transactions with the Plan, participant or beneficiary account, or IRA, and identifies and discloses the Material Conflicts of Interest associated with such transactions. See Section VII(d)(2)(i)-(iii) of the Exemption. This disclosure may be provided in person, electronically or by mail, and does not have to be repeated for any subsequent recommendations during the Transition Period. See Section VII(d)(2)(iv) of the Exemption. Relief for good faith errors and reliance on information from other parties is provided, along the lines of the similar relief provided for disclosures given under the conditions that apply after the Transition Period, as described in ¶4.c.1)e) and ¶4.c.1)f) above. See Section VII(d)(v) of the Exemption.

¶4.c.7)b) Limitations on role of Adviser, Financial Institution, and Affiliates. Consistent with the limitations imposed on the Principal Transaction Exemption, as described in ¶4.b.1) above, the same limitations on the role of the Adviser, Financial Institution, and Affiliates is also imposed with respect to the Transition Period. See Section VII(c) of the Exemption. Thus, the relief for such persons engaged in such roles is not available on or after April 10, 2017.

¶4.d. Definitions. For purposes of the Principal Transactions Exemption, the definitions of Adviser, Affiliate, Independent and Material Conflict of Interest that appear in Section VI of the Exemption, are the same as the corresponding definitions in the Best Interest Contract Exemption, as explained in ¶1.a.1) above and ¶1.c.3)b) above. The definitions of Financial Institution and Retirement Advisor are different from the corresponding definition in the Best Interest Contract Exemption and are described in ¶4.d.1) and ¶4.d.2) below.

¶4.d.1) Financial Institution. The Financial Institution for purposes of the Principal Transaction Exemption is the entity that employs the Adviser or otherwise retains such individual as an independent contractor, agent or registered representative, and customarily purchases or sells Principal Traded Assets for its own account in the ordinary course of its business. The entity must be a:

(1) registered as an investment adviser under the Investment Advisers Act of 1940 or under the laws of the State in which the adviser maintains its principal office and place of business,
(2) bank or similar financial institution supervised by the United States or state, or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 USC 1813(b)(1)), or
(3) broker or dealer registered under the Securities Exchange Act of 1934.

See Section VI(e) of the Exemption. The Financial Institution definition in the Best Interest Contract Exemption (see ¶1.a.1) above) also includes an insurance company.

¶4.d.2) Retirement Investor. A Retirement Investor is: (1) the fiduciary of a non-participant-directed Plan with authority to make investment decisions for the Plan, (2) a participant or beneficiary of a Plan with authority to direct the investment of assets in his or her Plan account or to take a distribution, or (3) the beneficial owner of an IRA acting on behalf of the IRA. See Section VI(k)(3) of the Exemption. A "Plan" for this purpose, as noted in ¶4.a. above, includes an ERISA-covered plan as well as a qualified plan described in IRC §4975(e)(1)(A) (which includes a non-ERISA plan). The definition of a Retirement Investor for the Best Interest Contract Exemption is broader with respect to a fiduciary of a Plan (referred to as a Retail Fiduciary in that Exemption), which may include a fiduciary of a participant-directed plan. See ¶1.a.1)a) above.

¶4.e. Enforcement of the Principal Transactions Exemption. As with the Best Interest Contract Exemption, enforcement of the Principal Transaction Exemption will differ depending on whether the transaction is with respect to an ERISA plan or with respect to an IRA or non-ERISA plan. See ¶1.h. above for additional commentary.

¶4.f. Other exemptions for principal transactions. Other exemptions for principal transactions are available for: (1) "blind" transactions, as discussed in the ERISA Conference Report (H.R. Rep. 93–1280, 93rd Cong., 2d Sess. 307 (1974)), and in Advisory Opinion 2004-05A, (2) investment advice transactions satisfying the conditions of the statutory exemption under ERISA §408(b)(14) and IRC §4975(d)(17), (3) transactions executed through an electronic communications network, as permitted under ERISA §408(b)(16) and IRC §4975(d)(19), (4) transactions under PTE 75-1, Part IV, which provides an exemption that is available to investment advice fiduciaries who are market-makers (see ¶6.a.4) below), (5) transactions under PTE 75-1, Part II(1), which provides relief for a principal transaction between a plan or IRA and a broker-dealer registered under the Securities Exchange Act of 1934 who is not a fiduciary, and (6) mutual fund principal transactions authorized by modifications to PTE 86-128 (see ¶5.c. below).

¶5. Modifications to PTE 86-128. PTE 86-128 allows a fiduciary, including both an investment advice fiduciary and fiduciaries with discretionary authority or control over plan assets, to cause a plan to receive a fee for effecting or executing securities transactions as agent on behalf of a plan ("securities transactions"). To prevent churning, PTE 86-128 does not apply if these covered securities transactions are excessive in either amount or frequency. PTE 86-128 also allows the fiduciary to receive a reasonable fee when it acts as the agent for both the plan and the other party to the transaction (i.e., the buyer and the seller of securities), known as an agency cross transaction (see Section VII(c) of PTE 86-128). To use the exemption, the fiduciary cannot be a plan administrator or employer, *unless* all profits earned by these parties are returned to the plan. The conditions of the exemption require that a plan fiduciary independent of the fiduciary relying on PTE 86-128 receive certain disclosures and authorize the transaction. In addition, the independent fiduciary must receive confirmations and an annual "portfolio turnover ratio" demonstrating the amount of turnover in the account during that year. Since the exemption under PTE 86-128 for securities transactions and agency cross transactions focuses on receipt of compensation by a fiduciary, the relief granted under Section I(a) (regarding securities transactions and agency cross transactions) is from the self-dealing provisions of ERISA §406(b) and IRC §4975(c)(1)(E) and (F), and not the other prohibited transaction provisions. Relief for mutual fund transactions described in ¶5.c. below provide broader relief.

No written contract requirement. **For transactions with IRAs that are covered by PTE 86-128, there is no written contract requirement akin to the one that applies under the Best Interest Contract Exemption discussed in ¶1 above.**

✪ *Summary of amendments.* The amendments to PTE 86–128 make the following changes as of April 10, 2017 (the "Applicability Date"): (1) require all fiduciaries relying on the exemption to adhere to the same Impartial Conduct Standards required in the Best Interest Contract Exemption (see ¶5.a. below), (2) eliminate PTE 86-128 relief for investment advice fiduciaries (but not other fiduciaries) to IRA owners (see ¶5.b. below), requiring use of the Best Interest Contract Exemption instead, (3) expand PTE 86-128 to all types of fiduciaries to sell mutual fund shares out of their own inventory (i.e. acting as principals, rather than agents) to plans (and IRAs under certain circumstances) and to receive commissions for doing so (see ¶5.c. below), (4) impose the conditions of PTE 86-128 on fiduciaries who exercise discretionary authority or control with respect to IRAs (see ¶5.d. below), (5) clarify that payments to related entities are covered (see ¶5.e. below), and (6) enhance the recordkeeping requirements under PTE 86-128 (see ¶5.f. below). See *Modifications to PTE 86-128 and PTE 75-1* (http://1.usa.gov/1S1cEcF). These amendments also revoke Part I(b) and (c) and Part II(2) of PTE 75-1. See ¶6.a.1) and ¶6.a.2) below.

✪ *Citations.* All references to sections of PTE 86-128 in the discussion below are to PTE 86-128 as revised by these amendments, unless the text states otherwise.

✪ *Definition of plan/IRA.* Unless otherwise specifically noted, the term "plan" is used under PTE 86-128 to encompass: (1) an employee benefit plan described in ERISA §3(3), and (2) any plan described in IRC §4975(e)(1), which includes non-ERISA qualified plans and IRAs. See Section VII(j) of PTE 86-128. The definition of an IRA for purposes of PTE 86-128 includes any account or annuity described in IRC §4975(e)(1)(B) through (F), which includes not only IRAs and Roth IRAs described in IRC §§408(a) and (b) and 408A, but also HSAs, Archer medical savings accounts, and Coverdell education savings accounts. See Section VII(k) of PTE 86-128. This is an expanded definition from the provisions of PTE 86-128 that are in effect prior to April 10, 2017. This is consistent with the definition used under the investment advice fiduciary regulations and the Best Interest Contract Exemption. Prior to April 10, 2017, PTE 86-128 is limited to IRAs meeting the conditions of DOL Reg. §2510.3-2(d), or plans, other than training programs, that cover no employees within the meaning of 29 CFR 2510.3-3.

¶5.a. Impartial Conduct Standards. Section II of PTE 86-128 imposes Impartial Conduct Standards on a fiduciary who engages in a transaction covered by Section I if the fiduciary exercises authority or control over the management of the plan or the management or disposition of plan assets (within the meaning of ERISA §3(21)(A)(i) or IRC §4975(e)(3)(A)), or is an investment advice fiduciary (within the meaning of ERISA §3(21)(A)(ii) or IRC §4975(e)(3)(B)) with respect to the assets involved in the transaction, to the extent the Impartial Conduct Standards are applicable to the fiduciary's actions. The Impartial Conduct Standards requiring that: (1) when exercising fiduciary authority, the fiduciary acts in the Best Interest (see ¶5.a.1) below) of the plan at the time of the transaction, (2) all compensation received by the person and any Related Entity (see ¶5.e. below) in connection with the transaction is not in excess of reasonable compensation within the meaning of ERISA §408(b)(2) and IRC §4975(d)(2), and (3) the fiduciary's statements about the transaction, fees and compensation, Material Conflicts of Interest, and any other matters relevant to a plan's investment decisions, are not materially misleading at the time they are made. A Material Conflict of Interest exists when a person has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to the plan. See Section VII(o) of PTE 86-128. For this purpose, a fiduciary's failure to disclose a Material Conflict of Interest relevant to the services the fiduciary is providing or other actions it is taking in relation to a plan's or IRA owner's investment decisions is deemed to be a misleading statement. Compliance with the Impartial Conduct Standards is a condition for the relief under PTE 86-128 with respect to all covered transactions identified in Section I of PTE 86-128.

¶5.a.1) Best Interest standard. The Best Interest standard is met when the fiduciary acts with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the employee benefit plan or IRA, without regard to the financial or other interests of the fiduciary, any affiliate or other party. See Section VII(m) of PTE 86-128. This is essentially the same language as used in the parallel provisions in the Best Interest Contract Exemption as discussed in ¶1.c.3) above).

¶5.b. Revocation of exemptive relief for investment advice fiduciaries of IRAs. Section I(c) of PTE 86-128 provides that, if a securities transaction or agency cross transaction, as described in Section I(a), involves an IRA, and the fiduciary engaging in the transaction is a fiduciary by reason of the provision of investment advice for a fee, as described in IRC §4975(e)(3)(B) and DOL Reg. §2510.3-21(c), the exemptive relief under PTE 86-128 is not available. Such fiduciaries must satisfy the conditions of the Best Interest Contract Exemption, as described in ¶1 above, in order to have relief with respect to the transaction. The DOL believes that the provisions of the Best Interest Contract Exemption better protect the interests of IRAs with respect to investment advice regarding securities transactions, primarily because there is no separate plan fiduciary in the IRA market to review and authorize the transaction. With this change, the exemptive relief under PTE 86-128 applies with respect to a transaction with an IRA only to a fiduciary who is an investment manager of the IRA (i.e., a fiduciary who exercises authority or control over the assets of the IRA, within the meaning of ERISA §3(21)(A)(i) or IRC §4975(e)(3)(A)), rather than an investment advice fiduciary. Note that this revocation does not apply to investment advice provided to a non-ERISA plan.

¶5.c. Mutual fund transactions. New Section I(b) of PTE 86-128 provides relief for transactions that, prior to April 10, 2017, are covered in PTE 75–1, Part II(2) (which is revoked as of April 10, 2017 - see ¶6.a.2) below). (Securities transactions and agency cross transactions that, prior to the revisions were the only transactions addressed in Section I, are now moved to Section I(a) of PTE 86-128.) Section I(b) permits a broker-dealer fiduciary (see ¶5.c.2) below) to use its authority to cause a plan (but not IRA - see Section I(c)(2) of PTE 86-128) to purchase shares of a mutual fund from the broker-dealer fiduciary, and for the receipt of a Commission (see ¶5.c.1) below) by such fiduciary in connection with the transaction. Note that the exemption applies only to purchase by the plan or IRA of mutual fund shares from the broker-dealer, and not the sale by the plan of mutual shares to the broker-dealer. This is because the DOL does not believe it is necessary for a plan to sell a mutual fund share to a fiduciary that is acting as a principal. Transactions covered by Section I(b) are subject to the Impartial Conduct Standards (see ¶5.a. above), the general prohibition on churning (i.e., the covered mutual fund transactions cannot be "excessive") and the conditions of new Section IV of proposed PTE 86-128 (see ¶5.c.2) below), which incorporate the conditions that, prior to April 10, 2017, are applicable to transactions described in PTE 75-1, Part II(2).

> ***IRAs.* Note that PTE 75-1, Part II(2), covered IRAs in these transactions. Under PTE 86-128, mutual fund transactions described in Section I(b) do not apply to transactions with IRAs. Such transactions, if engaged in by an investment advice fiduciary, could qualify for relief under the Best Interest Contract Exemption described in ¶1. above.**
>
> ***Not confined to principal transactions.* The proposed version of these amendments had referred to these mutual fund transactions as principal transactions. As revised, the exemption is not limited to riskless principal transactions, and provides relief for all covered transaction regardless of whether they are technically confirmed as "principal" transactions.**

¶5.c.1) Commissions. A Commission for purposes of these mutual fund transactions, as well as the securities transactions and agency cross transactions described in Section I(a) of PTE 86-128, is defined to mean a brokerage commission or sales load paid for the service of effecting or executing the transaction, but *not* a 12b-1 fee, revenue sharing payment, marketing fee, administrative fee, sub-TA fee, or sub-accounting fee. See Section VII(n) of PTE 86-128. "Effecting or executing a securities transaction" means the execution of a securities transaction as agent for another person and/or the performance of clearance, settlement, custodial or other functions ancillary thereto. See Section VII(e) of PTE 86-128. A commission paid with respect to a transaction under Section I(b) could be paid directly by the plan or from the mutual fund. Note that this is different from a securities transaction described in Section I(a), where the commission must be paid directly by the plan.

¶5.c.2) Broker-dealer fiduciary. A fiduciary is eligible for relief under Section I(b) of PTE 86-128 only if the fiduciary: (1) is a broker-dealer registered under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) acting in its capacity as a broker-dealer, and (2) is not a principal underwriter for, or affiliated with, such Mutual Fund, within the meaning of sections 2(a)(29) and 2(a)(3) of the Investment Company Act of 1940. If the broker-dealer does not satisfy these requirements, it may look to other applicable exemptions, such as the Best Interest Contract Exemption, for relief. Also, fiduciary status can be avoided altogether with respect to advice rendered to fiduciaries with financial expertise, as set forth in DOL Reg. §2510.3-21(c)(1) (see the discussion in ¶1.b.2) above). Relief under PTE 75-1 remains available for securities transactions executed by non-fiduciaries.

¶5.c.3) Section IV conditions. Section IV of PTE 86-128, which applies to mutual fund transactions described in ¶5.c. above, requires that: (1) the fiduciary engaging in the covered transaction customarily purchases and sells securities for its own account in the ordinary course of its business as a broker-dealer, (2) at the time the transaction is entered into, the transaction is at least as favorable to the plan as the terms generally available in an arm's length transaction with an unrelated party, and (3) unless rendered inapplicable by Section V of PTE 86-128, the requirements of Sections III(a) through III(f) (relating to limitations on trustee services, written authorization requirements, the furnishing of certain documents, and annual summaries of information), III(h) and III(i), if applicable (relating to minimum plan asset levels for certain discretionary trustees and the furnishing of certain information on an annual basis to the authorizing plan fiduciary), and III(j) (regarding the price of mutual fund shares) are satisfied with respect to the transaction. See ¶5.e. below for additional information about Section III of PTE 86-128.

¶5.c.4) Relief. Since the mutual fund transaction, involves the purchase and sale of shares between a plan and a party-in-interest or disqualified person, and the transfer of a plan asset to a party-in-interest or disqualified person, which would violate ERISA §406(a)(1)(A) and (D) and IRC §4975(c)(1)(A) and (D) in the absence of an exemption, relief is provided with respect to such sections. Also, since the person relying on the exemption would be a fiduciary, the exemption also provides relief from the self-dealing and conflict-of-interest rules under ERISA §406(b) and IRC §4975(c)(1)(E) and (F).

¶5.d. Changes to Section III of PTE 86-128.

¶5.d.1) Extension of Section III conditions to covered transactions with IRAs. Section IV(a) of PTE 86-128, as applicable to transactions occurring before April 10, 2017, contains an exception from the conditions of Section III of PTE 86-128 for securities transactions and agency cross transactions covered by Section I(a) of PTE 86-128, if the transaction is engaged in or on behalf of IRAs. Due to a dramatic increase in the amount of assets held in IRAs, and increased complexity in the financial services marketplace, the DOL has extended the conditions of Section III of PTE 86-128 to IRA transactions that are covered by PTE 86-128. As revised, Section IV of PTE 86-128 no longer provides an IRA exception from Section III.

¶5.d.2) IRA owner acting as authorizing fiduciary. Section III(b), which requires a covered transaction to occur under a written authorization by an independent fiduciary, is modified to clarify that an IRA owner can act as the fiduciary for this purpose. However, the IRA owner need not be "independent" of the person engaging in the covered transaction. Therefore, an IRA owner employed by the investment management fiduciary relying on the exemption will still be able to satisfy the authorization requirement. This reflects the DOL's view that the interaction of the employer and employee with regard to an IRA that is not employer sponsored is likely to be voluntary and less likely to have the heightened conflicts of interest associated with an employer providing advice to an employer-sponsored plan, and earning a profit. Accordingly, an investment management fiduciary may provide advice to the beneficial owner of an IRA who is employed by the fiduciary and receive prohibited compensation as a result, provided the IRA is not covered by Title I of ERISA. See the preamble to these revisions to PTE 86-128 at 81 F.R. 21196 (April 8, 2016).

¶5.d.2)a) Existing customers. For existing customers as of April 10, 2017, the fiduciary engaging in the transaction need not receive an affirmative consent from the authorizing fiduciary of a non-ERISA plan or IRA. Instead, the fiduciary may rely on the IRA's or non-ERISA plan's negative consent, as long as the disclosures and consent termination form are provided to the IRA or non-ERISA plan by April 10, 2017.

¶5.d.3) Annual authorization. Under Section III(c) of PTE 86-128, an annual reauthorization is necessary for a fiduciary to engage in a covered transaction. However, in lieu of affirmative reauthorization, the fiduciary engaging in the transaction may supply the authorizing fiduciary with a form expressly providing an election to termination the authorization (with instructions on the use of the form). A 30-day window must be provided, after which a failure to return the form (or some other written notification to terminate the authorization) will result in continued authorization. The DOL clarifies at 81 F.R. 21197 (April 10, 2017) that, since a fiduciary will not be in breach of a condition until the expiration of the 30- day window, the fiduciary may rely on PTE 86-128 relief until the closing of that window, and it will not retroactively lose the relief relied upon by the fiduciary during the 30-day window.

¶5.d.4) Portfolio turnover ratio. Section III(f)(4) requires fiduciary provide a portfolio turnover ratio at least once per year. The portfolio turnover ratio is a disclosure designed to assist the authorizing fiduciary or IRA owner by disclosing the amount of turnover or churning in the portfolio during the applicable period. As amended, PTE 86-128 makes clear that the portfolio turnover ratio is not required from fiduciaries that have not exercised discretionary authority over trading in the plan's account during the applicable year.

¶5.d.5) Pooled funds. Section V(c) provides that the disclosure and authorization conditions set forth in Section III(b), (c) and (d) do not apply to pooled funds if certain alternative conditions. Section V(c)(1)(B) requires that certain information reasonably available to the fiduciary engaging in the transaction be furnished to the authorizing fiduciary. The proposal would have changed "reasonably available" to "reasonably necessary." That change was not adopted.

¶5.d.6) Independent fiduciary. Section VII(f) of PTE 86-128 is amended to provide that an authorizing fiduciary is considered to be Independent if the fiduciary engaging in the transaction does not receive or is not projected to receive within the current federal income tax year, compensation or other consideration for his or her own account from the person in excess of 2% of the fiduciary's annual revenues based upon its prior income tax year. As noted in ¶5.d.2) above, the independence requirement does not apply when the authorizing fiduciary is an IRA owner.

¶5.e. Related Entities. Section I(a) of revised PTE 86-128 clarifies that a commission paid with respect to covered securities (which must be paid directly by the plan) may be paid to the Related Entity of the fiduciary. A Related Entity for this purpose is an entity, other than an affiliate, in which a person has an interest which may affect the person's exercise of its best judgment as a fiduciary. See Section VII(l) of PTE 86-128. (Payment to an affiliate, as defined in Section VII(b) of PTE 86-128 of a fiduciary already is permitted by PTE 86-128.) The Impartial Conduct Standards described in ¶5.a. and the Best Interest standard described in ¶5.a.1) also refer to Related Entities. Note that there is no reference to Related Entities with respect to commissions paid in agency cross transactions covered by Section I(a) of PTE 86-128. Such commissions are covered by the exemption to the extent paid to the plan fiduciary who is acting as agent in the transaction, or to any affiliate of the fiduciary. (Any reference to a person in PTE 86-128 includes a reference to their affiliates - see Section VII(a) of PTE 86-128.)

¶5.f. Recordkeeping requirements. New Section VI of PTE 86-128 imposes recordkeeping requirements that are similar to those under the Best Interest Contract Exemption described in ¶1.h. above. The fiduciary engaging in the covered transaction must maintain for a period of six years, in a manner that is reasonably accessible for examination, the records necessary to enable the persons described in ¶5.f.1) below to determine whether the conditions of PTE 86-128 have been met. No party other than the fiduciary who is responsible for the recordkeeping will be subject to sanctions under ERISA §502(i) or IRC §4975 if such records are not properly maintained or not available for examination. In addition, if records are lost or destroyed due to circumstances beyond the Financial Institution's control, no prohibited transaction will have occurred merely because of the unavailability of such records. See Section VI(a) of PTE 86-128.

¶5.f.1) Persons with right of inspection. The records described in ¶5.f. above must be reasonably available at their customary location for examination during normal business hours by: (1) any duly authorized employee or representative of the IRS or DOL, (2) any fiduciary of a plan (which includes an IRA owner) involved in a covered transaction (or authorized employee or representative of the fiduciary), (3) any contributing employer and any employee organization whose members are covered by a plan that is involved in a covered transaction (or any authorized employee or representative of such entities), and (4) any participant or beneficiary of a plan, including an IRA owner in the case of an IRA involved in a covered transaction (or authorized representative of such participant, beneficiary or IRA owner). See Section VI(b)(1) of PTE 86-128.

¶5.f.2) Exception for privileged information. A person described in ¶5.f.1) above (other than the DOL or IRS): (1) may not examine privileged trade secrets or privileged commercial or financial information of such fiduciary, and (2) is not authorized to examine records regarding a plan or IRA other than the plan or IRA with which they are the fiduciary, contributing employer, employee organization, participant, beneficiary or IRA owner. See Section VI(b)(2) of PTE 86-128.

¶5.f.3) Refusal to disclose exempt information. If the fiduciary refuses to disclose any information on the basis that the information is exempt from disclosure, such fiduciary must, by the close of the 30th day following the request, provide a written notice advising the requestor of the reasons for the refusal and that the DOL may request such information. See Section VI(b)(3) of PTE 86-128.

¶5.f.4) Consequences of failure. A failure to maintain the required records necessary to determine whether the conditions of PTE 86-128 have been met will result in the loss of the exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions. See Section VI(b)(4) of PTE 86-128.

¶5.g. Recapture of profits exception. Section V(b) of PTE 86-128 provides that Sections III(a) and III(i) do not apply in any case where the person engaging in the covered transaction returns or credits to the plan or IRA all profits earned by that person (including Related Entities, as described in ¶5.e. above) in connection with the securities transaction associated with the covered transaction. Amended Section III(h) clarifies that the recapture of profits exception under Section V(b) applies to any trustee, regardless of the size of the plan. Earlier amendments to PTE 86-128 had inadvertently limited the exception to trustees of plans that met the minimum asset requirements of Section III(h). "Profits" include all charges relating to effecting or executing securities transactions, less reasonable and necessary expenses including reasonable indirect expenses (such as overhead costs) properly allocated to the performance of these transactions under generally accepted accounting principles. See Section VII(g) of PTE 86-128.

¶5.h. Compliance with reasonable services exemption. Note that relief from ERISA §406(a)(1)(C) and IRC §4975(c)(1)(C), which generally prohibits compensation for services rendered to a plan or IRA, is not provided by PTE 86-128. To avoid a prohibited transaction with respect to its services contract or arrangement, the fiduciary must comply with the services exemption under ERISA §408(b)(2) and IRC §4975(d)(2), including the fee disclosure requirements under DOL Reg. §2550.408b-2.

¶6. Modifications to PTEs 75-1, PTE 77-4, PTE 80-83 and PTE 83-1. With the issuance of the investment advice fiduciary regulations, the DOL also reviewed the financial transaction exemptions under PTEs 75-1, 77-4, 80-83 and 83-1 to identify what changes are appropriate, particularly in light of the Best Interest Contract Exemption. These changes are explained below. The Applicability Date of these modifications (including a revocation of relief previously in any of these exemptions) is April 10, 2017, meaning they apply to transactions occurring on or after such date.

Definition of an IRA. **All of the PTEs discussed below are amended to define an IRA as any account or annuity described in IRC §4975(e)(1)(B) through (F), which includes not only IRAs and Roth IRAs described in IRC §§408(a) and (b) and 408A, but also HSAs, Archer medical savings accounts, and Coverdell education savings accounts. This is consistent with the definition used under the investment advice fiduciary regulation (DOL Reg. §2510.3-21) and the Best Interest Contract Exemption.**

No written contract requirement. **For transactions with IRAs that are covered by PTEs 75-1, 77-4, 80-83 and 83-1, there is no written contract requirement akin to the one that applies under the Best Interest Contract Exemption discussed in ¶1 above.**

¶6.a. Modifications to PTE 75-1. PTE 75-1 is a multi-part exemption for securities transactions involving broker-dealers and banks, and plans and IRAs. The DOL has adopted several modifications. The modifications described in ¶6.a.1) and ¶6.a.2) below are found in *Modifications to PTE 86-128 and PTE 75-1* (http://1.usa.gov/1S1cEcF). The modifications described in ¶6.a.3) and ¶6.a.4) below are found in *Modifications to PTE 75-1, PTE 77-4, PTE 80-83 and PTE 83-1* (http://1.usa.gov/1PYmHe6). The modifications described in ¶6.a.5) below are found in *Modifications to PTE 75-1, Part V* (http://1.usa.gov/1S1cAtD).

¶6.a.1) Exemption for certain nonfiduciary services revoked. The exemptions formerly in Part I(b) and (c) of PTE 75-1 are revoked as of April 10, 2017. Part I(b) of PTE 75–1 provides relief from ERISA §406 and the taxes imposed by IRC §4975 for the effecting of securities transactions, including clearance, settlement or custodial functions incidental to effecting the transactions, by parties-in-interest or disqualified persons *other than* fiduciaries. Part I(c) of PTE 75–1 provides relief from ERISA §406 and IRC §4975 for the furnishing of advice regarding securities or other property to a plan or IRA by a party-in-interest or disqualified person under circumstances which do *not* make the party-in-interest or disqualified person a fiduciary with respect to the plan or IRA. By revoking these exemptions, the DOL is intending such nonfiduciaries to rely instead on the services exemptions under ERISA §408(b)(2) and IRC §4975(d)(2), and DOL Reg. §2550.408b-2, with respect to such services. The DOL believes the relief under Part I(b) and (c) of PTE 75-1 is duplicative of the statutory services exemption. Note that Part I(a) of PTE 75-1 pertained solely to pre-May 1, 1978, transactions so wouldn't have any ongoing application anyway. Therefore, after April 10, 2017, Part I no longer provides for any relief on current transactions.

¶6.a.2) Mutual fund commissions. Part II(2) of PTE 75-1, which provides relief for fiduciaries to receive commissions for selling mutual fund shares to plans and IRAs is revoked as of April 10, 2017. Instead, such transactions must comply with the amended provisions under PTE 86-128 (see ¶5.c. above) or the Best Interest Contract Exemption. To reflect the changes, the DOL has restated Part II of PTE 75-1, which is set forth in the preamble to the release of the revisions. See 81 F.R. 21207 (April 8 2017). As restated, the only transactions covered by Part II of PTE 75-1 is a transaction that involves the purchase or sale of a security between an employee benefit plan and a: (1) broker-dealer registered under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), (2) reporting dealer who makes primary markets in securities of the United States Government or of any agency of the United States Government (Government securities) and reports daily to the Federal Reserve Bank of New York its positions with respect to Government securities and borrowings thereon, or (3) a bank supervised by the United States or a State. The last paragraph of Part II of PTE 75-1 clarifies that the terms ''broker-dealer,'' ''reporting dealer'' and ''bank'' include any affiliates of such persons, and that the term ''affiliate'' is defined in the same manner in DOL Reg. §2510.3–21(e) and Treas. Reg. §54.4975–9(e). To obtain relief under PTE 75-1 for a covered transaction, the conditions set forth in Part II(a) through (f) must be satisfied.

¶6.a.2)a) Shift of recordkeeping burden. For the transactions that remain covered by Part II of PTE 75-1 after April 10, 2017, Part II(e) is amended to shift the recordkeeping burden from the plan or IRA to the broker-dealer, reporting dealer, or bank engaging in the covered transaction. Part II(e) of amended PTE 75-1 provides that: (1) no party-in-interest other than the broker-dealer, reporting dealer, or bank engaging in the covered transaction can be sanctioned under ERISA §502(i) or IRC §4975 if the requirements are not satisfied, and (2) a prohibited transaction will not be deemed to have occurred if, due to circumstances beyond the control of the broker-dealer, reporting dealer, or bank, such records are lost or destroyed prior to the end of such six year period.

¶6.a.2)b) Inspection of records. Part II(f)(1) of amended PTE 75-1 permits examination of the records described in ¶6.a.2)a) above by: (1) any duly authorized employee or representative of the DOL or IRS, (2) any fiduciary of the plan, or any duly authorized employee or representative of the fiduciary, (3) a contributing employer and any employee organization whose members are covered by the plan, or any duly authorized representative of such entities, and (4) any participant or beneficiary of a plan, or IRA owner (or duly authorized representative of such individual).

¶6.a.2)b)i) Limitations on records available for examination. Part II(f)(2) of amended PTE 75-1 provides that the persons described in (2) through (4) are not authorized to example trade secrets or commercial or financial information of the broker-dealer, reporting dealer, or bank which is privileged or confidential, or records regarding a plan or IRA other than the plan or IRA with respect to which they are the fiduciary, contributing employer, employee organization, participant, beneficiary, or IRA owner.

¶6.a.2)b)ii) Refusal to disclose. If the broker-dealer, reporting dealer, or bank refuses to disclose information on the basis that such information is exempt from disclosure, the such person must, by the close of the 30th day following the request, provide a written notice advising the person requesting the information of the reasons for the refusal and that the DOL may request such information. See Part II(f)(3) of PTE 75-1.

¶6.a.2)c) Failure to maintain records. Failure to maintain the required records necessary to determine whether the conditions of this exemption have been met will result in the loss of the exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions. See Part II(f)(4) of PTE 75-1.

¶6.a.3) Acquisition of securities from a syndicate. Part III of PTE 75-1 provides relief for a plan's acquisition of securities during an underwriting or selling syndicate from any person *other than* a fiduciary who is a member of the syndicate, when the fiduciary is also a member of the syndicate. New Part III(f) of PTE 75-1 requires that if the fiduciary is a fiduciary under ERISA §3(21)(A)(i) or (ii) or IRC §4975(e)(3)(A) or (B) (i.e., is an investment advice fiduciary or is a fiduciary because of discretionary authority or control respecting management of the plan or exercises authority or control respective management or disposition of plan assets), the fiduciary must comply with the Impartial Conduct Standards set forth in Part III(f). The Impartial Conduct Standards require that: (1) the fiduciary act in the Best Interest (see ¶6.a.3)a) below) of the plan or IRA at the time of the transaction, (2) all compensation received by the fiduciary in connection with the transaction does not exceed compensation for services that is reasonable within the meaning of ERISA §408(b)(2) and IRC §4975(d)(2), and (3) the fiduciary's statements about recommended investments, fees, Material Conflicts of Interest, and any other matters relevant to a plan's or IRA owner's investment decisions, are not materially misleading at the time they are made. A Material Conflict of Interest exists when a fiduciary has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a plan or IRA owner.

***Redesignation of sections.* Part III(f) and (g) of PTE 75-1, as applicable to transactions before April 10, 2017, are redesignated as Part III(g) and (h), respectively, for transactions occurring on or after April 10, 2017.**

¶6.a.3)a) Best Interest of the plan or IRA. The Best Interest standard is met when the fiduciary acts with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the employee benefit plan or IRA, without regard to the financial or other interests of the fiduciary, any affiliate or other party. See Part III(f) of PTE 75-1. This is essentially the same language as used in the parallel provisions in the Best Interest Contract Exemption as discussed in ¶1.c.3) above).

¶6.a.4) Principal transactions involving securities. Part IV of PTE 75-1 permits a plan or IRA to purchase securities in a principal transaction from a fiduciary that is a market maker with respect to such securities. New Part IV(e) requires that if the fiduciary is a fiduciary under ERISA §3(21)(A)(i) or (ii) or IRC §4975(e)(3)(A) or (B) (i.e., is an investment advice fiduciary or is a fiduciary because of discretionary authority or control respecting management of the plan or exercises authority or control respective management or disposition of plan assets), the fiduciary must comply with the Impartial Conduct Standards set forth in Part IV(e). The Impartial Conduct Standards require that: (1) the fiduciary act in the Best Interest (see ¶6.a.4)a) below) of the plan or IRA at the time of the transaction, (2) all compensation received by the fiduciary in connection with the transaction does not exceed compensation for services that is reasonable within the meaning of ERISA §408(b)(2) and IRC §4975(d)(2), and (3) the fiduciary's statements about recommended investments, fees, Material Conflicts of Interest, and any other matters relevant to a plan's or IRA owner's investment decisions, are not materially misleading at the time they are made. A Material Conflict of Interest exists when a fiduciary has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a plan or IRA owner.

***Redesignation of sections.* Part IV(e) and (f) of PTE 75-1, as applicable transactions occurring before April 10, 2017, are redesignated as Part IV(e) and (f), respectively, for transactions occurring on or after April 10, 2017.**

¶6.a.4)a) Best Interest of the plan or IRA. The Best Interest standard is defined in Part IV(e) in the same manner as described in ¶6 .a.3)a) above.

¶6.a.5) Extensions of credit. Part V of PTE 75-1 permits broker-dealers to extend credit to a plan or IRA in connection with the purchase or sale of securities (but without compensation if the broker-dealer is a fiduciary of the plan). The exemption is available for extensions of credit for: (1) the settlement of securities transactions, (2) short sales of securities, (3) the writing of option contracts on securities, and (4) purchasing of securities on margin. Part V has been modified to add Part V(c), which permits an investment advice fiduciary (as defined in ERISA §3(21)(A)(ii) or IRC §4975(e)(3)(B), and DOL Reg. §2510.3-21) to receive reasonable compensation for extending credit to a plan or IRA, but only for the limited purpose of avoiding a failed purchase or sale of securities involving the plan or IRA and the conditions described in ¶6.a.5)a) below are met. This modification was needed in light of the investment advice fiduciary regulations (DOL Reg. §2510.3-21) that may cause a broker-dealer to be treated as a fiduciary of the plan or IRA, thereby precluding the broker-dealer from relying on Part V(a) of PTE 75-1 because of its prohibition on a fiduciary receiving compensation for the transaction described therein.

¶6.a.5)a) Conditions for relief to investment advice fiduciary. The relief provided by Part V(c) is available only if: (1) the potential failure of the purchase or sale of the securities is not caused by such fiduciary or an affiliate (as defined in DOL Reg. §2510.3-21(g)), (2) the terms of the extension of credit are at least as favorable to the plan or IRA as the terms available in an arm's length transaction between unaffiliated parties, and (3) prior to the extension of credit, the plan or IRA receives written disclosure of the rate of interest (or other fees) that will apply and the method of determining the balance upon which interest will be charged, in the event that the fiduciary extends credit to avoid a failed purchase or sale of securities, as well as prior written disclosure of any changes to these terms. The required disclosures are considered satisfied if the plan or IRA receives the disclosure described in Securities and Exchange Act Rule 10b–16 (see 17 CFR §240.10b–16), which governs broker-dealers' disclosure of credit terms in margin transactions. The written disclosure does not need to be made on a transaction by transaction basis, and can be part of an account opening agreement or a master agreement.

¶6.a.5)b) Recordkeeping requirements. The broker-dealer must maintain records, for a period of six (6) years from the date of the transaction in any manner that is reasonably accessible for examination, as are reasonably necessary to determine whether the conditions of Part V of PTE 75-1 have been satisfied. See Part V(e) of PTE 75-1. Prior to these amendments, the plan or IRA bore the recordkeeping responsibility. No party other than the broker-dealer engaging in the covered transaction is subject to the civil penalty under ERISA §502(i) or the excise taxes under IRC §4975 if the recordkeeping requirements were not met. See Part V(d)(1) of PTE 75-1.

¶6.a.5)b)i) Lost records. A prohibited transaction does not occur if, due to circumstances beyond the control of the broker-dealer, such records are lost or destroyed prior to the end of such six- year period. See Part V(d)(2) of PTE 75-1.

¶6.a.5)b)ii) Inspection of records. The records described in ¶6.a.5)b) above must be reasonably available at their customary location for examination during normal business hours by: (1) an authorized employee or representative of the IRS or DOL, (2) any fiduciary of a plan that engaged in a covered transaction (or authorized employee or representative of the fiduciary), (3) any contributing employer and any employee organization whose members are covered by a plan that is involved in a covered transaction (or any employee or representative of these entities), and (4) any participant or beneficiary of a plan, or an IRA owner, involved in a covered transaction (or authorized representative of such participant, beneficiary or IRA owner). See Part V(d)(1) of PTE 75-1.

¶6.a.5)b)iii) Exception for privileged information. A person described in ¶6.a.5)b)ii) above (other than the DOL or IRS) may not examine records regarding a recommended transaction involving: (1) another investor, (2) privileged trade secrets or privileged commercial or financial information of the broker-dealer, or (3) information identifying other individuals. See Part V(d)(2) of PTE 75-1.

¶6.a.5)b)iv) Refusal to disclose exempt information. If the broker-dealer engaging in the covered transaction refuses to disclose any information on the basis that the information is exempt from disclosure, the broker-dealer must, by the close of the 30th day following the request, provide a written notice advising the requestor of the reasons for the refusal, and that the DOL may request such information. See Part V(d)(3) of PTE 75-1.

¶6.a.5)b)v) Scope of recordkeeping failures. Failure to maintain the required records necessary to determine whether the conditions of PTE 75-1, Part V, have been met will result in the loss of the exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions. See Part V(d)(4) of PTE 75-1.

¶6.a.5)c) Extension to IRAs. Part V of PTE 75-1 also has been modified to extend its provisions to cover extensions of credit to IRAs. See the first paragraph of Part V proposed PTE 75-1. Also, IRA owners have been added to the list of persons with the authority to examine records (see ¶6.a.5)b) above. An IRA is defined as any account or annuity described in IRC §4975(e)(1)(B) through (F), which includes not only IRAs and Roth IRAs described in IRC §§408(a) and (b) and 408A (including SEPs and SIMPLE-IRAs), but also HSAs, Archer medical savings accounts, and Coverdell education savings accounts. See the last paragraph of Part V(d) of PTE 75-1. This is consistent with the definition used under the investment advice fiduciary regulations and the Best Interest Contract Exemption.

¶6.a.5)d) Services exemption. Note that relief from ERISA §406(a)(1)(C) and IRC §4975(c)(1)(C), which generally prohibits compensation for services rendered to a plan or IRA, is not provided by the proposed amendment to Part V of PTE 75-1. Since investment advice is a service rendered to plans, the investment advice fiduciary is not relieved of the need to comply with the services exemption under ERISA §408(b)(2) and IRC §4975(d)(2), including the fee disclosure requirements under DOL Reg. §2550.408b-2.

¶6.b. Modifications to PTE 77-4, PTE 80-83 and PTE 81-3. PTE 77-4 provides relief for a plan's or IRA's purchase or sale of open-end investment company shares (mutual fund shares) where the investment adviser for the mutual fund company is also a fiduciary to the plan or IRA. PTE 80-83 provides relief for a fiduciary causing a plan or IRA to purchase a security when the proceeds of the securities issuance may be used by the issuer to retire or reduce indebtedness to the fiduciary or an affiliate. PTE 83-1 provides relief for the sale of certificates in an initial issuance of certificates, by the sponsor of a mortgage pool to a plan or IRA, when the sponsor, trustee or insurer of the mortgage pool is a fiduciary with respect to the plan or IRA assets invested in such certificates.

¶6.b.1) Imposition of Impartial Conduct Standards. Section II(g) of PTE 77-4, Section II(A)(2) of PTE 80-83, and Section II(B) of PTE 81-3, as revised, require that if, the fiduciary is a fiduciary under ERISA §3(21)(A)(i) or (ii) or IRC §4975(e)(3)(A) or (B) (i.e., is an investment advice fiduciary or is a fiduciary because of discretionary authority or control respecting management of the plan or exercises authority or control respective management or disposition of plan assets), the fiduciary must comply with the Impartial Conduct Standards set forth in that section. The Impartial Conduct Standards require that: (1) the fiduciary act in the Best Interest (see ¶6.b.1)a) below) of the plan or IRA at the time of the transaction, (2) all compensation received by the fiduciary in connection with the transaction does not exceed compensation for services that is reasonable within the meaning of ERISA §408(b)(2) and IRC §4975(d)(2), and (3) the fiduciary's statements about recommended investments, fees, Material Conflicts of Interest, and any other matters relevant to a plan's or IRA owner's investment decisions, are not materially misleading at the time they are made. A Material Conflict of Interest exists when a fiduciary has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a plan or IRA owner. These modifications are found in *Modifications to PTE 75-1, PTE 77-4, PTE 80-83 and PTE 83-1* (http://1.usa.gov/1PYmHe6).

¶6.b.1)a Best Interest of the plan or IRA. The Best Interest standard is met when the fiduciary acts with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the employee benefit plan or IRA, without regard to the financial or other interests of the fiduciary, any affiliate or other party. This is essentially the same language as used in the parallel provisions in the Best Interest Contract Exemption as discussed in ¶1.c.3) above).

¶7. Modifications to PTE 84-24. PTE 84–24, as applicable to transactions occurring before April 10, 2017, provides an exemption for certain prohibited transactions that occur when plans or IRAs purchase insurance and annuity contracts and shares in an investment company registered under the Investment Company Act of 1940 (a mutual fund). The exemption permits insurance agents, insurance brokers and pension consultants that are parties in interest or fiduciaries with respect to plans and IRAs to effect the purchase of the insurance or annuity contracts for the plans or IRAs and receive a commission on the sale. The exemption is also available for the prohibited transaction that occurs when the insurance company selling the insurance or annuity contract is a party in interest or disqualified person with respect to the plan or IRA. Likewise, with respect to mutual fund transactions, PTE 84–24 permits mutual fund principal underwriters that are parties in interest or fiduciaries to effect the sale of mutual fund shares to plans or IRAs, and receive a commission on the transaction. The modifications explained below are found in *Modifications to PTE 84-24* (http://1.usa.gov/1qxO1vc). The apply to transactions occurring on or after April 10, 2017 (The "Applicability Date").

✪ *Definition of plan/IRA.* Under PTE 84-24, the term "plan" does not automatically include an IRA. Thus, provisions that apply to an IRA are only that specifically refer to an IRA. A definition of a plan as been added which defines a plan as an employee benefit plan under ERISA §3(3) or a qualified plan described in IRC §4975(e)(1)(A). See Section VI(l) of PTE 84-24. An IRA is defined as any account or annuity described in IRC §4975(e)(1)(B) through (F), which includes not only IRAs and Roth IRAs described in IRC §§408(a) and (b) and 408A (including SEPs and SIMPLE-IRAs), but also HSAs, Archer medical savings accounts, and Coverdell education savings accounts. See Section VI(d) of PTE 84-24. This is consistent with the definition used under the investment advice fiduciary regulations and the Best Interest Contract Exemption.

¶7.a. Application of Impartial Conduct Standards to fiduciaries relying on the exemption. A new Section II of PTE 84-24 requires an insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter who is an investment advice fiduciary under ERISA §3(21)(A)(ii) or IRC §4975(e)(3)(B) with respect to assets involved in the covered transaction, to satisfy Impartial Conduct Standards in order to obtain exemptive relief under PTE 84-24. The Impartial Conduct Standards require that: (1) when exercising authority as an investment advice fiduciary, the fiduciary act in the Best Interest (see ¶7.a.1) below) of the plan or IRA at the time of the transaction, and (2) the statements by the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter about recommended investments, fees, Material Conflicts of Interest, and any other matters relevant to a plan's or IRA owner's investment decisions, are not materially misleading at the time they are made. A Material Conflict of Interest exists when a fiduciary has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a plan or IRA owner. See Section VI(h) of PTE 84-24. Unlike the exemptions described in ¶1, ¶5 and ¶6 above that impose Impartial Conduct Standards, the standards in PTE 84-24 do not include a requirement that all compensation received by the fiduciary in connection with the transaction does not exceed reasonable under ERISA §408(b)(2) and IRC §4975(d)(2). This is because Section IV(c) of PTE 84-24 (which is redesignated as Section III(c) for transactions occurring on or after April 10, 2017) already has such a requirement.

¶7.a.1) Best Interest standard. The Best Interest standard is met when the fiduciary acts with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the employee benefit plan or IRA, without regard to the financial or other interests of the fiduciary, any affiliate or other party. See Section VI(b) of PTE 84-24. This is essentially the same language as used in the parallel provisions in the Best Interest Contract Exemption as discussed in ¶1.c.3) above).

¶7.b. Modifications to transactions covered by PTE 84-24.

¶7.b.1) Revocation of relief with respect to variable and indexed annuities. The list of covered transactions in Section I(b) no longer makes relief available under PTE 84-24 if the transaction involves annuity contracts other than Fixed Rate Annuity Contracts (see ¶7.b.1)a) below). See revised Section I(b)(1), (3)(i), (4) and (5), which now refer only to transactions involving the assets of a Plan or IRA to purchase Fixed Rate Annuity Contract or insurance contract. A Fixed Rate Annuity Contract does not include a variable annuity or an indexed annuity or similar annuity. Appendix I to revised PTE 84-24 provides a chart which described some of the basic features and attributions of the different categories of annuities (Fixed Rate Annuity, Indexed Annuity, and Variable Annuity). The Best Interest Contract Exemption, however, is available for transactions involving Indexed and Variable Annuities that occur on or after April 10, 2017.

¶7.b.1)a) Fixed Rate Annuity Contract. A Fixed Rate Annuity Contract is a fixed annuity contract issued by an insurance company that is either an immediate annuity contract or a deferred annuity contract that (1) satisfies applicable State standard nonforfeiture laws at the time of issue, or (2) in the case of a group fixed annuity, guarantees return of principal net of reasonable compensation and provides a guaranteed declared minimum interest rate in accordance with the rates specified in the standard nonforfeiture laws in that State that are applicable to individual annuities. In either case, the benefits of a Fixed Rate Annuity do *not* vary, in part or in whole, based on the investment experience of a separate account or accounts maintained by the insurer or the investment experience of an index or investment model. See Section I(b) of PTE 84-24.

¶7.b.1)b) Statutory employees. Section I(b) provides relief for, in addition to an Insurance Commission, related employee benefits from an insurance company in connection with the transaction. This is to address concerns regarding benefits provided by an insurance company to individuals who are treated as statutory employees under IRC §3121. This issue was also clarified in the final version of the Best Interest Contract Exemption, as discussed in ¶1.c.4)c) above.

¶7.b.2) Revocation of relief for many mutual fund transactions (including transactions involving IRAs). The list of covered transactions in Section I(b) no longer makes relief available under PTE 84-24 if the transaction involves mutual fund shares, except in the case of: (1) a purchase of mutual fund securities with Plan assets by a Principal Underwriter (as defined in section 2(a)(29) of the Investment Company Act of 1940 - see Section VI(m) of PTE 84-24), or (2) a the purchase of mutual fund securities, or the sale of such securities to, a mutual fund or a mutual fund Principal Underwriter, when the mutual fund, Principal Underwriter, or the mutual fund's investment adviser, is a fiduciary or a service provider (or both) with respect to the Plan solely by reason of the sponsorship of a Master or Prototype Plan, or the provision of Nondiscretionary Trust Services (as defined in Section VI(j) of PTE 84-24) to the Plan, or both. See revised Section I(b)(2), (3)(ii) and (6). Note that neither of the remaining transactions involving mutual fund securities involve IRAs.

Thus no mutual fund transactions involving IRAs are covered by PTE 84-24 if they occur on or after April 10, 2017. Mutual fund transactions no longer eligible for relief under PTE 84-24 on or after April 10, 2017, may qualify for relief, however, under the Best Interest Contract Exemption.

¶7.b.3) Rollovers or distributions. Section I has been amended to clarify that a purchase of a Fixed Rate Annuity or a mutual fund investment includes one that is effected as part of a rollover or distribution transaction. See Section I(b)(1)-(4).

¶7.c. Definition of commissions. Revised PTE 84-24, for clarity, now includes definitions of Insurance Commissions and Mutual Fund Commissions.

¶7.c.1) Insurance Commission. An Insurance Commission is defined as a sales commission paid (directly or indirectly) by the insurance company to the insurance agent, insurance broker or pension consultant for the service of effecting the purchase of a Fixed Rate Annuity or insurance contract, including renewal fees and trailers. See Section VI(f) of PTE 84-24. Insurance Commissions do not include revenue sharing payments, administrative fees or marketing fees (including 12b-1 fees). The reference to commissions "indirectly" paid by the insurance company would encompass payment of such commissions by a third party, such as an independent marketing organization.

¶7.c.2) Mutual Fund Commission. A mutual fund commission is a commission or sales load paid either by the Plan or the mutual fund for the service of effecting or executing the purchase of mutual fund shares, but *not* a 12b–1 fee, revenue sharing payment, administrative fee or marketing fee. See Section VI(i) of proposed PTE-24.

¶7.d. Revised recordkeeping requirements. Section V of PTE 84-24 prescribes broader recordkeeping requirements than what are in the exemption for transactions occurring before April 10, 2017. The recordkeeping burden is placed on the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter engaging in the covered transaction. Such person must maintain for a period of six years, in a manner that is reasonably accessible for examination, the records necessary to enable the persons described in ¶7.d.1) below to determine whether the conditions of PTE 84-24 have been met. No party-in-interest other than the person who is responsible for the recordkeeping will be subject to sanctions under ERISA §502(i) or IRC §4975 if such records are not properly maintained or not available for examination. See Section V(a)(2) of PTE 84-24. In addition, if records are lost or destroyed due to circumstances beyond the Financial Institution's control, no prohibited transaction will have occurred merely because of the unavailability of such records. See Section V(a)(2) of PTE 84-24.

¶7.d.1) Persons with right of inspection. The records described in ¶7.d. above must be reasonably available at their customary location for examination during normal business hours by: (1) any duly authorized employee or representative of the IRS or DOL, (2) any fiduciary of a Plan (or authorized employee or representative of the fiduciary), (3) any contributing employer and any employee organization whose members are covered by a Plan that is involved in a covered transaction (or any authorized employee or representative of such entities), and (4) any participant or beneficiary of a Plan, (or authorized representative of a participant, beneficiary or IRA owner). See Section V(b)(1) of PTE 84-24.

¶7.d.2) Exception for privileged information. A person described in ¶7.d.1) above (other than the DOL or IRS): (1) may not examine trade secrets or commercial or financial information of the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter which is privileged or confidential, and (2) is not authorized to examine records regarding a transaction involving a Plan or IRA unrelated to the person. See Section V(b)(2) of PTE 84-24.

¶7.d.3) Refusal to disclose exempt information. If the insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter refuses to disclose any information on the basis that the information is exempt from disclosure, such person must, by the close of the 30th day following the request, provide a written notice advising the requestor of the reasons for the refusal and that the DOL may request such information. See Section V(b)(3) of PTE 84-24.

¶7.d.4) Consequences of failure. A failure to maintain the required records necessary to determine whether the conditions of PTE 84-24 have been met will result in the loss of the exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions. See Section V(c) of PTE 84-24.

¶7.e. Clarifying amendments. Section I of PTE 84-24, relating to retroactive relief, is eliminated by the amendments because it is no longer necessary. Section II and III are combined into revised Section I in order to increase readability and clarity.

¶7.e.1) Clarifications to conditions under Section IV of PTE 84-24. Section IV prescribes conditions for the covered transactions described in Section I(b)(1), (2), (3) and (4) of PTE 84-24. Revised PTE 84-24 includes some modifications to these conditions.

¶7.e.1)a) Insurance Commission disclosures. Section IV(b)(1) prescribes certain information that must be furnished to an independent fiduciary, or to an IRA owner (if applicable), regarding a transaction involving the purchase with Plan or IRA assets of a Fixed Rate Annuity Contract or insurance contract, or the receipt of an Insurance Commission thereon. Section IV(b)(1)(B) is clarified to provide that Insurance Commissions should be expressed as a dollar figure unless that is not feasible, in which case a percentage will be permitted. In addition, disclosure must be made of Insurance Commissions paid directly by the insurance company or indirectly (i.e., through a third party).

¶7.e.1)b) Approval of transaction. After receiving the disclosures described in ¶7.e.1)a), an independent fiduciary must authorize the transaction. See Section IV(b)(2) of PTE 84-24. As revised, in the case of an IRA, the authorization can be provided by the IRA owner. Furthermore, the independence requirement does not apply to an IRA owner. This allows insurance agents and brokers, for example, to recommend Fixed Rate Annuity Contracts and insurance contracts to family members and receive a commission.

¶7.e.1)d) Additional purchases. Section IV(d) of PTE 84-24 sets forth disclosure requirements when additional purchases are made of Fixed Rate Annuity Contracts, insurance contracts, or mutual fund securities that are covered by PTE 84-24. As revised, the written disclosures required under Sections IV(b) and IV(c) do not have to be repeated, unless: (1) more than one year has passed since the disclosure was made with respect to the purchase of the same kind of contract or security, or (2) the contract or security being recommended for purchase or the Insurance Commission or Mutual Fund Commission with respect thereto is materially different from that for which the approval described in paragraphs (b) and (c) of Section IV was obtained. See Section IV(d) of PTE 84-24. The "one year" rule in (1) reflects a reduction from three years that applies to transactions occurring before April 10, 2017. The one-year rule tracks to similar requirements under the Best Interest Contract Exemption. In addition, the language was revised so that the one-year period runs from the purchase of an annuity. If any disclosures were given with respect to a recommendation that was not acted upon by the customer, the one-year period does not apply.

Determination Letter Procedures

Determination letter applications for reasons other than initial qualification and plan termination being eliminated for individually-designed plans effective January 1, 2017; 5-year remedial amendment cycles will be eliminated [Citation: *Announcement 2015-19*, 2015-32 I.R.B (August 6, 2015)] Text available at http://1.usa.gov/1LApD2x

The IRS has announced an anticipated cutback of its determination letter program. Effective January 1, 2017, the IRS no longer will accept a determination letter application with respect to the amendment or restatement of an individually-designed plan (IDP). Only applications for new plans and terminated plans will be accepted. Although not explicitly stated in the announcement, this would presumably apply to applications with respect to the amendment or restatment of a pre-approved plan (master/prototype plan or volume submitter plan) with respect to which the adopting employer has made modifications that render the plan an IDP for reliance purposes. No mention is made of the future of Form 5307 applications, which are used by adopters of volume submitter plans that make certain types of changes that are not considered by the IRS to render the plan an IDP.

✪ Limited determination letter applications will be permitted under other circumstances. The IRS expects that a sponsor of an IDP will be permitted to submitted a determination letter application in certain other limited circumstances. The IRS and Treasury will determine what these circumstances should be after input from the public. The IRS will issue guidance on a periodic basis to identify these other circumstances.

✪ Elimination of 5-year remedial amendment cycles for IDPs. In conjunction with the restrictions on determination applications, the IRS will be eliminating, effective January 1, 2017, the 5-year remedial amendment cycles for IDPs that are currently provided in Rev. Proc. 2007-44. However, the third Cycle A period, which runs from February 1, 2016, through January 31, 2017, will continue to apply, during which Cycle A IDPs may file for a determination letter for restatements. At this time, it appears that the 6-year cycle for restating pre-approved plans will continue.

✪ No off-cycle submissions permitted (other than new plans). Effective July 21, 2015 (the date Announcement 2015-19 became public), the IRS will not accept any off-cycle determination letter applications from IDPs. However, a new plan that is not currently on cycle will be permitted to apply for a determination letter during this period, pursuant to section 14.02(2) of Rev. Proc. 2007-44.

✪ Regular remedial amendment rules will apply. As a result of the elimination of the 5-year remedial amendment cycles, the extension of the remedial amendment period provided by section 5.03 of Rev. Proc. 2007-44 will not longer apply. That section provides that the normal remedial amendment period established under Treas. Reg. §1.401(b)-1 with respect to the adoption or amendment of a plan is extended to the end of a plan's applicable 5-year remedial amendment cycle. However, the IRS will issue a blanket extension of the remedial amendment period for IDPs to a date that is expected to end no earlier than December 31, 2017. Any remedial amendment period under Treas. Reg. §1.401(b)-1 that would otherwise end before such date will be affected by that extension.

Comment sought. **The IRS is seeking comments on what changes should be made to the remedial amendment period rules for IDPs under Treas. Reg. §1.401(b)-1 in light of this change.**

✪ Making document compliance easier. In connection with these modifications to the determination letter program, the Treasury and the IRS are considering ways to make it easier for plan sponsors to comply with the qualified plan document requirements. This may include, in appropriate circumstances: (1) providing model amendments, (2) not requiring certain plan provisions or amendments to be adopted if and for so long as they are not relevant to a particular plan (e.g., because of the type of plan, employer, or benefits offered), or (3) expanding plan sponsors' options to document qualification requirements through incorporation by reference.

✪ Interim amendments. The IRS is seeking comment on what additional considerations should be taken into account in connection with the current interim amendment requirements in section 5 of Rev. Proc. 2007-44.

✪ Conversion to pre-approved plan. The IRS is asking for comments on what guidance should be issued to assist plan sponsors that wish to convert an IDP into a pre-approved plan.

✪ EPCRS. The IRS is asking for comments on what changes should be made to other IRS programs (EPCRS in particular) to facilitate the changes to the determination letter program.

Information Relating to Remedial Amendment Cycles/Interim Amendments

Expiration dates on determination letters no longer apply, April 30, 2017, deadline for individually-designed defined contribution plans to elect pre-approved plan cycle, Cycle A clarification for related employers [*Notice 2016-3*, 2016-3 (January 19, 2016)]
Text available at http://1.usa.gov/1O6D0pI

In light of the contraction of the determination letter program effective January 1, 2017, the IRS announced several changes to the determination letter program and remedial amendment periods.

* **Related group Cycle A election for third cycle.** Under section 10.06 of Rev. Proc. 2007-44, if more than one individually-designed (IDP) plan is maintained by members of a controlled group under IRC §414(b) or (c) or an affiliated service group under IRC §414(m), the employers may elect that the 5-year remedial amendment cycle for all plans maintained by any members of the group (other than multiemployer plans under IRC §414(f), multiple employer plans, governmental plans under § 414(d), or certain jointly trusteed single employer collectively bargained plans) will be Cycle A. Rev. Proc. 2007-44 will be amended to provide that controlled groups and affiliated service groups that maintain more than one plan are permitted to submit determination letter applications during the Cycle A submission period beginning February 1, 2016, and ending January 31, 2017, provided that a prior Cycle A election with respect to the controlled group or affiliated service group had been made by January 31, 2012 (the last day of the previous Cycle A submission period). See Section III of Notice 2016-3. Thus, related groups that did not elect Cycle A for the second Cycle A will not be able to do so for the third Cycle A. After the third Cycle A period ending January 31, 2017, there will be no more 5-year remedial amendment cycles for IDPs.

*** <u>Migrating individually-designed DC plans to pre-approved plan 6-year cycle</u>.** Rev. Proc. 2007-44 will be modified to provide that the deadline for an employer to adopt a current DC pre-approved plan and to apply for a determination letter, if otherwise permissible, is extended from April 30, 2016, to April 30, 2017, with respect to any defined contribution pre-approved plan adopted on or after January 1, 2016, <u>other than a plan that is adopted as a modification and restatement of a defined contribution pre-approved plan that had been maintained by the employer prior to January 1, 2016</u>. See Section V of Notice 2016-3. This extension will facilitate a plan sponsor's ability to convert an existing IDP into a current DC pre-approved plan (i.e., one that was approved based on the 2010 Cumulative List) and have an opportunity, through April 30, 2017, to obtain a determination letter on the adoption of that pre-approved plan if a determination letter application is otherwise permissible (e.g., Form 5307 submission of a modified volume submitter plan). This applies both to existing individually-designed DC plans that have not adopted a pre-approved DC plan before January 1, 2016, as well as a <u>new</u> individually-designed DC plan that is established on or after January 1, 2016.

✪ *Example - existing IDP.* Employer A currently maintains Plan X, a DC IDP. Employer A is considering converting Plan X into a DC pre-approved plan. Employer A has until April 30, 2017, to adopt a current DC pre-approved plan within the current 6-year remedial amendment cycle and to apply for a determination letter, if permissible. This is Example 1 in Section V of Notice 2016-3.

✪ *Example - new IDP.* Employer B establishes Plan Y, a DC IDP, on January 1, 2016. Employer B is considering converting Plan Y into a DC pre-approved plan. Employer B has until April 30, 2017, to adopt a current DC pre-approved plan within the current 6-year remedial amendment cycle and to apply for a determination letter, if permissible. This is Example 2 in Section V of Notice 2016-3.

✪ *No extension of April 30, 2016, deadline for pre-approved plans.* An employer that had adopted a DC pre-approved plan prior to January 1, 2016, still has until April 30, <u>2016</u>, to adopt a modification and restatement of the defined contribution pre-approved plan within the current 6-year remedial amendment cycle for such plans and to apply for a determination letter, if permissible. Thus, the April 30, 2017, deadline described in the prior paragraph for IDPs is <u>not</u> applicable to the two-year restatement window applicable to pre-2016 adopters of DC pre-approved plans.

✔ Example - previous adopter of VS plan. On April 1, 2010, Employer C initially adopted the defined contribution VS plan of Sponsor Z, which was approved based on the 2004 Cumulative List. On January 15, 2016, Employer C adopts the current defined contribution VS plan of Sponsor Z as a modification and restatement of Employer C's existing defined contribution VS plan. Employer C continues to have until April 30, 2016, to apply for a determination letter, if permissible. The April 30, 2017, deadline does <u>not</u> apply here. This is Example 3 in Section V of Notice 2016-3.

✔ <u>Example - change to new VS provider during remedial amendment cycle</u>. On April 1, 2010, Employer C initially adopted the defined contribution VS plan of Sponsor Z, which was approved based on the 2004 Cumulative List. On January 15, 2016, Employer C adopts the current defined contribution VS plan of <u>Sponsor Y</u> as a modification and restatement of Employer C's existing defined contribution VS plan, instead of adopting the current defined contribution VS plan of Sponsor Z. Employer C continues to have until April 30, 2016, to apply for a determination letter, if permissible. The April 30, 2017, deadline does <u>not</u> apply here. This is Example 4 in Section V of Notice 2016-3. Note that, if Employer C does not restate its plan by April 30, 2016, but instead adopts Sponsor Y's defined contribution VS plan after April 30, 2016 to restate the plan for the second remedial amendment cycle, Employer C has a late amender situation that needs to be corrected through EPCRS, even if the adoption of the VS plan is accomplished by April 30, 2017.

✪ *What about Form 8905 intended adopters?* Notice 2016-3 does not reference the status of individually-designed DC plans that had executed a Form 8905 in order to be on the 6-year cycle applicable to DC pre-approved plans. Presumably, such plans must still restate and, if applicable, submit for a determination letter, no later than April 30, 2016, if the effect of the signing of Form 8905 was to extend the plan's second remedial amendment cycle, and the plan wasn't restated and submitted for a determination letter by its normal second cycle deadline (i.e., January 31, 2012, January 31, 2013, January 31, 2014, January 31, 2015, or January 31, 2016, for Cycles A, B, C, D and E, respectively). Some practitioners believe that the IRS intended the April 30, 2017, to all individually designed plans that, as of January 1, 2016, had not yet adopted a pre-approved plan, even if the plan had not been restated and submitted for a determination letter by the otherwise applicable second cycle deadline. Unless the IRS clarifies that this is the case, our recommendation is to continue to treat April 30, 2016, as the deadline to adopt the pre-approved plan in such case.

Example. Employer A maintains an individually-designed DC plan. Employer A's EIN ends in 3, so the plan was on Cycle C (which ended January 31, 2014). In 2013, Employer A executed a Form 8905 with TPA Firm X, which sponsors a volume submitter DC plan. Accordingly, Employer A's plan was not restated by January 31, 2014. Instead, Employer A waited until the two-year window applicable to TPA Firm X's volume submitter DC plan. Notice 2016-3 would seem to require that Employer A still complete its restatement of its plan by <u>April 30, 2016</u>, and, by such date, apply for a determination letter if permissible.

* **<u>No more expiration dates on determination letters</u>.** Section 13.02 of Rev. Proc. 2007-44 provides that determination letters issued for IDPs will include a statement that the letter may not be relied on after the end of the plan's first 5-year remedial amendment cycle that ends more than 12 months after the application was received, and will include the specific "expiration date." However, the IRS is authorized to extend such expiration dates. Section IV of Notice 2016-3 provides that expiration dates on determination letters issued prior to January 4, 2016, <u>are no longer operative</u>. Subsequently-issued determination letters will not contain expiration dates. See §21.01 of Rev. Proc. 2016-6. Future guidance will clarify the extent to which an employer may rely on a determination letter <u>after a subsequent change in law or plan amendment</u>.

Voluntary closing agreement option available to Pre-Approved Plan sponsors who have missed April 30, 2016, restatement deadline for 20 or more clients [Citation: *Umbrella Closing Agreement Program*, IRS Employee Plan News, Issue No. 2016-5 (April 4, 2016)]
Text available at http://1.usa.gov/1qleUCI

The IRS has announced an Umbrella Closing Agreement Option for Pre-Approved Plan sponsors (master/prototype (M&P) plans or volume submitter (VS) plans) that may be used in lieu of a VCP submission. The Umbrella Closing Agreement Option is similar to the Group Submission under VCP. However, with a Group Submission, the Pre-Approved Plan Sponsor would have to show that the late restatements were due to a systemic error.

* **Parameters.** To use the Umbrella Closing Agreement Option, there must be a minimum of 20 plans covered by closing agreement.

Fee. A fee must be paid equal to $10,000 for the first 20 plans plus $250 for each additional plan, with a maximum fee of $50,000. This is similar to the Group Submission fee under VCP.

Eligible plans. A plan is eligible for inclusion in the closing agreement if the service provider can certify that they have a record of: (1) the plan sponsor's affirmative agreement to participate in the closing agreement program, (2) timely EGTRRA documents that had been adopted by the plan sponsor (or IRS compliance statements regarding the late adoption of the EGTRRA documents), and (3) the plan sponsor's execution of a PPA 2006 restatement using the service provider's pre-approved document (i.e., the late PPA restatement has been corrected).

Follow-up information. Financial institutions or other service providers that apply and are approved will have until the later of 120 days from the closing agreement execution date or May 1, 2017, to: (1) provide a final list of employers covered by the closing agreement, and (2) pay additional fees (if applicable). The IRS does not say why additional fees might be required.

* **Address for submission.** A letter outlining the proposal for correction of late restatements under the Umbrella Closing Agreement Option should be mailed to:
Internal Revenue Service
TE/GE:EP:VC Group 7554
Request for Voluntary Closing Agreement
9350 Flair Drive, 3rd Floor
El Monte, CA 91731

Rollover to SIMPLE-IRAs

Rollovers from workplace retirement plans may be made to SIMPLE-IRAs after December 18, 2015 [Citation: *Section 306 of the Protecting Americans from Tax Hikes Act (PATH Act) of 2015*, Division Q of the Consolidated Appropriations Act, 2016, P.L. 114-113 (December 18, 2015)]
Text available at http://1.usa.gov/1TvuBjd

IRC §408(p)(1)(B) is amended by the PATH Act to permit a SIMPLE-IRA to accept a rollover from a qualified plan, 403(b) plan or governmental 457(b) plan, but only if: (1) the rollover is made after December 18, 2015, and (2) the two-year period under IRC §72(t)(6) has passed with respect to the SIMPLE-IRA. The two-year period under IRC §72(t)(6) is the first two taxable years in which the employee participated in the SIMPLE-IRA plan.

Same-Sex Marriage

IRS updated same-sex marriage guidance to incorporate the *Obergefell* decision and to clarify timing of amendments [Citation: *Notice 2015-86*]
Text available at http://1.usa.gov/1NVJoFw

In light of the Supreme Court's decision in *Obergefell v. Hodges*, 135 S.Ct. 2584 (2015), http://1.usa.gov/1R4Py7u, the IRS is updating its guidance on how same-sex marriages are recognized under qualified retirement plans. *Obergefell* held that the Fourteenth Amendment to the U.S. Constitution: (1) requires a state's civil marriage laws to apply to same-sex couples "on the same terms and conditions as opposite-sex couples," and (2) prohibits a state from refusing to "recognize a lawful same-sex marriage performed in another State on the ground of its same-sex character." Although this decision will result in the recognition of same-sex marriages for the first time in certain States, it does not have a dramatic impact on qualified retirement plans. The *Windsor* decision, 133 S.Ct. 2675 (2013), http://1.usa.gov/1FVbfSk, was more significant for retirement plans in that it required them to recognize a same-sex marriage performed in any jurisdiction, regardless of whether same-sex marriage was recognized in the jurisdiction in which the plan was administered. Notice 2015-86 clarifies the effect of *Obergefell* and provides clarifications of the post-*Windsor* guidance issued by the IRS in Rev. Rul. 2013-17 (employee benefit and employment tax issues), Notice 2014-19, as amplified by Notice 2014-37 (effective dates and plan amendment issues), Notice 2013-61 (employment tax issues), and Notice 2014-1 (elections and reimbursements for same-sex spouses under cafeteria plans, flexible spending arrangements, and health savings accounts). Proposed regulations also were issued on October 23, 2015, to reflect the holdings of *Obergefell* and *Windsor*, and Rev. Rul. 2013-17 with respect to tax code definitions describing marital status.

* **Optional plan amendments.** No plan amendments are required as a result of *Obergefell*. Amendments were required for certain plans as a result of *Windsor*, generally no later than December 31, 2014. See Q&A-8 of Notice 2014-19. However, the IRS recognizes that some plan sponsors may decide to amend their plans following *Obergefell* to make certain optional changes or clarifications. Amendments described in (1) and (2) below are examples of optional amendments that may be adopted.

(1) New rights or benefits. A plan sponsor could decide to adopt an amendment to provide new rights or benefits with respect to participants with same-sex spouses. For example, such amendment could allow a participant who commenced an annuity prior to June 26, 2013 (the date of the *Windsor* decision) with an opportunity elect a qualified joint and survivor annuity (QJSA). If the employer did

not decide to adopt such an amendment in response to *Windsor* it might decide to do so in response to *Obergefell*. See Q&A-2 of Notice 2015-86. Such discretionary amendments may be adopted at any time, as long as they otherwise satisfy the qualification requirements (e.g., not discriminatory in timing or effect under IRC §401(a)(4)).

(2) Pre-June 26, 2013, recognition of same-sex marriage. Q&A-3 of Notice 2014-19 allow a plan to be amended to recognize same-sex marriages on a retroactive basis to a date earlier than June 26, 2013. Such an amendment could recognize the marriage for just certain purposes under the plan (e.g., QJSA election). If such an amendment was not made after the issuance of Notice 2014-19, the plan sponsor may adopt such an amendment now. See Q&A-3 of Notice 2015-86. Such discretionary amendments may be adopted at any time, as long as they otherwise satisfy the qualification requirements (e.g., not discriminatory in timing or effect under IRC §401(a)(4)).

* **Application of IRC §436(c).** Optional amendments, including those described in (1) and (2) above, that are adopted in response to *Windsor* or *Obergefell* are subject to IRC §436(c) if the plan is a defined benefit plan. Thus, such an amendment cannot take effect unless the plan's adjusted funding target attainment percentage (AFTAP) is at least 80% or the plan sponsor makes the additional contribution specified under IRC §436(c)(2).

* **Deadline for optional amendments.** Optional amendments, including those described in (1) and (2) above, are discretionary amendments under Rev. Proc. 2007-44. As such, they must be adopted by the end of the plan year in which the amendment is operationally effective, as prescribed by section 5.06 of Rev. Proc. 2007-44. For a governmental plan, the amendment deadline is the later of: (1) the end of the plan year in which the amendment is operationally effective, or (2) the last day of the next regular legislative session beginning after the amendment is operationally effective in which the governing body with authority to amend the plan can consider a plan amendment under the laws and procedures applicable to the governing body's deliberations.

* **Health and welfare plans.** Rev. Rul. 2013-17 and Notice 2014-1 already addressed the federal tax law treatment of benefits provided to a same-sex spouse under a health or welfare plan. No additional changes are needed to the terms of those plans as a result of *Obergefell*. However, a change in State law as a result of *Obergefell* might have the effect of expanding coverage of spouses under the health or welfare plan (e.g., the plan offered health coverage to a spouse as defined by State law). See Q&A-6 of Notice 2015-86.

✪ *Cafeteria plans.* A cafeteria plan under IRC §125 may allow a participant to make a change in coverage due to a significant improvement in coverage during the coverage period. When such a change occurs, the participant may revoke an existing election and make a new election, as permitted under Treas. Reg. §1.125-4(f)(3)(iii). Q&A-7 of Notice 2015-86 provides that, if the eligibility criteria for a qualified benefit offered under the plan change during a plan year to add eligibility for a same-sex spouses, the change constitutes a significant improvement in coverage for purposes of Treas. Reg. §1.125-4(f)(3)(iii). Such a change could occur because of a change in State law as a result of *Obergefell*, a plan amendment to expand spousal coverage, or a change in the interpretation of an existing plan. The new election by a participant may add coverage for a same-sex spouse to a benefit option in which the participant is already enrolled, or may add coverage for both the participant and the same-sex spouse if the participant had not previously elected to be covered by the benefit option.

➤ *Amendment to permit a change of election.* For a cafeteria plan that does not permit a change in election for a significant improvement in coverage, the plan may be amended to add such an election. With respect to a change described in the prior paragraph, the amendment must be adopted by the end of the plan year which includes the later of: (1) December 9, 2015, or (2) the date same-sex spouses first became eligible for coverage under the plan.

Hardship Withdrawals and Participant Loans

IRS posts reminder on plan sponsor's obligations regarding hardship withdrawals and participant loans [Citation: *It's Up To Plan Sponsors To Track Loans, Hardship Distributions*, Retirement News for Employers (April 2, 2015, Edition)]
Text available at http://1.usa.gov/1InmzCX

In its periodic newsletter to plan sponsors, the IRS reminds plan sponsors of their obligations regarding hardship withdrawals and participant loans made from their plans. Even if the sponsor uses a TPA to handle participant transactions, the sponsor, as the plan administrator, is still ultimately responsible for the proper administration of the plan. In this regard, a plan sponsor must obtain and keep hardship records which are available for examination. The IRS views a failure to do so as a qualification failure that would require correction under EPCRS.

* **Records to be retained for hardship withdrawals.** The plan sponsor should keep, in paper or electronic form, the following records.

➤ Documentation of the hardship request, review and approval.
➤ Financial information and documentation that substantiates the employee's immediate and heavy financial need.
➤ Documentation to support that the hardship distribution was made in accordance with applicable law and plan provisions.
➤ Proof of the actual distribution made and the Form 1099-R that was issued.

✪ *Reliance on participants.* The IRS does not believe that recordkeeping of hardship distributions should be left solely to the participant because a participant may leave employment or fail to keep the necessary records, making them inaccessible in an IRS audit. In addition, electronic self-certification by the participant is *not* sufficient documentation of the *nature* of the hardship. While self-certification is permissible with respect to whether the participant has resources to alleviate the hardship, pursuant to Treas. Reg. §1.401(k)-1(d)(3)(iv)(C) and (D), it is not allowed to show the nature of the hardship (e.g., whether the participant has eligible medical expenses, tuition obligations, or is purchasing a principal residence). Plan sponsors are instructed by the IRS to request and retain additional documentation to show the nature of the hardship. Although the IRS does not discuss the types of additional documentation that are sufficient, presumably medical or tuition bills or a contract to purchase a residence, as applicable, would suffice.

* **Records to be retained for participant loans.** The plan sponsor should keep, in paper or electronic form, the following records.

➤ Evidence of the loan application, review and approval process.
➤ Executed plan loan note.
➤ If applicable, documentation verifying that the loan proceeds were used to purchase or construct a primary residence (if the principal residence exception is being used to exceed the general 5-year maximum repayment term).
➤ Evidence of loan repayments.
➤ Evidence of collection activities associated with loans in default and the related Forms 1099-R, if applicable.

✪ *Self-certification of residence exception not permissible.* If a participant requests a loan with a repayment period in excess of five years for the purpose of purchasing or constructing a primary residence, the plan sponsor must obtain documentation of the home purchase before the loan is approved. IRS audits have found that some plan administrators impermissibly allowed participants to self-certify their eligibility for these loans.

Minimum Distribution Requirements: Annuity Distributions

"De-risking" programs that allow retirees in pay status to convert annuity stream to lump sum payment will no longer be permitted under many circumstances [Citation: *Notice 2015-49*, I.R.B. 2015-30 (July 23, 2015)]
Text available at http://1.usa.gov/1MiS837

Notice 2015-49 announces the IRS' intention to amend the IRC §401(a)(9) regulations to prohibit so-called "de-risking" programs adopted by many defined benefit plan sponsors. A de-risking program provides a window period during which participants who are in pay status may commute the remaining value of their annuity benefit into a lump sum. These programs are referred to as "de-risking" programs because they shift longevity risk and investment risk to the retiree. In the past, the IRS has allowed these programs on the basis that the adoption of the lump sum option is an amendment to the plan that triggers an exception under Treas. Reg. §1.401(a)(9)-6, Q&A-14, to allow for a lump sum to be paid after an annuity has commenced without violating the required minimum distribution (RMD) rules. See, for example, PLR 201228045, http://1.usa.gov/1M6rVIh. However, upon further reflection, the IRS has decided that these de-risking programs are not consistent with the intent of the IRC §401(a)(9) regulations to ensure that distribution of an employee's benefit is not unduly deferred. Under the current regulations, a defined benefit plan cannot permit a current annuitant to commute annuity payments to a lump sum or otherwise accelerate those payments, except in a narrow set of circumstances specified in the regulations, such as in the case of retirement, death, or plan termination. See Treas. Reg. §1.401(a)(9)-6, A-13(a) and (b). If a participant has the ability to accelerate distributions at any time, then the actuarial cost associated with that acceleration right would result in smaller initial benefits, which the IRS believes contravenes the purpose of IRC §401(a)(9).

Accordingly, the Treasury will be amending the regulations in a way that will prohibit, in most cases, changes to the annuity payment period for ongoing annuity payments from a defined benefit plan, including changes accelerating (or providing an option to accelerate) ongoing annuity payments. The amendments to Treas. Reg. §1.401(a)(9)-6, Q&A-14(a)(4), will provide that the types of permitted benefit increases described in that paragraph will include only those that increase the ongoing *annuity* payments, and do not include those that accelerate the annuity payments. The exception for changes to the annuity payment period would not permit acceleration of annuity payments even if the plan amendment also increases annuity payments.

"Pre-Notice Acceleration" provisions will be exempt. A Pre-Notice Acceleration will be defined as a plan amendment that meets any one of the following four criteria: (1) the amendment was adopted (or specifically authorized by a board, committee, or similar body with authority to amend the plan) prior to July 9, 2015 (the date Notice 2015-49 was made public), (2) a private letter ruling or determination letter was issued by the IRS with respect to the plan amendment prior to July 9, 2015. (3) a written communication about the amendment was provided to affected plan participants stating an explicit and definite intent to implement the lump sum risk-transferring program, and such communication was received by those participants prior to July 9, 2015, or (4) the amendment is adopted pursuant to an agreement between the plan sponsor and an employee representative (with which the plan sponsor has entered into a collective bargaining agreement) specifically authorizing implementation of such a program that was entered into and was binding prior to July 9, 2015. With respect to a Pre-Notice Acceleration, the IRS will not challenge the treatment of such program as a permissible increase in benefits that is described in the current version of Treas. Reg. §1.401(a)(9)-6, Q&A-14(a)(4). Thus, with respect to a Pre-Notice Acceleration, the annuity payment period will be permitted to be changed under Treas. Reg. §1.401(a)(9)-6, Q&A-13(a) (which allows for a change in the annuity period as a result of a plan amendment described in Q&A-14). Other exceptions which are provided in Q&A-13(b) and Q&A-14 will not be affected by the amendments describe in Notice 2015-49.

Notice 2015-49 does not provide guidance on the tax consequences of a lump sum de-risking program for purposes of IRC §§401(a)(4), 411, 415, 417 and 436. In other words, any rulings on a Pre-Notice Acceleration only address the consequences under IRC §401(a)(9). Any private letter ruling or determination letter issues by the IRS or the IRS Office of Chief Counsel involving a plan that provides for a lump sum de-risking program will generally include a caveat expressing no opinion as to the federal tax consequences of such program. However, the IRS and the IRS Office of Chief Counsel has the discretion to determin that the addition of a right to make a Pre-Notice Acceleration is an increase in benefits that is described in the current version of Treas. Reg. §1.401(a)(9)-6, Q&A-14(a)(4).

State-Sponsored Retirement Programs

DOL issues Interpretive Bulletin regarding State programs that sponsor or facilitate ERISA-covered plans [Citation: *Interpretative Bulletin 2015-02 (DOL Reg. §2509.2015-02)*, 80 F.R. 71936-71940 (November 18, 2015)]
Text available at http://1.usa.gov/1MVdd20

Interpretive Bulletin 2015-02 sets forth the DOL's views on how ERISA applies to certain programs sponsored or facilitated by the States. Several States have adopted or considered legislation that is intended to increase the coverage of private sector employees in retirement savings programs. One issue often raised is whether ERISA preempts the State program. This Interpretive Bulletin not only addresses the ERISA preemption issue but how involved a State may be in an ERISA-covered plan that is made available to the private sector by the State government. This guidance has the potential of significantly changing the marketplace for private-sector retirement programs.

Interpretive Bulletin 2015-02, §2509.2015-02(b), addresses three types of State involvement in private-sector retirement plans:

- ✔ Marketplace Approach (see ¶1 below)
- ✔ Prototype Plan Approach (see ¶2 below)
- ✔ Multiple Employer Plan Approach (see ¶3 below)

Due to preemption concerns, some States have legislated mandated IRA-based savings programs, under which private-sector employers that do not maintain a retirement savings program are required to offer employees a payroll-deduction IRA savings option. However, in the DOL's view, ERISA preemption principles leave room for States to sponsor or facilitate ERISA-covered savings options for private-sector employees, provided: (1) the employers participate voluntarily, and (2) ERISA's requirements, liability provisions, and remedies fully apply to the State programs. See Interpretive Bulletin 2015-02, §2509.2015-02(a). Thus, unlike the IRA-based initiatives, these programs can't be mandatory. But they can exist in a voluntary environment. The DOL hopes this guidance will encourage the States to roll out one or more of the approaches discussed in Interpretive Bulletin 2015-02, rather than limiting their initiatives to IRA-based programs. The DOL believes this is in the public interest because ERISA-based programs offer: (1) higher contribution limits, (2) stronger protection from creditors, (3) fiduciary standards, (4) recordkeeping requirements, (5) automatic enrollment rules, (6) disclosure requirements, (7) legal accountability, and (8) spousal protections. There also may be tax credits available for certain small employers to offset the cost of the plan, pursuant to IRC §45E. See Interpretive Bulletin 2015-02, §2509.2015-02(b). The ERISA preemption issue is furthered discussed in ¶4 below.

¶1. **Marketplace Approach.** This approach is embodied in the 2015 Washington State Small Business Retierement Savings Marketplace Act (text available at http://1.usa.gov/1NfIC0q), which was effective on July 24, 2015. The law requires the State to contract with a private-sector entity to establish a program ("marketplace") that connects eligible employers with qualifying savings plans available in the private sector. Only products that the State determines are suited to small employers, provide good quality, and charge low fees would be included in the State's marketplace. Washington State employers would not be required to establish any savings plans for their employees and do not have to use the marketplace if they decide to establish one. A plan established through the marketplace could be an ERISA-covered plan or a non-ERISA-covered plan. If ERISA applies to the plan, then full ERISA requirements and protections apply. If the plan is not ERISA-covered (e.g., a payroll deduction IRA arrangement that meets the requirements of DOL Reg. §2510.3-2(d), the State's involvement would not by itself cause the arrangement to be covered by ERISA. Programs fashioned along the lines of the Washington State program would, in the DOL's view, be permissible under ERISA.

¶2. **Prototype Approach.** Under this approach, the State sponsors a prototype program. Each employer adopting the program would be establishing its own plan, in the same fashion as prototypes currently marketed in the private sector. In the DOL's view, ERISA would not preempt a State from sponsoring such a program, nor would it preclude the document from designating the State or a State designee (e.g., a private-sector third party) to perform the functions of a named fiduciary or plan administrator. Thus, the State or a designated third party could assume responsibility for most administrative and asset management functions of an employer's prototype plan, thereby shifting primary fiduciary responsibility away from the employer. The State also could designate low-cost investment options and a third- party administrative service provider for its prototype plans. The DOL's discussion cites a Massachusetts program that allows small nonprofit organizations to adopt a plan developed and administered by the State, which has been characterized by a Massachusetts official as a volume submitter 401(k) plan.

¶3. **Multiple Employer Plan (MEP) Approach.** The boldest of the approaches discussed by the DOL would have the State sponsor a multiple employer plan (MEP) made available to private-sector employers in the State. The DOL anticipates that such an approach would generally involve permitting employers that meet specified eligibility criteria to join the State-sponsored MEP. The plan documents would provide that the plan is subject to Title I of ERISA and is intended to comply with tax qualification requirements.[7] The plan would have a separate trust holding contributions made by the participating employers, the employer's employees (e.g., 401(k) contributions), or both. The plan could be a 401(k) plan, a defined benefit plan, or other qualified plan arrangement. The State, or a designated governmental agency or instrumentality, would be the plan sponsor under ERISA §3(16)(B).[8] This is different from the Prototype Approach described in ¶2 above, where each adopting employer is treated as establishing its own plan under the prototype and is the plan sponsor of its respective plan. The State also would be the named fiduciary and plan administrator responsible for administering the plan, selecting service providers, communicating with employees, paying benefits, and providing other plan services. The State could perform the fiduciary and administrative

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[7] The requirements of IRC §413(c) would have to be satisfied by a State-sponsored MEP. Thus, certain provisions, such as coverage and nondiscrimination testing requirements under IRC §§401(a)(4) and 410(b) and the top heavy rules under IRC §416, would have to be satisfied on an employer level, as if each participating employer had a separate plan.

[8] ERISA §3(16)(B) states that, in the case of a MEP, the plan sponsor is the "association, committee, joint board of trustees, or other similar group of representatives of the parties who establish or maintain the plan."

functions directly or through one or more contract agents, which could be private-sector providers. The State could take advantage of economies of scale to lower administrative and other costs.

✪ *Single plan treatment.* Although there would likely be no pre-existing relationship among the employers that participate in the State-sponsored MEP, the DOL would treat this arrangement as a single plan for ERISA purposes. Thus, only one Form 5500 would be required. Presumably, the accountant audit and bonding requirements under ERISA would be determined at the plan level, not at the individual participating employer level. An employer could participate solely by executing a participation agreement.

✪ *Fiduciary responsibility.* The State could design the MEP so that the employer has limited fiduciary responsibility, although the employer would retain the duty to prudently select the arrangement and to monitor its operation. The employer's ongoing involvement in a State-sponsored 401(k) MEP could be limited to enrolling employees and forwarding voluntary employee and employer contributions to the plan. In footnote 8 to Interpretive Bulletin 2015-02 the DOL notes that the State could submit an Advisory Opinion request to the DOL to confirm that the MEP, at least in form, has assigned the fiduciary roles of plan administrator and named fiduciary, and attendant fiduciary responsibilities, to persons other than the participating employers. Although the DOL notes the employer's duty to prudently select the arrangement and to monitor its operation, the tone of the Interpretive Bulletin suggests a desire by the DOL to virtually eliminate the employer's fiduciary responsibilities, presumably to encourage employer participation and thereby increase plan coverage of private-sector employees. It would be unlikely that the DOL would rule the selection of a State-sponsored MEP to be an imprudent selection. In addition, if the employer has no responsibility over plan administrative and management functions, its duty to "monitor" would probably be confined to review of periodic reports from the State or its fiduciary designee(s) which, again, would unlikely be challenged by the DOL except under unusual circumstances. Moreover, an employer might argue its role is limited to its decision to participate in the plan, some plan design issues that might be available for the participating employer to choose (either initially or as an amendment to its participation agreement) and its decision when to terminate its participation in the MEP, which are settlor functions not governed by ERISA's fiduciary standards. In the case of a State-sponsored defined benefit MEP, additional obligations could apply to the employer, such as minimum funding requirements and PBGC obligations. For example, ERISA §4043 imposes notice requirements for "reportable events" that might have to be reported by a contributing sponsor under the plan (i.e., each participating employer), although in many cases the reporting obligation can be met on behalf of the contributing employers by the plan administrator, which would be the State that sponsors the MEP or its designee acting as the plan administrator.

✪ *Open MEP issue.* The DOL discusses the issue of whether the State-sponsored plan could satisfy the definition of an employee pension benefit plan under ERISA §3(2), which requires a plan to be established or maintained by an employer or employee organization, or both. ERISA §3(5) in turn defines an employer as a person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan, including a group or association of employers acting for an employer in such capacity. As the DOL expressed in Advisory Opinion 2012-04A, a person can act in the interest of an employer if the person is tied to the contributing employers or their employees by genuine economic or representational interests unrelated to the provision of benefits. This is the commonality test that the DOL applies to determine whether a MEP should be treated as a single plan. Advisory Opinion 2012-04A ruled that a so-called "open MEP" maintained in the private sector is not a single plan for ERISA purposes and must be treated as a collection of separate plans maintained by the participating employers. Interpretive Bulletin 2015-02 distinguishes a private-sector open MEP from a State-sponsored MEP to support the DOL's conclusion that the State-sponsored MEP would be a single plan for ERISA purposes. In the DOL's view, the State has a "unique representational interest in the health and welfare of its citizens" that connects it to the in-State employers that choose to participate in the State-sponsored MEP. Accordingly, the State should be considered to act indirectly in the interest of the participating employers for purposes of ERISA §3(5).

¶4. ERISA preemption. Interpretive Bulletin 2015-02, §2509.2015-02(c), addresses the issue of whether State laws adopting the approaches described in ¶1, ¶2 or ¶3 above would be preempted by ERISA. The DOL summarizes the Supreme Court cases as concluding that ERISA preempts State laws that: (1) mandate employee benefit structures or their administration, (2) provide alternative enforcement mechanisms, or (3) bind employers or plan fiduciaries to particular choices or preclude uniform administrative practice, thereby functioning as a regulation of an ERISA plan itself. In the DOL's view, the approaches in ¶, ¶2 and ¶3 above would not cause these ERISA preemption principles to come into play, even though they involve ERISA plans. The State would be acting as a participant in the ERISA plan market, rather than as a regulator. Regulation of the State program would remain with the Federal government and the courts. The DOL notes in footnote 15 of Interpretive Bulletin 2015-02 that if a State were to mandate participation in a State-sponsored prototype or in a State-sponsored MEP, even if it allowed an employer to opt out, would cross the line into ERISA preemption. But merely offering these arrangements does not dictate how an employer's plan is designed or operated, nor does it make offering a plan more costly for employers.

✪ *Prohibited State conduct.* It would not be permissible for a State to establish standards inconsistent with ERISA, or to provide its own regulatory or judicial remedies for conduct governed exclusively by ERISA. A contractor retained by the State under the Marketplace Approach described in ¶1 above would have to be subject to the same ERISA standards and remedies that apply to any company offering the same services directly to employers. Similarly, a State-sponsored prototype, as described in ¶2 above, or a State-sponsored MEP, as described in ¶3 above, would have to comply with the same ERISA requirements and would have to be subject to the same remedies as any private party offering such products and services. In this regard, footnote 17 of Interpretive Bulletin 2015-02 notes that State laws relating to sovereign immunity for State governments and their employees would have to be "evaluated carefully to ensure they do not conflict with ERISA's remedial provisions."

Due Dates For Returns

Highway funding extension bill changes due dates for corporate and partnership tax returns, which will affect contribution deadlines for deductions relating to qualified plan contributions [Citation: *Surface Transportation and Veterans Health Care Choice Improvement Act of 2015* (HR 3236), P.L. 114-41 (July 31, 2015)]
Text available at http://1.usa.gov/1KMxjAg

Section 2006 of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 ("the Act") amends IRC §6072 to change the due dates and extension rules for income tax returns filed by corporations and partnerships. Since the deadline for making qualified plan contributions that can be deducted for a prior taxable year is geared to the due date of the plan sponsor's income tax return, these changes will affect the timing of plan contributions as well.

> ✪ ***Repeal of modification to Form 5500 extension.*** **Section 2006(b)(3) of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 directed the IRS to amend its regulations so that the automatic extension for calendar year plans to file the Form 5500 series be changed to a 3½-month period ending November 15. The change was to become effective for plan years beginning after December 31, 2015. However, section 32104 of the Fixing America's Surface Transportation (FAST) Act, P.L. 114-41 (December 4, 2015) repealed section 2006(b)(3) of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015. Accordingly, the automatic extension period for the Form 5500 series will remain as a 2½-month period.**

*** Partnerships and S corporations.** For partnership and S corporations, the regular deadline under IRC §6072(b), as amended by the Act is changed to the 15th day of the 3rd month after the close of the taxable year. Prior to the amendment, IRC §6072(b) applied to corporations (including S corporations). With the amendment, corporations (other than S corporations) fall back to the general deadline rules of IRC §6072(a) (see below). Thus, the effect of the amendment is to: (1) accelerate the deadline for partnership returns by one month (e.g., calendar year partnership's return due by March 15 instead of April 15), (2) leave the deadline for S corporations the same, and (3) extend the normal deadline for C corporations by one month (see below). The change for the partnership filing deadline is effective for taxable years beginning after December 31, 2015 (e.g., the 2016 taxable year for a calendar year partnership).

> ✪ Change to automatic extension rule. The IRS is directed to amend its regulations to provide a 6-month automatic extension to calendar year partnerships, effective for taxable years beginning after December 31, 2015. See section 2006(b)(1) of the Act. No change to the regulations is required for noncalendar partnerships nor for S corporations. Treas. Reg. §1.6081-2 currently grants an automatic 5-month extension if a partnership timely files Form 8804. Thus, the 5-month extension rule will be retained for noncalendar partnerships, but a 6-month extension rule will be provided to calendar year partnerships. For a calendar year partnership this means that, although the normal deadline will be accelerated to March 15, with the longer extension period, the extended deadline will remain at September 15. On the other hand, for a noncalendar year, since the extension period remains at 5 months, there is a one-month extension of the filing deadline, regardless of whether the partnership extends its return. For example, a June 30 partnership currently has a normal deadline of October 15 (i.e., 15th day of the 4th month following June 30), and can extend that to March 15 of the following calendar year (5-month extension on the October 15 deadline). For post-2015 years, the normal deadline will be September 15 (i.e., 15th date of the 3rd month following June 30), and extended due date will be February 15 of the following calendar year (5-month extension on the September 15 deadline). Extensions for S corporation returns are addressed in the extension rules for corporations, which is discussed below.

*** C corporations.** For C corporations, the regular deadline is changed to the 15th day of the 4th month after the close of the taxable year. This is accomplished by modifying IRC §6072(b) to refer to partnerships and S corporations, as explained above, leaving C corporations governed by the general rule of IRC §6072(a) that refers to the 15th day of the 4th month following the close of the taxable year. For a calendar year corporation, this means a deadline of April 15 (rather than the current rule of March 15). This change is effective for taxable years beginning on or after January 1, 2017. But see the discussion below of June 30 corporations.

✪ Change to automatic extension rule. Currently IRC §6081(b) provides for an automatic 3-month extension for corporate tax returns. However, Treas. Reg. §1.6081-3 allows for a 6-month automatic extension. Section 2006(c) of the Act codifies the 6-month automatic extension rule by substituting "6 months" for "3 months" in IRC §6081(b). The effective date is for taxable years beginning after December 31, 2015. The 6-month statutory automatic extension rule will apply to both C corporations and S corporations. However, for C corporations, the rule is 5 months for taxable years beginning after December 31, 2015, and before January 1, 2026. When considered in combination with the change in the normal due date discussed above, the due date with the 5-month extension would fall on the same date as under current law until the 2026 taxable year. For example, a calendar year corporation currently has a normal due date of March 15 and can obtain a 6-month automatic extension to September 15. Under the new law, for 2016, the normal due date is April 15, 2017, but with a 5-month automatic extension, the extended due date is September 15, 2017. However, after 2025, the 6-month automatic extension would take the 2026 return due date to October 15, 2027. The Act does not state whether the IRS could still apply its current regulation (Treas. Reg. §1.6081-3) to add a 6-month extension to the C corporation's normal due date for taxable years beginning after 2015 and before 2026.

✪ Special rules for June 30 corporations. If a C corporation has a June 30 year end, the changes described above do not take effect until taxable years beginning on or after January 1, 2026. See section 2006(a)(3)(B) of the Act. Thus, for June 30 corporations' taxable years beginning before January 1, 2026, the normal deadline will remain as the 15th day of the 3rd month after the close of the taxable year (i.e., September 15, 2017, for the taxable year ending June 30, 2017). However until the taxable year beginning July 1, 2026, and subsequent years, the automatic extension rule under IRC §6081(b) is amended to be 7 months for a C corporation with a June 30 year. See section 2006(c)(1)(B) of the Act. Consider for example, the taxable year beginning July 1, 2016, and ending June 30, 2017. The normal due date is September 15, 2017, because of the special rule for June 30 plans, but the 7-month automatic extension would bring the due date to April 15, 2018. Starting with the year beginning July 1, 2026, the maximum automatic extension period would be 6 months rather than 7 months.

✪ S corporations. The 6-month automatic extension rule under amended IRC §6081(b) applies to S corporations for post-2015 taxable years, without the transition rule, as described above, for C corporations. Since Treas. Reg. §1.6081-3 already provides for a 6-month automatic extension, there is no change on the extension period for the S corporation.

Practice Before The IRS

IRS discontinuing ERPA exam [Citation: *ERPA Program Changes*, IRS Website Announcement (November 9, 2015)]
Text available at http://1.usa.gov/1WL8Amb

Effective February 12, 2016, the IRS will no longer be offering the ERPA Special Enrollment Examination (ERPA SEE) to become an ERPA. Due to a steady decline in the volume of ERPA-SEE test takers, the IRS determined that the cost to administer the examination no longer warranted the offering of the test. Any current ERPAs will continue to hold the ERPA designation, allowing them to practice before the IRS. Anyone who has passed both parts of the SEE can still become an ERPA if they file the Form 23-EP, Application for Enrollment to Practice before the Internal Revenue Service as an Enrolled Retirement Plan Agent (ERPA), no later than one year after passing both parts of the test.

The final testing window runs from January 5 through February 12, 2016. A candidate may take each part of the test only once during that final testing window. If only one part of the test is passed by February 12, 2016, there will not be an opportunity to take the second part of the test. Accordingly, anyone who has not passed both parts of the test by February 12, 2016, will not be able to become an ERPA.

The program is not changed for existing ERPAs. Such individuals may retain their ERPA license by continuing to complete continuing education requirements.

Form 5500 Reporting Requirements

2015 Form 5500 series includes new IRS compliance questions; Form 5500-SUP issued for nonelectronic filers [Citation: *Frequently Asked Questions Regarding the IRS Compliance Questions on the Form 5500- Series Returns*, www.irs.gov; *2015 Instructions for Form 5500*]
Text available at http://1.usa.gov/1RAj5nQ (FAQs from IRS), http://1.usa.gov/1jQJCzs (Form 5500 instructions)
Note: IRS says NOT to complete for 2015 returns

The 2015 Form 5500 series includes new IRS compliance questions. For filers that do not file electronically, these compliance questions will appear on a new form, Form 5500-SUP, which will be filed directly with the IRS, either on paper or through the IRS' electronic filing system known as FIRE.

* **Schedules H and I.** Questions relating to unrelated business taxable income (UBTI) (line 4o), in-service distributions (line 4p), and trustee information (lines 6c and 6d) were added.

✪ *UBTI.* If the plan doesn't have a trust (e.g., fully-insured plan under IRC §412(e)(3) or certain 403(b) annuity plans), check the "N/A" box. See FAQ-4.

✪ *In-service distributions.* For 2015, in the case of a 401(k) plan, answer yes only if the plan made hardship distributions, and enter the total amount of such distributions. In the case of a defined benefit or money purchase plan, answer yes only if the plan made in-service distributions to employees who have attained age 62 at the time of the distribution, and enter the total amount of such distributions. The question is answered No in all other cases. Do not report amounts from corrective distributions, EPCRS distributions, deemed distributions, or direct rollovers of eligible rollover distributions. If these were the only in-service distributions made by the plan, answer No. The IRS plans to modify this question on the 2016 forms. See FAQ-5.

✪ *Trustee information.* If there is no trust EIN, the EIN used on Form 1099-R and Form 945 may be used. However, the IRS encourages trustees to get a trust EIN. See FAQ-6.

*** Schedule R.** Part VII has been added, which requests information about: (1) whether a 401k plan is a safe harbor plan or an ADP-tested plan, (2) whether ADP/ACP testing was performed using the current year testing method, (3) the testing method (ratio test or average benefits test) used to pass coverage under IRC §410(b), (4) whether coverage testing was performed using permissive aggregation, (5) whether the plan has been amended timely for all law changes, (6) the date of the last amendment/restatement for required law changes, (7) the date and serial number of the most receipt opinion letter or advisory letter, in the case of a plan sponsor that is an adopter of a pre-approved plan (i.e., master/prototype plan or volume submitter plan), (8) the date of the last determination letter, in the case of an individually-designed plan, and (9) whether the plan is maintained in a U.S. territory (i.e., Puerto Rico (if no election under ERISA §1022(i)(2) has been made), American Samoa, Guam, the Commonwealth of the Northern Mariana Islands or the U.S. Virgin Islands).

✪ *Both ADP/ACPACP test.* If the plan uses both the safe-harbor 401(k) plan and an ADP/ACP test, FAQ-1 says to check only the ADP/ACP test box. This might apply to a safe harbor 401(k) plan that has to perform the ACP test, or a 401(k) that is disaggregated using different methods (e.g., otherwise excludable employees are not eligible for the safe harbor, so ADP/ACP testing is performed but safe harbor applies to statutory employees). The 2016 forms will further clarify this question.

✪ *Both prior-year and current-year testing used.* If the plan uses the prior year testing method for the ADP test and the current year testing method for the ACP test, or vice versa, the Yes or No box should be checked based on whether the current year testing method is used for the ADP test. See FAQ-2. The 2016 forms will further clarify this question.

✪ *Coverage passed using an exception.* If the plan uses an exception to satisfy the coverage rules, the line should be left blank. This applies if the plan relies on any of the following exceptions: (1) the employer employs only HCEs, (2) no HCEs benefit under the plan, (3) the plan benefits only collectively-bargained employees, (4) the plan benefits all nonexcludable NHCs of the employer (including all such employees of any related group member), and any leased employees and self-employed individuals, if applicable, or (5) the plan is deemed to meet coverage under the IRC §410(b)(6)(C) transition rule. See FAQ-3.

✪ *Plans that corrected late amendments through EPCRS.* If the plan sponsor used EPCRS to correct the failure to amend the plan for required law changes, answer Yes to the question about whether the plan has been timely amended for law changes, indicating that amendments were timely adopted. See FAQ-7.

✪ *Adopters of pre-approved plans that haven't adopted restated document yet.* If plan uses a pre-approved document and has adopted all required interim amendments but has not been restated for PPA as of December 31, 2015, for the most recent amendment date for required law changes, enter the adoption date of the most recent interim amendment. See FAQ-8. This recognizes that the two-year window for adopting the PPA restatement for pre-approved defined contribution plans does not end until April 30, 2016.

* **Form 5500-SUP.** Only a draft of this form has been circulated. With the decision to make the IRS compliance questions optional for 2015, it is presumed that a 2015 Form 5500-SUP will also be optional, or may not be issued at all until 2016. Based on the draft, the table below shows the location of the compliance questions on Form 5500-SUP and on Schedules H, I or R, as applicable.

Question	Form 5500 series location	Form 5500-SUP location
Is the plan a 401k plan?	Schedule R, Part VII, line 20a	Part III, line 4a
If a 401k, is plan a safe harbor or ADP-tested?	Schedule R, Part VII, line 20b	Part III, line 4b
If ADP-tested, is the current year testing method used?	Schedule R, Part VII, line 20c	Part III, line 4c
Does plan pass 410(b) using the ratio test or the average benefits test?	Schedule R, Part VII, line 21a	Part III, line 5a
Does the plan use permissive aggregation to satisfy 410(b) and 401(a)(4) testing?	Schedule R, Part VII, line 21b	Part III, line 5b
Has plan been amended timely for all required law changes?	Schedule R, Part VII, line 22a	Part III, line 6a
Enter last amendment/restatement date for required law changes (plus code found in instructions)	Schedule R, Part VII, line 22b	Part III, line 6b
Pre-approved plan opinion letter or advisory letter date and serial number	Schedule R, Part VII, line 22c	Part III, line 6c
Determination letter date and serial number	Schedule R, Part VII, line 22d	Part III, line 6d
Maintenance of plan in U.S. territory	Schedule R, Part VII, line 23	Part III, line 7
Did plan have UBTI	Schedules H & I, line 4o	Part III, line 8
In-service distributions	Schedules H & I, line 4p	Part III, line 9
Name of trustee or custodian	Schedules H & I, line 6c	Part III, line 3c
Trustee's or custodian's phone number	Schedules H & I, line 6d	Part III, line 3d

* **Multiple employer plans.** The IRS compliance questions should be answered at the plan level, not at the individual participating employer level. S
ee FAQ-9.

* **Preparer signature.** If a person prepared the Form 5500 series form for compensation, there is space on the Form 5500 or Form 5500-SF to enter the name, address and telephone number of the preparer. Completion of that information remains optional for 2015. The draft of Form 5500-SUP requires entry of the preparer information, but it is presumed that such information will be optional for 2015 assuming the form is even issued for 2015.

Comments requested on 2016 IRS Compliance Questions

- Inclusion of trust information, including name, EIN, and name and telephone number of trustee or custodian.
- Inclusion of preparer information, including name, address and telephone number.
- Information on how a 401(k) plan satisfies the nondiscrimination testing requirements, and if the Average Deferral Percentage test is used, whether testing is done using the current year or prior year testing method.
- Information on the method the plan uses to satisfy the minimum coverage requirements of Code Section 410(b), and whether the plan is permissibly aggregated with any other plans for coverage and nondiscrimination testing purposes.
- Disclosure of whether a defined benefit or money purchase pension plan made distributions to an employee who had attained age 62 and who had not separated from service. The original question asked if any in-service distributions were made during the plan year, and applied to all types of plans.
- For sponsors who have adopted a pre-approved master and prototype or volume submitter plan that received a favorable IRS opinion or advisory letter, inclusion of the date of such letter and the serial number.
- For sponsors who have an individually designed plan that received a favorable determination letter from the IRS, providing the date of the most recent favorable determination letter.
- Removal of the question asking whether the trust incurred unrelated business taxable income.
- Removal of the questions relating to whether the plan has been timely amended for all required law changes, and the date of the last plan amendment/restatement for required law changes.
- Removal of the question requesting disclosure of whether the plan is maintained in a U.S. territory.

Definition of Employee

DOL's Wage and Hour Division issues interpretation of joint employment relationships [Citation: *Administrator's Interpretation No. 2016-1* (January 20, 2016)]
Text available at http://1.usa.gov/1ZOLGGC

In July 2015, the Wage and Hour Division (WHD) of the DOL issued Administrator's Interpretation (AI) No. 2015-1, which dealt with the identification of employees and their misclassification as independent contractors under certain circumstances (the "Misclassification AI"). AI 2016-1 deals with joint employment situations.

✪ *Scope.* AI 2016-1 is focused on the definition of an employer for purposes of the Fair Labor Standards Act (FLSA) and the Migrant and Seasonal Agricultural Worker Protection Act (MSPA). It may be broader in scope than common law principles regarding the employer-employee relationship in order to ensure that wage practices are adequately protected (e.g., right to overtime pay).

✪ *Correlation with ERISA.* ERISA identifies employees based on common law principles. See *Nationwide Mutual Insurance Company v. Darden*, 112 S.Ct. 1344 (1992). In fact, the Supreme Court noted in the *Darden* opinion that the FLSA's "suffer to permit" standard of employment (discussed in the Misclassification AI) "stretches the meaning of 'employee' to cover some parties who might not qualify as such under a strict application of the traditional agency law principles"). See 112 S. Ct at 326. Nonetheless, the WHD principles regarding joint employment can be applicable to the ERISA context regarding the establishment of multiple employer plans by joint employers (e.g., supporting a nexus between the employer sufficient to treat the plan as a single plan for ERISA purposes), or service crediting rules established by joint employers in their respective plans with respect to shared employees (e.g., the crediting by both employers for all services to determine if a shared employee qualifies as an eligible employee under their respective plan's eligibility service conditions). These principles regarding coverage of shared employees, or joint maintenance of plans by joint employers, in ERISA plans also will apply to tax-qualified plans under the Internal Revenue Code.

* **Types of joint employment relationships.** AI 2016-1 divides joint employment relationships into two categories: (1) horizontal joint employment, and (2) vertical joint employment.

* **Horizontal joint employment.** This relationship exists where the employee has employment relationships with two or more employers *and* the employers are sufficiently associated or related with respect to the employee such that they jointly employ the employee. Thus, the relationship of the employers to each other is the focal point. Typically an established or admitted employment relationship exists between the employee and each of the employers, and often the employee performs separate work or works separate hours for each employer. Examples may include separate restaurants that share economic ties and have the same managers controlling both restaurants where the employee works.

✪ Situations in which horizontal joint employment generally exists. A horizontal joint employment relationship generally will exist in the following situations: (1) arrangements between the employers to share or interchange the employee's services, (2) where one employer acts directly or indirectly in the interest of another employer in relation to the employee, or (3) where the employers are associated with respect to the employment of a particular employee and may be deemed to share control of the employee, directly or indirectly, by reason of the fact that one employer controls, is controlled by, or is under common control with the other employer.

Qualified plan controlled group rules. **In scenarios described in (3), if the control involved rises to the level of a controlled group under IRC §414(b) or (c) or an affiliated service group under IRC §414(m) or (o), the employees will be deemed to be employed by a single employer for qualified plan purposes anyway, so a joint employment relationship under AI No. 2016-1 wouldn't have any substantive impact on the operation of the plan.**

✪ Factors. AI 2016-1 cites the following facts that may be relevant when analyzing the degree of association between, and sharing of control by, potential horizontal joint employers: (1) who owns the potential joint employers (i.e., does one employer own part or all of the other or do they have any common owners), (2) do the potential joint employers have any overlapping officers, directors, executives, or managers, (3) do the potential joint employers share control over operations (e.g., hiring, firing, payroll, advertising, overhead costs), (4) are the potential joint employers' operations inter-mingled (e.g., is there one administrative operation for both employers, or does the same person schedule and pay the employees regardless of which employer they work for), (5) does one potential joint employer supervise the work of the other, (6) do the potential joint employers share supervisory authority for the employee, (7) do the potential joint employers treat the employees as a pool of employees available to both of them, (8) do the potential joint employers share clients or customers, and (9) are there any agreements between the potential joint employers.

✪ Example - shared restaurant employment. An employee is employed at two locations of the same restaurant brand. The two locations are operated by separate legal entities (Employers A and B). The same individual is the majority owner of both Employer A and Employer B. The managers at each restaurant share the employee between the locations and jointly coordinate the scheduling of the employee's hours. The two employers use the same payroll processor to pay the employee, and they share supervisory authority over the employee. These facts are indicative of a horizontal joint employment between Employers A and B.

✪ Example - separate restaurant establishments. An employee works at one restaurant (Employer C) in the mornings and at a different restaurant (Employer D) in the afternoons. The owners and managers of each restaurant know that the employee works at both establishments. The establishments do not have an arrangement to share employees or operations, and do not otherwise have any common management or ownership. These facts are not indicative of joint employment between Employers C and D.

* **Vertical joint employment.** This relationship exists where the employee has an employment with one employer that acts as an intermediary with 1 or more other employers. The intermediary is typically a staffing agency, subcontractor, labor providers, or other intermediary employer. For there to be a joint employer relationship with respect to the employee, the economic realities must show that the employee is economically dependent on, and thus also employed by, another entity involved in the work. This other entity typically contracts with the intermediary employer to receive the benefit of the employee's labor. The analysis for vertical joint employment focuses on the economic realities of the working relationship between the employee and the potential joint employer. It come into play, for example, to determine whether a construction worker who works for a subcontractor is also employed by the general contractor. Rather than focus on the relationship between the subcontractor and the general contractor, which would be the focus of a horizontal joint employment relationship, the vertical joint employment analysis focuses on the economic realities of the relationship between the construction worker and the general contractor (as potential joint employer). Where there is vertical joint employment, there is likely a contract or other arrangement, but not necessarily an employment relationship, between the intermediary employer and the potential joint employer.

✪ Situations where intermediary employer is an employee of the potential joint employer. A threshold question in a vertical joint employment case is whether the intermediary employer (who may simply be an individual responsible for providing labor) is actually an employee of the potential joint employer. If the intermediary employer is an employee of the potential joint employer, then all of the intermediary employer's employees are employees of the potential joint employer too, and there is no need to conduct a vertical joint employment analysis. For example, if a farm labor contractor is not actually an independent contractor but is an employee of the grower (i.e., is economically dependent on the grower as a matter of economic reality), then all of the farm labor contractor's farmworkers are also employees of the grower. Likewise, if a drywall subcontractor is not actually an independent contractor but is an employee of the higher-tier contractor, then all of the drywall subcontractor's workers are also employees of the higher-tier subcontractor.

✪ Analysis of economic realities of relationship with potential joint employer. Once it is determined that the intermediary is not an employee, the vertical joint employment analysis should be applied to determine whether the intermediary employer's employees are also employed by the potential joint employer. Since the analysis involves the FLSA and MPSA, the vertical joint employment analysis must be an economic realities analysis and cannot focus only on control. There are seven factors identified by AI 2016-1.

(1) Directing, controlling, or supervising work. To the extent that the work performed by the employee is controlled or supervised by the potential joint employer beyond a reasonable degree of contract performance oversight, such control suggests that the employee is economically dependent on the potential joint employer. The control may be exercised indirectly (e.g., through the intermediary). Additionally, the potential joint employer need not exercise more control than, or the same control as, the intermediary employer to exercise sufficient control to indicate economic dependence by the employee.

(2) Controlling employment conditions. To the extent that the potential joint employer has the power to hire or fire the employee, modify employment conditions, or determine the rate or method of pay, such control indicates that the employee is economically dependent on the potential joint employer. Again, the potential joint employer may exercise such control indirectly and need not exclusively exercise such control for there to be an indication of joint employment.

(3) Permanency and duration of relationship. An indefinite, permanent, full-time or long-term relationship by the employee with the potential joint employer suggests economic dependence. This factor should be considered in the context of the particular industry at issue. For example, if the work in the industry is by its nature seasonal, intermittent, or part-time, such industry condition should be considered when analyzing the permanency and duration of the employee's relationship with the potential joint employer.

(4) Repetitive and rote nature of work. To the extent that the employee's work for the potential joint employer is repetitive and rote, is relatively unskilled, and/or requires little or no training, those facts indicate that the employee is economically dependent on the potential joint employer.

(5) Integral to business. If the employee's work is an integral part of the potential joint employer's business, which is a hallmark of determining whether an employment relationship exists, that fact indicates that the employee is economically dependent on the potential joint employer.

(6) Worked performed on premises. The employee's performance of the work on premises owned or controlled by the potential joint employer indicates that the employee is economically dependent on the potential joint employer. The potential joint employer's leasing as opposed to owning the premises where the work is performed is immaterial because the potential joint employer, as the lessee, controls the premises.

(7) Performing administratively functions commonly performed by employers. To the extent that the potential joint employer performs administrative functions for the employee, such as handling payroll, providing workers' compensation insurance, providing necessary facilities and safety equipment, housing, or transportation, or providing tools and materials required for the work, those facts indicate economic dependence by the employee on the potential joint employer.

✪ Disclaimer of liability not relevant. The contract between the potential joint employer and the intermediary employer may purport to disclaim or deny any responsibility by the potential joint employer as an employer. However, that type of contractual provision is not relevant to the economic realities of the working relationship between the potential joint employer and the employee. See footnote 14 to AI 2016-1.

✪ Example - subcontractor employee in a joint employment relationship. A laborer is employed by ABC Drywall Company, which is an independent subcontractor on a construction project. ABC Drywall was engaged by the General Contractor to provide drywall labor for the project. ABC Drywall hired and pays the laborer. The General Contractor provides all of the training for the project. The General Contractor also provides the necessary equipment and materials, provides workers' compensation insurance, and is responsible for the health and safety of the laborer (and all of the workers on the project). The General Contractor reserves the right to remove the laborer from the project, controls the laborer's schedule, and provides assignments on site, and both ABC Drywall and the General Contractor supervise the laborer. The laborer has been continuously working on the General Contractor's construction projects, whether through ABC Drywall or another intermediary. These facts are indicative of joint employment of the laborer by the General Contractor.

✪ Example - farmworker in a joint employment relationship. A worker is hired by a farm labor contractor (FLC) to pick produce on a Grower's farm. The FLC hired and pays the worker. The Grower dictates the timing of the harvest, which fields the worker should harvest, and the schedule each day. The work is unskilled, and any training is provided by the Grower. The Grower keeps track of the amount of produce that the worker picks per hour. The Grower provides the buckets for the produce, transports the produce from the field, and stores the produce. The Grower pays the FLC per bucket of produce picked, and withholds money to cover workers' compensation insurance. The worker has been continuously working on the Grower's farm during the harvest seasons, whether through this FLC or another farm labor contractor. These facts are indicative of joint employment of the worker by the Grower.

✪ Example - short-term contract with potential joint employer not indicative of joint employment. A mechanic is employed by Airy AC & Heating Company ("Company"). The Company has a short-term contract to test and, if necessary, replace the HVAC systems at Condor Condos. The Company hired and pays the mechanic and directs the work, including setting the mechanic's hours and timeline for completion of the project. For the duration of the project, the mechanic works at the Condos and checks in with the property manager there every morning, but the Company supervises his work. The Company provides the mechanic's benefits, including workers' compensation insurance. The Company also provides the mechanic with all the tools and materials needed to complete the project. The mechanic brings this equipment to the project site. These facts are not indicative of joint employment of the mechanic by the Condos.

* **Separate employer-employee relationships that do not fall into joint employment.** An individual may hold 2 jobs where the employers have no association or relationship so that joint employment does not exist. In such case, the individual has 2 separate employment relationships (e.g., the employee works for two different retailers that are not engaged in a horizontal joint employment or vertical joint employment relationship), and the individual's rights under the FLSA are independently determined. For example, even if the individual works more than 40 hours per week on a combined basis with the 2 employers, neither employer is required to pay overtime if the individual works no more than 40 hours for either of the employers. On the other hand, if there is sufficient relationship between the employers for horizontal joint employment to exist, then the hours for the two employers would be combined to determine the individual's rights to overtime pay.

Church Plans

PATH Act modifies controlled group definition for church plans, grandfathers certain defined benefit 403(b) arrangements maintained by churches, protects auto-enrollment arrangements for church plans, allows mergers between qualified plans and 403(b) plans maintained by a church, and permits investment of church plan assets and assets of certain church organizations in a Rev. Rul. 81-100 group trust [Citation: *Section 336 of the Protecting Americans from Tax Hikes Act (PATH Act) of 2015*, Division Q of the Consolidated Appropriations Act, 2016, P.L. 114-113 (December 18, 2015)]
Text available at http://1.usa.gov/1TvuBjd

The PATH Act adopts changes to the tax code with respect to how the following rules apply to church plans: (1) controlled group rules (see ¶1 below), (2) IRC §415(b) (see ¶2 below), (3) automatic enrollment (see ¶3 below), (4) transfers and mergers involving qualified plans and 403(b) plans (see ¶4 below) and (5) group trusts under Rev. Rul. 81-100 (see ¶5 below).

¶1. Application of controlled group rules to church plans. Treas. Reg. §1.414(c)-5(a) provides that the controlled group regulations under §1.414(c)-5 generally do not apply to a church, as defined in IRC §3121(w)(3)(A), or any qualified church-controlled organization, as defined in IRC §3121(w)(3)(B) 414(c)(2). Until further guidance is issued, the IRS allowed the safe harbor rules under Notice 89-23 to continue to apply to church plans. Section 336(a) of the PATH Act adds IRC §414(c)(2) to prescribe controlled group rules for church plans. Except as provided in ¶1.a. and ¶1.b. below, for purposes of applying the controlled group rules under IRC §414(c) and the affiliated service group rules under IRC §414(m) for a plan year that begins in a taxable year of an organization that is otherwise eligible to participate in a church plan, such organization is not aggregated with another such organization unless: (1) one such organization provides (directly or indirectly) at least 80% of the operating funds for the other organization during the preceding taxable year of the recipient organization, *and* (2) there is a degree of common management or supervision between the organizations such that the organization providing the operating funds is directly involved in the day-to-day operations of the other organization. See IRC §414(c)(2)(A).

¶1.a. Nonqualified church-controlled organizations. For a nonqualified church-controlled organization, such organization is aggregated with 1 or more other nonqualified church-controlled organizations, or with an organization that is not exempt from tax under IRC §501, and treated as a single employer with such other organization for purposes of IRC §§414(c) and (m), if at least 80% of the directors or trustees of such other organization are either representatives of, or directly or indirectly controlled by, such nonqualified church-controlled organization. See IRC §414(c)(2)(B) This is the general rule for tax-exempt organizations under Treas. Reg. §1.414(c)-5(b).

¶1.a.1) Definition of a nonqualified church-controlled organization. The term "nonqualified church-controlled organization" means a church-controlled tax-exempt organization described in IRC §501(c)(3) that is not a qualified church-controlled organization (as defined in IRC §3121(w)(3)(B)).

¶1.b. Permissive aggregation among church-related organizations. A church or convention or association of churches with which an organization described in IRC §414(c)(2)(A) (see ¶1 above) is associated (i.e., shares common religious bonds and convictions with that church or convention or association of churches - see IRC §414(e)(3)(D)), or an organization designated by such church or convention or association of churches, may elect to treat such organizations as a single employer for a plan year. See IRC §414(c)(2)(C). Such election, once made, applies to all succeeding plan years unless revoked with notice provided to the Treasury in such manner as prescribed by the Treasury.

¶1.c. Permissive disaggregation of church-related organizations. With respect to a church plan, an employer may elect to treat churches (as defined in IRC §403(b)(12)(B)) separately from entities that are not churches, without regard to whether such entities maintain separate church plans. See IRC §414(c)(2)(D). A "church" under IRC §403(b)(12)(B) means a church described in IRC §3121(w)(3)(A) (i.e., a church, a convention or association of churches, or an elementary or secondary school which is controlled, operated, or principally supported by a church or by a convention or association of churches), or a qualified church controlled organization described in IRC §3121(w)(3)(B). Such election, once made, applies to all succeeding plan years unless revoked with notice provided to the Treasury in such manner as prescribed by the Treasury.

¶1.d. Anti-abuse rule. The anti-abuse rule under Treas. Reg. §1.414(c)-5(f) applies to the rules described in ¶1. through ¶1.c. above. See section 336(a)(2) of the PATH Act.

¶1.e. Applicable to all years. The rules under IRC §414(c)(2) apply as if they were always part of the law. See section 336(a)(3) of the PATH Act.

¶2. Grandfathered defined benefit 403(b) church plans. Treas. Reg. §1.403(b)-10(f)(1) requires that a section 403(b) plan be a defined contribution plan. However, the regulations recognize defined benefit 403(b) church plans that were in existence on the date TEFRA was enacted in 1982 and which were grandfathered by TEFRA §251(e)(5). See Treas. Reg. §1.403(b)-10(f)(2). Treas. Reg. §1.415(c)-1(a)(2)(iii) provides that the annual additions limit under IRC §415(c) still applies to a grandfathered defined benefit 403(b) church plan. Section 336(b) of the PATH Act amends §251(e)(5) of TEFRA to clarify that the benefit limitations under IRC §415(b) apply to a grandfathered defined benefit 403(b) church plan as if such plan were a defined benefit plan under IRC §401(a), and the annual additions limit under IRC §415(c) does not apply to such plans, thereby overruling the cited IRC §415 regulations. It also changes the reference in TEFRA §251(e)(5) to "403(b)(2)" to refer to "403(b)" instead. This change recognizes that, since the passage of TEFRA, IRC §403(b) has modified and the reference to IRC §403(b)(2) no longer makes sense.[9]

***Effective date.* This modification is effective as if it were included in TEFRA §251(e)(5) and, thus, applies to apply years.**

¶3. Auto-enrollment provisions in church plans. Section 336(c)(1) of the PATH Act supersedes any State law that relates to wage, salary, or payroll payment, collection, deduction, garnishment, assignment, or withholding which would directly or indirectly prohibit or restrict the inclusion in any church plan (as defined in IRC §414(e)) of an automatic contribution arrangement, as defined in ¶3.a. below. This provision is effective on December 18, 2015 (i.e., the date of enactment of the PATH Act).

[9] Section 251(e)(5) of TEFRA as originally enacted read as follows: "Special rule for existing defined benefit arrangements.—Any defined benefit arrangement which is established by a church or a convention or association of churches (including an organization described in section 414(e)(3)(B)(ii) of the Internal Revenue Code of 1954) and which is in effect on the date of the enactment of this Act shall not be treated as failing to meet the requirements of section 403(b)(2) of such Code merely because it is a defined benefit arrangement."

¶3.a. Definition of automatic contribution arrangement. The term "automatic contribution arrangement" for purposes of this State law preemption rule means an arrangement: (1) under which a participant may elect to have the plan sponsor or the employer make payments as contributions under the plan on behalf of the participant, or to the participant directly in cash (i.e., the plan has an elective deferral arrangement), (2) under which a participant is treated as having elected to have the plan sponsor or the employer make such contributions in an amount equal to a uniform percentage of compensation provided under the plan until the participant specifically elects not to have such contributions made (or specifically elects to have such contributions made at a different percentage) (i.e., deemed enrollment provision), and (3) under which the notice and election requirements described in ¶3.b. and ¶3.c. below and the investment requirements described in ¶3.d. below are satisfied. See section 336(c)(2) of the PATH Act.

¶3.b. Notice requirements. Within a reasonable period before the first day of each plan year, the plan sponsor, plan administrator or employer maintaining the automatic contribution arrangement must provide a notice to each participant to whom the arrangement applies for such plan year. The notice must describe the participant's rights and obligations under the arrangement which: (1) is sufficiently accurate and comprehensive to apprise the participant of such rights and obligations, and (2) is written in a manner calculated to be understood by the average participant to whom the arrangement applies. See section 336(c)(3)(A) of the PATH Act. Presumably the 30-day safe harbor notice period adopted by the IRS for qualified automatic arrangements (QACAs) under IRC §401(k)(13) and for eligible automatic contribution arrangements (EACAs) under IRC §414(w) will apply here as well.

¶3.c. Election requirements. A notice is not be treated as meeting the requirements of ¶3.b. above unless: (1) the notice includes an explanation of the participant's right under the arrangement not to have elective contributions made on the participant's behalf (or to elect to have such contributions made at a different percentage), (2) the participant has a reasonable period of time, *after* receipt of the explanation described in (1) and before the first elective contribution is made, to make such election, and (3) the notice explains how contributions made under the arrangement will be invested in the absence of any investment election by the participant. See section 336(c)(3)(B) of the PATH Act.

¶3.d. Default investment. If no affirmative investment election has been made with respect to any automatic contribution arrangement, contributions to such arrangement must be invested in a default investment selected with the care, skill, prudence, and diligence that a prudent person selecting an investment option would use. See section 336(c)(3)(B) of the PATH Act.

¶4. Mergers and transfers between qualified church plans and 403(b) church plans. Although the tax code allows rollovers between qualified plans and 403(b) plans, the IRS does not recognize any statutory support for a merger of such plans or a transfer between such plans outside of the rollover rules. Section 336(d) of the PATH Act adds IRC §414(z) to expressly permit such mergers and transfers involving qualified plans and 403(b) plans that are maintained by the same church or same convention or association of churches. A "church or convention or association of churches" includes an organization described in IRC §414(e)(3)(A) or IRC §414(e)(3)(B)(ii) (relating to certain church-controlled organizations). See IRC §414(z)(4)(A). A section 403(b) plan involved in these transactions may be an annuity contract under IRC §403(b)(1), a custodial account under IRC §403(b)(7) or a retirement income account under IRC §403(b)(9). See IRC §414(z)(4)(B).

¶4.a. Transactions permitted under IRC §414(z). As long as the two plans are maintained by the same church or convention or association of churches, IRC §414(z)(1) permits the following transactions: (1) a transfer of all or a portion of the accrued benefit of a participant or beneficiary, whether or not vested, from a church plan that is a qualified plan under IRC §401(a) ("qualified church plan") or a section 403(b) plan to a section 403(b) plan, (2) a transfer of all or a portion of the accrued benefit of a participant or beneficiary, whether or not vested, from a section 403(b) plan to a qualified church plan, and (3) a merger of a qualified church plan or section 403(b) plan, with a section 403(b) plan. Note that (1) and (3) would permit transfers or mergers involving two section 403(b) plans, presumably without regard to the requirements set forth in Treas. Reg. §1.403(b)-10(b)(3).

***Effective date.* A transaction is eligible for this treatment only if it occurs after December 18, 2015 (the enactment date of the PATH Act).**

¶4.b. Preservation of total accrued benefit required. A transfer or merger described in ¶4.a. above is not permitted unless the participant's or beneficiary's total accrued benefit immediately after the transfer or merger is equal to or greater than the participant's or beneficiary's total accrued benefit immediately before the transfer or merger, and such total accrued benefit is nonforfeitable after the transfer or merger. See IRC §414(z)(2). The "accrued benefit" for this purpose means the accrued benefit determined under a defined benefit plan or the account balance under a defined contribution plan, as the case may be. See IRC §414(z)(4)(C).

¶4.c. Qualification protected. A transfer or merger that meets the conditions described in ¶4.a. and ¶4.b. above will not cause a section 403(b) plan involved in the transaction to be treated as satisfying the requirements of IRC §403(b) and will not cause a qualified plan involved in the transaction to be treated as failing to satisfy the requirements of IRC §401(a). See IRC §414(z)(3).

¶5. Expansion of 81-100 group trust rules. Rev. Rul. 81-100, as modified by Rev. Ruls. 2004-67, 2011-1, and 2014-24, permit the collective investment of funds in certain plans through the use of a group trust that meets prescribed requirements. Section 336(e) of the PATH Act permits an 81-100 group trust to hold: (1) the assets of a church plan, and (2) the assets of a church-controlled organization described in IRC §414(e)(3)(A) the principal purpose or function of which is the administration of a plan described in (1). The assets eligible for investment in a group trust also include any assets otherwise permitted to be commingled for investment purposes with the assets of such a plan or organization. A church plan for this purposes includes a qualified plan under IRC §401(a) and a retirement income account under IRC §403(b)(9).

Effective date. This provision applies to any investments in a group trust made after December 18, 2015 (the enactment date of the PATH Act).

A church agency, as described in ERISA §3(33)(C)(i), may maintain but cannot establish a church plan
[Citation: *Stapleton v. Advocate Health Care Network*, No. 15-1368, ___ F.3d ___ (7th Cir. March 17, 2016)]
Text available at http://1.usa.gov/1MsgMhc

The Seventh Circuit, with this opinion, joins the Third Circuit in adopting a narrower construction of the definition of a church plan under ERISA §3(33) than the IRS has in its historical private letter ruling process and several district courts that have considered these issues. The Third Circuit case is *Kaplan v. Saint Peter's Healthcare System*, 810 F.3d 175 (3rd Cir. December 29, 2015).

* **Definition of a church plan.** The crux of the matter is the proper meaning of ERISA §3(33)(C)(i), which is part of the definition of a church plan.[10] ERISA §3(33)(A) defines a church plan as one that is "established and maintained ... for its employees (or their beneficiaries)" by a church or by a convention or association of churches which is exempt from tax under IRC §501. ERISA §3(33)(C)(i), as amended by the MPPAA of 1980, provides that a church plan includes a plan "a plan maintained by an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, if such organization is controlled by or associated with a church or a convention or association of churches" (emphasis added). The organization described in ERISA §3(33)(C)(i) is referred to in this discussion as a church-affiliated "principal purpose" entity. An example of a church-affiliated "principal purpose" entity is a pension board, which some churches use to maintain and administer their plans, rather than having the church directly maintain the plans.

* **Establishment of a church plan.** The issue in this case and the Third Circuit's *Kaplan* case is whether the statutory reference in ERISA §3(33)(C)(i) to a church-affiliated "principal purpose" entity means that such entity may establish a church plan, or whether it only allow such an entity to maintain a church plan that has otherwise been established by a church or a convention or association of churches, as described in ERISA §3(33)(A). The Seventh Circuit concludes in this case that a church-affiliated "principal purpose" is not permitted to establish a church plan, but only can maintain church plan that has been properly established by a tax-exempt church or by a tax-exempt convention or association of churches.

* **Effect of IRS private letter rulings.** The IRS had issued a private letter ruling (PLR), which was based on a 1983 IRS General Counsel Memorandum (GCM), that concluded the plan maintained by Advocate was a church plan. The Seventh Circuit determined that the ruling was owed no deference because PLRs and GCMs are not agency interpretations that emerge from a formal process. The Third Circuit, in the *Kaplan* case, also declined to give deference to a PLR issued to the plan in that case because it was based on an interpretation that conflicts with what the court believes to be the clear statutory text.

* **Coverage of employees of church-affiliated organizations.** These church plan cases also discuss ERISA §3(33)(C)(ii) (parallel provision in IRC §414(e)(3)(B)), which allows a church plan to treat as employees of the church or of the convention or association of churches: (1) a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry, regardless of the source of his or her compensation (including self-employment), (2) an employee of a tax-exempt organization, whether a civil law corporation or otherwise, which is controlled by or associated with a church or a convention or association of churches,

[10] The tax code contains parallel provisions defining a church plan. IRC §414(e)(1) parallels ERISA §3(33)(A). IRC §414(e)(3)(A) parallels ERISA §3(33)(C)(i).

and (3) former employees of a tax-exempt organization described in (2) (including the right to continue contributions for such former employees, but not more than a period of 5 years unless the former employee is disabled - see ERISA §3(33)(C)(v) and IRC §414(e)(3)(E)). With respect to a church plan that covers such employees, the church or convention or association of churches is treated as the employer of such employees. See ERISA §3(33)(C)(iii) and IRC §414(e)(3)(C). Thus, a properly-established church plan, pursuant to these provisions, may cover such employees.

✪ Application to tax-exempt hospitals. Both the *Advocate* case in the Seventh Circuit and the *Kaplan* case in the Third Circuit dealt with plans covering employees of a tax-exempt hospital. The hospital in the *Advocate* case employs 33,000 people and has $4.6 billion of annual revenue. An issue not directly addressed by the courts in these case is even whether the tax-exempt hospitals are properly treated as employees under ERISA §3(33)(C)(ii)/IRC §414(e)(3)(B). The statutory language refers to the organization employing such employees as "controlled by" or "associated with" a church or a convention or association of churches. The statute provides that an organization is associated with a church or a convention or association of churches if it shares common religious bonds and convictions with that church or convention or association of churches. See ERISA §3(33)(C)(iv) and IRC §414(e)(3)(D). The statute does not provide any guidance on "control," although presumably it would be focused on control over the board of directors or trustees of the tax-exempt organization and/or the funding of the tax-exempt organization. IRC §414(c)(2)), which prescribes controlled group rules for churches, expressly applies just to the definitions of a controlled group under IRC §414(c) and affiliated service group under IRC §414(m), but does not reference the church plan definition in IRC §414(e). The control test under IRC §414(c)(2) focuses on the provision of operating funds by the church to the tax-exempt organization, and the degree of common management or supervision between the tax-exempt organization and the church providing the funds. It is not clear whether a similar analysis would be used in interpreting ERISA §3(3309C)(ii) and IRC §414(e)(3)(B). Whether a tax-exempt organization is controlled by or associated with a church or a convention or association of churches may become a focus of future litigation once more of the Circuits (and possibly the Supreme Court) weigh in on the proper interpretation of the church plan definition in ERISA §3(33).

✪ Maintenance of plans covering employees of church-affiliated organizations. Even if a tax-exempt organization's employees are eligible to participate in a church plan, pursuant to ERISA §3(33)(C)(ii) and IRC §414(e)(3)(B), the *Advocate* and *Kaplan* cases gloss over the issue of whether the tax-exempt organization can even maintain the church plan covering its employees. These courts focused only on the issue of "establish vs. maintain" under ERISA §3(33)(C)(i), and simply assumed that the hospitals in question were the type of organization described in ERISA §3(33)(C)(i). As noted above, ERISA §3(33)(C)(i) refers to a church-affiliated "principal purpose" entity. The hospitals in these cases would certainly not meet the "principal purpose" test under ERISA §3(33)(C)(i) even though their employees would be eligible to participate in a church plan pursuant to ERISA §3(33)(C)(ii). Thus, it is arguable that in cases like these, even if a church or a convention or association of churches has originally established the plan, ERISA §3(33)(C)(i) wouldn't support the tax-exempt hospital being the organization maintaining the plan. This may become a more important issue if other Circuits take a different view of ERISA §3(33)(C)(i) and hold that a church-affiliated "principal purpose" entity can both establish and maintain a church plan. In such case, the court presumably would have to find that a tax-exempt hospital that is controlled by or associated with a church or with a convention or association of churches is also permitted to establish and maintain a church plan pursuant to ERISA §3(33)(C)(i).

* **Consequence of this litigation/statutory correction rule.** By finding that the hospital plans involved in the Third and Seventh Circuit opinions were not church plans, the affected plans become subject to ERISA coverage and lose treatment under the tax code as church plans. The courts did not address, however, whether the correction mechanisms in ERISA and the tax code can avoid these consequences.

✪ Statutory correction rule. ERISA §3(33)(D) provides that if a plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under IRC §501 fails to meet one or more of the requirements of ERISA §3(33), and corrects its failure to meet such requirements within the correction period (see below), the plan is deemed to meet the requirements of ERISA §3(33) for the year in which the correction was made and for all prior years. IRC §414(e)(4) contains a parallel provision that protects the plan's treatment under IRC §414(e) as a church plan.

➤ Correction period. The term "correction period" means: (1) the period ending 270 days after the date of mailing by the Secretary of the Treasury of a notice of default with respect to the plan's failure to meet one or more of the requirements of ERISA §3(33) or IRC §414(e), (2) any period set by a court of competent jurisdiction after a final determination that the plan fails to meet such requirements, or, if the court does not specify such period, any reasonable period determined by the Secretary of the Treasury on the basis of all the facts and circumstances, but in any event not less than 270 days after the determination has become final, or (3) any additional period which the Secretary of the Treasury determines is reasonable or necessary for the correction of the default. If two or more periods described in (1), (2) and (3) apply, then the ending date of the correction period is the latest of those dates.

➤ Failure to correct. If a correction is not made within the correction period, the plan is deemed not to meet the requirements of ERISA §3(33) and IRC §414(e) beginning with the date on which the earliest failure to meet one or more of such requirements occurred (i.e., retroactive coverage by ERISA and failure to be treated as a church plan for tax code purposes). Retroactive reclassification of the plan could result in disqualification because of failure of the plan to meet qualification requirements under IRC §401(a) that are not applicable to a church plan.

✪ Could the courts allow the plan to be retroactively established by a proper church or a convention or association of churches? That question is not addressed in the *Advocate* and *Kaplan* cases. If the failure relates back to the original establishment of the plan, because a church or a convention or association of churches did not establish the plan, would it be possible for a church or a church convention/association to retroactively establish the plan, thereby triggering the corrective relief offered by ERISA §3(33)(D) and IRC §414(e)(4)? Note that the introductory clause under both ERISA §3(33)(D) and IRC §414(e)(4) refers to a plan "established and maintained . . . by a church or by a convention or association of churches. . ." Would this language confine the statutory correction rule to those plans that are least properly established by a church or a church convention/association? Also note that the correction rule makes no mention of a plan maintained by an organization described in ERISA §3(33)(C)(i) and IRC §414(e)(3)(A). Does that preclude plans that were properly established by a church or church convention/association, but now maintained by a church-affiliated "principal purpose" entity described in ERISA §3(33)(C)(i) and IRC §414(e)(3)(A) from using the statutory correction rule? Perhaps future litigation will address these issues.

Cash Balance Plans And Other Statutory Hybrid Plans

Regulations finalize additional amendments to the regulations to cover transitional amendments to satisfy the market rate of return rules; delays applicability date and plan amendment deadline by one year [Citation: *Treas. Reg. §§1.411(a)(13)-1(e)(2)(ii), 1.411(b)(5)-1(d)(1)(iv)(A) and (E), (e)(3)(vi), and (f)(2)(i)(B)*, 80 F.R. 70680-70687 (November 16, 2015)]
Text available at http://1.usa.gov/1WSsWdc

These regulations amend the 2014 final regulations to: (1) delay the applicability date from the 2016 plan year to the 2017 plan year, (2) delay the deadline for conforming amendments from the end of the 2015 plan year to the end of the 2016 plan year, and (3) finalize anti-cutback relief for certain amendments made to conform a noncompliance interest crediting rate to the requirements of the 2014 regulations.

¶1. Effective date/applicability date of the 2014 regulations. The 2014 final regulations now apply to plan years beginning on or after January 1, 2017, as a result of amendments adopted to Treas. Reg. §1.411(b)(5)-1(f)(2)(i)(B). However, where the 2014 final regulations merely clarify provisions that were included in the 2010 final regulations, the regulations continue to apply to plan years that begin on or after January 1, 2011, which was the effective/applicability date of the 2010 final regulations. The 2017 plan year applicability date applies to the following provisions: (1) Treas. Reg. §1.411(b)(5)-1(d)(1)(iii) (market return rules for a single rate), (2) Treas. Reg. §1.411(b)-5(d)(1)(iv)(D) (debits and credits during the interest crediting period) and (E) (rounding of interest crediting rate), (3) Treas. Reg. §1.411(b)(5)-1(d)(1)(vi) (market return rules for "greater of" rates), (4) Treas. Reg. §1.411(b)(5)-1(d)(2)(ii) (application of the preservation of capital requirement to multiple annuity starting dates), (5) Treas. Reg. §1.411(b)(5)-1(d)(4)(v) (fixed rate of interest), (6) Treas. Reg. §1.411(b)(5)-1(d)(5)(ii)(B) (subset of plan assets used for market rate of return), (7) Treas. Reg. §1.411(b)(5)-1(d)(5)(iv) (rate of return on certain regulated investment companies), (8) Treas. Reg. §1.411(b)(5)-1(d)(6) (combination of rates of return), (9) Treas. Reg. §1.411(b)(5)-1(e)(2) (determining certain plan factors after the plan termination date), (10) Treas. Reg. §1.411(b)(5)-1(e)(3)(iii) (coordination of IRC §411(d)(6) and market rate of return limitation), (11) Treas. Reg. §1.411(b)(5)-1(e)(3)(iv) (change in lookback month or stability period used to determine interest credits), (12) Treas. Reg. §1.411(b)(5)-1(e)(3)(v) (rate of return based on RIC that has ceased to exist), and (13) Treas. Reg. §1.411(b)(5)-1(e)(4) (actuarial increases after normal retirement age), as discussed in ¶4 below. See Treas. Reg. §1.411(b)(5)-1(f)(2)(i)(B), as amended on November 16, 2015. Any rules that are subject to the delayed effective date either were added by the 2014 regulations or the 2015 amendments to those regulations, or were in the 2010 regulations, but finalized by the 2014 regulations.

> ✪ *Delayed effective date for collectively-bargained plans.* In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified on or before November 13, 2015, the provisions identified in the prior paragraph apply to plan years that begin on or after the later of: (1) January 1, 2017, or (2) the date on which the last of those collective bargaining agreements terminates (without regard to any extensions on or after November 13, 2015). However, the date in (2) cannot be later than January 1, 2019. See Treas. Reg. §1.411(b)(5)-1(f)(2)(i)(B)(*3*).
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> ✪ *Plan amendments to reflect 2014 final regulations.* As promised in Notice 2011-85, a plan must be amended to comply with the 2014 final regulations by the last day of the 2016 plan year, which is the last plan year before the 2014 final regulations first apply to the plan. Anti-cutback relief under IRC §411(d)(6) is provided with respect to these amendments. See 79 F.R. 56445 (September 19, 2014) and

80 F.R. 70683 (November 16, 2015). The 2015 amendments to the 2014 regulations address anti-cutback relief for plans that are not compliant with the interest crediting rate rules under the final regulations, where a plan amendment to comply with those rules would otherwise result in a prohibited cutback of benefits. See the discussion in ¶2. below.

¶2. Additional anti-cutback relief for plan amendments to conform noncompliant interest rates to the 2014 final regulations. Prior to the first day of the 2017 plan year, a statutory hybrid plan that uses an interest crediting rate that is not permitted by the 2014 final regulations must be amended to change to an interest crediting rate that is on the list of permitted rates in Treas. Reg. §1.411(b)(5)-1(d). Normally, IRC §411(d)(6) would be violated if the amendment to the permissible interest rate reduced the interest rate on benefits already accrued. The regulations issued on November 16, 2015, prescribe IRC §411(d)(6) relief to a plan that is amended to replace a noncompliant interest rate to a permissible rate under the 2014 final regulations for purposes of determining future interest credits on benefits already accrued. See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi). The approach taken by the Treasury focuses on the aspects of the noncompliant interest rate that make it noncompliant, which the Treasury believes to be the most appropriate manner to resolve the conflict between the market rate of return rules and the anti-cutback rule.

a. Timing of amendment. The deadline for adopting an amendment that is eligible for anti-cutback relief is the last day of the 2016 plan year (i.e., the deadline for adopting amendments to conform to the 2014 final regulations). See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(B)(*3*).

a.1) Relief applies only to post-amendment interest credits. The anti-cutback relief for amending noncompliant interest rates applies to a plan amendment only with respect to interest credits that are credited for interest crediting periods that begin after the *later of* the adoption date or the effective date of the amendment (i.e., the applicable amendment date within the meaning of Treas. Reg. §1.411(d)-3(g)(4)). See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(B)(*3*).

b. Rules of application for adopting amendments to eliminate noncompliant features. The regulations provide special rules that may be used in conjunction with adopting any of the permissible amendments described in c. below. The rule in b.1) below was in the proposed regulations as well, but the rules in b.2), b.3) and b.4) below were added to address comments made on the proposed regulations.

b.1) Multiple noncompliant features. If a plan's interest crediting rate has more than one noncompliant feature, then each noncompliant feature must be addressed separately, in the manner specified in c. below. See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(B)(*1*).

b.2) Amendments that provide for greater interest crediting rate. If a noncompliant rate is amended to a compliant rate, in accordance with the rules described in c. below, and then is subsequently amended to switch to a second compliant rate that can never be less than the first compliant rate, the second amendment does not violate the anti-cutback rule under IRC §411(d)(6). The same result applies if, within a single amendment, the plan switches from the noncompliant rate to the second compliant rate, IRC §411(d)(6) is not violated. See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(B)(*4*). This facilitates, for example, the adoption of the third segment rate to replace a noncompliant rate, as shown in the example in b.2)a) below.

b.2)b) Example. Suppose, under the permissible amendment rules described in c. below, a noncompliant rate can be amended to provide for an interest crediting rate that is the lesser of the noncompliant rate or a third segment rate described in Treas. Reg. §1.411(b)(5)-1(d)(3). It would then be permissible to later amend that rate to simply be the third segment rate, because it could never be less than the rate under the original amendment. Since such a multiple amendment is permissible, it also would be permissible to simply amend the noncompliant rate to the third segment rate, without the need for two amendments. In the preamble to the 2015 regulations (80 F.R. 70682), the Treasury notes that the amendment to the third segment rate also could be coupled with a permissible fixed minimum annual rate.

b.3) Noncompliant cumulative floors. This rule applies if: (1) the plan applies a cumulative floor (i.e., a minimum rate of return that is applied less frequently than annually), and that floor doesn't comply with the requirements of Treas. Reg. §1.411(b)(5)-1(d)(6), or (2) the plan determines a participant's benefit as of the annuity starting date based on the greatest of two or more account balances (e.g., to comply with IRC §411(d)(6) in connection with a prior amendment to change the plan's interest crediting rate), and the "greatest of" formula doesn't comply with the requirements of Treas. Reg. §1.411(b)(5)-1(d)(6). In such case, the plan must be amended to provide that the benefit for the participant is based solely on the benefit (and the associated interest crediting rate with respect to that benefit) that is greatest for that participant as of the applicable amendment date to bring the interest crediting rate into compliance, and then, if that remaining interest crediting rate is not a compliant interest rate, that remaining interest crediting rate must be brought into compliance in accordance with the rules described in c. below. See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(B)(*5*). Also see the example in d.10) below.

b.4) Plans that permit participant-directed interest crediting rates. Although the 2014 regulations did not expressly outlaw plans that allow participants to choose from a menu of interest crediting rates, it only promised to protect plans that contained such a design as of September 18, 2014, when those regulations were published. The regulations adopted on November 16, 2015, provide special rules for amendments adopted by these plans into compliance in the event that any of the menu options available to participants is a noncompliant interest rate. One option is to apply the rules described in c. below separately to each noncompliant crediting rate option that is available to participants. Alternatively, the entire investment menu may be treated as a single noncompliant investment-based rate for which there is no permitted investment-based rate with similar risk and return characteristics (i.e., the rule described in c.7) below does not apply). Plans that choose this alternative approach may be amended to eliminate a participant's ability to choose an interest crediting rate from among a menu of hypothetical investment options in accordance with the rule described in c.9) below.

c. Categories of noncompliant features and how to correct without violating IRC §411(d)(6). Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(C) identifies specific features that make an interest rate noncompliant, and then prescribes what type of amendment is eligible for anti-cutback relief if it is adopted by the end of the 2016 plan year and effective no later than the first day of the 2017 plan year. The 2015 regulations generally follow the approach taken in the 2014 proposal, but make some changes to increase flexibility in the corrective amendment options available. In particular, there are more options that allow for the adoption of a third segment rate that complies with Treas. Reg. §1.411(b)(5)-1(d)(3).

c.1) Noncompliant timing rule. If the plan has an otherwise compliant interest rate, but doesn't satisfy the timing rules for how interest credits are determined and credited, as described in Treas. Reg. §1.411(b)(5)-1(d)(iv) (e.g., frequency of interest credits, permissible lookback month or stability period), the plan must be amended one of two ways: (1) to correct the aspect of the plan's interest crediting rate that fails to comply with such rules, or (2) if the plan's interest rate is a variable rate that is not an investment-based rate, to amend the plan to adopt a third segment rate option permitted under Treas. Reg. §1.411(b)(5)-1(d)(3) that also meets the timing rules under §1.411(b)(5)-1(d)(1)(iv). See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(C)(*1*).

c.2) Fixed rate in excess of 6%. If the plan uses a fixed rate that exceeds the 6% permitted in Treas. Reg. §1.411(b)(5)-1(d)(4)(v), the plan must be amended to reduce the interest crediting rate to an annual rate of 6%. See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(C)(*2*).

c.3) Permissible bond-based rate with margin exceeding maximum permitted margin. If the plan uses a permissible bond-based rate described in Treas. Reg. §1.411(b)(5)-1(d)(3) or (d)(4), except that it applies a margin that exceeds the maximum permitted margin under those rules, then the plan must be amended to either: (1) reduce the margin to the maximum permitted margin under the applicable regulatory rule, or (2) use a rate that is the lesser of the noncompliant rate or a permissible third segment rate. The rate in (1) or (2), whichever is used, must also include any fixed minimum rate (i.e., annual or more frequent floor) that was part of the noncompliant rate, reduced to the extent necessary to meet the minimum rate requirements in Treas. Reg. §1.411(b)(5)-1(d)(6)(ii). See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(C)(*3*).

c.4) Permissible bond-based rate with an impermissible floor rate. If the plan uses a permissible bond-based rate described in Treas. Reg. §1.411(b)(5)-1(d)(3) or (d)(4) in combination with an impermissible fixed minimum rate (i.e., a floor rate that exceeds the permissible rate), then the plan must be amended in one of the following manners: (1) to reduce the fixed minimum rate to the highest permitted fixed minimum rate that is permissible for that type of bond-based rate, (2) to credit interest using a fixed annual interest crediting rate of 6% (which is the maximum fixed rate permitted), or (3) use a rate that is the lesser of the noncompliant rate or a permissible third segment rate (together with a fixed minimum rate of 4%). See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(C)(*4*).

c.5) Greater of two or more variable bond-based rates. Normally, a bond-based rate described in Treas. Reg. §1.411(b)(5)-1(d)(3) or (d)(4) must be used as a single interest crediting rate, subject to the exceptions for the preservation of principal rule, an annual or more frequent floor, a cumulative floor rate, actuarial increases after normal retirement age, or to comply with the IRC §411(d)(6) rules. See Treas. Reg. §1.411(b)(5)-1(d)(6)(i). Thus, if a plan credits interest using a composite rate that is the greatest of two or more permissible bond-based rates described in §1.411(b)(5)-1(d)(3) or (d)(4), the formula is noncompliant because of the use of the composite rate. In such case, the plan must be amended to credit interest using the lesser of: (1) the impermissible composite rate that was being used by the plan, or (2) a permissible third segment rate described in Treas. Reg. §1.411(b)(5)-1(d)(3). See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(C)(*5*).

c.6) Impermissible bond-based rate. If the plan uses a bond-based rate that is not permissible under Treas. Reg. §1.411(b)(5)-1(d)(3) or (d)(4), but the options described in c.1) through c.5) are not applicable, and the rate is not an investment rate described in c.7)a) below, then the plan must be amended either: (1) to provide for a permissible bond-based rate described in §1.411(b)(5)-1(d)(3) or (d)(4) that has similar duration and quality characteristics as the plan's impermissible rate, if such a rate can be selected, or (2) to provide for an interest crediting rate that is the lesser of the plan's impermissible bond-based rate or a third segment rate that satisfies Treas. Reg. §1.411(b)(5)-1(d)(3). See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(C)(*6*).

c.7) Impermissible investment-based rate. If the plan uses an investment-based rate (as defined in c.7)a) below) that does not meet the requirements of Treas. Reg. §1.411(b)(5)-1(d)(5), and a permissible investment-based rate described in §1.411(b)(5)-1(d)(5)(ii)(A) (rate of return on entire plan assets), (d)(5)(ii)(B) (rate of return on specified subset of plan assets), or (d)(5)(iv) (rate of return on a specified RIC) has similar duration and quality characteristics as the plan's impermissible rate, the plan must be amended to use such rate. See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(C)(*7*).

c.7)a) Definition of investment-based rate. For purposes of applying the rule in c.7) above, an investment-based rate is either: (1) a rate of return provided by actual investments (taking into account the return attributable to any change in the value of the underlying investments), or (2) a rate that is based on the rate of return for an index that measures the change in the value of investments. See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(B)(*2*). A rate is an investment-based rate even if it based only in part on a rate described in (1) or (2).

c.8) Investment-based rate with minimum fixed rate or bond-based rate. If the plan has an investment-based rate that would otherwise be permissible under Treas. Reg. §1.411(b)(5)-1(d)(5), except that it uses an annual or more frequent floor that is either a fixed rate or a bond-based rate, the plan must be amended either: (1) to use the investment-based rate without the minimum rate, and eliminate any reduction (or other adjustment) to the investment-based rate, or (2) to use a permissible third segment rate permitted under Treas. Reg. §1.411(b)(5)-1(d)(3) together with any fixed minimum rate that applied prior to the amendment (reduced to the extent necessary to comply with Treas. Reg. §1.411(b)(5)-1(d)(6)(ii). See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(C)(*8*). This rule was added by the November 16, 2015, regulations.

c.9) Other impermissible investment-based rates. If an impermissible investment-based rate cannot be fixed after application of c.1), c.7) or c.8) above, the plan must be amended either: (1) to credit interest using one of the permissible investment-based rates under Treas. Reg. §1.411(b)(5)-1(d)(5) and that is otherwise similar to the plan's impermissible rate, but without the risk and return characteristics that caused the rate to be impermissible (generally requiring the use of a rate that is less volatile than the plan's impermissible rate but is otherwise similar to that rate), or (2) use a permissible third segment rate described in Treas. Reg. §1.411(b)(5)-1(d)(3), but with a fixed minimum rate of 4%. See Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(C)(*9*). This rule was added by the November 16, 2015, regulations.

d. Examples. Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(D) offers eleven examples to illustrate this anti-cutback relief rule.

d.1) Example - impermissible timing rule for determining interest crediting rate. A plan determines interest credits for a plan year using the average yield on 30-year Treasury Constant Maturities for the last week of the preceding plan year (which is an impermissible lookback period because it is not a month). Either of the following corrective amendments of the interest crediting rate will comply: (1) determine interest credits for a plan year using the average yield on 30-year Treasury Constant Maturities for a period that complies with the crediting requirements under Treas. Reg. §1.411(b)(5)-1(d)(1)(iv)(B), or (2) cap the existing rate so that it cannot exceed a third segment rate described in Treas. Reg. §1.411(b)(5)-1(d)(3) for a period that complies with the crediting requirements of Treas. Reg. §1.411(b)(5)-1(d)(1)(iv)(B). See Example 1 of Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(D).

d.2) Example - impermissible timing rule and impermissible margin on bond-based rate. Same facts as in the example in f.4.d)i) above, except that the plan's interest crediting rate is determined as the average yield on 30-year Treasury Constant Maturities for the period, plus 50 basis points. Now there are two impermissible elements of the plan's interest crediting rate - an impermissible lookback period and an impermissible bond-based rate (the regulations permit only a zero basis points margin on a rate based on 30-year Treasury Constant Maturities). Either of the following amendment approaches will work: (1) use the average yield on 30-year Treasury Constant Maturities (with no margin) for a period that complies with the crediting requirements of Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(D), or (2) cap the existing rate so that it cannot exceed a third segment rate described in Treas. Reg. §1.411(b)(5)-1(d)(3) for a period that complies with the crediting requirements of Treas. Reg. §1.411(b)(5)-1(d)(1)(iv)(B). See Example 2 of Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(D).

d.3) Impermissible timing rule for investment-based return. A plan credits interest for a plan year using the rate of return on plan assets for the preceding plan year. Under Treas. Reg. §1.411(b)(5)-1(d)(5), a return based on the investment performance of the plan assets must be referenced to the current year's return. An amendment must be adopted to reference to the current plan year's return on plan assets. See Example 3 of Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(D).

d.4) Impermissible annual floor. A plan's interest crediting rate is the greater of the average yield on 30-year Treasury Constant Maturities or 5.5%. Any of the following three approaches may be taken by a timely plan amendment: (1) to retain the 30-year Treasury Constant Maturities as the bond-based rate, but lower the annual floor to 5%, as required under Treas. Reg. §1.411(b)(5)-1(d)(6)(ii)(B), (2) to adopt a fixed interest rate of 6%, or (3) cap the existing rate so that it cannot exceed a third segment rate described in Treas. Reg. §1.411(b)(5)-1(d)(3) within a minimum 4% annual floor on the entire resulting rate. See Example 4 of Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(D). This example illustrates the rule discussed in c.4) above.

d.5) Impermissible composite rate. A plan credits interest using the greater of the unadjusted yield on 30-year Treasury Constant Maturities and the yield on 1-year Treasury Constant Maturities plus 100 basis points. Although each bond-based rate, standing alone, would be permissible, this type of "greater of" formula is not permissible under Treas. Reg. §1.411(b)(5)-1(d)(6). See c.5) above. An amendment must be adopted to cap the existing noncompliant composite rate so that it doesn't exceed a third segment rate that meets the requirements of Treas. Reg. §1.411(b)(5)-1(d)(3). See Example 5 of Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(D).

d.6) Impermissible bond-based rate referencing to long-term investment-grade bonds. A plan credits interest using a broad-based index that measures the yield to maturity on a group of intermediate-term investment grade bonds. This is not a permissible bond-based rate under the 2014 regulations. Either of the following two amendment approaches is permissible: (1) change the rate to a second segment rate that is permissible under Treas. Reg. §1.411(b)(5)-1(d)(4)(iv), or (2) cap the existing rate so that it will not exceed a third segment rate described in Treas. Reg. §1.411(b)(5)-1(d)(3). See Example 6 of Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(D).

d.7) Impermissible bond-based rate referencing to non-investment-grade bonds. A plan credits interest using a broad-based index that measures the yield to maturity on a group of short-term non-investment-grade bonds. This is not a permissible bond-based rate under the 2014 regulations. Since the index being used is based on the yield of non-investment-grade bonds, the rule in c.6) above requires that the plan be amended to cap the existing rate so that it cannot exceed a third segment rate described in Treas. Reg. §1.411(b)(5)-1(d)(3). See Example 7 of Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(D).

d.8) Impermissible investment-based index. A plan credits interest using the rate of return for the S&P 500. Since this index measures the return on investments, it is treated as an investment-based return for purposes of the anti-cutback relief rule (see c.7)a) above), so the rule in c.7) above applies. To bring the plan into compliance it is amended to change the interest crediting rate to the rate of return on a RIC that is designed to track the rate of return on the S&P 500 index. This amendment satisfies the requirements for anti-cutback relief. See Example 8 of Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(D).

d.9) Example - use of an outside collective trust return. A plan credits interest based on a collective trust that holds a balanced portfolio of equity and fixed income investments, which provides a rate of return that is reasonably expected to be not significantly more volatile than the broad U.S. equities market or a similarly broad international equities market. The regulations only permit the return on an outside investment to be used if the referenced hypothetical investment is a RIC, which the collective trust is not. To bring the plan into compliance with the market rate of return rules, the plan sponsor amends the plan to credit interest based on the actual rate of return on the assets within a specified subset of the plan's assets that is actually invested in the collective trust, which would meet the requirements of Treas. Reg. §1.411(b)(5)-1(d)(5)(ii)(B). The amendment satisfies the conditions discussed in c.7) above. See Example 9 of Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(D).

d.10) Example - noncompliant RIC. A plan credits interest for a plan year using the rate of return on a RIC that has most of its investments concentrated in the semiconductor industry. As discussed in c.9) above, the plan must be amended in one of two manners: (1) provide for an interest crediting rate that is a compliant investment-based rate that is described in Treas. Reg. §1.411(b)(5)-1(d)(5) and that is similar to the plan's impermissible investment-based rate, except to the extent that the risk and return characteristics of the impermissible investment-based rate caused it to be impermissible, or (2) provide that the plan's interest crediting rate is a third segment rate described in Treas. Reg. §1.411(b)(5)-1(d)(3) with a fixed minimum rate of 4%. Option (1) would allow, for example, an amendment to provide for an interest crediting rate based on the rate of return on a RIC that is invested in a broader sector of the market than the semiconductor industry (e.g., the overall technology sector of the market), provided that the sector in which the RIC is invested is broad enough that the volatility requirements of Treas. Reg. §1.411(b)(5)-1(d)(5)(iv) are satisfied. See Example 10 of Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)(E).

d.11) Example - noncompliant cumulative floor. A plan was amended in 2014 to change its interest crediting rate for all interest crediting periods after the applicable amendment date of the amendment. The amendment changed the rate from the yield on 30-year Treasury Constant Maturities to the rate of return on aggregate plan assets under Treas. Reg. §1.411(b)(5)-1(d)(5)(ii)(A). The amendment also provided for IRC §411(d)(6) protection with respect to the account balance as of the applicable amendment date, by providing that the account balance after the applicable amendment date will never be smaller than the account balance as of the applicable amendment date credited with interest using the yield on 30-year Treasury Constant Maturities. This created a "greater of" formula described in b.2) above. A timely amendment of the interest crediting rate is only required for participants who were not benefiting at the time of the applicable amendment.

✪ *Participants benefiting as of the applicable amendment date.* With respect to those participants who were benefiting under the plan as of the applicable amendment date of the 2014 amendment, the requirements of Treas. Reg. §1.411(b)(5)-1(e)(3)(iii), which provides a special market rate of return rule to permit certain changes in rates for participants benefiting under the plan, are satisfied. Accordingly, no amendment is required to bring the interest crediting rate applicable to such participant into compliance.

✪ *Participants not benefiting as of the applicable amendment date.* For participants who were <u>not</u> benefiting as of the applicable amendment date of the 2014 amendment, the requirements of Treas. Reg. §1.411(b)(5)-1(e)(3)(iii) are not satisfied and, accordingly, the ''greater-of'' rate resulting from the IRC §411(d)(6) protection does not satisfy the requirements of Treas. Reg. §1.411(b)(5)-1(d)(6) regarding floor rates. As a result, pursuant to the rule discussed in b.3) above, it must be determined on a participant-by-participant basis which account balance provides the greater benefit as of the applicable amendment date for the transitional amendment (i.e., the amendment needed to bring the interest crediting rate into compliance the 2014 regulations, pursuant to Treas. Reg. §1.411(b)(5)-1(e)(3)(vi)). If, as of the applicable amendment date for the transitional amendment, the account balance credited with interest after the change in rates using the yield on 30-year Treasury Constant Maturities is greater, then the plan must be amended to provide that the participant's benefit is based solely on that account balance credited with interest using the yield on 30-year Treasury Constant Maturities. On the other hand, if, as of the applicable amendment date for the transitional amendment, the account balance using the rate of return on aggregate plan assets is greater, then the plan must be amended to provide that the participant's benefit is based solely on that account balance credited with interest at the rate of return on aggregate plan assets. In this example, the two rates used in the "greater of" formula were otherwise permissible rates. If the account balance that is greater as of the transitional amendment date had been based on an impermissible rate, an additional amendment would have been necessary to bring that impermissible rate into compliance, using the applicable rule described in c. above.

¶3. <u>Rounded interest crediting rates</u>. Treas. Reg. §1.411(b)(5)-1(d)(1)(iv)(E), as added by the November 16, 2015, regulations, permits a variable interest-crediting rate, including an investment-based rate, to be subject to a rounding rule. An annual rate may be rounded to the nearest <u>25 basis points</u> (or a smaller rounding interval), as provided by the plan. If interest is credited more frequently than annually, then the rounding interval must not exceed a pro rata portion of the 25 basis points. For example, a plan that credits quarterly could round to the nearest 6 basis points (i.e., 6 doesn't exceed 6.25, which would be the quarterly proration of 25 basis points). In addition, a plan is permitted to round to the nearest basis point, regardless of the frequency of interest crediting.

¶4. <u>Anti-cutback relief for amendments to comply with plan termination crediting rules</u>. A plan amendment adopted before the end of the 2016 plan year (or the end of the year preceding the plan year in which the 2014 regulations are applicable, in the case of a collectively-bargained plan) is not treated as violating IRC §411(d)(6) merely because the amendment changes the rules that apply upon plan termination, in order to satisfy the requirements of Treas. Reg. §1.411(b)(5)-1(e)(2).

Title IV of ERISA - Coverage/Premiums

Proposed regulations would cut penalties in half for late payment of premiums; substantially reduce penalty for plans with good premium compliance record that correct promptly upon notification by PBGC [Citation: *Prop. PBGC Reg. §4007.8*, 81 F.R. 25363-25366 (April 28, 2016)]
Text available at http://1.usa.gov/1TgahR5

PBGC Reg. §4007.8 imposes penalties for late payment of premiums. The general late payment penalty is 5% per month (calculated on the unpaid premium payment), with a floor of $25 and a ceiling of 100% of the premium due. However, the penalty is reduced from 5% per month to 1% per month if paid before PBGC notification (e.g., a premium bill, a letter initiating a premium compliance review, a notice of a filing error in a premium determination, or a letter questioning a failure to make a premium filing). See PBGC §4007.8 (a)(1). To encourage voluntary correction of late premium payments, a late payment that is made on a voluntary basis (i.e., where the 1% per month penalty rate applies), the penalty is capped at 50% (rather than 100%) of the unpaid premium effective April 10, 2014. See PBGC Reg. §4007.8(a)(1). A voluntary payment for this purpose means a payment that is made before the PBGC issues a written notice to any person liable for the premium that there is or may be a premium delinquency (e.g., a premium bill, a letter initiating a premium compliance review, a notice of filing error in premium determination, or a letter questioning a failure to make a premium filing).

* **Proposed reduction of penalties.** The PBGC is proposing to cut the above penalties in half. Thus, the general penalty would be 2½% per month (rather than 5%) with a ceiling of 50% (rather than 100%), and the reduced penalty for voluntary compliance would be ½% per month (rather than 1%) with a ceiling of 25% (rather than 50%). See Prop. PBGC Reg. §4007.8(a). In addition, the $25 floor on the general penalty would be eliminated. The PBGC is proposing this change because it has determined that lower penalties will encourage compliance. This change would apply to late premium payments for post-2015 plan years.

* **80% waiver of penalty for certain prompt corrections following PBGC notice.** The reduced penalty for voluntary compliance is generally available only if the late payment is corrected voluntarily, which requires payment before notification from the PBGC. However, the PBGC has determined that a plan's compliance history may warrant a reduced penalty if the late premium is paid promptly upon PBGC notification. Prop. PBGC Reg. §4007.8(h) would reduce the late penalty by 80% (i.e., the general penalty would be reduced to the level of the reduced penalty for voluntary compliance) if: (1) the plan has a five-year record of premium compliance, and (2) the premium shortfall is made good within 30 days after the PBGC notifies the plan in writing that there was or might be a problem with premiums. The 80% waiver rule would apply to late premium payments for post-2015 plan years.

> ✪ *5-year compliance history.* To satisfy condition (1) of the 80% waiver rule, the plan would have to show that the required premium filing was made for each plan year within the last five plan years preceding the plan year for which the late premium penalty is being determined. See Prop. PBGC Reg. §4007.8(h)(1). If the PBGC has required payment of a penalty for any of such prior years, the plan would not be eligible for the 80% waiver. A plan would meet this condition for a year for which a penalty could have been assessed as long as the PBGC did not ultimately require a penalty to be paid (e.g., PBGC granted a waiver for reasonable cause). If the plan has been covered under Title IV for a period that is

less than the last five plan years, then the compliance record would be examined for the entire lesser period of coverage.

PBGC Reporting Rules: Reportable Events (ERISA §4043)

Regulations revise reportable event rules to create a low-default-risk safe harbor for financially-sound companies, a revised well-funded plan waiver, a public company waiver, a revised small plan waiver, and other revisions to the reporting and waiver rules, including mandatory electronic filing requirement for required notices [Citation: *PBGC Reg. §§4000.3(b)(3), 4043.1-4043.10, 4043.20-4043.35, 4043.61-4043.68, 4043.81*, 80 F.R. 549080-55010 (September 11, 2015)]
Text available at http://1.usa.gov/1gRRcZh

The PBGC has finalized the proposal it published April 3, 2013, to revise the reportable event regulations issued under ERISA §4043. The final regulations amend the PBGC's reportable events regulations to: (1) make the advance reporting threshold test consistent with the PPA 2006 funding rules and PBGC's new variable rate premium rules, (2) waive reporting for most events currently covered by funding-based waivers if a plan or its sponsor comes within a low-default-risk safe harbor based on widely available measures already used in business (a modified version of a financial soundness safe harbor proposed in 2013) or if the plan satisfies a well-funded plan safe harbor, (3) expand the availability of small plan waivers, (4) reduce reporting of active participant reductions, (5) clarify the provisions dealing with missed contributions and preserve a waiver for missed quarterly contributions for small plan sponsors, (6) simplify the reporting for failure to pay benefits when due, (7) simplify the reporting threshold for distributions to substantial owners, (8) clarify the reporting event for controlled group changes, (9) simplify the definition of extraordinary dividends, (10) clarify the benefit liability transfer event, (11) expand the reporting of loan defaults, (12) limit the reporting of bankruptcy and insolvency to exclude bankruptcies under the U.S. Bankruptcy Code, (13) preserve all post-event foreign-entity reporting waivers in the old regulations, (14) retain all post-event reporting waivers for *de minimis* transactions and add two additional *de minimis* waivers, as well as simplifying the definition of a *de minimis* transaction, (15) remove from the regulations the lists of information items to be submitted (which will be handled by the filing instructions for the applicable forms), (16) eliminate most advance notice reporting extensions for loan defaults and insolvency events, and (17) require filers to use PBGC forms to file reportable events notices and to file those forms electronically. The PBGC estimates that, under these revised regulations, 94% of PBGC-covered plans (as compared to 89% under the old regulations) will qualify for at least one waiver of reporting for events dealing with active participant reductions, controlled group changes, extraordinary dividends, benefit liability transfers, and substantial owner distributions (which PBGC identifies as Category 1 events). According to the PBGC, on average only 4% of plans in a given year experience a reportable event that must be reported (i.e., a waiver is not available), and even fewer are required to report Category 1 events.

* **Applicability date.** The revised regulations are applicable to post-event reports for reportable events occurring on or after January 1, 2016, and to advance reports due on or after that date.

* **Structure of regulations.** The reportable event reporting rules are found in Part 4043 of Title 29 of the Code of Federal Regulations. Subpart A (§§4043.1 - 4043.10) provides definitions and prescribes certain procedural rules, Subpart B (§§4043.20-4043.35) prescribes the post-event notice requirements, Subpart C (§§4043.61-4043.68) prescribes advance notice requirements, and subpart D prescribes the notice of failure

to make certain required contributions (PBGC Form 200). The new regulations do not make changes to the Form 200 filing requirements, so this summary focuses on the other subparts of these regulations.

¶l. Notice requirements. The timing of the post-event and advance notices are addressed in PBGC Reg. §4043.20 (for post-event notices) and §4043.61 (for advance notice). PBGC Reg. §4043.3 prescribes additional guidance relating to the notice requirements, which is discussed below. Failure to meet reportable event notice requirements is subject to penalties under ERISA §4071. See PBGC Reg. §4043.3(e).

a. Due date of post-event notice. A post-event notice requirement applies to the plan administrator *and* each contributing sponsor[11] of a plan for which a reportable event occurs. The deadline is generally 30 days after the person responsible for the notice knows or has reason to know that the event has occurred, unless a waiver or extension applies. See PBGC Reg. §4043.20. If there is a change in the plan administrator or contributing sponsor, the responsibility for any failure to file or defective filing lies with the person who is the plan administrator or contributing sponsor on the 30th day after the reportable event occurs.

b. Due date of advance notice. An advance notice is the responsibility of each contributing sponsor of a plan that is subject to the advance reporting requirement (see criteria below). Normally, the advance notice is due no later than 30 days before the effective date of the reportable event, unless an extension applies. See PBGC Reg. §4043.61(a). If there is a change in the contributing sponsor, the responsibility for any failure to file or defective filing lies with the person who is the contributing sponsor on the notice date. In some cases, an event is subject to both advance reporting and post-event reporting. In such case, the filing on the earliest due date of the two notices satisfies the filing obligation for both notices. See PBGC Reg. §4043.3(a)(1). In most cases, the advance notice deadline will come first, but there are limited circumstances where the post-event notice may be due earlier than the advance notice.

c. Multiple plans with reportable event reporting obligations. If a reportable event occurs for more than one plan, the filing obligation for each plan is independent of the filing obligation for any other plan. See PBGC Reg. §4043.3(a)(2).

d. Optional consolidated filing. A filing of a notice with respect to a reportable event by any person required to file is deemed to be a filing by all persons required to give notice to the PBGC. See PBGC Reg. §4043.3(a)(3). For example, if a plan administrator files a required post-event notice, that filing also covers the obligation of any contributing sponsor to file such notice. A single filing also may be made with respect to more than one event that is required to be reported with respect to the same plan. These consolidation rules were not changed by the new regulations.

e. Mandatory use of PBGC forms. With a view toward greater uniformity in reporting, the regulations require the use of the PBGC-issued forms for reportable events. See PBGC Reg. §4043.3(c). The current forms are Form 10 for post-event reporting, Form 10-Advance for advance reporting, and

[11] A "contributing sponsor" is defined in ERISA §4001(a)(16) and PBGC Reg. §4001.2 as a person described in ERISA §302(b)(1) (without regard to §302(b)(2)) or IRC §412(b)(1) (without regard to §412(b)(2)). [ERISA §302(b)(2) and IRC §412(b)(2) impose joint and several liability for funding on members of the employer's controlled group. So, by disregarding those sections, a controlled member would not be a contributing sponsor solely because it might have joint and several liability for contributions pursuant to ERISA §302(b)(2) or IRC §412(b)(2).]

Form 200 for reporting an unpaid funding balance in excess of $1 million. The old regulations made the use of the forms (other than Form 200) optional. Forms and instructions will be made available at the PBGC website (www.pbgc.gov). See PBGC Reg. §4043.3(c). In addition, the listing of the content requirements for each of the forms has been eliminated from the regulations and provided solely in the instructions to the forms. See PBGC Reg. §4043.3(b). This will enable the PBGC to respond more quickly to changes needed in the information provided.

f. Mandatory electronic filing. PBGC Reg. §4043.5, as revised, mandates electronic filing of reportable event notices in accordance with the instructions posted at the PBGC website (http://www.pbgc.gov). Filing guidance is provided by the instructions and by subpart A of 29 C.F.R. Part 4000. Under the old regulations, the PBGC treated a reportable event filing as timely if certain basic information was submitted on time electronically and followed within 1 or 2 business days with the remaining required information. This was known as partial electronic filing. With the mandatory electronic filing rule, this partial electronic filing is no longer necessary and has been deleted from the regulations.

g. Date of filing/computation of time. The rules under subpart C of 29 CFR Part 4000 apply to determine when a reportable event notice is treated as filed. See PBGC Reg. §4043.6. Note that advance reporting and Form 200 filings are treated as filed on the date received by the PBGC, as determined under subpart C of 29 C.F.R. Part 4000. Also, the rules in subpart D of 29 C.F.R. Part 4000 apply to compute any time period relevant to reportable event notice obligations. See PBGC Reg. §4043.7.

h. Confidentiality. Pursuant to ERISA §4043(f), any information or documentary material that is not publicly available and is submitted to PBGC pursuant to the post-event or advance reporting requirements will not be made public, except as may be relevant to any administrative or judicial action or proceeding or for disclosures to either body of Congress or to any duly authorized committee or subcommittee of the Congress. See PBGC Reg. §4043.8. This confidentiality rule does not apply to information or material submitted to PBGC in Form 200, relating to notice of a failure to make required contributions in excess of $1 million, even where the submission of Form 200 serves as an alternative method of compliance with PBGC Reg. §4043.25 (discussed in ¶4.b. below).

¶2. Waivers and extensions. PBGC Reg. §4043.4 gives the PBGC the authority to grant waivers or extensions on a case by case basis. The old regulations provided automatic waivers and extensions for most reportable events. The revised regulations eliminate some waivers and extensions, and simplify or extend others.

a. Retention of automatic waivers for certain events. The revised regulations retain the complete notice waivers for the following events: (1) PBGC Reg. §4043.21 (tax disqualification of the plan or determination by the DOL that the plan does not comply with Title I of ERISA), (2) PBGC Reg. §4043.22 (amendment decreasing benefits payable), (3) PBGC Reg. §4043.24 (termination or partial termination of a plan), and (4) PBGC Reg. §4043.28 (merger, consolidation, or transfer of assets under ERISA §208 or IRC §414(l))) (although notice may be required in connection with a controlled group change under PBGC Reg. §4043.29 or a transfer of benefit liabilities under PBGC Reg. §4043.32). For these events that have automatic waivers, no additional criteria need be satisfied in order to have a filing waiver.

b. Small Plan Waiver. For purposes of the reportable event regulations, a small plan is a plan with 100 or fewer participants for whom flat-rate premiums were payable for the plan year preceding the event year. A Small Plan Waiver from the notice requirement is granted for some of the reportable events. See ¶4. below for the post-reporting events for which the Small Plan Waiver applies. Where a Small Plan Waiver is not provided, a small plan is subject to such reporting requirement (as well as any conditions for a particular waiver from that reporting requirement) in the same manner as any other plan. Note that the 2013 proposal had used a fewer than 100 participant standard, but the revised regulations changed that to 100 or fewer to be consistent with the PBGC's premium payment regulations.

c. Public Company Waiver. The term "public company," when used in the reportable event regulations, means: (1) a person subject to the reporting requirements of section 13 or 15(d) of the Securities Exchange Act of 1934, or (2) a subsidiary (as defined for purposes of the Securities Exchange Act of 1934) of a person subject to such reporting requirements. See PBGC Reg. §4043.2. For certain reportable events, a Public Company Waiver from the notice requirement is provided if a public company is a contributing sponsor and the contributing sponsor timely files a SEC Form 8-K disclosing the event under an item of the Form 8-K other than under Item 2.02 (Results of Operations and Financial Condition) or in financial statements under Item 9.01 (Financial Statements and Exhibits). See ¶4. below for the post-reporting events for which the Public Company Waiver applies.

d. Foreign Entity Waiver. For certain reportable events described in ¶4., a waiver from the notice requirements is provided with respect to a Foreign Entity, other than a Foreign Parent. A foreign entity, as defined in PBGC Reg. §4043.2, is an entity that is not a contributing sponsor of the plan, is not organized under the laws of any state, and meets one of the following three tests: (1) does not file a U.S. tax return, (2) does not have income reportable on a U.S. federal income tax return other than passive income not exceeding $1,000, or (3) does not own substantial assets in the U.S. (disregarding stock of a member of the plan's controlled group) and is not required to file any quarterly U.S. tax returns for employee withholding. A Foreign Parent means a Foreign Entity that is a direct or indirect parent of a person that is a contributing sponsor of a plan.

e. Multiemployer plans. The requirements of ERISA §4043 are waived in their entirety with respect to multiemployer plans. See PBGC Reg. §4043.4(c).

f. Terminated plans. No notice under ERISA §4043 is required if the notice date is on or after the date on which: (1) all of the plan's assets (other than any excess assets) are distributed pursuant to a termination under ERISA §4041, or (2) a trustee is appointed for the plan under ERISA §4042. See PBGC Reg. §4043.4(d).

g. Reporting of event must be required by regulation. ERISA §4043(c) specifies reportable events and then gives the PBGC the authority to identify other reportable events. To avoid any confusion, PBGC Reg. §4043.4(e) provides that, unless the regulations require reporting of any event listed in ERISA §4043(c), notice of a reportable event is waived.

¶3. New safe harbors for certain waivers. Under the old regulations, several reporting waivers were contingent on the plan meeting certain funding criteria. The revised regulations simplify the funding criteria at the plan level (Well-Funded Plan Safe Harbor - see b. below) and add an alternative safe harbor that is based on the financial soundness of the plan sponsor (Company Low-Default-Risk Safe Harbor). The PBGC believes these changes will focus on the plans most in trouble since distress terminations under Title IV are confined to situations where the plan sponsors are in bankruptcy or severe financial straits. The discussion on the individual post-reporting events in ¶4. below identifies the events for which reporting is waived if the Company Low-Default-Risk Safe Harbor or the Well-Funded Plan Safe Harbor is met.

a. Company Low-Default-Risk Safe Harbor. A company meets the Company Low-Default-Risk Safe Harbor on the date of an event if that date falls within a safe harbor period of the company, which is defined as a period that: (1) begins on a financial information date (see a.(1) below) on which the company satisfies the low-default-risk standard (see a.(2) below), and (2) ends 13 months later (or, if earlier, on the company's next financial information date). See PBGC Reg. §4043.9(a) and (b). The 13-month rule gives companies some flexibility regarding the annual date for collecting information to demonstrate satisfaction with the Low-Default-Risk Safe Harbor. Where a reporting waiver is provided for the Company Low-Default-Risk Safe Harbor, the low-default-risk standards must be satisfied by: (1) each contributing sponsor to the plan and, (2) if a contributing sponsor is part of a controlled group, the highest level U.S. parent of such contributing sponsor.

a.(1) Financial information date. The financial information date for a company is whichever of the following applies.

(a) The date on which the company files on Form 10-K with the SEC audited annual financial statements (including balance sheets, income statements, cash flow statements, and notes to the financial statements) for the company's most recent completed fiscal year preceding the date of such filing.

(b) If (a) doesn't apply, the ''closing date'' on which the company closes the annual accounting period that results in the production of audited or unaudited annual financial statements for the company's most recent completed fiscal year preceding the closing date, if audited annual financial statements are not required to be filed with the SEC.

(c) If (a) or (b) doesn't apply, the date on which the company files with IRS an annual federal income tax return or IRS Form 990 (in either case, a ''return'') for the company's most recent completed fiscal year preceding the date of such filing. See PBGC Reg. §4043.9(c).

Any reference below to "supporting financial information" is to the annual financial statements referred to in (a) and (b) above, or the return referred to in (c) above, associated with the establishment of the qualifying financial information date. See PBGC. Reg. §4043.9(d).

a.(2) Low-default-risk standard. A company meets this date as of a financial information date (the "qualifying date") if the company has adequate capacity to meet its obligations in full and on time on the qualifying date. This is evidenced by satisfying either: (1) both of the criteria described in a.(2)(i) and a.(2)(ii) below, or (2) any four of the seven criteria described in a.(2)(i) through a.(2)(vii). See PBGC. Reg. §4043.9(e)(1). The supporting financial information, as described in a.(1) above, associated with the qualifying date, must be used to evaluate whether the criteria in a.(2)(ii) through a.(2)(v) are satisfied. See PBGC Reg. §4043.9(e)(3)(i). If a company receives an audit or review report for the supporting financial information associated with a financial information date that expresses a material adverse view or qualification, the company does not satisfy the low-default-risk standard with respect to such date. See PBGC Reg. §4043.9(e)(4).

a.(2)(i) Probability of default test. The probability that the company will default on its financial obligations is not more than 4% over the next five years or not more than 0.4% over the next year, in either case determined on the basis of widely available financial information on the company's credit quality. See PBGC Reg. §4043.9(e)(2)(i). This replaced the "creditworthiness" test that had been proposed in 2013.

a.(2)(ii) Debt test. The company's secured debt, disregarding leases and debt incurred to acquire or improve property and secured only by that property, does not exceed 10% of the company's total assets. See PBGC Reg. §4043.9(e)(2)(ii). The 2013 proposal had require that there be no secured debt, but the PBGC loosened this standard in response to comments. The exception for certain leases or secured debt is to recognize that such obligations may be incurred even though the company is capable of borrowing without security (e.g., a secured debt to acquire property may lower the cost of the loan).

a.(2)(iii) Retained earnings test. The company has a ratio of retained-earnings-to-total assets of 0.25% or more. See PBGC Reg. §4043.9(e)(2)(iii).

a.(2)(iv) EBITDA test. The company has a ratio of total-debt-to-EBITDA of 3.0 or less. (EBITDA is earnings before interest, taxes, depreciation, and amortization.) See PBGC Reg. §4043.9(e)(2)(iv).

a.(2)(v) Income test. The company has positive net income for the two most recently completed fiscal years preceding the qualifying date. See PBGC Reg. §4043.9(e)(2)(v). For a tax-exempt entity, net income means the excess of total revenue over total expenses, as reported on the IRS Form 990. See PBGC Reg. §4043.9(e)(3)(iii). In addition to the supporting financial information, as described in a.(1) above, associated with the qualifying date, a company must evaluate whether this test is met by also using the supporting financial information associated with the financial information date for the preceding fiscal year. See PBGC Reg. §4043.9(e)(3)(ii).

a.(2)(vi) Loan default test. For the two-year period ending on the qualifying date, the company has not experienced a loan default reportable event, as described in PBGC Reg. §4043.34(a)(1) or (2) (as described in ¶4.i. below) has occurred with respect to any loan with an outstanding balance of $10 million or more to the company, regardless of whether reporting of such event was waived under PBGC Reg. §4043.34(b). See PBGC Reg. §4043.9(e)(2)(vi).

a.(2)(vii) Plan obligations test. For the two-year period ending on the qualifying date, there has not been a failure to make when due any minimum funding payment described in PBGC Reg. §4043.25(a)(1) or (2) (as described in ¶4.b. below), unless reporting of such event was waived under PBGC Reg. §4043.25(c). See PBGC Reg. §4043.9(e)(2)(vii).

b. Well-Funded Plan Safe Harbor. A plan meets the Well-Funded Plan Safe Harbor for an event year if no variable-rate premium (VRP) was required for the plan year preceding the event year. See PBGC Reg. §4043.10. Any event occurring in an event year for which a plan meets the Well-Funded Plan Safe Harbor is eligible for notice waiver if the Well-Funded Safe Harbor applies to that type of event. See ¶4 for which events are eligible for the notice waiver under the Well-Funded Plan Safe

Harbor. The Well-Funded Plan Safe Harbor is substantially simplified from the plan financial soundness safe harbor that had been in the 2013 proposal.

¶4. Post-event reportable events. Events for which post-event reporting is required are listed below, along with a discussion of any applicable waivers. The list below does not include automatic waivers, as discussed in ¶2.a. above, for which there is never a post-event filing obligation.

a. Active participant reduction reportable event. An active participant reduction that requires post-event reporting under PBGC Reg. §4043.23 is a single-cause event described in a.(1) below or an attrition event described in a.(2) below, unless a waiver or extension applies. See a.(3) and a.(4) below for special rules, exceptions and waivers applicable to this reportable event. The new regulations essentially rewrite this section. The events that trigger this reporting requirement are more specifically defined with an eye toward minimizing the need to constantly monitor participant numbers during a period of attrition. As additional event known as the "short-period event" was part of the 2013 proposal but was not adopted in the final regulations.

a.(1) Single-cause event. A single-cause event occurs on a date in a plan year when, as a result of a single cause (e.g., a reorganization, the discontinuance of an operation, a natural disaster, a mass layoff, or an early retirement incentive program) the number of active participants is reduced to less than 80% of the number of active participants at the beginning of the plan year *or* less than 75% of the number of active participants at the beginning of the *previous* plan year. See PBGC Reg. §4043.23(a)(1).

a.(2) Attrition event. An attrition event occurs at the end of a plan year if the number of active participants under the plan at the end of such year is less than 80% of the number of active participants at the beginning of the plan year, or less than 75% of the number of active participants at the beginning of the previous plan year. See PBGC Reg. §4043.23(a)(2).

a.(3) Determination rules. The number of active participants at the beginning of a plan year may be determined by using the number of active participants at the end of the *previous* plan year. Similarly, the number of active participants at the end of a plan year may be determined by using the number of active participants at the beginning of the *next* plan year. See PBGC Reg. §4043.23(b)(1). An "active participant" is a participant who is: (1) receiving compensation for work performed, (2) is on paid or unpaid leave granted for a reason other than layoff, (3) is laid off for a period that has lasted less than 30 days, *or* (4) is absent from work due to a recurring reduction in employment that occurs at least annually (i.e., seasonal work). See PBGC Reg. §4043.23(b)(2). An employment relationship for this purpose is between the participant and all members of the plan's controlled group. See PBGC Reg. §4043.23(b)(3).

a.(4) Exceptions, waivers and extensions.

a.(4)(i) Exception for ERISA §4062(e) or 4063(a) reduction. Where an active participant reduction involves a substantial cessation of operations under ERISA §4062(e) or a substantial employer withdrawal under ERISA §4063(a), those ERISA sections separately require reporting to the PBGC. Accordingly, to avoid duplicative reporting, the regulations limit the active participant reduction event by excluding from consideration, in determining whether an active participant reduction reportable event has occurred, any reductions that fall within the provisions of ERISA §4062(a) or ERISA §4063(a) and are timely reported to the PBGC as required under ERISA §4063(a). See PBGC Reg. §4043.23(c).

a.(4)(ii) Waivers. A waiver from this reporting event is provided to plans that meet the conditions of: (1) the Small Plan Waiver, as defined in ¶2.a. above (see PBGC Reg. §4043.23(d)(1)), (2) the Company Low-Default-Risk Safe Harbor, as described in ¶3.a. above (see PBGC Reg. §4043.23(d)(2)), (3) the Well-Funded Plan Safe Harbor, as described in ¶3.b. above (see PBGC Reg. §4043.23(d)(3)), or (4) the Public Company Waiver, as defined in ¶2.c. above (see PBGC Reg. §4043.23(d)(4)).

a.(4)(iii) Extension. For an attrition event described in a.(2) above, the notice date is extended until the premium due date for the plan year following the event year. See PBGC Reg. §4043.23(e).

b. Failures to make required minimum contributions. PBGC Reg. §4043.25 deals with the reportable event of a failure to make required contributions. The new regulations clarify that this reportable event applies not just to statutory contribution requirements (e.g., quarterly contributions, liquidity shortfall calculations, and required minimum contribution requirements under the funding rules), and contributions to amortize funding waivers, but also to contributions required as a condition of a funding waiver that do not fall within the statutory provisions on waiver amortization charges. See PBGC Reg. §4043.25(a).

b.(1) Form 200 alternative compliance method. If, with respect to the same failure, a PBGC Form 200 filing is made in accordance with PBGC Reg. §4043.81 (relating to the notice required under IRC §430(k)(4) when aggregate missed funding obligations exceed $1,000,000), the reportable event obligation under §4043.25 is satisfied. The confidentiality rules under ERISA §4043(f) do not apply to information submitted on Form 200, even if it is submitted under this alternative compliance method under PBGC Reg. §4043.25. See PBGC Reg. §4043.8.

b.(2) Waivers. The following waivers are provided for this event.

b.(2)(i) Small plans. The notice is waived if the plan meets the conditions of the Small Plan Waiver, as defined in ¶2.a. above. See PBGC Reg. §4043.25(c)(1). This is more favorable than the small plan waiver under PBGC Technical Update 13-1, which required limited reporting for plans with fewer than 100 participants but at least 25 participants.

b.(2)(ii) Contributions paid within 30 days. The notice is waived if the missed contribution is made by the 30th day after its due date. See PBGC Reg. §4043.25(c)(2).

b.(2)(iii) Untimely funding balance election. The notice is waived if the failure to make a timely required contribution is solely because of the plan sponsor's failure to timely make a funding balance election. See PBGC Reg. §4043.25(c)(3).

c. Failure to pay benefits when due. PBGC Reg. §4043.26 requires reporting if a plan is currently unable (see c.(1) below) or projected to be unable (see c.(2) below) to pay benefits.

c.(1) Current inability to pay. A plan is currently unable to pay benefits if it fails to provide any participant or beneficiary the full benefits to which the person is entitled under the terms of the plan, at the time the benefit is due and in the form in which it is due. However, the plan is not treated as being currently unable to pay benefits if its failure to pay is caused solely by: (1) a limitation under IRC §436, (2) the inability to locate a person, or (3) any other administrative delay, including the need to verify a person's eligibility for benefits, to the extent that the delay is for less than the shorter of two months or two full benefit payment periods. See PBGC Reg. §4043.26(a)(1).

c.(2) Projected inability to pay. A plan is projected to be unable to pay benefits when, as of the last day of any quarter of a plan year, the plan's liquid assets are less than two times the amount of the disbursements from the plan for such quarter. The terms "liquid assets" and "disbursements from the plan" have the same meaning as ERISA §303(j)(4)(E) and IRC §430(j)(4)(E). See PBGC Reg. §4043.26(a)(2).

c.(3) Waiver for plans subject to liquidity shortfall rules. Notice of this reportable event is waived unless the reportable event occurs during a plan year for which the plan is exempt from the liquidity shortfall rules in ERISA§303(j)(4) and IRC §430(j)(4) because it is a small plan (as defined in ERISA §303(g)(2)(B) and IRC §430(g)(2)(B)). See PBGC Reg. §4043.26(b). The reason why this reporting requirement is waived for plans that are subject to the liquidity shortfall rules is because the liquidity shortfall rules would require contributions that would avoid the inability to pay benefits when due, and if such contribution were not made the reportable event under PBGC Reg. §4043.25 (see b. above) would apply anyway.

d. Distribution to a substantial owner. The conditions under which a distribution to a substantial owner has to be reported is modified by the new regulations to add a requirement that either: (1) the sum of the values of all distributions to any one substantial owner within the one-year period ending with the date of the distribution is more than 1% of the end-of-year total amount of the plan's assets (as required to be reported on Schedule H or Schedule I to Form 5500) for each of the two plan years preceding the event year, or (2) the sum of the values of all distributions to all substantial owners within the one-year period ending with the date of the distribution is more than 5% of the end-of-year total amount of the plan's assets (as required to be reported on Schedule H or Schedule I to Form 5500) for each of the two plan years immediately preceding the event year. See PBGC Reg. §4043.27(a)(5). This change will reduce the number of reportable distributions to substantial owners.

d.(1) Alternative compliance method for annuities. The new regulations add an alternative method of compliance that simplifies the reporting requirements for annuities paid to a substantial owner. Under this alternative, a reportable event filing that satisfies the requirements of §4043.27 with respect to any payment under the annuity and that discloses the period, the amount of the payment, and the duration of the annuity would satisfy the reporting requirement for all subsequent annuity payments. See PBGC Reg. §4043.27(c). The 2013 proposal had limited this alternative compliance method to just non-increasing annuities, but, in response to comments, the PBGC finalized the regulation without that limitation.

d.(2) Waivers. The new regulations replace the waivers that had been provided under the old regulations. The notice for this reportable event is waived if the plan satisfies the conditions of: (1) the Company Low-Default-Risk Safe Harbor, as described in ¶3.a. above, (2) the Well-Funded Plan Safe Harbor, as described in ¶3.b. above, or (3) the Public Company Waiver, as defined in ¶2.c. above. See PBGC Reg. §4043.27(d).

e. Change in contributing sponsor or controlled group. A reportable event occurs when there is a transaction that results, or will result, in one or more persons ceasing to be members of the plan's controlled group (other than by merger involving members of the same controlled group).[12] See PBGC Reg. §4043.29(a). A "transaction" for this purpose includes, but is not limited to, a legally binding agreement, whether or not written, to transfer ownership, an actual transfer of ownership, and an actual change in ownership that occurs as a matter of law or through the exercise or lapse of pre- existing rights. The new regulations clarify that whether an agreement is legally binding is to be determined without regard to any conditions in the agreement. A transaction is not reportable if it will result solely in a reorganization involving a mere change in identity, form, or place of organization, however effected.

e.(1) Waivers. The new regulations retain a waiver of this notice requirement if the person ceasing to be a member of the plan's controlled group represents a *de minimis* 10% segment of the plan's old controlled group for the most recent fiscal year(s) ending on or before the date the reportable event occurs. See PBGC Reg. §4043.29(b)(1). They also retain a waiver of this notice requirement if each person that will cease to be a member of the plan's controlled group is a Foreign Entity other than a Foreign Parent. See PBGC Reg. §4043.29(b)(2). Notice waivers are also provided to plans that satisfy the conditions of the Small Plan Waiver, the Company Low-Default-Risk Safe Harbor, the Well-Funded Plan Safe Harbor, or the Public Company Waiver. See PBGC Reg. §4043.29(b)(3), (4), (5) and (6).

e.(2) Example - controlled group breakup. Plan A's controlled group consists of Company A (its contributing sponsor), Company B (which maintains Plan B), and Company C. As a result of a transaction, the controlled group will break into two separate controlled groups: one segment consisting of Company A and the other segment consisting of Companies B and C. Both Company A (Plan A's contributing sponsor) and the plan administrator of Plan A are required to report that Companies B and C will leave Plan A's controlled group. Company B (Plan B's contributing sponsor) and the plan administrator of Plan B are required to report that Company A will leave Plan B's controlled group. Company C is not required to report because it is not a contributing sponsor or a plan administrator. This example appears in PBGC Reg. §4043.29(c)(1).

[12] Note the reference to the plan's controlled group. A plan's controlled group means all contributing sponsors of the plan and all members of each contributing sponsor's controlled group. See PBGC Reg. §4001.2. A controlled group of a contributing sponsor consists of such person and all other persons under common control with such person, determined under PBGC Reg. §4001.3. PBGC Reg. §4001.3 in turn defines common control to mean common control as defined in the Treasury regulations under IRC §414(c), regardless of whether the persons involved are incorporated or unincorporated.

e.(3) Example - change in contributing sponsor. Plan Q is maintained by Company Q. Company Q enters into a binding contract to sell a portion of its assets and to transfer employees participating in Plan Q, along with Plan Q, to Company R, which is not a member of Company Q's controlled group. There will be no change in the structure of Company Q's controlled group. On the effective date of the sale, Company R will become the contributing sponsor of Plan Q. A reportable event occurs on the date of the transaction (i.e., the date the binding contract was executed), because as a result of the transaction, Company Q (and any other member of its controlled group) will cease to be a member of Plan Q's controlled group. The event is not reported before the notice date. If on the notice date the change in the contributing sponsor has not yet become effective, Company Q has the reporting obligation. If the change in the contributing sponsor has become effective by the notice date, Company R has the reporting obligation. This example is in PBGC Reg. §4043.29(c)(2). Note that, since the focus is on the plan's controlled group, the transfer of the plan to an unrelated contributing sponsor falls within this reportable event. This example also illustrates the rule discussed in ¶1.a. above regarding who is required to file the notice when there is a change in contributing sponsor, which depends on whether a notice of the event is filed before or after the change in contributing sponsor is effectuated.

f. Liquidation. PBGC Reg. §4043.30 requires reporting when any member of the plan's controlled group: (1) is involved in a transaction to implement its complete liquidation (including liquidation into another controlled group member), (2) institutes or has instituted against it a proceeding to be dissolved or is dissolved, whichever comes first, or (3) liquidates in a case under the Bankruptcy Code, or under any similar law.

f.(1) Waivers. The new regulations eliminate the funding-based waivers that were available under the old regulations for this reporting event, and does not extend the Company Low-Default-Risk Safe Harbor to Well-Funded Plan Safe Harbor to this event. However, the new regulations retain: (1) the *de minimis* 10% segment waiver (i.e., the person or persons liquidating are not contributing sponsors and represent a *de minimis* 10% segment of the plan's controlled group for the most recent fiscal year(s) ending on or before the date of the reportable event), and (2) the Foreign Entity waiver (i.e., each person that is liquidating is a Foreign Entity other than a Foreign Parent). See PBGC Reg. §4043.30(b).

g. Extraordinary dividend or stock redemption. The new regulations simplify the definition of this event. Under the revised definition, a reportable event occurs when any member of the plan's controlled group declares a dividend or redeems its own stock and the amount or net value of the distribution, when combined with other such distributions during the same fiscal year of the person, exceeds the person's net income before after-tax gain or loss on any sale of assets, as determined in accordance with generally accepted accounting principles, for the prior fiscal year. See PBGC Reg. §4043.31(a). A distribution by a person to a member of its controlled group is disregarded (which is broader than the exception in the old regulations for intra-group distributions).

g.(1) Determination rules. The valuation rules for non-cash distributions closely follow the old regulations. The net value of a non-cash distribution for this purpose is defined as the fair market value of assets transferred by the person making the distribution, reduced by the fair market value of any liabilities assumed or consideration given by the recipient in connection with the distribution. Net value determinations generally must be based on readily available fair market value(s) or independent appraisal(s) performed within one year before the distribution is made. To the extent that fair market values are not readily available and no such appraisals exist, the fair market value of an asset transferred in connection with a distribution or a liability assumed by a recipient of a distribution is deemed to be equal to 200% of the book value of the asset or liability on the books of the person making the distribution. Stock redeemed is deemed to have no value. See PBGC Reg. §4043.31(b).

g.(2) Waivers. Notice waivers are provided if any of the following applies: (1) the person making the distribution is a *de minimis* 10% segment (up from 5% segment in the old regulations) of the plan's controlled group for the most recent fiscal year(s) ending on or before the date the reportable event occurs, (2) the person making the distribution is a Foreign Entity other than a Foreign Parent, (3) the Small Plan Waiver conditions are met, (4) the Company Low-Default-Risk Safe Harbor is satisfied, (5) the Well Funded Plan Safe Harbor is satisfied, or (6) the Public Company Waiver conditions are satisfied. See PBGC Reg. §4043.31(c). The waivers in (1) and (2), and a modified small plan were in the old regulations as well.

h. Transfer of benefit liabilities. If, in any 12-month period, 3% or more of a plan's benefit liabilities are transferred to a person outside the transferor plan's controlled group or to a plan maintained by a person outside the transferor plan's controlled group, a reportable event occurs under ERISA §4043(c)(12). PBGC Reg. §4043.32(a) has been revised to clarify that the reporting obligation falls solely on the transferor plan. The old regulations required every other plan maintained by a member of the transferor plan's controlled group to report as well. This change results in the same rules applying with respect to benefit liability transfers for both post-event reporting and advance reporting.

h.(1) Date of the transfer. The date of transfer is to be determined on the basis of the facts and circumstances of the particular situation. For transfers subject to the requirements of IRC §414(l), the date determined in accordance with Treas. Reg. §1.414(l)-1(b)(11) will be considered the date of transfer. Treas. Reg. §1.414(l)-1(b)(11) also uses a facts and circumstances test, but identifies the following factors as relevant (but not necessarily controlling): (i) the date on which the affected employees stop accruing benefits under one plan and begin coverage and benefit accruals under another plan, (ii) the date as of which the amount of assets to be eventually transferred is calculated, and (iii) if the merger or spinoff agreement provides that interest is to accrue from a certain date to the date of actual transfer, the date from which such interest will accrue.

h.(2) Certain distributions disregarded. The payment of lump sum distributions, or the purchase of an irrevocable commitment to provide an annuity, in satisfaction of benefit liabilities is not a transfer of benefit liabilities for purposes of determining whether this reportable event has occurred. See PBGC Reg. §4043.32(b)(2). This is a recognition that the benefit restrictions under IRC §436 and ERISA §206(g) prohibit or limit cashouts and annuitizations by significantly underfunded plans, thus tending to prevent cashouts and annuitizations that would most seriously reduce a transferor plan's funded percentage. Also, since the cashouts and annuitizations satisfy the associated benefit liabilities, they would not create any concerns for the transferee plan's financial health.

h.(3) Waivers. The waivers in the old regulations are entirely replaced in the new regulations. Under the new regulations, the notice for this reportable event is waived if the plan satisfies the conditions of any of the following: (1) the Small Plan Waiver, (2) the Company Low-Default-Risk Safe Harbor, (3) the Well-Funded Plan Safe Harbor, or (4) the Public Company Waiver. See PBGC

Reg. §4043.32(c). However, the waivers in the old regulations, in slightly modified form, still apply to the advance notice reporting requirement for this event. See ¶5.c.

i. Loan default. The circumstances under which loan default results in a reportable event are expanded by the new regulations. Under PBGC Reg. §4043.34(a), a reportable event occurs for a plan when, with respect to a loan with an outstanding balance of $10 million or more to a member of the plan's controlled group: (1) there is an acceleration of payment or a default under the loan agreement, or (2) the lender waives or agrees to an amendment of any covenant in the loan agreement the effect of which is to cure or avoid a breach that would trigger a default. The PBGC believes that the significance of loan defaults is so great with respect to potential liability for the PBGC that reporting should not be restricted to the list of events described in the old regulations. Under this revised definition, any default on a loan of $10 million or more, even a default on a loan within the controlled group, should be reported unless a waiver applies. The reference in the revised definition to any amendment or waiver by a lender of any loan agreement covenant is due to the PBGC's belief that such actions may reflect financial difficulty and, thus, like actual defaults, pose serious challenges for the pension insurance system.

i.(1) Waivers. The new regulations add a waiver if the debtor is not a contributing sponsor of the plan and represents a *de minimis* 10% segment of the plan's controlled group for the most recent fiscal year(s) ending on or before the date of the reportable event. See PBGC Reg. §4043.34(b)(1). The waiver in the old regulations if the debtor is a Foreign Entity other than a Foreign Parent is retained. See PBGC Reg. §4043.34(b)(2). All other waivers in the old regulations (default cured or waived by lender within 30 days, and funding-based waivers) are eliminated. The Company Low-Default-Risk Safe Harbor and the Well-Funded Plan Safe Harbor do not apply to this reportable event.

j. Insolvency or similar settlement. This reportable event has been revised to eliminate reporting of a bankruptcy case under the U.S. Bankruptcy Code, because notice of bankruptcies under the Bankruptcy Code can be and routinely is reliably obtained by the PBGC by other means. Otherwise the events that trigger reporting under this section are retained. As revised, a reportable event occurs when any member of the plan's controlled group: (1) commences or has commenced against it any insolvency proceeding (including, but not limited to, the appointment of a receiver) other than a bankruptcy case under the Bankruptcy Code, (2) commences, or has commenced against it, a proceeding to effect a composition, extension, or settlement with creditors, (3) executes a general assignment for the benefit of creditors, or (4) undertakes to effect any other nonjudicial composition, extension, or settlement with substantially all its creditors. See PBGC Reg. §4043.35(a).

j.(1) Waivers. The new regulations retain a notice waiver if the debtor is a Foreign Entity other than a Foreign Parent. See PBGC Reg. §4043.35(b)(2). A waiver is added if the person with respect to which this reportable event applies is not a contributing sponsor of the plan and represents a *de minimis* 10% segment of the plan's controlled group for the most recent fiscal year(s) ending on or before the date the reportable event occurs. See PBGC Reg. §4043.35(b)(1).

k. Application for minimum funding waiver. No changes have been made to PBGC Reg. §4043.33, which requires notice of an application for a minimum funding waiver. Like the old regulations, there are no waivers with respect to this reporting obligation.

¶5. Advance reporting test. ERISA §4043 requires advance reporting by contributing sponsors for certain reportable events if a "threshold test" is satisfied, unless the contributing sponsor or any member of the plan's controlled group to which the event relates is a public company (as defined in ¶2.c. above). PBGC Reg. §4043.61 has been revised so that the threshold test for advance reporting reflects changes in the statute that were made by the PPA 2006. These changes are consistent with the guidance previously provided in PBGC Technical Update 13-1 and predecessors to that Technical Update. The threshold test is based on the aggregate funding level of plans maintained by the contributing sponsor and member's of the contributing sponsor's controlled group. The funding level criteria are referenced to values used to determine variable rate premiums (VRPs) under ERISA §4006. The statute describes the threshold test as met if, as of the close of the *preceding* plan year: (1) the aggregate unfunded vested benefits (UVBs), as determined under ERISA §4006(a)(3)(E)(iii), of plans subject to Title IV of ERISA which are maintained by the contributing sponsor and members of such sponsor's controlled groups (disregarding plans with no UVBs) exceed $50 million, and (2) the funded vested benefit percentage for such plans (i.e., the percentage which the aggregate value of the assets of such plans bears to the aggregate vested benefits of such plans, determined in accordance with ERISA §4006(a)(3)(E)(iii)) is less than 90%. ERISA §4006(a)(3)(E)(iii), as amended by the PPA 2006, defines the UVBs for a plan year as the excess (if any) of the funding target over the fair market value of plan assets for the plan year which are held by the plan on the valuation date. The funding target for this purpose is determined by taking into account only vested benefits and by using the interest rate described in ERISA §4006(a)(3)(E)(iv) (without adjustment for the MAP-21/HATFA segment rates).

a. Using valuation date as the reference date for determining values. Since the valuation date will be the first day of the plan year for virtually all plans that are subject to advance reporting (since any other valuation date is permitted only for small plans), the new regulations would require that the advance reporting threshold test be applied as of the valuation date of the preceding plan year, rather than the "close" of the preceding plan year as suggested by the statutory language. This is accomplished by requiring UVBs, values of plan assets, and premium funding targets to be calculated in accordance with the PBGC premium regulations under ERISA §4006 for the plan year preceding the effective date of the event. See PBGC Reg. §4043.61(c). This avoids having to make separate calculations of these values as of the last day of the preceding plan year, and it will enable a plan to determine before a reportable event occurs (and before an advance report is due) whether it is subject to the advance reporting requirement.

b. Determination of plans taken into account and public company status. Only plans maintained on the notice date by the contributing sponsor and any members of the contributing sponsor's controlled group are taken into account, subject to the requirement to disregard any plans with no UVBs. See PBGC Reg. §4043.61(c). Similarly, the "public company" status of a contributing sponsor or controlled group member to which the event relates also is determined as of the notice date. See PBGC Reg. §4043.61(b). If there is a change in contributing sponsor, the responsibility for any failure to file or defective filing lies with the person who is the contributing sponsor of the plan on the notice date. See PBGC Reg. §4043.61(a).

c. Events requiring advance notice. If a contributing sponsor is subject to advance reporting, the following events, as described above under post-event reporting, are subject to advance reporting: (i) change in contributing sponsor or controlled group, as described in PBGC Reg. §4043.29(a) (see PBGC Reg. §4043.62), (ii) liquidation, as described in PBGC Reg. §4043.30 (see PBGC Reg. §4043.63), (iii) extraordinary dividend or stock redemption, as described in PBGC Reg. §4043.31(a) (see PBGC Reg. §4043.64), (iv) transfer of benefit liabilities, as described in PBGC Reg. §4043.32(a) (see PBGC Reg. §4043.65), (v) application for minimum funding waiver, as described in PBGC Reg. §4043.33 (see

PBGC Reg. §4043.66, (vi) loan default, as described in PBGC Reg. §4043.34(a) (see PBGC Reg. §4043.67), and (vii) insolvency or similar settlement, as described in PBGC Reg. §4043.35 (see PBGC Reg. §4043.68). These advance notice events are unchanged in the new regulations.

c.(1) Waivers. As under the old regulations, the new regulations do not provide any waivers for the events described in (v) and (vii) of c. above. The waivers in the old regulations for the events described in (i), (ii), and (iii) in c. above remain unchanged. Note that the *de minimis* segment waivers for advance reporting is a 5% threshold rather than the 10% threshold for waivers of post-event reporting. For the transfer of benefit liabilities (item (iv) in c. above), advance reporting is waived under the new regulations under four circumstances: (1) a complete transfer of all of the benefit liabilities and assets of the transferor plan to another plan, (2) a transfer of less than 3% of the assets of the transferor plan (determined as of at least one day of the plan year), if the value of the transferred assets equals the present value of the accrued benefits (whether or not vested) being transferred (using actuarial assumptions that comply with IRC §414(l)), (3) a transfer of the benefit liabilities of 500 or fewer participants, if the transfer complies with IRC §414(l) using the actuarial assumptions prescribed for valuing benefits in trusteed plans under PBGC Reg. §§4044.51 through 4044.57, and (4) a transfer between a fully-funded transferor plan and a fully-funded transferee plan, determined in accordance with PBGC Reg. §§4044.51 through 4044.57 and PBGC Reg. §4010.8(d)(1)(ii), if the transfer complies with IRC §414(l) using reasonable actuarial assumptions. See PBGC Reg. §4043.65(b). These waivers from advance reporting for a transfer of benefit liabilities also applied to post-event notices for these events under the old regulations, but the new regulations eliminated such waivers for the post-event notices. Under the new regulations, there are no waivers for advance reporting of the loan default events (item (vi in c. above). The limited waiver in the old regulations with respect to loan defaults that were cured or waived by the lender within 10 days (or the end of the cure period, if later) have been eliminated.

c.(2) Extensions. The extensions for advance reporting of loan defaults (item (vi) in c. above) that were in the old regulations have been eliminated. See PBGC Reg. §4043.67, which no longer provides for extensions. Extensions for advance reporting of insolvency (item (vii) in c. above) also have been eliminated except for a proceeding that is not commenced by a member of the plan's controlled group. See PBGC Reg. §4043.68(b). The PBGC believes that in most cases the person responsible for reporting will be aware in advance of these events and thus, will be able to meet the reporting obligation on a timely basis. However, if a situation arises where advance reporting is not possible, the delinquent filer could seek a retroactive filing extension from the PBGC. For the application of minimum funding waiver (item (v) in c. above), the new regulations retain the extension in the old regulations to 10 days after the reportable event occurs. See PBGC Reg. §4043.66(b). Thus, a contributing sponsor that is subject to advance reporting must give notice of an application of minimum funding waiver within 10 days of the application rather than the normal 30-day period that applies to post-event reporting.

¶6. Reference tables. The following reference tables are provided to facilitate understanding the scope of the reportable event rules and the applicable waivers.

Table 1: Applicable Reporting Waivers

Event	Company Low-Default-Risk Safe Harbor or Well-Funded Plan Safe Harbor	Small Plan Waiver	Public Company Waiver	CG member causing event: De Minimis	CG member causing event: non-parent Foreign Entity	CG member causing event: De minimis & not CG member	Not over 30 days late or late credit balance election	Large plan subject to liquidity rules
Extraordinary Dividend or Stock Redemption	✔	✔	✔	✔	✔			
Change in Contributing Sponsor or Controlled Group	✔	✔	✔	✔	✔			
Active Participant Reduction	✔	✔	✔					
Transfer of Benefit Liabilities	✔	✔	✔					
Distribution to Substantial Owner	✔		✔					
Insolvency◆					✔	✔		
Liquidation					✔	✔		
Loan Default					✔	✔		
Failure to Make Required Contribution		✔**					✔	
Application for Funding Waiver								
Inability to Pay Benefits When Due								✔

◆ Waived in all cases for events under the Bankruptcy Code

** Only waived if the missed contribution is a quarterly installment under IRC §430(j)

Table 2: Reportable Events By Category

Corporate Events	**Plan Events**
Extraordinary Dividend or Stock Redemption ◆	Active Participant Reduction
Change in Contributing Sponsor or Controlled Group◆	Distribution To Substantial Owner
Insolvency or Similar Settlement◆	Transfer of Benefit Liabilities◆
Loan Default◆	Missed Required Contribution
Liquidation◆	Application For Minimum Funding Waiver◆
	Inability To Pay Benefits When Due

◆ These events are also subject to advance reporting if the contributing sponsor meets the conditions for being subject to advance reporting.

Table 3: Small Plans (100 or fewer participants)

Event	Waived	Required to Report
Extraordinary Dividend or Stock Redemption	✔	
Change in Contributing Sponsor or Controlled Group	✔	
Active Participant Reduction	✔	
Transfer of Benefit Liabilities	✔	
Distribution to Substantial Owner		✔
Insolvency		✔
Liquidation		✔
Loan Default		✔
Failure to Make Required Contribution (quarterly installments)	✔	
Failure to Make Required Contribution (other than quarterly installments)		✔
Application for Funding Waiver		✔
Inability to Pay Benefits When Due		✔

ERISA Enforcement: Claim For Benefits

Burden of proof shifts to plan if claimant makes prima facie case of benefit entitlement, in spite of deferential standard of review with respect to plan administrator's benefits claim denial [Citation: *Estate of Bruce H. Barton v. AFT Security Services Pension Plan*, No. 13-56379, ___ F.3d ___ (9th Cir. April 21, 2016)]
Text available at http://1.usa.gov/1rqnoJj

The plan administrator in this case was entitled to the *Firestone* deferential review standard (i.e., an abuse of discretion standard) with respect to its factual determinations regarding the plaintiff's benefit claim. The administrator denied the claim because participant failed to produce sufficient records to demonstrate his service record entitled him to benefits. The documentation he submitted include a letter from the company president congratulating him on satisfying his years of service requirement for vesting, W-2 statements, pay stubs, and documentation from the Social Security Administration. However, the administrator found the documentation he submitted to be inconclusive. The lower court upheld the plan administrator's findings based on an "abuse of discretion" standard. The Ninth Circuit held that the plan had the burden of proof to show that the plaintiff was not eligible for benefits. In circumstances where the participant has better (or at least equal) access to the evidence needed to provide entitlement to a benefit (e.g., the establishment of an illness to show entitlement to disability benefits), then the burden of proof rests with the claimant. See, for example, *Muniz v. American Constitution Management, Inc.*, 623 F.3d 1290, 1294-95 (9th Cir. 2010). But that was not the case here. The plan in this case was placing the burden on the plaintiff to establish that his employment with various members of the related group of employers, which also require annual hours of service determinations, proved his entitlement to a benefit. According to the Ninth Circuit, the defendants in this case are in a better position to determine which employers participate in the plan, and whether the plaintiff had earned the requisite 1,000 hours of covered service in a sufficient number of years (especially in light of the fact that the period of service in question spans two decades). ERISA's disclosure and recordkeeping requirements support this conclusion.

> *Holding.* If the plaintiff has made a prima facie case that he is entitled to pension benefits, the defendants carry the burden to clarify what entities are covered under the plans and whether the plaintiff has met the requisite years of service requirement, so that it can be determined whether he is entitled to a benefit. The Ninth Circuit remanded the case to the lower court to determine if the plaintiff has made a prima facie case for benefit entitlement, which may consider the documentation he has already submitted.
>
> *Does burden-shifting conflict with the deferential standard of review?* A strong dissenting opinion challenges the court's decision not to apply an abuse of discretion review with respect to the plan administrator's decision, which had been based on the documentation submitted by the plaintiff. The dissenting judge believes that the burden-of-proof standard adopted by the court is in direct conflict with the abuse of discretion standard of review.

ERISA Enforcement: Equitable Relief Under ERISA §502(a)(3)

Supreme Court clarifies that enforcement of a plan's remedy for equitable recovery against third-party payments made to participant is limited to identifiable funds [Citation: *Montanile v. Board of Trustees of the National Elevator Industry Health Benefit Plan*, 136 S.Ct. 651 (January 20, 2016)]
Text available at http://1.usa.gov/1NmZroP

The *Montanile* case reviews the Supreme Court's past precedents on the issue of equitable liens and clarifies an important aspect of those prior cases - whether the plan can seek recovery from the participant's general assets if the participant has dissipated the funds over which the plan claims it has a lien. The Supreme Court concluded that the plan may not recover from the participant's general assets. The decision was 8-1 with Justice Ginsburg as the sole dissenting voice. The case was remanded for the lower court to determine if the settlement funds had, in fact, been completely dissipated.

The case involves a health plan's enforcement of a subrogation clause which requires a participant to reimburse the plan for medical expenses if the participant later recovers money from a third party for his injuries. Due to a car accident, the plan paid over $120,000 for medical expenses incurred by Montanile. He later recovered a settlement for $500,000 with respect to his injuries. Pursuant to the subrogation clause, the plan sought recovery of the medical expenses it had paid. However, by the time the plan filed its suit to recover the expenses, Montanile had spent the settlement. The Supreme Court held that, when a participant wholly dissipates a third-party settlement on nontraceable items, the plan fiduciary may not bring suit under ERISA §502(a)(3) to attach the participant's separate assets. Although the plan's claim to enforce its lien is an equitable claim, and a remedy to enforce such a lien against specifically identifiable funds that were within the participant's possession and control would also have been equitable, an attempt to seek recovery against the participant's general assets would be a legal remedy not authorized by ERISA §502(a)(3).

In explaining its holding, the Supreme Court noted that it was a misreading of its decision in *Sereboff v. Mid Atlantic Medical Services, Inc.*, 547 U. S. 356 (2006) to conclude that an equitable lien by agreement (i.e., a lien created by the terms of the plan), as opposed to an equitable lien by restitution, does not require recovery to be against identifiable funds. However, there is a great deal of discussion in the *Sereboff* opinion about application of the "strict tracing rules" for an equitable lien by restitution, which the Supreme Court ruled did not apply to a lien by agreement. How can these cases be reconciled then? Apparently, the Supreme Court is saying that its discussion of the application of strict tracing rules should not be interpreted to suggest that the funds over which the plan seeks recovery need not be identifiable at all. In other words, there needs to be evidence that the funds have been set aside by the participant in an identifiable way (e.g., an investment account) in order to recover funds pursuant to an equitable lien by agreement as well. The strict tracing rules discussed in *Sereboff* were in the context of an equitable lien by restitution, which is predicated on a particular asset belonging to the lienholder which is in the possession of the person against whom recovery is sought. The equitable lien by agreement, as is the case here, arises because of pre-existing plan language and does not involve a specific asset of the plan when the agreement becomes effective. Rather, the lien is against a portion of the settlement proceeds that are awarded at some later time. Although a specific asset of the plan is not identified when the settlement proceeds are awarded, the settlement proceeds themselves represent identifiable funds from which the Supreme Court is saying must be the source of recovery. If it can be shown the funds have been dissipated, the plan cannot then seek recovery from the participant's general assets.

Dissent. Justice Ginsburg dissenting opinion, which supplements her dissent in *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U. S. 204 (2002), questions the whole premise of the Supreme Court's interpretation of the words "equitable relief" under ERISA §502(a)(3). In her opinion, the Supreme Court is in error when it reads the work product of Congress in 1974 as "unravel[ling] forty years of fusion of law and equity, solely by employing the benign sounding word 'equitable' when authorizing 'appropriate equitable relief.'" In her opinion, it doesn't make sense for a plan's claim to be defeated by a participant spending the money before the plan can bring suit.

Ramifications on pension benefit overpayments. Although these Supreme Court cases deal with subrogation clauses under health benefit plans, they have implications for plans seeking recovery of overpayment of pension benefits or disability benefits. Except in the case where it can be shown that the participant set aside his or her overpayment, or where an overpayment is part of a distribution that is rolled over to an identifiable fund, these cases would make it difficult for a plan to seek recovery against the participant under ERISA §502(a)(3).

ERISA Preemption

Vermont law requiring reporting of claims information preempted by ERISA [Citation: *Gobeille v. Liberty Mutual Insurance Co.*, 136 S.Ct. 936 (March 1, 2016)]
Text available at http://1.usa.gov/1RPalJo

A majority of the Supreme Court held that ERISA preempts a Vermont law that requires health insurance, health care providers, health care facilities, and governmental agencies to report information relating to health care costs, prices, quality, utilization, or resources, including data relating to health insurance claims and enrollment. Justice Kennedy wrote the 6-2 ruling. Justices Thomas and Breyer filed separate concurring opinions. A separate dissent was filed by Justice Ginsburg, who was joined by Justice Sotomayor.

The suit was brought by a plan sponsor, who instructed the plan administrator of its health plan not to report the information because of its concern that disclosure of confidential information about the participants in the plan would violate the plan sponsor's fiduciary duties. Although the law did not specifically reference ERISA plans, preemption can still be found if the law governs or interferes with the uniformity of plan administration, thereby having an impermissible connection with ERISA plans. The Supreme Court determined that the extensive reporting, disclosure, and recordkeeping requirements set forth in ERISA led to a finding of such an impermissible connection. The reporting regime in the Vermont law compels plans to report detailed information about claims and plan members, which the Supreme Court believes intrudes upon a central matter of plan administration, and interferes with nationally uniform plan administration. The court cited its precedent in *Egelhoff v. Egelhoff*, 532 U.S. 141 (2001).

The separate concurring opinion by Justice Thomas questions the constitutionality of ERISA's broad preemptive language. Justice Ginsburg's dissent, although not raising constitutional issues, warns that the Court's precedents on ERISA preemption are too broad in their scope. In this case for example, she didn't see any meaningful overlap in the type of disclosure and recordkeeping required by ERISA and the reporting mandated by the Vermont law.

SUPPORTING MATERIALS FOR ETHICS CASE STUDIES

ASPPA's Revised Code of Conduct

Amended July 1, 2013

Preamble
The purpose of this Code of Professional Conduct ("Code") is to identify the professional and ethical standards with which a Member must comply, in order to fulfill the Member's responsibility to ASPPA and its affiliate organizations, other Members, and the public. Members are required to adhere to the high standards of conduct, practice, and qualification set forth in this Code.

1. Definitions

- Advertising: all communications by whatever medium, including oral communications, which may directly or indirectly influence any person or organization to decide whether there is a need for Professional Services or to select a specific person or firm to perform such services.

- Confidential Information: information not in the public domain of which the Member becomes aware during the course of rendering Professional Services to a Principal. It may include information of a proprietary nature, information which is legally restricted from circulation, or information which the Member has reason to believe that the Principal would not wish to be divulged.

- Credential: a membership designation (e.g., Certified Pension Consultant; Member, Society of Pension Actuaries; or Associated Professional Member) conferred by ASPPA.

- Law: statutes, regulations, judicial decisions, and other statements having legally binding authority.

- Member: An individual who is a Member of ASPPA or any affiliate organization of ASPPA.

- Principal: any present or prospective client of a Member or the employer of a Member where the Member provides retirement plan services for their employer's plan.

- Professional Communication: a written, electronic or oral communication issued by a Member with respect to Professional Services.

- Professional Services: services provided to a Principal by a Member, including the rendering of advice, recommendations, findings, or opinions related to a retirement or other employee benefit plan.

- Titles: leadership positions, volunteer experience, awards and other honors conferred by ASPPA.

2. Advertising

A Member shall not engage in any Advertising with respect to Professional Services that the Member knows or is reasonably expected to know are false.

3. Communications

A Member who issues a Professional Communication shall take appropriate steps to ensure that the Professional Communication is appropriate to the circumstances and its intended audience.

4. Compliance

A Member shall be knowledgeable about this Code, keep current with Code revisions and abide by its provisions. Laws may impose binding obligations on a Member. This Code is not intended to supplant, contradict or supersede Law (e.g., Circular 230) or other Codes of Conduct that establish professional standards for Members in the rendition of Professional Services and that have been sanctioned by the federal or a state government. Where the requirements of Law or such governmentally-sanctioned Codes conflict with this Code, the requirements of Law or such governmentally-sanctioned Codes take precedence.

5. Confidentiality

A Member shall not disclose to another party any Confidential Information obtained in rendering Professional Services for a Principal unless authorized to do so by the Principal or required to do so by Law.

6. Conflicts of Interest

A Member shall not perform Professional Services involving an actual conflict of interest unless:

A. The Member's ability to act fairly is unimpaired; and
B. There has been full disclosure of the conflict to the Principal(s); and
C. All Principals have expressly agreed to the performance of the services by the Member.

If the Member is aware of any significant conflict between the interests of a Principal and the interests of another party, the Member should advise the Principal of the conflict and include appropriate qualifications or disclosures in any related communication.

7. Control of Work Product

A Member shall not perform Professional Services when the Member has reason to believe that they may be altered in a material way or may be used to violate or evade the Law. The Member should recognize the risk that materials prepared by the Member could be misquoted, misinterpreted or otherwise misused by another party to influence the actions of a third party and should take reasonable steps to ensure that the material is presented fairly and that the sources of the material are identified.

8. Courtesy and Cooperation

A. A Member shall perform Professional Services with courtesy and shall cooperate with others in the Principal's interest. A Principal has an indisputable right to choose a professional advisor. A Member may provide service to any Principal who requests it even though such Principal is being or has been served by another professional in the same manner.

B. When a Principal has given consent for a new or additional professional to consult with a Member with respect to a matter for which the Member is providing or has provided Professional Services, the Member shall cooperate in assembling and transmitting pertinent data and documents, subject to receiving reasonable compensation for the work required to do so. In accordance with Circular 230, the Member shall promptly, at the request of the Principal, return any and all records of the Principal that are necessary for the Principal to comply with federal tax Law, even if the Member is not subject to Circular 230. The existence of a fee dispute generally does not relieve the Member of this responsibility except to the extent permitted by applicable state Law. The Member need not provide any items of a proprietary nature or work product for which the Member has not been compensated.

9. Disclosure

A Member shall make full and timely disclosure to a present or prospective Principal of all sources of direct or indirect material compensation or other material consideration that the Member or the Member's firm has received or may receive in relation to an assignment for such Principal. The disclosure of sources of material compensation or consideration that the Member's firm has received, or may receive, is limited to those sources known to, or reasonably ascertainable by, the Member.

10. Professional Integrity

A Member shall perform Professional Services, and shall take reasonable steps to ensure that Professional Services rendered under the Member's supervision are performed, with honesty, integrity, skill and care. A Member has an obligation to observe standards of professional conduct in the course of providing advice, recommendations and other services performed for a Principal. A Member who pleads guilty to or is found guilty of any misdemeanor related to financial matters or any felony shall be presumed to have contravened this Code and shall be subject to ASPPA's counseling and disciplinary procedures.

11. Qualification Standards

A Member shall render opinions or advice, or perform Professional Services, only when qualified to do so based on education, training and experience.

12. Titles and Credentials

A Member shall make truthful use of the membership Titles and Credentials of ASPPA to which the Member is entitled, and only where that use conforms to the practices authorized by ASPPA.

13. Additional Obligations

A. A Member whose professional conduct is regulated by another membership organization shall abide by the professional Code of Conduct (or similar rules) of such organization. For example, a Member who is an actuary shall also abide by the Code of Professional Conduct for actuaries.

B. A Member shall respond promptly in writing to any communication received from a person duly authorized by ASPPA to obtain information or assistance regarding a Member's possible violation of this Code. The Member's responsibility to respond shall be subject to Section 5 of this Code, "Confidentiality," and any other confidentiality requirements imposed by Law. In the absence of a full and timely response, ASPPA may resolve such possible violations based on available information.

Excerpts from Circular 230

§10.21 Knowledge of client's omission

A practitioner who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws of the United States, must advise the client promptly of the fact of such noncompliance, error, or omission. The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error, or omission.

§10.22 Diligence as to accuracy

(a) In general. A practitioner must exercise due diligence —
(1) In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters;
(2) In determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and
(3) In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.
(b) Reliance on others. Except as modified by §§10.34 and 10.37, a practitioner will be presumed to have exercised due diligence for purposes of this section if the practitioner relies on the work product of another person and the practitioner used reasonable care in engaging, supervising, training, and evaluating the person, taking proper account of the nature of the relationship between the practitioner and the person.

§10.27 Fees

(a) In general. A practitioner may not charge an unconscionable fee in connection with any matter before the Internal Revenue Service.

(b) Contingent fees —
(1) Except as provided in paragraphs (b)(2), (3), and (4) of this section, a practitioner may not charge a contingent fee for services rendered in connection with any matter before the Internal Revenue Service.
(2) A practitioner may charge a contingent fee for services rendered in connection with the Service's examination of, or challenge to —
(i) An original tax return; or
(ii) An amended return or claim for refund or credit where the amended return or claim for refund or credit was filed within 120 days of the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return.

(3) A practitioner may charge a contingent fee for services rendered in connection with a claim for credit or refund filed solely in connection with the determination of statutory interest or penalties assessed by the Internal Revenue Service.
(4) A practitioner may charge a contingent fee for services rendered in connection with any judicial proceeding arising under the Internal Revenue Code.

(c) Definitions. For purposes of this section —
(1) Contingent fee is any fee that is based, in whole or in part, on whether or not a position taken on a tax return or other filing avoids challenge by the Internal Revenue Service or is sustained either by the Internal Revenue Service or in litigation. A contingent fee includes a fee that is based on a percentage of the refund reported on a return, that is based on a percentage of the taxes saved, or that otherwise depends on the specific result attained. A contingent fee also includes any fee arrangement in which the practitioner will reimburse the client for all or a portion of the client's fee in the event that a position taken on a tax return or other filing is challenged by the Internal Revenue Service or is not sustained, whether pursuant to an indemnity agreement, a guarantee, rescission rights, or any other arrangement with a similar effect.
(2) Matter before the Internal Revenue Service includes tax planning and advice, preparing or filing or assisting in preparing or filing returns or claims for refund or credit, and all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the Internal Revenue Service, rendering written advice with respect to any entity, transaction, plan or arrangement, and representing a client at conferences, hearings, and meetings.

(d) Effective/applicability date. This section is applicable for fee arrangements entered into after March 26, 2008.

§10.29 Conflicting interests.

(a) Except as provided by paragraph (b) of this section, a practitioner shall not represent a client before the Internal Revenue Service if the representation involves a conflict of interest. A conflict of interest exists if —

(1) The representation of one client will be directly adverse to another client; or
(2) There is a significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibilities to another client, a former client or a third person, or by a personal interest of the practitioner.

(b) Notwithstanding the existence of a conflict of interest under paragraph (a) of this section, the practitioner may represent a client if —

(1) The practitioner reasonably believes that the practitioner will be able to provide competent and diligent representation to each affected client;
(2) The representation is not prohibited by law; and
(3) Each affected client waives the conflict of interest and gives informed consent, confirmed in writing by each affected client, at the time the existence of the conflict of interest is known by the practitioner. The confirmation may be made within a reasonable period of time after the informed consent, but in no event later than 30 days.

(c) Copies of the written consents must be retained by the practitioner for at least 36 months from the date of the conclusion of the representation of the affected clients, and the written consents must be provided to any officer or employee of the Internal Revenue Service on request.

(d) Effective/applicability date. This section is applicable on September 26, 2007.

§10.34 Standards with respect to tax returns and documents, affidavits and other papers.

(a) Tax returns.

(1) A practitioner may not willfully, recklessly, or through gross incompetence —

(i) Sign a tax return or claim for refund that the practitioner knows or reasonably should know contains a position that —

(A) Lacks a reasonable basis;

(B) Is an unreasonable position as described in section 6694(a)(2) of the Internal Revenue Code (Code) (including the related regulations and other published guidance); or

(C) Is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in section 6694(b)(2) of the Code (including the related regulations and other published guidance).

(ii) Advise a client to take a position on a tax return or claim for refund, or prepare a portion of a tax return or claim for refund containing a position, that —

(A) Lacks a reasonable basis;

(B) Is an unreasonable position as described in section 6694(a)(2) of the Code (including the related regulations and other published guidance); or

(C) Is a willful attempt by the practitioner o understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in section 6694(b)(2) of the Code (including the related regulations and other published guidance).

(2) A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted willfully, recklessly, or through gross incompetence.

(b) Documents, affidavits and other papers —

(1) A practitioner may not advise a client to take a position on a document, affidavit or other paper submitted to the Internal Revenue Service unless the position is not frivolous.

(2) A practitioner may not advise a client to submit a document, affidavit or other paper to the Internal Revenue Service —

(i) The purpose of which is to delay or impede the administration of the Federal tax laws;

(ii) That is frivolous; or

(iii) That contains or omits information in a manner that demonstrates an intentional disregard of a rule or regulation unless the practitioner also advises the client to submit a document that evidences a good faith challenge to the rule or regulation.

(c) Advising clients on potential penalties —

(1) A practitioner must inform a client of any penalties that are reasonably likely to apply to the client with respect to —

(i) A position taken on a tax return if —

(A) The practitioner advised the client with respect to the position; or

(B) The practitioner prepared or signed the tax return; and

(ii) Any document, affidavit or other paper submitted to the Internal Revenue Service.

(2) The practitioner also must inform the client of any opportunity to avoid any such penalties by disclosure, if relevant, and of the requirements for adequate disclosure.

(3) This paragraph (c) applies even if the practitioner is not subject to a penalty under the Internal Revenue Code with respect to the position or with respect to the document, affidavit or other paper submitted.

(d) Relying on information furnished by clients. A practitioner advising a client to take a position on a tax return, document, affidavit or other paper submitted to the Internal Revenue Service, or preparing or signing a tax return as a preparer, generally may rely in good faith without verification upon information furnished by the client. The practitioner may not, however, ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.
(e) Effective/applicability date. Paragraph (a) of this section is applicable for returns or claims for refund filed, or advice provided, beginning August 2, 2011. Paragraphs (b) through (d) of this section are applicable to tax returns, documents, affidavits, and other papers filed on or after September 26, 2007.

§10.35 Competence.

(a) A practitioner must possess the necessary competence to engage in practice before the Internal Revenue Service. Competent practice requires the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged. A practitioner may become competent for the matter for which the practitioner has been engaged through various methods, such as consulting with experts in the relevant area or studying the relevant law.
(b) Effective/applicability date. This section is applicable beginning June 12, 2014.

§10.36 Procedures to ensure compliance.

(a) Any individual subject to the provisions of this part who has (or individuals who have or share) principal authority and responsibility for overseeing a firm's practice governed by this part, including the provision of advice concerning Federal tax matters and preparation of tax returns, claims for refund, or other documents for submission to the Internal Revenue Service, must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with subparts A, B, and C of this part, as applicable. In the absence of a person or persons identified by the firm as having the principal authority and responsibility described in this paragraph, the Internal Revenue Service may identify one or more individuals subject to the provision of advice concerning Federal tax matters and preparation of tax returns, claims for refund, or other documents for submission to the Internal Revenue Service, must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with subparts A, B, and C of this part, as applicable. In the absence of a person or persons identified by the firm as having the principal authority and responsibility described in this paragraph, the Internal Revenue Service may identify one or more individuals subject to the provisions of this part responsible for compliance with the requirements of this section.
(b) Any such individual who has (or such individuals who have or share) principal authority as described in paragraph (a) of this section will be subject to discipline for failing to comply with the requirements of this section if—

(1) The individual through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that the firm has adequate procedures to comply with this part, as applicable, and one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, of failing to comply with this part, as applicable;

(2) The individual through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that firm procedures in effect are properly followed, and one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, of failing to comply with this part, as applicable; or

(3) The individual knows or should know that one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, that does not comply with this part, as applicable, and the individual, through willfulness, recklessness, or gross incompetence fails to take prompt action to correct the noncompliance.
(c) Effective/applicability date. This section is applicable beginning June 12, 2014.

§10.37 Requirements for written advice.

* * *
(b) Reliance on advice of others. A practitioner may only rely on the advice of another person if the advice was reasonable and the reliance is in good faith considering all the facts and circumstances. Reliance is not reasonable when—

(1) The practitioner knows or reasonably should know that the opinion of the other person should not be relied on;

(2) The practitioner knows or reasonably should know that the other person is not competent or lacks the necessary qualifications to provide the advice; or

(3) The practitioner knows or reasonably should know that the other person has a conflict of interest in violation of the rules described in this part.

➠ Answer Key to Ethics Case Studies

1. <u>Growing Pains</u>
   a. Hiring Mike:
      i. Does Mike have the requisite competence to perform work under the circumstances?
      ii. Should you be concerned with what you learned about Mike from Seaver Pensions?
      iii. What if Mike tells you that Seaver was less than scrupulous and that "doing things his own way" meant trying to actually follow the rules?
      iv. If you do hire Mike, should you allow him to bring his clients even though it might be a violation of his non-compete agreement?
      v. Is there any harm in sending out some sort of communication to those clients announcing that Mike has joined your firm?

   Section 10.35 notes that "A practitioner must possess the necessary competence to engage in the practice before the Internal Revenue Service. Competent practice requires the appropriate knowledge, skill, thoroughness, and preparation necessary for the matter…"

   Section 10.36 requires a practitioner who has the principal responsibility of overseeing a firm's practice of preparing returns or documents to take reasonable steps to ensure that the firm and its members comply with Circular 230. It is a violation if the practitioner knows or should know if a member engages in a pattern of noncompliance and does not correct it.

   Do you owe any obligation, moral or possibly legal, to Seaver Pensions when you learn that there may be a non-compete agreement in place? Does it matter whether or not Mr. Seaver is an ASPPA member? Does it matter that he has a reputation for doing shoddy work.

   At a minimum, a call to your attorney would be advisable regarding scope of non-compete and how you should deal with that issue, if you decide to hire Mike.

b. Hiring Carol
   i. Does she have the requisite competence to perform?
   ii. Under the right circumstances, Carol would be a perfectly good candidate. What about these circumstances?

Sections 10.35 and 10.36 apply.
Given your limited availability to train a new employee, what additional steps (if any) might be required to satisfy these sections beyond making sure the candidate reads the instructions and takes a basic ERISA course? Consider getting "back office" help from other TPA firms in your area to get you through the crunch. Consider whether assignments can be reallocated so that the "easier" cases can be worked by Carol. Will need to make sure she gets appropriate supervisory help.

c. Other options? Can workload be redistributed, non-urgent cases put on hold, so that some of the new work can be handled by existing staff. Consider advertising the position again. Perhaps work out an arrangement with a local TPA that might have time to do the work on a subcontractor basis.

2. <u>Did we forget to mention that</u>?
   a. Knowing that this is intended to be a short term engagement (only 2 - 3 years), is it appropriate for you to charge an increased fee for the annual compliance/administration work?
      i. What would be the basis for charging a higher fee for the same work?
      ii. Do you normally amortize certain fixed costs over a longer life-expectancy for client relationships?
      iii. Would it make more sense to charge the additional amount as a conversion or deconversion fee instead of increasing the fees for the annual recurring work.

   Section 10.27 prohibits charging unconscionable fees. That is a subjective standard based on specific facts and circumstances. Conceptually, as long as there is some justification and it is not a matter taking advantage of a client that is backed into a corner, it doesn't seem there would be anything inherently wrong with increasing the fee.

   b. Once you become aware that former employees are not being allowed to take distributions even though the plan permits immediate distribution on termination of employment, do you have an obligation to communicate the discrepancy to Ziggy even though it contradicts the advisor who referred you in?
      i. Does Ziggy understand all these details enough to make an informed decision?
      ii. What if Ziggy has already told you he doesn't want to be involved and that you should consider any direction from the advisor to be a direction from him?

   Section 10.21 provides that when a practitioner becomes aware of an omission by a client, the practitioner must inform the client of the consequences of the omission.
   Section 10.34(c) requires a practitioner to inform clients of penalties that are likely to apply with respect to a position that client intends to take.
   The ASPPA code of conduct requires members to take appropriate steps to ensure professional communication is appropriate for the circumstances and the intended audience.
   Both Circular 230 and the ASPPA code require consideration of conflicts of interest between a client and other parties in determining whether and how services are to be provided and what must be communicated.

   c. Since the advisor is trying to avoid a surprise tax liability for the unsuspecting participants who are past due on their loans, are you able to help him get the loans back on track even though you know there is no intention to go through VCP or otherwise report the loans as deemed distributions?
      i. Would doing so create any ongoing qualification issues for the plan?

ii. Does the fact that deemed distributions of participant loans must be reported on Form 5500 impact your analysis?
iii. If your services include preparation of Forms 1099-R, does that impact your analysis?
iv. Could you prepare all forms, etc. as "drafts" so that Ziggy and/or the advisor can modify them as they deem appropriate before filing?

Section 10.22 - Diligence as to accuracy
Section 10.34 - Standards with respect to tax returns, etc.
The ASPPA code of conduct provides, "A Member shall not perform Professional Services when the Member has reason to believe that they may be altered in a material way or may be used to violate or evade the law."
Internal Revenue Code section 6694 imposes penalties on preparers who prepare covered returns in a manner that understates a tax liability.

d. Assume the advisor decides to go back to the previous TPA because they don't ask so many questions.

i. Does that change any of your obligations with respect to advising Ziggy of the compliance issues he faces?

ii. Assuming the answer to i. above is "Yes" and the client agreed to a higher fee, is it appropriate for you to charge for the time you spent on the conversion (you don't normally charge a conversion fee) and consulting since you will not actually be performing any of the annual compliance work?

This goes back to the issue of unconscionable fees. What does your service agreement provide? Section 10.28 notes that a dispute over fees generally does not relieve a practitioner of his or her obligation to return client records upon request.

3. Shake It Off?

a. What, if any, obligation do you have to bring your concerns to the attention of someone in a position of authority with respect to the plan?
   i. Who is your client? Presumably, it is not Taylor.

Under Circular 230 and the ASPPA code of conduct, your duties run to your client.

Comment. Don't put into your service agreement that you will report any malfeasance. Don't want to be contractually obligated if employer later questions why it wasn't informed sooner.

b. Assuming you feel compelled to communicate the concern, is it sufficient to tell the recordkeeper or advisor rather than going over Taylor's head to Tom?

If the advisor is acting in a fiduciary role, this may be appropriate. Otherwise, it would be incumbent upon you to follow up with whomever you ask to delegate this responsibility to ensure it's been done.

c. You eventually decide to discuss the matter with Tom, and he asks you to do a more detailed investigation and present him with a report of your findings, including all of the supporting calculations, account statements, transaction numbers, etc. You explain that you will need to charge for your time. He refuses to pay the additional fee but demands that you do the work, stating that if you would have paid closer attention, this never would have happened in the first place. Do you have an obligation to assist with the investigation without payment?

You are not required to perform services for which you are not compensated. However, ethical and professionalism concerns should be considered regarding your conduct during this period, at least with respect to the 2015 errors that might have been prevented had you acted more quickly in contacting the owner.

Comment. TPA should consider following up to see if corrections have been made because it can affect 5500 reporting (e.g., question regarding whether all benefits have been paid when due - Bob has not been paid his full benefit)

d. Is it appropriate for you to instruct the recordkeeper to freeze Taylor's account to prevent her from taking any more loans or in-service distributions until the issue is resolved?

Regarding loans, the fact that she has not properly paid back her loans would be an appropriate consideration regarding whether additional loans should be authorized. However, you are not the fiduciary and have no authority to direct the recordkeeper in this manner. It should be the employer or other appropriate fiduciary who should be doing this. Address the issue with that person. In addition, recommend that Taylor not be allowed to continue having direction authority regarding allocations and disbursements. If she is otherwise allowed to take in-service distributions, it is generally not appropriate to preclude that right. Funds that don't belong to Taylor can be reallocated as improper allocation.

4. <u>What's The Worst That Could Happen</u>?
   a. Should you accept the engagement?
      i. Do you have the required competence to prepare the Form 5500 for the DB plan under the circumstances?
      ii. Can you reasonably rely on the information provided to you by the actuarial firm?

Section 10.22 describes the due diligence a practitioner must exercise to ensure accuracy.

Section 10.22(b) allows a practitioner to rely on work performed by another party if the practitioner used "reasonable care in engaging, supervising, training, and evaluating" that party.

In addition to Section 10.35, ASPPA's code of conduct provides that a member shall only perform services when qualified to do so based on education, training and experience.

Various other sections (10.34, 10.36 and 10.37) include limitations on relying on information furnished by others - whether a client or other professional - if the preparer reasonably should know that information is inaccurate, incomplete, or lacks reasonable basis.

b. Are there any special circumstances or caveats that apply?
   i. Could you engage an independent actuary to review the work prepared by the national firm to provide you assurances as to the accuracy?
   ii. Would it be appropriate to charge C&M for this additional review?

Engaging an independent actuary is one possible solution. However, you would still be subject to Circular 230's requirements to exercise appropriate due diligence in selecting the independent actuary.

Section 10.27 prohibits charging unconscionable fees. That is a subjective standard based on specific facts and circumstances, but simply passing through the actuary's review fee or even building in some additional fee to compensate you for the time and effort to coordinate the review should generally not be a problem as long as everything is adequately disclosed.

c. Does the analysis change if, to your knowledge, there have not been any previous mistakes made by the national firm? You would still be obligated to determine, on some level, the degree to which you can rely on information furnished by your client or by another professional. However, absent any prior errors by the national firm, you might more readily conclude that their information is reliable.

1. Growing Pains

Facts

In February 2017 you learn that you won a block of 50 new plans from a referral source you've been courting for several years. She wants you to take over immediately and do the work for the 2016 plan year. The challenge is that you were already at capacity before one of your top administrators quit last week. You need to hire quickly but don't have the time to go through your regular, detailed recruiting/interview process. You just need to get the work out the door, so you consider hiring the first two candidates who present themselves - Mike and Carol.

- ➤ Mike has 10 years of experience working for Seaver Pensions across town, but recently left that position. As a bonus, he tells you that he can bring over a small group of clients who are "loyal to him." Since you know the owner of Seaver Pension, you make a telephone call to ask about Mike. You learn that while being very bright, Mike "preferred to do things his way" and that he was fired for taking "too many shortcuts." In fact, several of Seaver's clients complained about Mike making mistakes. It also comes to light that Seaver requires all of its employees to sign non-complete agreements.
- ➤ Carol recently graduated from the local university with an accounting degree. She had a summer internship at a CPA firm but has no experience dealing with qualified retirement plans. While Carol would be an excellent candidate, you know you will have little time to do any training over the next few months. She assures you, however, that she will read the Form 5500 Instructions "cover to cover" and take an online course to cover the basics before she starts work.

Questions

a. What considerations would you have in hiring Mike?

b. What considerations would you have in hiring Carol?

c. Are there other options you should consider in taking on the business?

2. Did We Forget To Mention That?

Facts

Spiders From Mars, Inc. (SFM) sold all of its assets to Scary Monsters, Inc. However, Ziggy (the owner of SFM) is going to keep the company intact to pursue a new venture that he expects to generate significant income over 2 to 3 years. After that, Ziggy intends to dissolve the company. Five (5) of the employees will remain at SFM. The other several hundred terminate employment on Friday, March 29th and begin working for Scary Monsters on Monday, April 1st. In November of that year, the investment advisor asks if you will take over as TPA for the SFM plan, which is one of his largest clients. He explains that because of the short-term nature of the project they are working on and the goal to eventually wind down the company, your services will likely only be needed for 2 or 3 years. No mention is made of the asset sale 8 months prior. You thank the advisor for the referral, send out your regular service agreement along with any requisite caveats or additional fees in anticipation of the termination of the plan in a couple years. SFM signs the agreement, and you begin collecting all of the regular takeover paperwork - plan documents, prior testing, etc.

- ➤ As you are wrapping up the conversion, Ziggy mentions something about having sold the company and that some former employees are asking about getting access to their balances. Before you can inquire about this new tidbit of information, the advisor reminds Ziggy that they told all of the former employees that they had to wait to take distributions until the earlier of SFM's dissolution or their termination of employment with Scary Monsters.
- ➤ Not wanting to second-guess the advisor in front of Ziggy, you have a separate phone call in which he gives you the details about the asset sale and confirms what participants were told about distributions. He further states that since this is his largest client and he has recently gone through an expensive divorce, he can't afford the loss of income that would result if participants were allowed to take distributions right away.
- ➤ Even more interestingly, he tells you that he needs your help to get the former employees back on track with making their loan payments to the SFM plan since none have been made since the sale.
- ➤ When you explain that all of those loans have passed the cure period and would require a VCP filing to avoid the deemed distributions, he tells you he believes it would be a breach of his fiduciary duty to advise Ziggy to confess his sins to the IRS. Instead, he wants you "think about the good of the participants" and simply get the loans back on track without "making a big deal out of it."

Questions

a. Knowing that this is intended to be a short term engagement (only 2 - 3 years), is it appropriate for you to charge an increased fee for the annual compliance/administration work?

b. Once you become aware that former employees are not being allowed to take distributions even though the plan permits immediate distribution on termination of employment, do you have an obligation to communicate the discrepancy to Ziggy even though it contradicts the advisor who referred you in?

c. Since the advisor is trying to avoid a surprise tax liability for the unsuspecting participants who are past due on their loans, are you able to help him get the loans back on track even though you know there is no intention to go through VCP or otherwise report the loans as deemed distributions?

d. Assume the advisor decides to go back to the previous TPA because they don't ask so many questions.

   i. Does that change any of your obligations with respect to advising Ziggy of the compliance issues he faces?

   ii. Assuming the answer to i. above is "Yes" and the client agreed to a higher fee, is it appropriate for you to charge for the time you spent on the conversion (you don't normally charge a conversion fee) and consulting since you will not actually be performing any of the annual compliance work?

3. Shake It Off?

Facts

Swift, Inc. sponsors a 401(k) plan for which you have been the TPA for several years. Taylor has been the office manager for Swift for 20+ years, but she is not an owner or officer. She has been your contact for the plan for as long as you have worked on it, and the two of you have become pretty good friends over the years.
Shortly after Swift funds its profit sharing contribution for 2014, you are reviewing the account of Bob, a participant who terminated in early 2015, and notice that no profit sharing contribution was deposited for him despite the fact that he was on the allocation schedule you provided to Taylor. Since the plan has a last day rule, Taylor must have assumed Bob's recent termination meant he shouldn't receive an allocation even though he was employed at the end of 2014. You call Taylor and explain the situation to her, and she assures you she will take care of it right away. She was planning to pay off her participant loan anyway, so she could send in Bob's contribution at the same time. You take her at her word without giving it a second thought.

- ➤ As you approach the end of 2015, you run a quick contribution report and notice that the total profit sharing contribution squares to the penny with what you calculated (including the amount for Bob).
- ➤ Taylor tells you Swift is eager to make its 2015 profit sharing contribution as quickly as possible and asks if you can expedite your year-end work.
- ➤ In the course of doing so, you discover that Bob's profit sharing contribution from 2014 was deposited into Taylor's account. You didn't notice before, because the total contribution was correct.
- ➤ You recall Taylor mentioning sending in her loan payoff at the same time, so you assume it was a simple oversight.
- ➤ You've just finished the 2015 calculations, so you inform Taylor of the need to correct Bob's account at the same time you give her the allocation of the 2015 contribution.
- ➤ You really like Taylor and want to help her make sure everything is adjusted properly, so you give it a couple weeks before logging into the recordkeeper's website to make sure all is in order.
- ➤ Not only do you discover that Taylor/Bob discrepancy has not been fixed, but you also see that Taylor has since taken a new loan and paid it off already, which is odd because you never received notification from the recordkeeper that there was a loan request pending.
- ➤ You dig a little further and see that there are two participants who were there at the end of 2015 but terminated in early 2016 who did not receive their allocations for 2015. It turns out that the sum of the missed allocations for those two participants is exactly equal to the amount of the loan and subsequent payoff in Taylor's account.

There are now a few too many "accidents" for your comfort. Even though you have never really worked much with Tom, the owner of Swift, you wonder whether it is appropriate to bring this to his attention.

<u>Questions</u>

a. What, if any, obligation do you have to bring your concerns to the attention of someone in a position of authority with respect to the plan?

b. Assuming you feel compelled to communicate the concern, is it sufficient to tell the recordkeeper or advisor rather than going over Taylor's head to Tom?

c. You eventually decide to discuss the matter with Tom, and he asks you to do a more detailed investigation and present him with a report of your findings, including all of the supporting calculations, account statements, transaction numbers, etc. You explain that you will need to charge for your time. He refuses to pay the additional fee but demands that you do the work, stating that if you would have paid closer attention, this never would have happened in the first place. Do you have an obligation to assist with the investigation without payment?

d. Is it appropriate for you to instruct the recordkeeper to freeze Taylor's account to prevent her from taking any more loans or in-service distributions until the issue is resolved?

4. What's The Worst That Could Happen?

<u>Facts</u>

Thanks to an investment advisor who is a key referral source for your company, Crusher & McCoy, P.C. (a 350+ participant medical practice) has just hired you to provide TPA services for its 401(k) plan. There will also be a change in recordkeepers. In addition to the 401(k), C&M also sponsors a traditional defined benefit plan, the actuarial work for which is performed by a large, national financial institution. You do not provide services to DB plans, so you don't mind that C&M prefers to keep the DB plan with the national provider.

➤ During the conversion of the 401(k) plan, it comes to light that said national firm has made some rather significant mistakes with respect to benefit calculations as well as the actual distribution of benefits.

➤ It also comes out that the C&M's accounting firm has reluctantly been preparing the Form 5500 for the DB plan, because the actuarial firm will not prepare it.

➤ Due to the other plan-related changes, the CPA sees a great opportunity to extricate itself from providing this service.

➤ The investment advisor, faced with having to bring another new provider into the mix, asks if you would be willing to prepare the Form 5500 for the DB plan. He suggests that if you will not, C&M might get fed up and move everything to a bundled arrangement.

<u>Questions</u>

a. Should you accept the engagement?

b. Are there any special circumstances or caveats that apply?

c. Does the analysis change if, to your knowledge, there have not been any previous mistakes made by the national firm?

NIPA National Institute of Pension Administrators Sacramento Valley Chapter

WP&BC Western Pension Benefits Council Sacramento

Capital Forum on Pensions 2016

The State of Retirement Plans

May 25, 2016

Presented by

James C. Paul • Beth Harrington • Ilene H. Ferenczy

Paul Benefits Law Corp.

benefit resources inc.

FERENCZY BENEFITS LAW CENTER LLP
Your ERISA Edge

Agenda

- Quick review of the current service provider situation and what we've seen change over the years …
- Trends for the future
- Preparing for the trends

WHERE ARE WE NOW?

TPAs/FAs: The Consistent Elements in Retirement Plan Services

Insurance Companies

Banks

Savings & Loans

Financial Institutions

Opportunities and Challenges

- Public awareness of retirement readiness is relatively high
  - Employees care about the availability of retirement plans
  - Employers want to help employees save
- Compliance is harder and more challenging … for our clients and for us

Opportunities and Challenges

- Government involvement is high
  - IRS (always)
  - DOL
  - SEC
  - FINRA
  - SSA
  - Congress
  - Courts

Operational Compliance

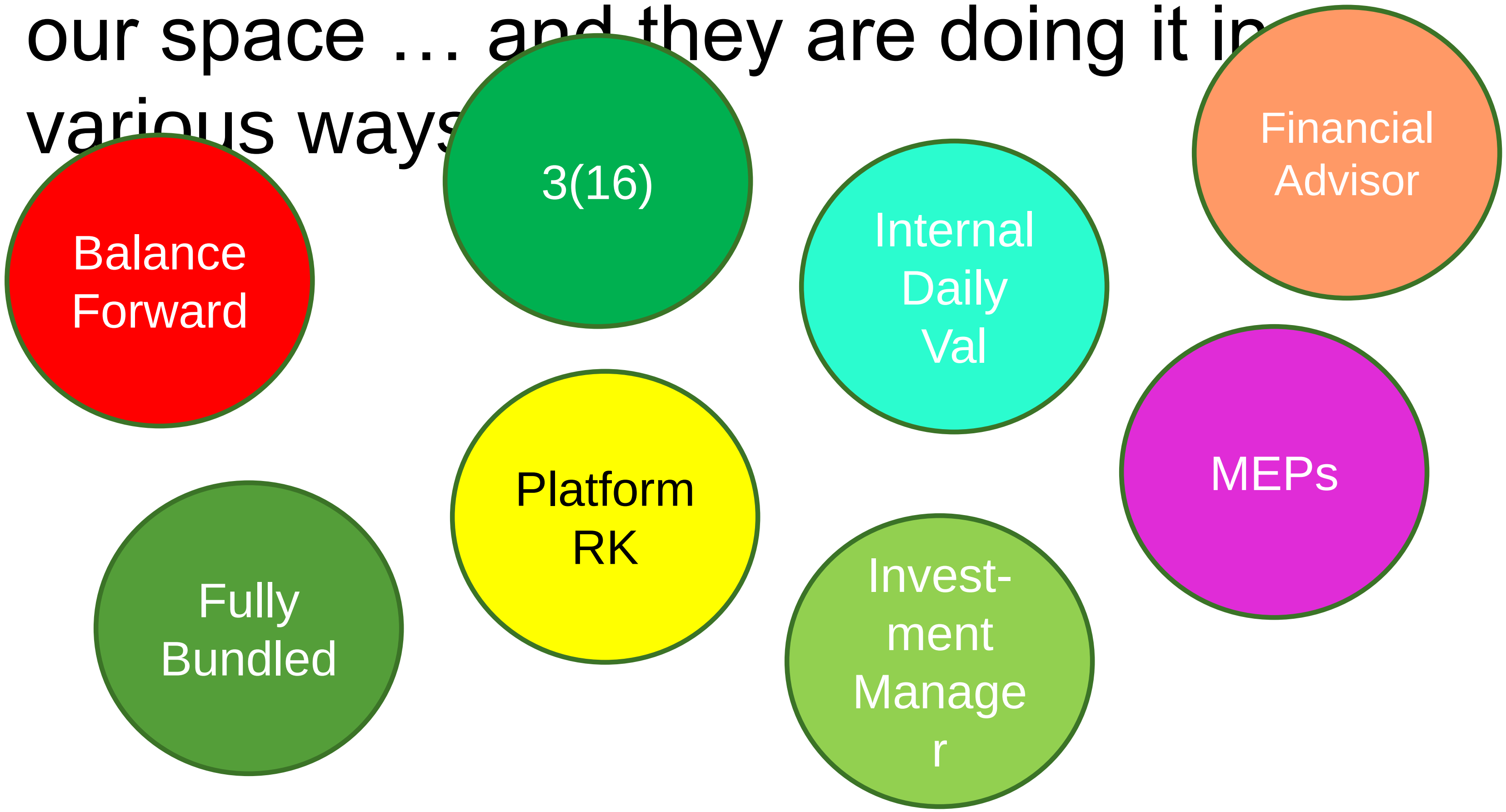
Financial Industry Issues

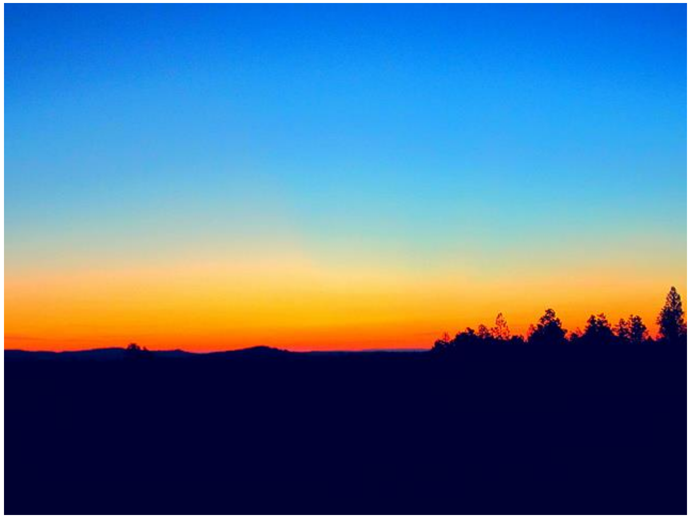
Budgetary Considerations

Participant and Legal Concerns

Opportunities and Challenges

- There are a lot of people doing business in our space … and they are doing it in various ways

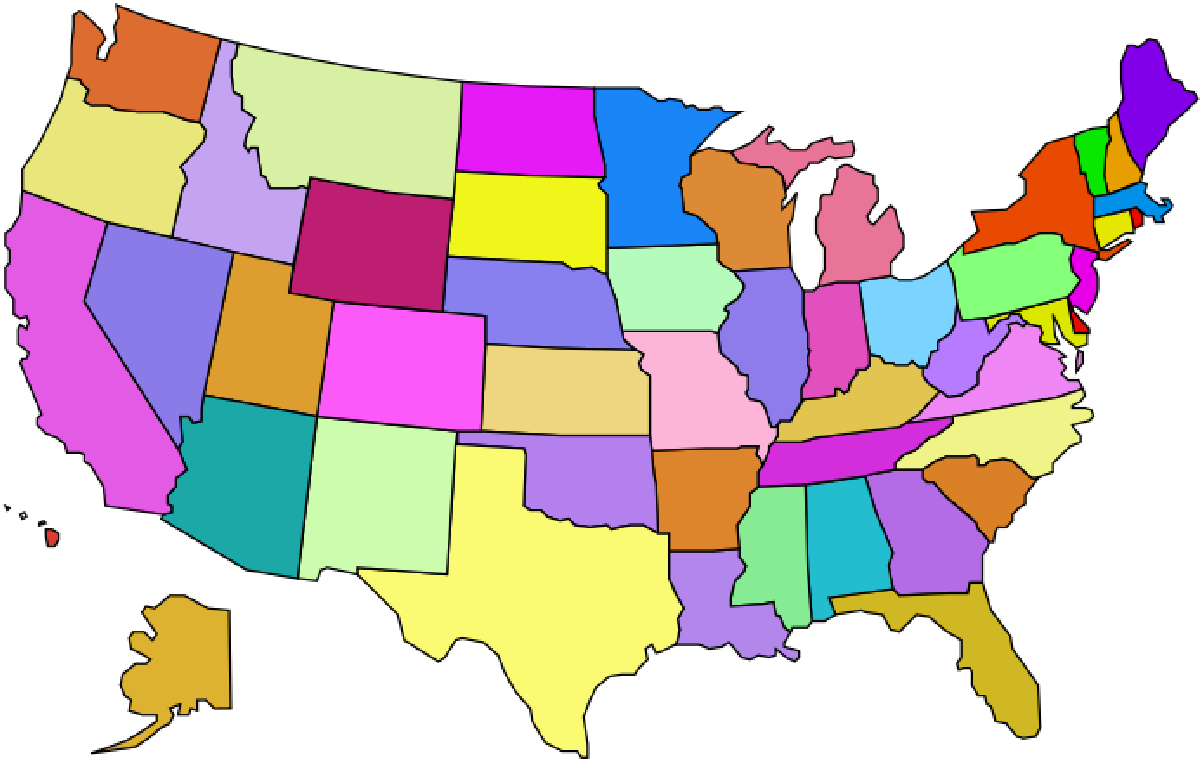




WHAT’S ON THE HORIZON …

Fiduciary Regulations

State Retirement Savings Programs



MEPs

3(16) Administration

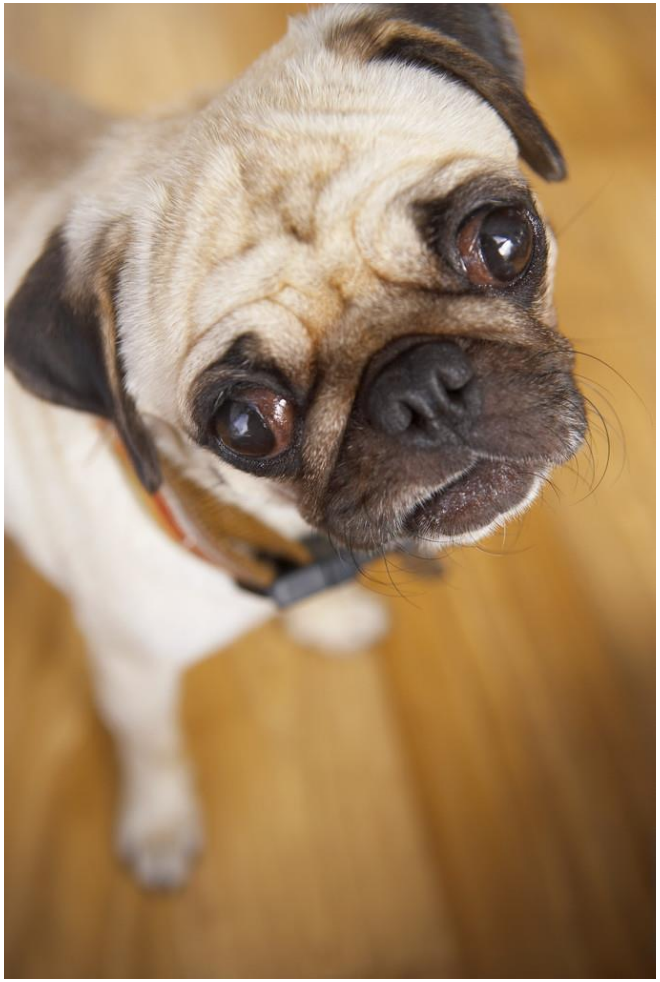
Tax Reform

Litigation – Especially Class Actions

Fenwirth was known for his uniquely gullible style of cross-examination.

The IRS

WHO WILL SUCCEED?



The Retirement Business Is Not for Sissies

So, We Need to Be

- Flexible

- In touch with what's happening

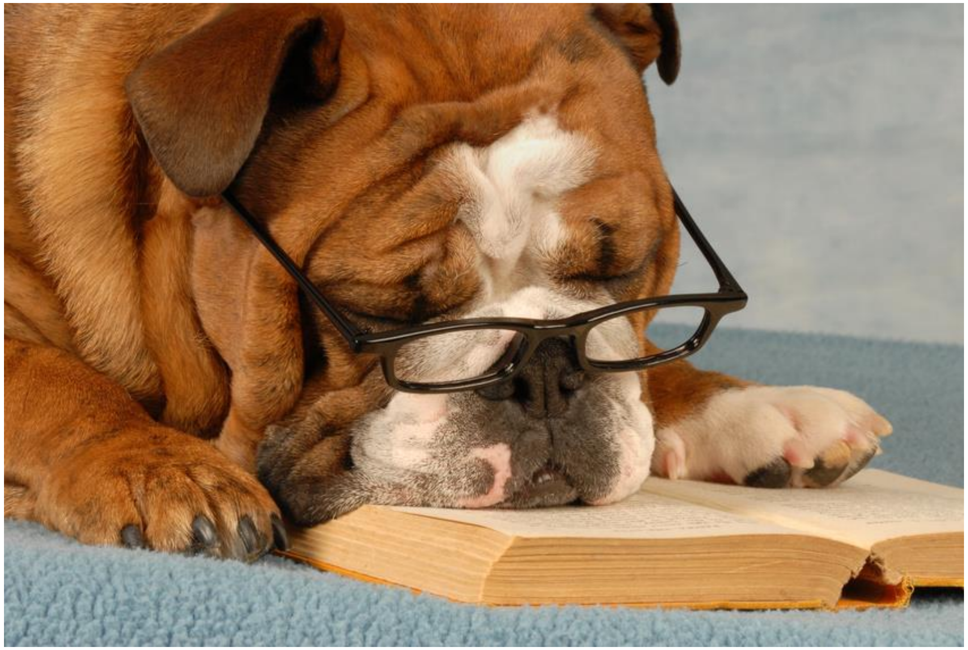
- Innovative

You Need to Figure Out What You Will Look Like in the Future

How Will You Be Fed …?

Who in Your Company …

Has Vision?



Hunting for the Right People

(they might be right behind you)

Staying Educated

Conclusion

Questions?

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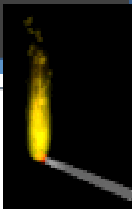

Mission Possible?

Correcting Common and Not-So-Common Plan Failures

Capital Forum On Pensions

May 25, 2016

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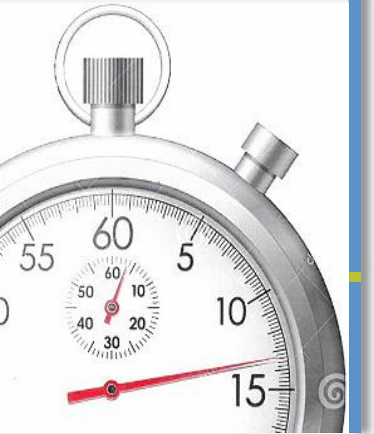
CHANG RUTHENBERG & LONG PC
EMPLOYEE BENEFITS LAWYERS

- Overview of Employee Plans Compliance Resolution System (EPCRS) Changes
- Issues That Are Not Covered By EPCRS
- EP Voluntary Closing Agreement Program
- Case Studies



Revenue Procedure 2015-27 Highlights

- Correcting plan overpayments
- Self-correcting 415 annual additions
- VCP fees when sole failure is required minimum distribution failure
- VCP fees when sole failure is participant loan failure
- VCP fees for regular VCP applications

VCP Fees: Failure to Make Required Minimum Distributions (RMD) That Would Cause IRC 4974 Excise Tax (sole failure)

Fees under Rev. Proc. 2013-12		New fees under Rev. Proc. 2015-27	
Number of Participants with RMD Failure	**Fee**	**Number of Participants with RMD Failure**	**Fee**
50 or Fewer	$500	150 or Fewer	$500
More than 50	Regular fee schedule based on number of participants	151 to 300	$1,500
		More than 300	Regular fee schedule based on number of participants

VCP Fees: Participant Loans Not Satisfying IRC 72(p) (sole failure)

Rev. Proc. 2013-12

- Failure can't impact more than 25% of participants
- Fee is 50% of regular fee schedule, based on number of plan participants

Number of Participants	Fee
20 or fewer	$ 375
21 to 50	$ 500
51 to 100	$ 1,250
101 to 500	$ 2,500
501 to 1,000	$ 4,000
1,001 to 5,000	$ 7,500
5,001 to 10,000	$ 10,000
Over 10,000	$ 12,500

Rev. Proc. 2015-27

- Failure can't impact more than 25% of participants
- Fees based on the number of participants with loan failures

Number of Participants with loan failures	Reduced Fee
13 or fewer	$ 300
14 to 50	$ 600
50 to 100	$ 1,000
101 to 150	$ 2,000
Over 150	$ 3,000

Revenue Procedure 2015-28 Highlights

- New safe harbor correction for the failure to implement election for 401(k)/403(b) plans with automatic enrollment
- New safe harbor corrections for elective deferral failures corrected within a short time (all 401(k)/403(b) plans)

New Fees for Regular Submissions Under VCP for Qualified Plans and 403(b) Plans Effective February 1, 2016, Rev. Proc. 2016-8

Rev. Proc. 2013-12

Number of Participants	Fees
20 or fewer	$750
21 to 50	$1,000
51 to 100	$2,500
101 to 500	$5,000
501 to 1,000	$8,000
1,001 to 5,000	$15,000
5,001 to 10,000	$20,000
Over 10,000	$25,000

Rev. Proc. 2016-8

Number of Participants	Fees
20 or fewer	$500
21-50	$750
51-100	$1,500
101-1,000	$5,000
1,001-10,000	$10,000
Over 10,000	$15,000

Issues That Are Not Covered by EPCRS

- Diversion or Misuse of Plan Assets – (See section 4.12 of Rev. Proc. 2013-12)
- Abusive Tax Avoidance Transactions (See section 4.13 of Rev. Proc. 2013-12)
- Matters Subject to Excise or Other Taxes (See section 6.09 of Rev. Proc. 2013-12)
  - EPCRS not available for events for which the Code provides tax consequences other than plan disqualification (such as the imposition of excise or additional income tax) including:
    - Funding deficiencies due to failures to make required contributions under Code section 412
    - Prohibited transactions
    - Failure to file Forms 5500

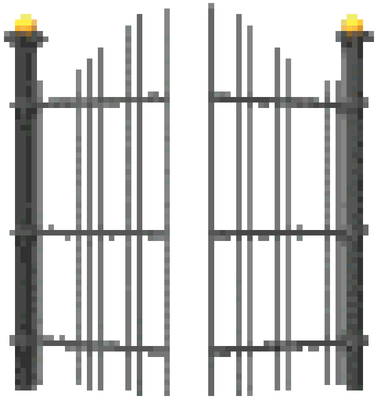
EP Voluntary Closing Agreements

- IRS announced in *Employee Plans News*, issue 2013-10, 12/19/13
  - *http://www.irs.gov/pub/irs-tege/epn_2013_10.pdf*

- A uniform system for handling requests in EP Voluntary Compliance
  - For issues that are not eligible for EPCRS

What is a Closing Agreement?

- A final agreement between the IRS and a taxpayer to resolve a tax issue authorized under IRC sec. 7121
- Meant to provide finality to issue
- Can only be changed due to
  - fraud, malfeasance, or misrepresentation of material fact
- In complete discretion of IRS Commissioner



Treas. Reg. Section 301.7121-1(a):

- The Commissioner may enter into a written agreement with any person relating to the liability of such person …
- in respect of any internal revenue tax for any taxable period...
- in any case in which there appears to be an advantage
  - in having the case permanently and conclusively closed, or
  - TP shows good and sufficient reasons and no disadvantage to U.S.

Rationale for Closing Agreements

- May be entered into if:
- Benefit in having the case permanently and conclusively closed; or
- Good and sufficient reasons by the taxpayer for desiring such an arrangement; and
- Not detrimental to the United States

When VCA Is Appropriate?

- Income or Excise Tax
- Plans:
  - QPs 401(a),QPs with GACs, 403(a), TSA 403(b), SEP 408(k), Simple 408(p)
  - No 457 plans
    - 457(b) use EPCRS
    - 457(f) expressly excluded
  - IRAs under 408
- Not under audit/investigation
- Not willful or abusive avoidance

Guidelines for Submitting VCA Request

- In most cases, IRS won't negotiate over income or excise tax amounts but may discuss penalty abatement
- For ERISA covered plans, any prohibited transactions should be corrected in DOL Voluntary Fiduciary Correction Program first
- All actions listed in the closing agreement must be completed before it is signed

Guidelines for Submitting VCA Request

- A VCA request does not prevent an IRS exam of plan or plan sponsor
- If plan or plan sponsor is examined after submitting VCA request, then EP Voluntary Compliance will consult with exams to see if issue should be precluded from exam – not available for anonymous requests

Guidelines for Submitting VCA Request

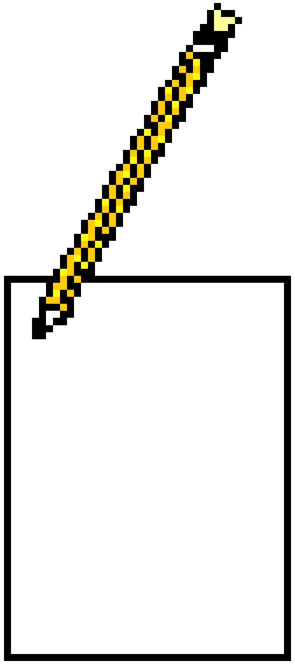
- A VCA is not appropriate to address a future event that may impact tax-favored status of plan or seek guidance on issues or actions that may impact retirement plan
- If there is willful or intentional plan to avoid paying or reporting taxes, EP reserves right to refer the VCA request to exams

New Umbrella VCA for Late Adopters

- Deadline for adopting preapproved PPA restatement was 4/30/16
- ERs who missed could file under VCP
- Now Sponsor of pre-approved document may file VCA for group of ERs
  - Need 20 plans
  - $5,000 fee for first 20, $250/plan thereafter
  - Consent of ER
  - Prior compliance
  - Can add ERs afterward

Request for VCA: Procedure

- Letter setting forth:
  - Eligibility
  - Details of problem and tax consequences
  - Proposed correction
  - How tax, penalties and interest were calculated
  - Proposed audit sanction and how calculated
- Signed by authorized individual
- May be Anonymous
- No User Fee-even if combined with VCP submission , don't submit user fee



What Should Taxpayer Show?

- To increase the likelihood that the IRS will enter into a voluntary closing agreement, a taxpayer should be prepared to show:
  - the taxpayer is willing to furnish necessary facts and documentation to establish its tax liabilities
  - the agreement is in the best interest of both the IRS and the taxpayer
  - the federal government will suffer no disadvantage from entering into the closing agreement, and
  - any Internal Revenue Code violation or tax deficiency was unintentional

What Can Be Fixed By VCA?

- ROBS
- IRAs
- PT excise taxes
- ESOPs 409(p)
- Reporting
  - 1099R
  - notices

Loans

- Loans to parties in interest are prohibited transactions
  - Statutory exemption for Participant Loans
- Participant Loans are distributions unless they meet Code section 72(p)
- EPCRS only addresses participant loans that fail to meet 72(p)

PT Exemption for Participant Loans

- PT Exemption for bona fide loans to participant or beneficiary
- Bona fide loan:
  - must be adequately secured;
  - a reasonable interest rate;
  - a definite repayment schedule; and
  - the availability of loans must be on a non-discriminatory basis. ERISA §408(d)(1) and I.R.C. §4975(d)(1).

Participant Loans under 72(p)

- Must have legally enforceable agreement in writing or electronic form
- Outstanding balance from all plans of ER may not exceed the lesser of $50,000 or 50% of the participant's non-forfeitable accrued benefit.
- No more than 5 year term (unless for first-time home)
- Level amortized payments at least quarterly
- Must be authorized by plan doc

Loans-Case Studies

- Plan makes loans to participants that meet section 72(p) but plan document does not provide for such loans
- VCP correction:
- Adopt retroactive plan amendment permitting loans
  - Can use Form 14568-I Correction by Plan Amendment

Loans-Case Studies
Excess Amount-No Payment Yet

- Loan made 6/1/16 exceeds $50,000/50%
  - $70,000 loan, amortized quarterly payments over 5 years
- VCP correction-no repayments made yet:
  - Repayment of excess
    - Pay back $20,000 by 9/1/16
  - Relief from Form 1099R filing

- Can use Form 14568-E
  - Unless affected participants are key EEs or owner-EEs and asking for more relief than just reporting in year of correction instead of year of loan

Loans-Case Studies
Excess Amount-Payments Began

- Loan made 6/1/15 exceeds $50,000/50%
  - $70,000 loan, payable over 5 years
- VCP correction-repayments made choice of:
  - Applying payments only to non-excess amount
    - Repayment is $20,000, plus interest
  - Applying to interest on excess then on allowed amount
    - Repayment is $20,000
  - Applying pro rata
    - Repayment is balance of excess

Loans-Case Studies
Default

- Participant Loan of $50,000 made 6/1/15
  - Five year amortization payable quarterly
- Participant fails to pay/defaults for first year
- VCP Correction?
  - Participant repays missed payments plus interest and resumes payment schedule; or
  - Re-amortize loan over remaining 4 years

Loans-Case Studies
Excess Repayment Period

- Participant Loan of $50,000 made 6/1/15
  - Payable over 10 years evenly amortized
  - Principal payments of $5,000/yr
- VCP Correction-Re-amortize over remaining 4 years
  - Original maximum term has not expired
  - Principal payments of $11,250 annually next 4 years

Loans-Case Studies
Maximum Term Expired

- Participant Loan of $50,000
- Made 6/1/10 with a demand note
- VCP Correction?
  - Not eligible for correction w/o tax because max term expired 6/1/15
  - Can correct by treating as distribution and ER paying income tax withholding
- VCA Correction?
  - Pay it back?
  - ER relief from 1099R filing from date made

Actual IRS VCA Case Study Loans

- The plan allowed for participant loans
- Due to an error in the administrator's program, the loan payments were not sufficient to pay the loans in full by the end of the 5-year period
- Under 72(p), the loans are consider deemed distributions
- The participant paid the loans in accordance with the payment schedules
- The plan administrator agrees that the loans should be considered deemed distributions, however request that the Service not require the issuance of forms 1099-R

Hardship Distribution Issues

- ASPPA Annual Conference Video
- https://vidforweb-8.wistia.com/medias/nt1b3xq5h7
- A 401(k) plan may allow participants to receive a hardship distribution because of immediate and heavy financial need with distributions limited to the amount necessary to meet that need

Hardship Distribution Issues

- Immediate and heavy financial need is limited to the following:
  - Medical care expenses incurred by or necessary for employee, spouse or dependents
  - Costs directly related to the purchase of a principal residence for the employee (excluding mortgage payments)
  - Payment of tuition, related educational fees, and room and board expenses for the next 12 months of post-secondary education for the employee, spouse, children or dependents.

Hardship Distribution Issues

– Payments necessary to prevent eviction of the employee from the employee’s principal residence or mortgage foreclosure on that residence
– Funeral expenses for the employee’s deceased parent, spouse, etc.
– Certain expenses relating to the repair of damage to the employee’s principal residence

Hardship Distribution Issues

- You may not treat a distribution as necessary to satisfy an immediate and heavy financial need:
  - If it exceeds the amount needed to relieve the employee’s financial need, or
  - If the financial need may be satisfied from other resources reasonably available to the employee (including plan loans)
- This determination generally made based upon all relevant facts and circumstances

Hardship Distribution Issues

- IRS Employee Plans News Issue No. 2015-4, April 1, 2015 provided significant new guidance concerning hardship distributions:
  - Electronic self-certification is not sufficient documentation of the nature of a participant's hardship (it is allowed to show that a distribution is the only way to alleviate the hardship)
  - It is not sufficient for participants to solely keep their own records of hardship distributions…the plan sponsor should retain those records in paper or electronic form – failure to do so is a qualification failure that should be corrected in Employee Plans Compliance Resolution System

Hardship Distribution Case Study 1 Plan Document Does Not Allow

- If the plan sponsor allowed hardship distributions to both highly compensated employees (HCEs) and non-highly compensated employees (NHCEs) but the plan document does not allow for them, what can be done?
- The plan sponsor can adopt a retroactive amendment to provide for hardships provided that it has established policies and procedures in place
- This is one of the few retroactive amendments allowed in the Self-Correction Program (SCP) of EPCRS

Hardshship Distribution Case Study 1 Plan Document Does Not Allow

- If plan sponsor does not have established policies and practices in place, then what?
- The plan sponsor can retroactively amend the plan and submit an application in the IRS Voluntary Correction Program (VCP) and pay a compliance fee to obtain a compliance statement

Hardshiip Distribution Case Study Plan Document Does Not Allow

- If the plan sponsor only made hardship distributions available to HCEs and the plan document did not provide for hardship distributions
- Correction by retroactive amendment under SCP or VCP is not available but an alternative correction in keeping with general correction principles of Section 6 of Rev. Proc. 2013-12 will be permitted

Hardship Distribution Case Study
Plan Document Does Not Allow

- An improper hardship distribution to an HCE can also be corrected in the Audit Closing Agreement Program if under audit or through an application in the Voluntary Closing Agreement Program

Hardship Distribution Case Study
Improper Documentation / No Valid Reason

- Plan sponsor maintains a 401(k) plan with 1,000 participants with the plan document allowing for hardships but the plan sponsor does not maintain written procedures for reviewing participant hardship applications
- The plan sponsor did not have proper documentation for 30 hardship requests

Hardship Distribution Case Study
Improper Documentation / Not Valid Reason

- Plan sponsor employs a large number of older male immigrants from the former Soviet Union, 20 of whom requested hardship distributions in order to fund dates with women

Hardship Distribution Case Study
Improper Documentation / Not Valid Reason

- These failures cannot be corrected in SCP since there are not adequate practices and procedures
- The plan sponsor may correct the failures in VCP by:
  - Requesting the 50 participants who received distributions not meeting hardship requirements repay the amounts plus earnings
  - Could be difficult to seek repayment
  - Could be spousal consent issues if plan document requires it
  - Correction may include payment, employer corrective contributions and amendments
  - Possible to work out a proper correction with IRS agent in VCP

Hardship Distribution Case Study
Improper Documentation / Not Valid Reason

- Plan Sponsor may correct in Audit CAP if under audit or in Voluntary Closing Agreement if at first a proper correction cannot be worked out in VCP
- VCA and Audit CAP require payment of a negotiated percentage of Maximum Payment Amount

In-Service Distribution Issues Other Than Hardships

- Defined contribution plans may allow in-service distributions of vested employer contributions after the funds have been in the plan for 2 years or of all employer contributions if the funds have been in the plan for 5 years
- 401(k) plans may provide for in-service distributions of pre-tax salary deferrals or after-tax Roth contributions for the following reasons:
  - A participant attains age 59 ½
  - A participant becomes disabled
  - A distribution is a "qualified reservist distribution"

In-Service Distribution Case Study
Plan Document Does Not Allow

- Plan sponsor allows for in-service distributions but the plan document does not provide for them
- This is a failure to operate the plan according to its terms
- Plan sponsor cannot self correct in SCP through a retroactive amendment
- Plan sponsor may be able to correct in VCP by retroactive amendment

In-Service Distribution Case Study
Plan Document Does Not Allow

- Correction in VCP through retroactive amendment requires documentation that it was always employer's intent and always participants' expectation of in-service distributions
- What if there is no documentation of employer intent and participant expectation?
- What if the in-service distributions only went to HCEs?

In-Service Distribution Case Study Plan Document Does Not Allow

- One could submit this in VCA and request a closing agreement
- Plan sponsor will have to be ready to pay an audit sanction penalty equal to a negotiated percentage of the Maximum Payment Amount (MPA) as an audit sanction penalty

In-Service Distribution Case Study Deferrals Before Age 59 1/2

- 401(k) plan participants were regularly allowed to take in-service distributions before attaining age 59 ½ and plan sponsor had no plan procedures covering distributions
- Since no procedures, must correct in VCP by requesting participants to return funds
- If affected participants do not return funds, then try to have the employer make the plan whole

In-Service Distribution Case Study
Deferrals Before Age 59 1/2

- If IRS does not approve in VCP, move to VCA and request a compliance statement
- If this failure only impacted HCEs, then what? Request repayment to plan? Can one make plan whole through employer contributions and correct in VCA?

In-Service Distribution Case Study
Unripe Employer Contributions

- Plan sponsor allows in-service distributions of unvested employer contributions that have not been in the plan for at least 2 years or of unvested funds of participants with less than 5 years of service
- Can be self corrected in SCP provided there are procedures and the failure is corrected within 2 years of year it occurred or it's insignificant

In-Service Distribution Case Study
Unripe Employer Contributions

- Plan sponsor can correct this in VCP by requesting that participants return “unripe” amounts plus earnings to the plan
- What if the affected participants do not return the funds?

In-Service Distribution Case Study
Unripe Employer Contributions

- If the affected participants do not return the funds and the VCP coordinator will not allow for employer contributions to make the plan whole, the plan sponsor may submit in VCA and pay a negotiated percentage of the MPA as an audit sanction penalty

In-Service Distribution Case
Large Distribution Repaid Within 60 Days

- Participant took $400,000 from plan for investment purposes with intent to repay in 60 days
- Participant did not have distributable event
- Loans weren't permitted under plan terms
- Amount taken out was 80% of total plan assets
- Participant repaid in 60 days
- Plan sponsor reported it as prohibited transaction on Form 5500

In-Service Distribution Case Study
Large Distribution Repaid Within 60 Days

- Is this an Egregious Failure precluding use of SCP?
- If yes, would compliance fee under VCP be negotiated percentage of Maximum Payment Amount?
- Is situation misuse or diversion of plan assets precluding use of SCP, VCP, and Audit Closing Agreement Program?
- Is filing of Form 5330 Excise Tax Return an admission of misuse or diversion of plan assets?
- Does VCP allow for relief from personal income tax on improper distribution?

In-Service Distribution Case Study
Large Distribution Repaid Within 60 Days

- Can it be characterized as participant loan and corrected according to section 6.07(2) of Rev. Proc. 2013-12?
- If affected participant was an owner, can this be considered employer error and eligible for relief under section 6.07(2)?
- If so, could plan be retroactively amended to allow participant loans and would it require determination letter application?

In-Service Distribution Case Study
Large Distributions To Plan Sponsor

- We intend to file a combined VCP/VCA to preserve the qualified status of the subject plan while addressing the income tax consequences of historical plan operation
- Plan sponsor is a very small law firm in a small rural town and because of the advanced ages of the three founding partners (83 (deceased), 83 (deceased), 74), the firm is rapidly winding down
- The managing partner of the firm, who was solely responsible for the investment and administration of the firm's profit sharing plan (Plan) recently died and left incomplete records for the Plan

In-Service Distribution Case Study
Large Distributions To Plan Sponsor

- According to the very limited plan records, there appears to be no record of an employer contribution to the Plan since before 1992
- Account balances of the 5 remaining participants have been reconstructed based on their relative shares in 1992 – the date of the last TPA prepared plan account summary that can be found

In-Service Distribution Case Study
Large Distributions To Plan Sponsor

- The Plan is a late amender and has been brought current (to be filed in VCP)
- The Plan and/or the now deceased trustee may possibly have engaged in a number of prohibited transactions during the period from 2009 – 2014, consisting of about $900,000 that went to the Plan sponsor
- If these are characterized as prohibited loans to the sponsor, the sponsor would not be in a position financially to make repayment

In-Service Distribution Case Study
Large Distributions To Plan Sponsor

- The sponsor and the 5 remaining participants want to know whether it would be possible under VCP/VCA for them to voluntarily agree to update the Plan, resolve the relative accounts of the 5 remaining participants, cause any previously unreported distributions that were arguably taken by the senior shareholders and then loaned to the law firm to be taxed to the senior partners or their estates
- They want to know that if they did these things, it would be possible to preserve the qualified status of the Plan and allow the remaining participants to receive rollover distributions in connection with a termination of the Plan

RMD Failure

- Failure to pay RMDs timely
- VCP correction:
  - Distribute missed RMDs, plus interest
  - Use Form 14568-H
- 4974 Excise Tax Relief
  - Check box to request
  - Include explanation if any affected participant
    - Sole proprietor;
    - 10% partner; or
    - 10% shareholder

Case Study ROBS

- Rollovers For Business Start-ups (ROBS)
  - Start-up C corporation
  - Adopts 401(k) plan permitting investment in employer securities
  - Rolls over money from another account
  - Invests in employer stock
  - Corporation buys business
  - Corporation hires employees

Case Study ROBS

- ER is S corporation that runs saloon
  - Employs part-time employees
- ER starts a new business
  - Thru ROBS
  - C corporation
  - Adopts plan
  - Rolls over from IRA and purchases stock
- New business has no employees

Case Study ROBS

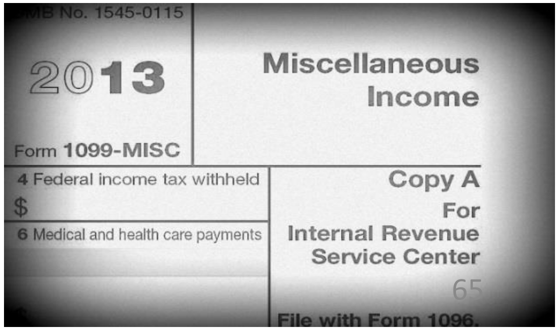
- Newco is automated shooting gallery
- Controlled group with Saloon
  - No saloon employees defer
  - Some did have over 1,000 hours
- Owner doesn't defer
  - Didn't pay himself salary
- ER doesn't make any PS contributions
- Years go by
- Only assets of the plan is the stock purchased with rollover

Case Study ROBS-Issues?

- Is it a plan?
- Intended to be permanent?
- VCP eligible?
  - – Operational failure?
  - – Document failure?
- VCA correction
  - – IRS agreed plan was not a plan
  - – Rollover not qualified
  - – Taxed as distribution
    - 10% penalty for early withdraw
    - Interest

Case Study-IRA

- Individual establishes self-directed IRA
- IRA purchases distressed rental real estate
  – Opens bank account for property in owner's name
- Owner applies to HUD to accept Sec. 8 vouchers
  – Mistakenly uses own name as owner not IRA
  – Gives HUD social security number
- Gets subsidized renters and federal money
  – HUD issues 1099 in owner's name



Case Study IRA-Issues?

- Who were the federal checks made out to?
  - Owner- who deposited them in property bank account
- Looks like a prohibited transaction
  - Makes entire IRA taxable as if distributed on 1/1
  - Titling error
- Not VCP eligible

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- VCA eligible?
  - Informal telephone answer

IRS VCA Case
401(k) Plan

- The employer set up a trust but did not sign the adoption agreement
- The employer employed approximately 70 employees
- The owner and about 3 employees made elective deferrals
- The owner deferred about $1,000 the first year and $400 the second year. The NHCE all together deferred less than $400. No other contributions were made
- In the first plan year the plan failed the ADP test and the plan was considered top heavy
- The employer would have to make a $14,000 top-heavy contribution and distribute the excess to meet the ADP test

IRS VCA Case
ESOP Plan

- The employer elected to report its revenues and expenses as a Subchapter S Corporation, pursuant to Code section 1361, for Federal income tax purposes
- The TPA determined that all allocations of S Corp Distributions for the plan years ended December 31, 2011 through December 31, 2014 was inconsistent with the terms of the plan. Consequently, participants did not receive sufficient allocations of S Corp Distributions
- When the TPA reallocated in accordance with the terms of the plan, it was determined that the plan failed Code section 409(p) for the 2013 plan year with the following consequences:
  - The plan was no longer qualified under Code section 401(a), and
  - The Employer became subject to excise tax under Code section 4979A as of December 31, 2012

IRS VCA Case
Non Compliance with Reporting Requirements

The plan sponsor properly made annuity payments to participant but failed to:

- File with the Service, Form 1099-Rs for certain participants, resulting in a penalty of $50 per participant (Code section 6721)
- Issue Forms 1099-Rs for certain participants for distributions received resulting in a penalty of $50 per participant (Code section 6722)
- Withhold 20% of the amount distributed, as required under Code section 3405(c) for participants who did not elect to have such distributions paid directly to an eligible retirement plan

Actual IRS Case
Service Provider

The provider served as an investment advisor for retirement plans

- The provider was considered a disqualified person as defined in Code section 4975(e)(2)(A)
- Due to the coding error, the provider directly or indirectly received certain fees or other payments with respect to certain retirement plan accounts that constituted prohibited transactions under Code section 4975(c)(1)(E)

Actual IRS Case Study
Service Provider

- The service provider concluded that some IRA Accounts were improperly administered. As a result, the provider did not distribute sufficient amounts from the IRAs to satisfy the required minimum distributions under Code section 408(a)(6)

Questions

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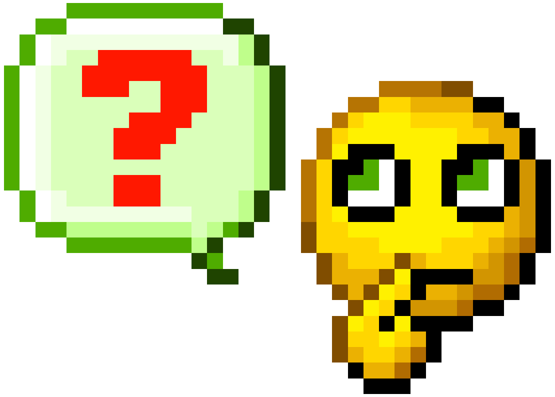

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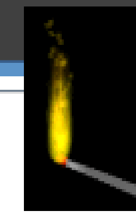

Mission Possible?

Correcting Common and Not-So-Common Plan Failures

Capital Forum On Pensions

May 25, 2016

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THE BURTON LAW FIRM

CHANG RUTHENBERG & LONG PC
EMPLOYEE BENEFITS LAWYERS

- Overview of Employee Plans Compliance Resolution System (EPCRS) Changes
- Issues That Are Not Covered By EPCRS
- EP Voluntary Closing Agreement Program
- Case Studies

Revenue Procedure 2015-27 Highlights

- Correcting plan overpayments
- Self-correcting 415 annual additions
- VCP fees when sole failure is required minimum distribution failure
- VCP fees when sole failure is participant loan failure
- VCP fees for regular VCP applications

Correcting Plan Overpayments

Rev. Proc. 2013-12 corrective actions include:

- The Plan taking reasonable steps to have the overpayment (adjusted for interest) returned by the participant

Rev. Proc. 2015-27 clarifies the availability of alternative corrections. Options include:

- Employer or other person makes contribution
- Retroactive amendment
- Condition: Follow correction principles

Self-Correcting Excess 415 Annual Additions

Rev. Proc. 2013-12

- Return excess elective deferrals within 2-½ months after end of limitation year

Rev. Proc. 2015-27

- Extends the correction period for correcting excess annual additions from 2-½ months to 9-½ months

VCP Fees: Failure to Make Required Minimum Distributions (RMD) That Would Cause IRC 4974 Excise Tax (sole failure)

<table>
<tr><th colspan="2">Fees under Rev. Proc. 2013-12</th><th colspan="2">New fees under Rev. Proc. 2015-27</th></tr>
<tr><td>Number of Participants with RMD Failure</td><td>Fee</td><td>Number of Participants with RMD Failure</td><td>Fee</td></tr>
<tr><td>50 or Fewer</td><td>$500</td><td>150 or Fewer</td><td>$500</td></tr>
<tr><td rowspan="2">More than 50</td><td rowspan="2">Regular fee schedule based on number of participants</td><td>151 to 300</td><td>$1,500</td></tr>
<tr><td>More than 300</td><td>Regular fee schedule based on number of participants</td></tr>
</table>

VCP Fees: Participant Loans Not Satisfying IRC 72(p) (sole failure)

Rev. Proc. 2013-12

- Failure can't impact more than 25% of participants
- Fee is 50% of regular fee schedule, based on number of plan participants

Number of Participants	Fee
20 or fewer	$ 375
21 to 50	$ 500
51 to 100	$ 1,250
101 to 500	$ 2,500
501 to 1,000	$ 4,000
1,001 to 5,000	$ 7,500
5,001 to 10,000	$ 10,000
Over 10,000	$ 12,500

Rev. Proc. 2015-27

- Failure can't impact more than 25% of participants
- Fees based on the number of participants with loan failures

Number of Participants with loan failures	Reduced Fee
13 or fewer	$ 300
14 to 50	$ 600
50 to 100	$ 1,000
101 to 150	$ 2,000
Over 150	$ 3,000

Miscellaneous Changes
Revenue Procedure 2015-27

- Clarifies determination letter submission requirements with VCP submissions
- Extends time for adopting certain plan amendments
- Reflects elimination of Social Security Administration letter forwarding program

Revenue Procedure 2015-28 Highlights

- New safe harbor correction for the failure to implement election for 401(k)/403(b) plans with automatic enrollment
- New safe harbor corrections for elective deferral failures corrected within a short time (all 401(k)/403(b) plans)

Safe Harbor Correction for Failure to Implement Election for 401(k)/403(b) Plans With Automatic Enrollment

- No QNEC required to correct the missed deferral opportunity if the failure corrected within 9-½ months after plan year end of failure, and satisfy the following conditions:
  - Correct elective deferrals begin – generally, by 9-½ months after plan year end of when failure first occurred (Earlier- if employee notifies)
  - Timely Notice to employee – Notice must satisfy the content requirements and given within 45 days of when the correct elective deferrals begin

Safe Harbor Correction for Failure to Implement Election for 401(k)/403(b) Plans With Automatic Enrollment (continued)

- Corrective contributions for missed matching contributions
  - Must make by end of the 2nd year following the year of failure (due date for correcting significant operational failures under SCP) Adjust for earnings
  - New earnings safe harbor: Plan's default investment alternative - don't reduce for losses
- Sunset – not available for failures occurring after 2020

What if All the Conditions Are Not Met?

May be able to use the safe harbor correction method under Rev. Proc. 2013-12

- Missed Deferral Opportunity:

    50% Qualified Nonelective Contribution (QNEC)

- Missed matching contribution:

    Corrective Employer Contribution to replace match

- Earnings

Safe Harbor Corrections for Elective Deferral Failures Corrected Within Three Months (all 401(k)/403(b) plans)

No QNEC required to correct for the missed deferral opportunity if the failure is corrected within 3 months and the following conditions are satisfied:

- Timely commencement of correct elective deferrals – generally within 3 months of the date when the failure first occurred (Earlier – if employee notifies)
- Timely Notice to employee – Notice must satisfy the content requirements and be provided to the employee within 45 days of the commencement of correct elective deferrals

Safe Harbor Corrections for Elective Deferral Failures Corrected Within Three Months (all 401(k)/403(b) plans) (continued)

Corrective contribution for missed matching contributions -

- Must be made by the due date for correcting significant operational failures under SCP
- In most cases that is the end of the 2nd year following the year in which the failure occurred
- Corrective contributions should be adjusted for earnings
- New Earnings safe harbor: Plan's default investment alternative. No reduction for losses

Safe Harbor Corrections for Elective Deferral Failures Corrected Before the End of the SCP Period (all 401(k)/403(b) plans)

Corrective QNEC = 25% of the missed deferrals, if the following conditions are met:

- Timely commencement of correct elective deferrals – generally no later than the last day of the 2nd plan year following the plan year in which the failure occurred (Earlier – if employee notifies)
- Timely Notice to employee – Notice must satisfy the content requirements and be provided to the employee within 45 days of the commencement of correct elective deferrals

Safe Harbor Corrections for Elective Deferral Failures Corrected Before the End of the SCP Period (all 401(k)/403(b) plans) (continued)

Corrective contributions for missed matching contributions-

- Made by the due date for correcting significant operational failures under SCP. In most cases that is the end of the 2nd year following the year in which the failure occurred
- Corrective contributions should be adjusted for earnings
- New earnings safe harbor: Plan's default investment alternative. No reduction for losses

New Fees for Regular Submissions Under VCP for Qualified Plans and 403(b) Plans Effective February 1, 2016, Rev. Proc. 2016-8

Rev. Proc. 2013-12

Number of Participants	Fees
20 or fewer	$750
21 to 50	$1,000
51 to 100	$2,500
101 to 500	$5,000
501 to 1,000	$8,000
1,001 to 5,000	$15,000
5,001 to 10,000	$20,000
Over 10,000	$25,000

Rev. Proc. 2016-8

Number of Participants	Fees
20 or fewer	$500
21-50	$750
51-100	$1,500
101-1,000	$5,000
1,001-10,000	$10,000
Over 10,000	$15,000

Issues That Are Not Covered by EPCRS

- Diversion or Misuse of Plan Assets – (See section 4.12 of Rev. Proc. 2013-12)
- Abusive Tax Avoidance Transactions (See section 4.13 of Rev. Proc. 2013-12)
- Matters Subject to Excise or Other Taxes (See section 6.09 of Rev. Proc. 2013-12)
  - EPCRS not available for events for which the Code provides tax consequences other than plan disqualification (such as the imposition of excise or additional income tax) including:
    - Funding deficiencies due to failures to make required contributions under Code section 412
    - Prohibited transactions
    - Failure to file Forms 5500

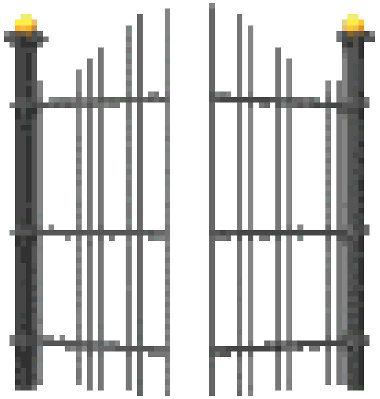
EP Voluntary Closing Agreements

- IRS announced in *Employee Plans News*, issue 2013-10, 12/19/13
  - *http://www.irs.gov/pub/irs-tege/epn_2013_10.pdf*

- A uniform system for handling requests in EP Voluntary Compliance
  - For issues that are not eligible for EPCRS

What is a Closing Agreement?

- A final agreement between the IRS and a taxpayer to resolve a tax issue authorized under IRC sec. 7121
- Meant to provide finality to issue
- Can only be changed due to
  - fraud, malfeasance, or misrepresentation of material fact
- In complete discretion of IRS Commissioner



Treas. Reg. Section 301.7121-1(a):

- The Commissioner may enter into a written agreement with any person relating to the liability of such person …
- in respect of any internal revenue tax for any taxable period...
- in any case in which there appears to be an advantage
  - in having the case permanently and conclusively closed, or
  - TP shows good and sufficient reasons and no disadvantage to U.S.

Rationale for Closing Agreements

- May be entered into if:
- Benefit in having the case permanently and conclusively closed; or
- Good and sufficient reasons by the taxpayer for desiring such an arrangement; and
- Not detrimental to the United States

When VCA Is Appropriate?

- Income or Excise Tax
- Plans:
  - QPs 401(a),QPs with GACs, 403(a), TSA 403(b), SEP 408(k), Simple 408(p)
  - No 457 plans
    - 457(b) use EPCRS
    - 457(f) expressly excluded
  - IRAs under 408
- Not under audit/investigation
- Not willful or abusive avoidance

Guidelines for Submitting VCA Request

- In most cases, IRS won't negotiate over income or excise tax amounts but may discuss penalty abatement
- For ERISA covered plans, any prohibited transactions should be corrected in DOL Voluntary Fiduciary Correction Program first
- All actions listed in the closing agreement must be completed before it is signed

Guidelines for Submitting VCA Request

- A VCA request does not prevent an IRS exam of plan or plan sponsor
- If plan or plan sponsor is examined after submitting VCA request, then EP Voluntary Compliance will consult with exams to see if issue should be precluded from exam – not available for anonymous requests

Guidelines for Submitting VCA Request

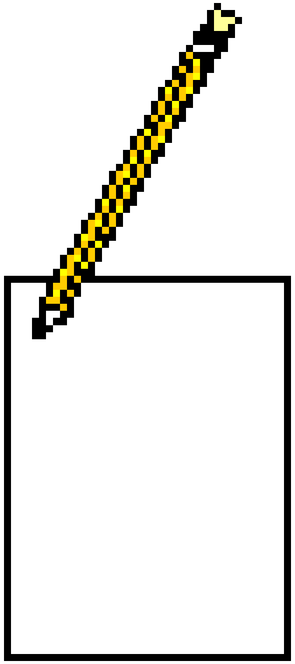
- A VCA is not appropriate to address a future event that may impact tax-favored status of plan or seek guidance on issues or actions that may impact retirement plan
- If there is willful or intentional plan to avoid paying or reporting taxes, EP reserves right to refer the VCA request to exams

New Umbrella VCA for Late Adopters

- Deadline for adopting preapproved PPA restatement was 4/30/16
- ERs who missed could file under VCP
- Now Sponsor of pre-approved document may file VCA for group of ERs
  - Need 20 plans
  - $5,000 fee for first 20, $250/plan thereafter
  - Consent of ER
  - Prior compliance
  - Can add ERs afterward

Request for VCA: Procedure

- Letter setting forth:
  - Eligibility
  - Details of problem and tax consequences
  - Proposed correction
  - How tax, penalties and interest were calculated
  - Proposed audit sanction and how calculated
- Signed by authorized individual
- May be Anonymous
- No User Fee-even if combined with VCP submission , don’t submit user fee



What Should Taxpayer Show?

- To increase the likelihood that the IRS will enter into a voluntary closing agreement, a taxpayer should be prepared to show:
  - the taxpayer is willing to furnish necessary facts and documentation to establish its tax liabilities
  - the agreement is in the best interest of both the IRS and the taxpayer
  - the federal government will suffer no disadvantage from entering into the closing agreement, and
  - any Internal Revenue Code violation or tax deficiency was unintentional

What Can Be Fixed By VCA?

- ROBS
- IRAs
- PT excise taxes
- ESOPs 409(p)
- Reporting
  - 1099R
  - notices

Loans

- Loans to parties in interest are prohibited transactions
  - Statutory exemption for Participant Loans
- Participant Loans are distributions unless they meet Code section 72(p)
- EPCRS only addresses participant loans that fail to meet 72(p)

PT Exemption for Participant Loans

- PT Exemption for bona fide loans to participant or beneficiary
- Bona fide loan:
  - must be adequately secured;
  - a reasonable interest rate;
  - a definite repayment schedule; and
  - the availability of loans must be on a non-discriminatory basis. ERISA §408(d)(1) and I.R.C. §4975(d)(1).

Participant Loans under 72(p)

- Must have legally enforceable agreement in writing or electronic form
- Outstanding balance from all plans of ER may not exceed the lesser of $50,000 or 50% of the participant's non-forfeitable accrued benefit.
- No more than 5 year term (unless for first-time home)
- Level amortized payments at least quarterly
- Must be authorized by plan doc

Loans-Case Studies

- Plan makes loans to participants that meet section 72(p) but plan document does not provide for such loans
- VCP correction:
- Adopt retroactive plan amendment permitting loans
  - Can use Form 14568-I Correction by Plan Amendment

Loans-Case Studies
Excess Amount-No Payment Yet

- Loan made 6/1/16 exceeds $50,000/50%
  - $70,000 loan, amortized quarterly payments over 5 years
- VCP correction-no repayments made yet:
  - Repayment of excess
    - Pay back $20,000 by 9/1/16
  - Relief from Form 1099R filing

- Can use Form 14568-E
  - Unless affected participants are key EEs or owner-EEs and asking for more relief than just reporting in year of correction instead of year of loan

Loans-Case Studies
Excess Amount-Payments Began

- Loan made 6/1/15 exceeds $50,000/50%
  - $70,000 loan, payable over 5 years
- VCP correction-repayments made choice of:
  - Applying payments only to non-excess amount
    - Repayment is $20,000, plus interest
  - Applying to interest on excess then on allowed amount
    - Repayment is $20,000
  - Applying pro rata
    - Repayment is balance of excess

Loans-Case Studies
Default

- Participant Loan of $50,000 made 6/1/15
  - Five year amortization payable quarterly
- Participant fails to pay/defaults for first year
- VCP Correction?
  - Participant repays missed payments plus interest and resumes payment schedule; or
  - Re-amortize loan over remaining 4 years

Loans-Case Studies
Excess Repayment Period

- Participant Loan of $50,000 made 6/1/15
  - Payable over 10 years evenly amortized
  - Principal payments of $5,000/yr
- VCP Correction-Re-amortize over remaining 4 years
  - Original maximum term has not expired
  - Principal payments of $11,250 annually next 4 years

Loans-Case Studies
Maximum Term Expired

- Participant Loan of $50,000
- Made 6/1/10 with a demand note
- VCP Correction?
  - Not eligible for correction w/o tax because max term expired 6/1/15
  - Can correct by treating as distribution and ER paying income tax withholding
- VCA Correction?
  - Pay it back?
  - ER relief from 1099R filing from date made

Actual IRS VCA Case Study Loans

- The plan allowed for participant loans
- Due to an error in the administrator's program, the loan payments were not sufficient to pay the loans in full by the end of the 5-year period
- Under 72(p), the loans are consider deemed distributions
- The participant paid the loans in accordance with the payment schedules
- The plan administrator agrees that the loans should be considered deemed distributions, however request that the Service not require the issuance of forms 1099-R

Hardship Distribution Issues

- ASPPA Annual Conference Video
- https://vidforweb-8.wistia.com/medias/nt1b3xq5h7
- A 401(k) plan may allow participants to receive a hardship distribution because of immediate and heavy financial need with distributions limited to the amount necessary to meet that need

Hardship Distribution Issues

- Immediate and heavy financial need is limited to the following:
  - Medical care expenses incurred by or necessary for employee, spouse or dependents
  - Costs directly related to the purchase of a principal residence for the employee (excluding mortgage payments)
  - Payment of tuition, related educational fees, and room and board expenses for the next 12 months of post-secondary education for the employee, spouse, children or dependents.

Hardship Distribution Issues

– Payments necessary to prevent eviction of the employee from the employee's principal residence or mortgage foreclosure on that residence
– Funeral expenses for the employee's deceased parent, spouse, etc.
– Certain expenses relating to the repair of damage to the employee's principal residence

Hardship Distribution Issues

- You may not treat a distribution as necessary to satisfy an immediate and heavy financial need:
  – If it exceeds the amount needed to relieve the employee's financial need, or
  – If the financial need may be satisfied from other resources reasonably available to the employee (including plan loans)
- This determination generally made based upon all relevant facts and circumstances

Hardship Distribution Issues

- IRS Employee Plans News Issue No. 2015-4, April 1, 2015 provided significant new guidance concerning hardship distributions:
  - Electronic self-certification is not sufficient documentation of the nature of a participant's hardship (it is allowed to show that a distribution is the only way to alleviate the hardship)
  - It is not sufficient for participants to solely keep their own records of hardship distributions…the plan sponsor should retain those records in paper or electronic form – failure to do so is a qualification failure that should be corrected in Employee Plans Compliance Resolution System

Hardship Distribution Case Study 1
Plan Document Does Not Allow

- If the plan sponsor allowed hardship distributions to both highly compensated employees (HCEs) and non-highly compensated employees (NHCEs) but the plan document does not allow for them, what can be done?
- The plan sponsor can adopt a retroactive amendment to provide for hardships provided that it has established policies and procedures in place
- This is one of the few retroactive amendments allowed in the Self-Correction Program (SCP) of EPCRS

Hardshship Distribution Case Study 1 Plan Document Does Not Allow

- If plan sponsor does not have established policies and practices in place, then what?
- The plan sponsor can retroactively amend the plan and submit an application in the IRS Voluntary Correction Program (VCP) and pay a compliance fee to obtain a compliance statement

Hardship Distribution Case Study
Plan Document Does Not Allow

- If the plan sponsor only made hardship distributions available to HCEs and the plan document did not provide for hardship distributions
- Correction by retroactive amendment under SCP or VCP is not available but an alternative correction in keeping with general correction principles of Section 6 of Rev. Proc. 2013-12 will be permitted

Hardship Distribution Case Study Plan Document Does Not Allow

- An improper hardship distribution to an HCE can also be corrected in the Audit Closing Agreement Program if under audit or through an application in the Voluntary Closing Agreement Program

Hardship Distribution Case Study
Improper Documentation / No Valid Reason

- Plan sponsor maintains a 401(k) plan with 1,000 participants with the plan document allowing for hardships but the plan sponsor does not maintain written procedures for reviewing participant hardship applications
- The plan sponsor did not have proper documentation for 30 hardship requests

Hardship Distribution Case Study
Improper Documentation / Not Valid Reason

- Plan sponsor employs a large number of older male immigrants from the former Soviet Union, 20 of whom requested hardship distributions in order to fund dates with women

Hardship Distribution Case Study
Improper Documentation / Not Valid Reason

- These failures cannot be corrected in SCP since there are not adequate practices and procedures
- The plan sponsor may correct the failures in VCP by:
  - Requesting the 50 participants who received distributions not meeting hardship requirements repay the amounts plus earnings
  - Could be difficult to seek repayment
  - Could be spousal consent issues if plan document requires it
  - Correction may include payment, employer corrective contributions and amendments
  - Possible to work out a proper correction with IRS agent in VCP

Hardship Distribution Case Study
Improper Documentation / Not Valid Reason

- Plan Sponsor may correct in Audit CAP if under audit or in Voluntary Closing Agreement if at first a proper correction cannot be worked out in VCP
- VCA and Audit CAP require payment of a negotiated percentage of Maximum Payment Amount

In-Service Distribution Issues Other Than Hardships

- Defined contribution plans may allow in-service distributions of vested employer contributions after the funds have been in the plan for 2 years or of all employer contributions if the funds have been in the plan for 5 years
- 401(k) plans may provide for in-service distributions of pre-tax salary deferrals or after-tax Roth contributions for the following reasons:
  - A participant attains age 59 ½
  - A participant becomes disabled
  - A distribution is a “qualified reservist distribution”

In-Service Distribution Case Study
Plan Document Does Not Allow

- Plan sponsor allows for in-service distributions but the plan document does not provide for them
- This is a failure to operate the plan according to its terms
- Plan sponsor cannot self correct in SCP through a retroactive amendment
- Plan sponsor may be able to correct in VCP by retroactive amendment

In-Service Distribution Case Study
Plan Document Does Not Allow

- Correction in VCP through retroactive amendment requires documentation that it was always employer's intent and always participants' expectation of in-service distributions
- What if there is no documentation of employer intent and participant expectation?
- What if the in-service distributions only went to HCEs?

In-Service Distribution Case Study
Plan Document Does Not Allow

- One could submit this in VCA and request a closing agreement
- Plan sponsor will have to be ready to pay an audit sanction penalty equal to a negotiated percentage of the Maximum Payment Amount (MPA) as an audit sanction penalty

In-Service Distribution Case Study Deferrals Before Age 59 1/2

- 401(k) plan participants were regularly allowed to take in-service distributions before attaining age 59 ½ and plan sponsor had no plan procedures covering distributions
- Since no procedures, must correct in VCP by requesting participants to return funds
- If affected participants do not return funds, then try to have the employer make the plan whole

In-Service Distribution Case Study
Deferrals Before Age 59 1/2

- If IRS does not approve in VCP, move to VCA and request a compliance statement
- If this failure only impacted HCEs, then what? Request repayment to plan? Can one make plan whole through employer contributions and correct in VCA?

In-Service Distribution Case Study
Unripe Employer Contributions

- Plan sponsor allows in-service distributions of unvested employer contributions that have not been in the plan for at least 2 years or of unvested funds of participants with less than 5 years of service
- Can be self corrected in SCP provided there are procedures and the failure is corrected within 2 years of year it occurred or it's insignificant

In-Service Distribution Case Study
Unripe Employer Contributions

- Plan sponsor can correct this in VCP by requesting that participants return “unripe” amounts plus earnings to the plan
- What if the affected participants do not return the funds?

In-Service Distribution Case Study
Unripe Employer Contributions

- If the affected participants do not return the funds and the VCP coordinator will not allow for employer contributions to make the plan whole, the plan sponsor may submit in VCA and pay a negotiated percentage of the MPA as an audit sanction penalty

In-Service Distribution Case
Large Distribution Repaid Within 60 Days

- Participant took $400,000 from plan for investment purposes with intent to repay in 60 days
- Participant did not have distributable event
- Loans weren’t permitted under plan terms
- Amount taken out was 80% of total plan assets
- Participant repaid in 60 days
- Plan sponsor reported it as prohibited transaction on Form 5500

In-Service Distribution Case Study
Large Distribution Repaid Within 60 Days

- Is this an Egregious Failure precluding use of SCP?
- If yes, would compliance fee under VCP be negotiated percentage of Maximum Payment Amount?
- Is situation misuse or diversion of plan assets precluding use of SCP, VCP, and Audit Closing Agreement Program?
- Is filing of Form 5330 Excise Tax Return an admission of misuse or diversion of plan assets?
- Does VCP allow for relief from personal income tax on improper distribution?

In-Service Distribution Case Study
Large Distribution Repaid Within 60 Days

- Can it be characterized as participant loan and corrected according to section 6.07(2) of Rev. Proc. 2013-12?
- If affected participant was an owner, can this be considered employer error and eligible for relief under section 6.07(2)?
- If so, could plan be retroactively amended to allow participant loans and would it require determination letter application?

In-Service Distribution Case Study
Large Distributions To Plan Sponsor

- We intend to file a combined VCP/VCA to preserve the qualified status of the subject plan while addressing the income tax consequences of historical plan operation
- Plan sponsor is a very small law firm in a small rural town and because of the advanced ages of the three founding partners (83 (deceased), 83 (deceased), 74), the firm is rapidly winding down
- The managing partner of the firm, who was solely responsible for the investment and administration of the firm's profit sharing plan (Plan) recently died and left incomplete records for the Plan

In-Service Distribution Case Study
Large Distributions To Plan Sponsor

- According to the very limited plan records, there appears to be no record of an employer contribution to the Plan since before 1992
- Account balances of the 5 remaining participants have been reconstructed based on their relative shares in 1992 – the date of the last TPA prepared plan account summary that can be found

In-Service Distribution Case Study Large Distributions To Plan Sponsor

- The Plan is a late amender and has been brought current (to be filed in VCP)
- The Plan and/or the now deceased trustee may possibly have engaged in a number of prohibited transactions during the period from 2009 – 2014, consisting of about $900,000 that went to the Plan sponsor
- If these are characterized as prohibited loans to the sponsor, the sponsor would not be in a position financially to make repayment

In-Service Distribution Case Study
Large Distributions To Plan Sponsor

- The sponsor and the 5 remaining participants want to know whether it would be possible under VCP/VCA for them to voluntarily agree to update the Plan, resolve the relative accounts of the 5 remaining participants, cause any previously unreported distributions that were arguably taken by the senior shareholders and then loaned to the law firm to be taxed to the senior partners or their estates
- They want to know that if they did these things, it would be possible to preserve the qualified status of the Plan and allow the remaining participants to receive rollover distributions in connection with a termination of the Plan

RMD Failure

- Failure to pay RMDs timely
- VCP correction:
  – Distribute missed RMDs, plus interest
  – Use Form 14568-H
- 4974 Excise Tax Relief
  – Check box to request
  – Include explanation if any affected participant
    - Sole proprietor;
    - 10% partner; or
    - 10% shareholder

Case Study ROBS

- Rollovers For Business Start-ups (ROBS)
  - Start-up C corporation
  - Adopts 401(k) plan permitting investment in employer securities
  - Rolls over money from another account
  - Invests in employer stock
  - Corporation buys business
  - Corporation hires employees

Case Study ROBS

- ER is S corporation that runs saloon
  - Employs part-time employees
- ER starts a new business
  - Thru ROBS
  - C corporation
  - Adopts plan
  - Rolls over from IRA and purchases stock
- New business has no employees

Case Study ROBS

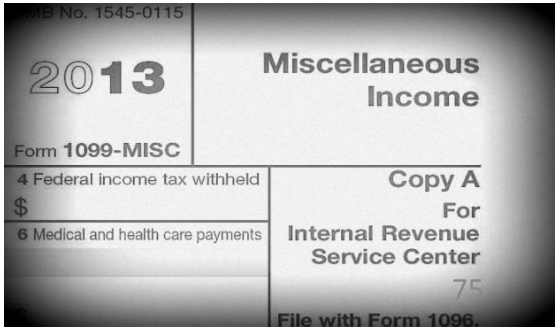
- Newco is automated shooting gallery
- Controlled group with Saloon
  - No saloon employees defer
  - Some did have over 1,000 hours
- Owner doesn't defer
  - Didn't pay himself salary
- ER doesn't make any PS contributions
- Years go by
- Only assets of the plan is the stock purchased with rollover

Case Study ROBS-Issues?

- Is it a plan?
- Intended to be permanent?
- VCP eligible?
  - Operational failure?
  - Document failure?
- VCA correction
  - IRS agreed plan was not a plan
  - Rollover not qualified
  - Taxed as distribution
    - 10% penalty for early withdraw
    - Interest

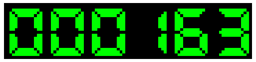
Case Study-IRA

- Individual establishes self-directed IRA
- IRA purchases distressed rental real estate
  - Opens bank account for property in owner’s name
- Owner applies to HUD to accept Sec. 8 vouchers
  - Mistakenly uses own name as owner not IRA
  - Gives HUD social security number
- Gets subsidized renters and federal money
  - HUD issues 1099 in owner’s name



Case Study IRA-Issues?

- Who were the federal checks made out to?
  - Owner- who deposited them in property bank account
- Looks like a prohibited transaction
  - Makes entire IRA taxable as if distributed on 1/1
  - Titling error
- Not VCP eligible



- VCA eligible?
  - Informal telephone answer

IRS VCA Case
401(k) Plan

- The employer set up a trust but did not sign the adoption agreement
- The employer employed approximately 70 employees
- The owner and about 3 employees made elective deferrals
- The owner deferred about $1,000 the first year and $400 the second year. The NHCE all together deferred less than $400. No other contributions were made
- In the first plan year the plan failed the ADP test and the plan was considered top heavy
- The employer would have to make a $14,000 top-heavy contribution and distribute the excess to meet the ADP test

IRS VCA Case
ESOP Plan

- The employer elected to report its revenues and expenses as a Subchapter S Corporation, pursuant to Code section 1361, for Federal income tax purposes
- The TPA determined that all allocations of S Corp Distributions for the plan years ended December 31, 2011 through December 31, 2014 was inconsistent with the terms of the plan. Consequently, participants did not receive sufficient allocations of S Corp Distributions
- When the TPA reallocated in accordance with the terms of the plan, it was determined that the plan failed Code section 409(p) for the 2013 plan year with the following consequences:
  - The plan was no longer qualified under Code section 401(a), and
  - The Employer became subject to excise tax under Code section 4979A as of December 31, 2012

IRS VCA Case
Non Compliance with Reporting Requirements

The plan sponsor properly made annuity payments to participant but failed to:

- File with the Service, Form 1099-Rs for certain participants, resulting in a penalty of $50 per participant (Code section 6721)
- Issue Forms 1099-Rs for certain participants for distributions received resulting in a penalty of $50 per participant (Code section 6722)
- Withhold 20% of the amount distributed, as required under Code section 3405(c) for participants who did not elect to have such distributions paid directly to an eligible retirement plan

Actual IRS Case
Service Provider

The provider served as an investment advisor for retirement plans

- The provider was considered a disqualified person as defined in Code section 4975(e)(2)(A)
- Due to the coding error, the provider directly or indirectly received certain fees or other payments with respect to certain retirement plan accounts that constituted prohibited transactions under Code section 4975(c)(1)(E)

Actual IRS Case Study
Service Provider

- The service provider concluded that some IRA Accounts were improperly administered. As a result, the provider did not distribute sufficient amounts from the IRAs to satisfy the required minimum distributions under Code section 408(a)(6)

www.irs.gov/retirement/Fix-It-Guides---Common-Problems,-Real-Solutions

- Plan Fix-It Guides (including one for harships)
- Common Problems, Real Solutions
- Video Explanations
- Checklists
  - 401(k)
  - 403(b)
  - SIMPLE IRA
  - SEP
  - SARSEP

www.irs.gov/retirement/Correcting-Plan-Errors

Information on

- All EPCRS programs
  - SCP, VCP, Audit CAP
- How to find, fix, and avoid errors
- What's new in EPCRS and the website

www.irs.gov/retirement/Newsletters

- Two free newsletters
  - Retirement News for Employers
    - For employers and business owners
  - Employee Plans News
    - For retirement plan practitioners

Links For More Information

- Articles on our web site
  - The IRS's Employee Plans Compliance Resolution System – Five Questions, Four Categories Of Failure, Three Paths To Forgiveness http://www.seethebenefits.com/showarticle.aspx?show=3887
  - Haste Does Not Always Make Waste http://www.seethebenefits.com/showarticle.aspx?show=5358

Links For More Information

- EPCRS Revenue Procedure 2013-12 – http://www.irs.gov/irb/2013-04_IRB/ar06.html
- Employee Benefits Security Administration of Department of Labor - www.dol.gov/ebsa/

Questions

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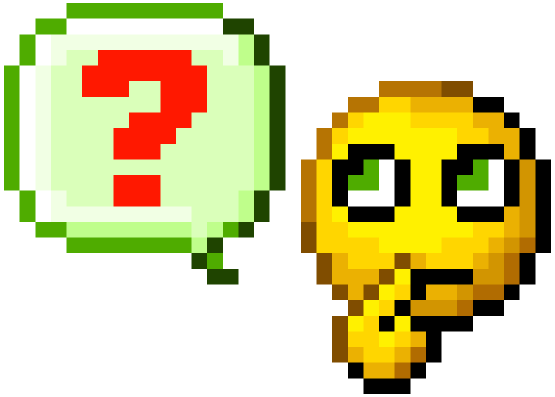

NIPA National Institute of Pension Administrators Sacramento Valley Chapter

WP&BC Western Pension Benefits Council Sacramento

CAPITAL FORUM ON PENSIONS

May 25, 2016

CASH BALANCE PLANS

Ilene H. Ferenczy, Esq., CPC, APA

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Agenda

- DB Fundamentals
- How Does a Cash Balance Plan Help?
- Other DB/CB Things That You Need to Know
- Practical Considerations

Fundamentals of DB Plans

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Traditional DB Plans

- Plan defines a monthly benefit payable in the normal form at normal retirement age
  - Benefit formula usually considers compensation, service or some combination of both
- Benefits are earned (accrued) over the participant's career
- Benefits are paid in the form of QJSA annuity unless participant elects one of the alternate forms offered by plan
    - Lump sum payment is often available
    - If lump sum elected, may be rolled over to an IRA or other qualified plan (same rules as DC plans)

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Traditional DB Plans

- Funding
  - Projected benefit payable at retirement age is determined
  - Lump sum equivalent benefit is determined, based on assumed post-retirement interest for the distribution period and mortality
  - Contribution determined as a "sinking fund" based on assumed rate of interest during the funding period and number of years to retirement

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Actuarial Equivalence

- Rough definition: something of the same economic value paid in a different way and/or at a different time
- "I'd just as soon have"
- E.g., if you can invest $1 and earn 5%, it is immaterial to you whether you receive $1 today or $1.05 in a year – so they are actuarially equivalent

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Actuarial Equivalence in DB

- If a monthly benefit is payable for life at age 65, an actuary can determine, based on interest and mortality assumptions what lump sum payable at age 65 is equivalent to the monthly payments for life
- If a benefit is payable at age 65, an actuary can determined, based on interest assumptions, an equivalent lump sum value today

Age Matters

- Ilene and Jared both start working as lawyers for the same company on the same day.
- Ilene is 59; Jared is 26.
- Assuming that they are making the same amount of salary and the benefit is not dependent on years of service, their benefits at age 65 are equal

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Age Matters

- Benefit value:
  - Ilene will get her benefit in 6 years
  - Jared will get his benefit in 39 years
  - Therefore, Ilene's benefit is more valuable
- Funding Cost
  - We have 6 years' of contributions to fund Ilene's benefit
  - We have 39 years of contributions to fund Jared's
  - Ilene's contribution is more expensive.

The Result

- Ilene has a much richer benefit package than Jared
- If Ilene and Jared leave the company at the same time, Ilene will get a termination benefit from the plan that is much more valuable than Jared's

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But, This is a Mixed Bag

- If Ilene and Jared are similarly situated employees, there is a fairness issue and a cost issue
- But, if Ilene is the owner, this is a way for Ilene to get a larger contribution for herself at less cost than for the employees, who will tend to be younger
- The contribution for Ilene can be much greater than the DC limit of $53,000 or $59,000

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Other DB Stuff

- Actual funding takes into account the difference between actual plan experience and the assumed interest/mortality
  - Investment risk is on the employer: if the plan earns less than expected, contributions go up (and vice versa if the plan earns better)
- An actuary must certify each year that the contribution amount is sufficient ("minimum funding standards")
- Generally, benefits are guaranteed by PBGC

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How Does a Cash Balance Plan Help?

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Goals

- Make similarly situated employees get similar contributions, regardless of age
- Get the owners as much as possible with as little cost for rank-and-file as possible
- Make the plans more understandable to rank-and-file participants

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Cash Balance is a Hybrid Plan

- It has elements of a DC plan:
  - Participants earn "annual allocations" plus "earnings," so it looks like the accumulation of a DC account
- It has elements of a DB plan:
  - It is funded like a DB plan:
    - Contribution is based on projected benefits vs. current assets, and uses various actuarial assumptions
    - Employer bears risk of investment loss
  - Need an actuary and must file a Schedule SB each year
  - Subject to the PBGC

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How a Cash Balance Plan Works

- A level of annual allocation is defined
  - Can be structured like a DC to have different tiers of allocations for different employees or groups
- An interest rate is defined
  - Can be a level amount or tied to an index of some sort
  - There are plans in which the employee is permitted to designate a investment or portfolio to shadow
- The plan keeps track of the annual allocations and earnings, providing a “cash balance” at any given time

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How a Cash Balance Plan Works

- The participant gets a benefit at retirement equal to the actuarial equivalent of the accumulated cash balance
- The participant may also get the lump sum value of the accumulated cash balance as an alternate form of benefit.

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How a Cash Balance Plan Works

- Plan is tested for nondiscrimination either as:
  - Safe harbor formula; or
  - Based on benefits at normal retirement
    - Again, if the owner is older than the other employees, the benefit at retirement is lower (the account has less time to accumulate)
- Commonly, there is a companion 401(k) plan (often safe harbor) and some percentage of employees participate only in the 401(k) plan
  - Both plans are tested for nondiscrimination on benefits basis; higher gateway applies (up to 7.5%)

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Section 401(a)(26)

- DB plan must cover lesser of:
  - 40% of all eligible employees (although, if only two employees, plan must cover both); or
  - 50 employees
- "Coverage" requires a significant benefit
  - Interpreted by IRS as accrual per year of at least .5% of compensation

Sample Case - Law Firm

	AA	RA	Compensation	Cash Balance Amount	Cash Balance %	401(k) Deferral	Safe Harbor	Profit Sharing Amount	Profit Sharing %	Total Contribution Amount	Total Contribution %	Total Contribution Employer Cost	Total Contribution %	Total Contribution % of Total
PARTNER	53	62	265,000	166,152	62.7	24,000	0	18,550	7.0	208,702	78.8	184,702	69.7	28.8
PARTNER	55	62	265,000	177,550	67.0	24,000	0	18,550	7.0	220,100	83.1	196,100	74.0	30.5
PARTNER	68	68	265,000	177,550	67.0	24,000	0	18,550	7.0	220,100	83.1	196,100	74.0	30.5
JR PARTNER	38	62	265,000	42,400	16.0	10,000	0	2,650	1.0	55,050	20.8	45,050	17.0	7.0
RN	42	62	103,573	0	0.0	0	3,107	4,661	4.5	7,768	7.5	7,768	7.5	1.2
OFFICE MGR	32	62	103,000	0	0.0	0	3,090	4,635	4.5	7,725	7.5	7,725	7.5	1.2
STAFF	33	62	37,822	0	0.0	0	1,135	1,702	4.5	2,837	7.5	2,837	7.5	0.4
STAFF	23	62	23,857	0	0.0	0	716	1,074	4.5	1,789	7.5	1,789	7.5	0.3
PRINCIPALS			1,060,000	563,652	53.2	82,000	0	58,300	5.5	703,952	66.4	621,952	58.7	96.9
STAFF			268,252	0	0.0	0	8,048	12,071	4.5	20,119	7.5	20,119	7.5	3.1
TOTAL			1,328,252	563,652	42.4	82,000	8,048	70,371	5.3	724,071	54.5	642,071	48.3	100.0

- Partners are in CB + 401(k) deferrals + profit sharing
- Others get 401(k) deferrals and safe harbor + profit sharing (7.5% gateway)

Sample Case - Manufacturer

				Cash Balance		Profit Sharing		Total Contribution				
										Employer		% of
	AA	RA	Compensation	Amount	%	Amount	%	Amount	%	Cost	%	Total
OWNER	51	62	180,000	90,000	50.0	3,600	2.0	93,600	52.0	93,600	52.0	70.3
SALESMAN	37	62	82,000	0	0.0	4,920	6.0	4,920	6.0	4,920	6.0	3.7
STAFF	45	62	50,000	1,000	2.0	3,500	7.0	4,500	9.0	4,500	9.0	3.4
STAFF	32	62	50,000	1,000	2.0	3,500	7.0	4,500	9.0	4,500	9.0	3.4
STAFF	51	62	37,000	740	2.0	2,590	7.0	3,330	9.0	3,330	9.0	2.5
STAFF	24	62	25,000	500	2.0	1,750	7.0	2,250	9.0	2,250	9.0	1.7
STAFF	42	62	44,000	880	2.0	3,080	7.0	3,960	9.0	3,960	9.0	3.0
STAFF	44	62	49,000	980	2.0	3,430	7.0	4,410	9.0	4,410	9.0	3.3
STAFF	52	62	58,000	1,160	2.0	4,060	7.0	5,220	9.0	5,220	9.0	3.9
STAFF	33	62	37,000	740	2.0	2,590	7.0	3,330	9.0	3,330	9.0	2.5
STAFF	24	62	19,000	380	2.0	1,330	7.0	1,710	9.0	1,710	9.0	1.3
STAFF	37	62	16,000	320	2.0	1,120	7.0	1,440	9.0	1,440	9.0	1.1
PRINCIPALS			180,000	90,000	50.0	3,600	2.0	93,600	52.0	93,600	52.0	70.3
STAFF			467,000	7,700	1.6	31,870	6.8	39,570	8.5	39,570	8.5	29.7
			647,000	97,700	15.1	35,470	5.5	133,170	20.6	133,170	20.6	100.0

- Everyone but salesman gets CB + PSP
- Salesman gets PSP only

Actual Funding in Future

- Funding in cash balance plan is done as defined benefit plan:
  - Projected benefit is determined based on accumulated cash balance
  - Required contribution is determined for that benefit as with other DB plans
  - If plan investment returns are greater than assumption, contribution will be less than annual allocation; if lower than assumption, contribution will be greater than annual allocation

Investment Strategy?

- The more than investment returns vary from assumption, the less the required contribution will look like the annual allocation
- Plan can get highly underfunded or overfunded, creating a large variance from the contribution amounts that the client expects
- Strategy: target assumed interest rate for investments; use 401(k) or personal investments for more aggressive investment portfolio

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Co-Owner Split?

- Co-owners will generally adjust their compensation to reflect the differential in benefits
- Example:
  - Joe and Janice are business owners
  - Profit for 2016 is $500,000 before owner compensation and plan contribution
  - Plan contributions are $100,000 for Joe and $110,000 for Janice
  - Compensations will be $150,000 for Joe and $140,000 for Janice

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Co-Owner Split?

- Impact of this is that Joe and Janice expect that the relative amount they will get from the plan will reflect historic contributions and earnings
  - Therefore, want the plan benefits to be as close as possible to contributions plus investment earnings
- What if there is wider variance?
  - It is a violation of Treasury regulations to have a side agreement to adjust the pre-established buyout to account for differences between benefit expectations and actuality

Co-Owner Split?

- Result: important to have the plan parallel expectations as closely as possible
- Recommendations:
  - Again, follow investment strategy where the actual plan investments parallel the assumptions as closely as possible
  - The actuary will calculate a range of contributions (maximum and minimum). It is prudent for the actual contribution to bring the assets and benefits back into alignment each year.

Other DB/CB Things That You Need to Know

AFTAP

- AFTAP = Adjusted Funding Target Attainment Percentage
- General meaning: plan assets divided by plan benefits – i.e., how funded is the plan
- If AFTAP is 80%+ - plan is considered to be reasonably funded
- If AFTAP is 60-80%, plan is at risk
- If AFTAP is less than 60%, plan is critically underfunded

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AFTAP Impact

- If AFTAP is 60-80%
  – Lump sum distributions are restricted to 50%
  – Participant required to either wait to get lump sum or to take annuity form of payment
  – Cannot amend plan to increase benefits if the result is to have AFTAP of less than 80%
- If AFTAP is less than 60%
  – No lump sum distributions
  – Benefit accruals cease
- Participants must be notified

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AFTAP Timing

- If the actuary has not yet certified the AFTAP for a year, assume the following in relation to benefit restrictions:
  - If in first 3 months of the year: assume same AFTAP as prior year
  - First day of 4th month to last day of 9th month: assume AFTAP is the same as AFTAP from prior year – 10%
  - First day of 10th month and thereafter: assume AFTAP is below 60%

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PBGC Coverage

- Coverage: all CB/DB plans except:
  - Plans covering only substantial owners
  - Plans of professional service employers with less than 26 participants
  - Various other exceptions such as government plans

Premiums Are Expensive

- Annual premiums = flat rate premium + variable rate premium

Year	Flat Rate Premium (per Participant)	Variable Rate Premium (per $1,000 of underfunding)
2016	$64	$30
2017	$69	$33
2018	$74	$37
2019	$80	$41

- Due by the 15th day of the 10th month of the plan tear

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Annual Funding Notice

- Applies to PBGC-covered plans
  - Replaces Summary Annual Report
  - Must be provided to participants, beneficiaries and other interested parties
  - Due by 15th day of the 10th month following plan year end
  - Contains information re plan's funded status, assets and liabilities, and PBGC guarantees

Deduction Limit Under IRC §404(a)(7)

- Applies if plan has at least one participant in both the CB/DB and the defined contribution plan AND the CB/DB plan is not covered by the PBGC
- Maximum deduction is the total of:
  - DB minimum funding amount, plus
  - 401(k) salary deferrals
  - 6% defined contribution plan
- Or, if more, 31% of compensation plus salary deferrals

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Practical Considerations

A CB is Not a Super-PSP

- There is not the flexibility to decide not to contribute or to contribute less in a given year
  - The plan can be amended, but not after the benefit has accrued
  - How often can the benefit be amended, particularly for given "tiered" benefits?
- Therefore, need commitment for the plan to be ongoing

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PBGC Rules May Prevent Termination

- If plan is covered by the PBGC, cannot terminate with insufficient assets unless:
  - Company is in bankruptcy or receivership
  - Company can convince the PBGC that it will not be able to continue if the plan is not terminated
  - PBGC institutes termination
  - There is a majority who can waive enough benefit to make plan funding sufficient
- If cannot terminate, can only freeze and wait for plan to be fully funded

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Assets Will Always Be A Little Different From Benefits

- If there are multiple owners, need to be aware of:
  - Potential for required contribution for a person who leaves the company mid-year
  - Need to follow suggestions regarding funding and investment so that the differential between assets and benefits is low
  - If any differential between assets and benefits will make the owners crazy, this may not be the right vehicle

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Likely Prospects

- Clients who have maxed out their defined contribution amounts and:
  - They want larger benefits
  - They want larger deductions
  - They want to benefit selected employees

Likely Prospects

- Clients in the following categories:
  - Professionals, such as doctors, dentists, attorneys
  - Family businesses
  - Businesses with high cash flow / retained earnings
  - Multi-partner practices with partners with different goals / needs
  - Closely-held businesses with age 45+ owner(s)
  - Consultants
  - Baby boomers

Questions?

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Increasing Income in Retirement Plans

Kevin’s presentation will be a lively discussion that he invites the attendees to join. Attached are support documents and supplements Kevin has provided that he will be using during his session.

Fiduciary implications: Using re-enrollment to improve target date fund adoption

A white paper
by
C. Frederick Reish & Bruce Ashton

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The research contained in this white paper was compiled by Drinker Biddle & Reath LLP. J.P. Morgan Asset Management is a subsidiary of JPMorgan Chase & Co. and is not affiliated with Drinker Biddle & Reath LLP. Drinker Biddle & Reath LLP is solely responsible for the information and content of this white paper. J.P. Morgan is not responsible for conclusions of law set forth in this white paper. The research referred to in this white paper is current as of June 30, 2011. The reader should independently determine whether the research set forth in this white paper is current after that date.

C. Frederick Reish and Bruce Ashton are partners in the Employee Benefits & Executive Compensation Practice Group of Drinker Biddle & Reath LLP. They have been compensated by J.P. Morgan Asset Management to provide advice and to give an opinion regarding the ERISA fiduciary implications of using a re-enrollment strategy when adding target date funds to an investment line up.

Table of Contents

Introduction

An assumption underlying most 401(k) plans is that participants know how to invest their funds. Based on that assumption, most plan sponsors offer their participants an array of prudently selected mutual funds, provide investment education and conclude that they have fulfilled their responsibilities. Unfortunately, the assumption isn't correct — as either a matter of fact or a matter of law.[1]

What plan sponsors[2] don't realize is that they are responsible — and thus potentially liable — for participant investing, even when the plan has delegated that authority to the participants and they have exercised control over the investments. (By "participant investing," we mean the allocation of the money in a participant's account among the plan's investment options.) There are a few exceptions (or "safe harbors") that we will discuss later. But, unless a plan satisfies these exceptions, plan sponsors and their fiduciaries (such as the committee members) are still on the legal "hook."

The marketplace has developed solutions for this problem, including participant investment advice and professionally designed portfolios, such as managed accounts, risk-based portfolios and target date funds (TDFs). The last of these, TDFs, has proven to be the most popular with both fiduciaries and participants.[3] When TDFs are coupled with an ERISA[4] safe harbor, plan sponsors and fiduciaries will be shielded from potential liability for participant investing.

Plan sponsors and fiduciaries have a number of ways to introduce TDFs into a plan:

- Add them to the plan's investment line-up and allow participants to choose for themselves
- Use the mapping or investment reset process to move the funds from existing investments to the TDFs
- Adopt a "re-enrollment" strategy to take advantage of the ERISA safe harbor for default investments under the qualified default investment alternative (QDIA) rules.

In light of the benefit to participants of using TDFs and the fiduciary protections offered by the QDIA rules (discussed later in this white paper), fiduciaries are well advised to add TDFs to the investment line-up and to take steps to cause as many participants as possible to be invested in those funds. One of the most effective ways of doing so is through the "re-enrollment" process — because it enables fiduciaries to rely on the default investing rules that provide a fiduciary safe harbor from liability for imprudent participant investing. (Re-enrollment refers to a process where participants may re-direct the investment of their plan accounts or, alternatively, be defaulted into a QDIA.)

In the remainder of this white paper, we discuss legal principles and industry practices, and then illustrate the advantages of using the re-enrollment process to provide the greatest protection for plan fiduciaries.

Discussion of legal principles and industry practices

This section discusses the fiduciary obligations of plan sponsors and fiduciaries for plan investments, the options for improving participant investing outcomes and the QDIA safe harbor, with emphasis on the concept of re-enrollment.

Fiduciary obligation for plan investments

Under ERISA, fiduciaries have the obligation to act prudently in managing a plan's investments.[5] This includes both (i) the prudent selection and monitoring of the investment options offered by the plan and (ii) the investing of participant accounts.[6] The latter obligation applies to accounts of participants who fail to direct the investment of their accounts and to accounts of participants who direct their investments, but the plan fails to comply with all of the 404(c) conditions (explained below). That is, fiduciaries may be responsible for both imprudent participant investing as well as the investment of the accounts of participants who fail to direct their investments.

In addition, fiduciaries have the duty to operate the plan for the exclusive purpose of providing retirement benefits.[7] In participant-directed plans, fiduciaries face a dilemma: plan assets, including participant accounts, must be invested according to generally accepted investment theories, such as modern portfolio theory,[8] and in a manner that meets the needs of the participant and is designed to avoid large losses. In other words, the participant accounts must be prudently invested; but, for the most part, participants don't have the ability to do this….because of lack of investment expertise, time or interest. As a result, fiduciaries may turn to professionally designed investment options, including managed accounts, risk-based investments or age-based investments (target date funds). For purposes of this discussion, we assume that the fiduciaries have selected a TDF suite.

Fiduciary safe harbors

To provide a context for the discussion that follows, we should review the fiduciary safe harbors for participant investing:

1. The first is found in ERISA Section 404(c).[9] Under this section, if a plan complies with a number of disclosure and other requirements, fiduciaries are relieved of liability for investment decisions made by the participants. In our experience, based on audits we have conducted of a large number of plans, few actually comply with all of the conditions; as a result, the fiduciaries remain responsible for the investing decisions made by the participants.[10]
2. The second arises when an investment advisor (a bank, insurance company or registered investment advisor) is given discretion over the management of investments.[11] In the context of participant investing, to obtain this protection, fiduciaries must select an investment advisor who, if used by a participant, is given discretionary control of the participant's account and manages it on an ongoing basis.
3. The third is available when a participant fails to exercise control over his account — that is, when the participant "defaults." In that situation, the fiduciaries have an obligation to prudently invest the participant's account. For this safe harbor to apply, the plan must comply with specific requirements.[12] They include the selection of an appropriate default investment option, referred to as a "qualified default investment alternative" or QDIA. Once these are met, the defaulting participant is deemed to have exercised control over his account, so that the fiduciaries are not responsible for whether the investment is otherwise appropriate for the participant (e.g., whether the QDIA suffered losses compared to the result of a risk-free investment). The key to obtaining this safe harbor, however, is that there be a default by the participant — which can occur in a number of ways. We will discuss this safe harbor in more detail later in this paper.

Investing participant accounts in professionally designed investments

What can fiduciaries do to increase the likelihood that participant accounts are invested in one of these options?

One approach is to include professionally designed investments as core options, with the goal that participants will select them on their own. This may be more effective than offering only individual asset class investment options, but the experience is not encouraging — particularly for participants who have already directed their investments. Several studies reveal that participants tend to stick with their initial investment choices and, due to inertia, do not later modify their investment elections, even if more choices become available.[13] Based on the experience of at least one provider, this is also the case when participants are defaulted into an investment option.[14]

The fiduciary protection can be expanded if the plan complies with the requirements of the regulation under ERISA section 404(c)(1), which provides that fiduciaries are not responsible for participant investment decisions if they are given the opportunity to exercise control over their accounts and actually do so. In order for this protection to apply, the plan must be a "404(c) plan"; that is, it must offer a "broad range" of investment options and meet approximately 20 disclosure requirements.[15] As previously noted, many plans have not satisfied these requirements, making this safe harbor somewhat illusory.

The mapping or investment reset approach

Another approach is to "map" or "reset" all the participant accounts into age-appropriate TDFs.[16] This strategy is commonly known as "investment reset." Studies have shown that a substantial percentage of participants will leave their funds in the TDF once this occurs. But there are limitations on the protections afforded by the mapping approach because, at best, it is a limited safe harbor. That is because, in order for the mapping protection to be available, the plan must be a 404(c) plan before the mapping occurs. And there are other requirements that make the mapping protection of questionable value in moving funds into TDFs.

Mapping is sometimes used when a plan (i) changes providers (and thus investment options), (ii) changes investment options without changing the provider or (iii) there is a fiduciary decision to take control over participant accounts and move the funds to age-appropriate TDFs. But in order for the limited safe harbor to apply, the fiduciaries must, among other things, move the participants' funds to a "reasonably similar" investment.[17] While the Department of Labor has not issued guidance on the meaning of "reasonably similar," it seems certain that moving from a money market account or stable value fund or even a risk-based investment to TDFs will not satisfy this requirement; other than another TDF, no other investment is "reasonably similar" to a target date fund, so this approach is not a viable option.

Even though mapping or resetting all participant accounts to TDFs would be helpful in increasing the number of participants investing in TDFs, it will not provide the protections afforded by an ERISA fiduciary safe harbor. This is because the decision to map a participant's funds to a TDF would not be viewed as participant direction, but as a fiduciary decision for which there is no safe harbor. Having said that, most — if not all — TDFs are based on the investing theories that underlie ERISA's fiduciary rules, such as modern portfolio theory and strategic asset allocation. Nevertheless, the mapping or investment reset approach does not provide the fiduciary protections afforded under the QDIA default approach.

The default approach

ERISA provides a safe harbor for fiduciaries if participants are given the opportunity to invest their accounts but fail, for whatever reason, to do so.[18] The reason for this safe harbor is to improve investing of defaulted participant accounts.[19] If fiduciaries comply with the QDIA requirements, they will not be liable for any loss that occurs as a result of the default investments, though they remain responsible for the prudent selection and monitoring of the qualified default investment alternative itself. In essence, once a plan sponsor has identified the type of QDIA that will be used by the plan, the fiduciary must engage in a prudent process to select the particular investment fund, portfolio or managed account service and monitor that selection to ensure that it remains a prudent choice, but will not be liable for how defaulted participants are invested.[20]

While there are several requirements that must be met for the safe harbor to be available, the key elements are that there be a default and that the participant's account be invested in a QDIA.[21] There are three types of QDIAs: a managed account service, a balanced (risk-based) portfolio or a TDF suite.

How does a "default" — as defined for QDIA purposes — occur? There are several ways:

- a newly eligible employee enrolls in a plan but fails to elect how his account is invested;
- an employee is automatically enrolled in a plan and fails to make an investment election; or
- a default occurs through a process called "re-enrollment" (described in the next section).

Re-enrollment

Re-enrollment allows fiduciaries to exercise a degree of control over participant investing and, at the same time, enjoy the protection of the QDIA safe harbor. The concept applies to participants who have previously made an affirmative election about how to invest their accounts. In many cases, it may be beneficial for the participants, and thus for the plan sponsor, to utilize the re-enrollment process to improve the quality of participant investing. Because of participant inertia, even if new TDFs are made available in a plan, most participants who have already directed their investments are unlikely to act to obtain the benefits of improved investing through the TDFs. Thus, for fiduciaries who want to improve the quality of the investing of current participants, re-enrollment, together with the QDIA rules, affords that opportunity.

By going through a re-enrollment process, QDIA safe harbor protection will be available to fiduciaries if they provide the participants who have previously made affirmative investment elections with the opportunity to make a new investment decision or, if not, to be defaulted into a QDIA. In other words, if participants are defaulted into a QDIA after re-enrollment and the QDIA conditions are satisfied, the fiduciaries will be entitled to the QDIA safe harbor protection. While this conclusion is not directly addressed in the QDIA regulation for plans remaining with the same provider, we have reached this conclusion based on certain provisions in the regulation, together with expansive language in the preamble to the regulation and statements by DOL officials.[22]

First, we consider the expansive language in the preamble. There, the DOL explains that if the plan sponsor cannot tell whether participants were defaulted into the plan's prior default investment or affirmatively elected that investment, it may default participants into a QDIA, including those who affirmatively selected that investment.[23] In the preamble, the DOL also discusses several situations in which a participant who previously made an affirmative investment election may be defaulted into a QDIA. Under the heading "Application of the Final Rule to Circumstances Other Than Automatic Enrollment," the DOL states:

> The failure of a participant or beneficiary to provide investment direction following the elimination of an investment alternative or a change in service provider, the failure of a participant or beneficiary to provide investment instruction following a rollover from another plan, and **any other failure of a participant to provide investment instruction. Whenever a participant or beneficiary has the opportunity to direct the investment of assets in his or her account, but does not direct the investment of such assets,** plan fiduciaries may avail themselves of the relief provided by this final regulation, so long as all of its conditions have been satisfied. [Emphasis added.][24]

The preamble makes it clear that there are at least four situations in which a participant who previously made an affirmative investment election may nevertheless be defaulted into a QDIA:

1. Where the plan sponsor is unable to determine whether participants were defaulted into the plan's default investment or affirmatively selected it;
2. When a participant fails to provide investment direction after an elimination of an investment alternative;
3. When a participant fails to provide investment direction after a change in a service provider; and
4. The "catch-all," where there is *any other failure* of a participant to provide investment instruction.

The catch-all language, read in conjunction with the quote above ("whenever a participant or beneficiary has the opportunity to direct the investment …but does not… the fiduciaries may avail themselves of the relief provided by this final regulation"), leads to the conclusion that plan sponsors may be entitled to the safe harbor protections afforded by the QDIA regulation in any situation where a participant fails to provide investment instructions, including re-enrollment (so long as the plan otherwise satisfies the conditions in the regulation).

This interpretation is further supported by statements made by one of the primary drafters of the QDIA regulation, as reflected by her response to a question at a benefits conference:

Question: Is it okay to use a QDIA with a fresh start approach (i.e., you are not changing fund families but everyone is required to make a new affirmative election; if they don't, it goes to the QDIA, assume all notice and other requirements are satisfied)?

Answer: **I think the short answer is yes.** The scope of our rule would cover this situation. **I've heard this referred to as re-enrolling**…where you sort of say we're going to start over here — we've maybe, perhaps, changed our investment line-up based on the reg, we've picked new products, gone through a prudence analysis, we think this is a good way to go and we kind of want to reach out to everybody again and have them re-direct their investments or make sure they are still comfortable where they are…if they don't get back to you we are going to put you into the QDIA. [Emphasis added.][25]

As a result, re-enrollment is a viable option for improving participant investing through the use of TDFs and at the same time providing the fiduciaries with the QDIA safe harbor protection.

The next section of this white paper discusses the re-enrollment process and the advantages it provides to fiduciaries.

Advantages of re-enrollment

In light of the fiduciary responsibility for managing plan investments and for participant investing, fiduciaries are well advised to consider the fiduciary protections, especially the safe harbors, offered by ERISA. Adding TDFs to a plan's investment line-up helps by providing a professionally designed alternative for participants to chose; but this alone does not provide fiduciary safe harbor protection. Further, based on industry experience, only a limited number of participants, and very few of those who previously decided how to invest their accounts, opt to use the TDFs. Using the mapping or investment reset strategy may help, although the fiduciary protection is limited because of the requirements that the plan already be a 404(c) plan and that the new investment be "reasonably similar" to the one it replaces.

The QDIA safe harbor is especially valuable because of the simplicity of complying and the breadth of the protection. The fiduciaries' responsibility extends to the prudent selection and monitoring of the investment vehicle, but not to whether the TDF is appropriate for the particular participant. Absent a re-enrollment process, however, the QDIA safe harbor protection may not cover many participants and, therefore, may afford only limited protection to the fiduciaries. Consider the following example:

Add target date funds to investment menu

Apex Industries sponsors a 401(k) plan. Over time, the fiduciaries have added new investments, including a line-up of TDFs. Reflecting the well-documented inertia of participants, even though TDFs were added to the plan, most of the existing participants left their funds invested in the same manner as they selected at enrollment. Unfortunately and consistent with industry data, most were poorly invested and not well diversified.

As new participants enter the plan, some select the TDFs and some fail to designate investments and are defaulted into TDFs as QDIAs. As a result, the fiduciaries have ERISA safe harbor protection, but only for the limited number of participants who were defaulted into the TDFs.

Automatic enrollment may offer a slightly better alternative in that it may increase the number of participants who are defaulted into a TDF. For example:

Add target date funds along with automatic enrollment

Baker Enterprises is a rapidly growing firm specializing in the environmental clean-up business. Baker's 401(k) plan provides for automatic enrollment, and the plan committee has selected a suite of TDFs as the QDIA for the plan. Most of the automatically enrolled participants default and are invested in the TDFs.

Unfortunately, despite a robust education campaign, few of the pre-existing participants elected to move their funds to the TDFs. As a result, while the newly defaulted participants are in TDFs (and the fiduciaries have the QDIA safe harbor), many of the pre-existing participants continue to be poorly invested, and the fiduciaries are exposed to potential claims.

Now, consider the example of changing providers and using the investment reset approach to move participant funds into the TDFs. (Note that this approach is different from combining a change in providers with a re-enrollment process, discussed in the example that follows this one.)

Use investment reset approach while converting to a new provider

Consolidated Corporation decides to change providers. As a part of the conversion, the committee decides to transfer all participant accounts into age-appropriate TDFs. This approach will be used for participants who directed the investment of their accounts and for those who previously defaulted and have their funds invested in an existing default investment.

With respect to the latter group — those who previously defaulted — the fiduciaries will obtain the safe harbor QDIA protection. With respect to the former group — those who previously directed their accounts — they will not. While the decision to move the assets of this group into TDFs may be a prudent fiduciary decision, it does not afford the fiduciaries any safe harbor protection because the fiduciaries will be considered to have exercised control over the accounts of non-defaulting participants and thus remain responsible for the fiduciary decision on how to invest their assets.

Changing providers, combined with a re-enrollment, may be helpful in improving participant investing and provide significant safe harbor protection to the fiduciaries. The following illustrates the concept:

Engage in re-enrollment while converting to a new provider

Delta Company decides to change providers and decides that, as a part of the conversion, all participants will be defaulted into TDF QDIAs unless they opt out or actively make a new investment election. During the conversion, 70% of the participants do not submit new investment elections and, as a result, are defaulted into QDIAs (that is, age-appropriate TDFs). (Based on the experience of one provider, the default rate typically ranges between 65% and 85% on a plan conversion.) As a result, the committee members are entitled to the fiduciary protection for the investing of 70% of the participants' accounts.

If the committee for the Delta Company 401(k) plan desired a similar level of protection but was satisfied with the plan's provider, they could opt to engage in a re-enrollment process while staying with the current provider as well.

Engage in re-enrollment while staying with current provider

To implement that process, once a prudently selected TDF suite has been added to the plan, the committee would determine a re-enrollment date (that is, an effective date when accounts would be re-invested according to new participant instructions or, if none, to the default investment — in this case, an age-appropriate TDF). Then, re-enrollment notices, along with information about the TDFs and other investments, would be given to all affected participants.

> COMMENT: The initial notice is commonly given about 60 days before the re-enrollment date. Then, reminder notices are often given 30 days and again 7 to 10 days before that date. The first notice is to satisfy legal requirements;[26] and the subsequent notices are to ensure that no participant is inadvertently defaulted.

On the effective date, the participant instructions are implemented for those who gave new directions; for those who did not, the accounts are placed (or "defaulted") into the QDIAs. Based on our experience, 50% to 80% of the participants will default, resulting in significant fiduciary protections for the committee members.

Conclusion

Fiduciaries are legally responsible (1) for prudently selecting and monitoring the investments offered under the plan and (2) for how their participants use those investments. For new participants, plan sponsors can obtain fiduciary protections with respect to the participants who are defaulted into QDIAs. For existing participants, fiduciaries — such as plan committee members — can obtain the safe harbor protection by utilizing the re-enrollment strategy either when going through a plan conversion to a new provider or while staying with the existing provider. In both scenarios, participants must be given the opportunity to make a new investment election or they will be defaulted into the plan's QDIA.

Endnotes

[1] See, e.g., Gary R. Mottola and Stephen P. Utkus, "Red, Yellow, and Green: Measuring the Quality of 401(k) Portfolio Choices," (August 2007, prepared for inclusion in "Improving the Effectiveness of Financial Education and Saving Programs," published by University of Chicago Press; "The Financial Engines National 401(k) Evaluation," Financial Engines (2010), which points out that "only about one third of participants (32%) have efficient portfolios with the appropriate amount of risk…."

[2] Throughout this white paper, we refer to the responsible plan fiduciary to a plan as the plan sponsor. This is based on the fact that in most cases, the plan sponsor undertakes this role rather than delegating the duties and responsibilities to third parties. While a committee may be established to carry out the fiduciary duties, the plan sponsor — the employer—has the ultimate responsibility.

[3] See, e.g., Jean A. Young, "Target Date Fund Adoption in 2010," The Vanguard Group, Inc. (March 2011).

[4] The Employee Retirement Income Security Act of 1974, as amended.

[5] ERISA §404(a)(1)(B) and ERISA Regulation §2550.404a-1.

[6] ERISA §409(a). See also, Department of Labor's Amicus Brief in *Hecker v. Deere:* "It is the fiduciary's responsibility to choose investment options in a manner consistent with the core fiduciary duties of prudence and loyalty. If it has done so, section 404(c) relieves the fiduciary from responsibility for the participants' exercise of authority over their own accounts. If, however, the funds offered to the participants were imprudently selected or monitored, the fiduciary retains liability for the losses attributable to the fiduciary's own imprudence."

[7] ERISA §404(a)(1)(A).

[8] See, e.g., the preamble to the DOL's final regulation on qualified default investment alternatives, 72 FR 60451, 60461 (2007) (the "QDIA Regulation").

[9] Technically, this is not a safe harbor but a defense to a claim of breach of fiduciary duty. Since it is commonly referred to as a "safe harbor," however (except by the Department of Labor), we have elected to use that term here as well.

[10] See ERISA Regulation §2550.404a-5.

[11] See ERISA §§3(38), 402(c)(3) and 405(d).

[12] ERISA §404(c)(5).

[13] Preamble to QDIA Regulation, 72 FR 60475, FN 40. Cites to studies showing that "Participants have been found to exhibit inertia in their investment choices, being slow to rebalance or to respond to changes in the investment options offered to them (see, e.g., Olivia S. Mitchell, Gary R. Mottola, Stephen P. Utkus, and Takeshi Yamaguchi, The Inattentive Participant: Portfolio Trading Behavior in 401(k) Plans, Pension Research Council Working Paper 2006–5 (2006) at 16, which finds a lack of rebalancing; see also Jeffrey R. Brown and Scott Weisbenner, Individual Account Investment Options and Portfolio Choice: Behavioral Lessons from 401(k) Plans (Dec. 2004).")

[14] Based on a study of 92 mid- and large-size plan conversions, T. Rowe Price determined that approximately 81% of the participants were defaulted into TDFs on conversion to a new provider. After three months, 96% of these participants remained invested in the TDFs and after 18 months, the percentage remained at about 93.8% (we refer to this as the rate of persistency). While similar statistics are not available for re-enrollments, we believe the persistency rates could be somewhat lower (inasmuch as, in the re-enrollment context, participants have the option of leaving their accounts invested as they previously directed, whereas this option is not available in a conversion); but at least one provider reported that after one year "87% of participants maintained a full or partial position in the target-date approach and that re-enrollment had boosted plan diversification substantially." See "Research report: Reenrollment and target-date funds: A case study in portfolio reconstruction," Vanguard 09/22/09.

[15] ERISA Regulation 2550.404c-1(b)(3) provides that this requirement is met only if the investment options offered by the plan offer the participant an opportunity to "Materially affect the potential return on amounts in his individual account with respect to which he is permitted to exercise control and the degree of risk to which such amounts are subject; [and] Choose from at least three investment alternatives: (1) Each of which is diversified; (2) Each of which has materially different risk and return characteristics; (3) Which in the aggregate enable the participant or beneficiary by choosing among them to achieve a portfolio with aggregate risk and return characteristics at any point within the range normally appropriate for the participant or beneficiary; and (4) Each of which when combined with investments in the other alternatives tends to minimize through diversification the overall risk of a participant's or beneficiary's portfolio…."

[16] ERISA §404(c)(4).

[17] The section provides that "the stated characteristics of the remaining or new investment options …, including characteristics relating to risk and rate of return, are, as of immediately after the change, reasonably similar to those of the existing investment options as of immediately before the change." ERISA Section 404(c)(4)(A)(ii).

[18] ERISA §404(c)(5)

[19] Preamble to QDIA Regulation, 72 FR 60463

[20] Preamble to QDIA Regulation, 72 FR 60453 and ERISA Regulation §2550.404c-5(b)(1) and (2).

[21] ERISA Regulation §2550.404c-5 provides six requirements: (1) assets are invested in a qualified default investment alternative; (2) the participant had the opportunity to direct the investment of the assets in his account but did not do so; (3) the participant is furnished a notice regarding his right to direct his account, his right to move his account out of the QDIA and the other investment options available under the plan; (4) the participant receives certain information regarding the features of the QDIA; (5) the participant is given the right to transfer out of the QDIA to any other investment alternative available under the plan with appropriate frequency and without penalty; and (6) the plan offers a broad range of investment alternatives.

[22] This conclusion is supported in a recent case, *Bidwell v. University Medical Center, Inc.,* 2011 WL 995944 (W.D.Ky.).

[23] Although not discussed in the preamble, presumably if the plan sponsor knows that the participant made an election to invest in the fund used as the prior default investment, it cannot rely on this approach. That is, if the plan sponsor can tell whether the participant was defaulted or not, this approach is not available.

[24] Preamble to the QDIA Regulation, 71 FR 60453.

[25] Statement by Kristen Zarenko at the 2008 Los Angeles Benefit Conference Workshop 7, "QDIA Update" (January 25, 2008).

[26] ERISA Regulation §2550.404c-5(c)(3).

About C. Frederick Reish

C. Frederick Reish is a partner in the Drinker Biddle & Reath Employee Benefits & Executive Compensation Practice Group and Chair of the Financial Services ERISA Team. He has specialized in employee benefits law since 1973 and works with both private and public sector entities and their plans and fiduciaries; representation of plans, employers and fiduciaries before the governing agencies (e.g., the IRS and the DOL); consulting with banks, trust companies, insurance companies and mutual fund management companies on 401(k) investment products and issues related to plan investments; and representation of broker-dealers and registered investment advisers on issues related to fiduciary status and compliance, prohibited transactions and internal procedures.

Fred serves as a consultant on ERISA litigation and FINRA arbitration, with a focus on cases involving broker-dealers, registered investment advisors, financial service companies and other service providers. He also has been engaged to serve as an expert witness in state courts, federal courts and FINRA arbitration proceedings involving issues as diverse as fiduciary liability, fiduciary status of advisors, prohibited transactions, plan interpretation and bankruptcy issues for ERISA plans.

Professional recognition and awards

Fred has received a number of awards for his contributions to benefits education, communication and service, including:

- In 2011, selection by *PLANSPONSOR* magazine as one of the 5 "Legends" of the retirement industry and with retirement advisors.
- The 2009 American Society of Pension Professionals & Actuaries (ASPPA)/Morningstar 401(k) Leadership Award for directly and positively influencing the ability of Americans to build successful retirements.
- Selection by *PLANSPONSOR* magazine as one of the 15 Legends in the development of retirement plans.
- Recognition by *401kWire* as the 401(k) Industry's Most Influential Person for 2007 (and has, for every year of that survey, been in the top 10).
- The IRS Director's Award and the IRS Commissioner's Award for his contributions to employee benefits education.
- 2006 Lifetime Achievement Award from *PLANSPONSOR* magazine.
- The 2006 Lifetime Achievement Award from *Institutional Investor* for his contributions to the benefits community.
- The 2004 Eidson Founder's Award from ASPPA for his significant contributions to that organization and to the benefits community.
- Recognition as one of "The Best Lawyers in America."
- The Alumni Service Award from Arizona State University.

On behalf of ASPPA, he has co-authored amicus curiae briefs with the Supreme Court of the United States in the case of *Patterson v. Shumate* and with the Tax Court in the case of *Citrus Valley Estates v. Commissioner of Internal Revenue*.

Publications

Fred has written four books and more than 350 articles on fiduciary responsibility, prohibited transactions, IRS and DOL audits and pension plan disputes. He authors a monthly column on 401(k) fiduciary responsibility for *PLANSPONSOR* magazine and has written a quarterly column on that subject for the *Journal of Pension Benefits*. Fred has authored or co-authored most of the IRS plan correction articles published by the *Journal of Taxation* and the *Journal of Pension Benefits*.

As an experienced lawyer on benefits matters, Fred is frequently quoted by both professional and public publications, including *The Wall Street Journal, Fortune, Forbes, Inc., CFO Magazine, New York Times, Washington Post, Los Angeles Times, USA Today, Institutional Investor, PLANSPONSOR* and *Pensions & Investments*.

Speaking engagements

Fred is a nationally known speaker on fiduciary responsibility, technical compliance matters and litigation issues. He has spoken at the annual conferences of the American Bar Association, the American Society of Pension Professionals and Actuaries, the Western Pension and Benefits Conference, the Enrolled Actuaries Conference, the International Foundation of Employee Benefit Plans and the National Institute of Pension Administrators.

In general

Fred received a J.D. from the University of Arizona James E. Rogers College of Law and B.S. from Arizona State University.

About Bruce Ashton

Bruce L. Ashton is a partner in the Drinker Biddle & Reath Employee Benefits & Executive Compensation Practice Group. With more than 35 years of practice, Bruce has gained wide experience representing businesses in sophisticated business transactions and employee benefits matters. Bruce's practice focuses on all aspects of employee benefits issues, including representing public and private sector plans and their sponsors; negotiating the resolution of plan qualification issues under IRS remedial correction programs; advising and defending fiduciaries on their obligations and liabilities; structuring qualified plans, non-qualified deferred compensation arrangements and health care arrangements; and representing plan service providers (including RIAs, independent record-keepers, third-party administrators, broker-dealers and insurance companies) in fulfilling their obligations under ERISA. Combining his employee benefits and transactional expertise, Bruce is also active in the installation and funding of employee stock ownership plans (ESOPs).

Bruce served as president of the American Society of Pension Professionals and Actuaries (ASPPA) for the 2003–2004 term. From 1998 through 2002, he served as the co-chair of ASPPA's Government Affairs Committee and was a member of its board of directors from 1997 to 2007. He was a member of the Board of Directors of the American Academy of Actuaries during 2003–2004, was the president of the Western Pension & Benefits Conference Los Angeles Chapter from 2008–2009 and currently serves as a member of the leadership council of the National Tax Sheltered Accounts Association (NTSAA). He will serve as president of NTSAA during the 2013–2014 term.

He has been recognized as one of "The Best Lawyers in America" and as a "Super Lawyer" in Southern California. Bruce is listed in the California edition of *Who's Who Legal* and has been recognized by *401kWire* as one of the Most Influential People in the 401(k) Industry.

Bruce has co-authored four books on employee benefits issues and a quarterly column in the *Journal of Pension Benefits* on IRS remedial programs and is a frequent contributor to various tax and pension publications, including *Journal of Taxation, CCH Pension Plan Guide, Journal of Pension Benefits* and *The ASPPA Journal*. He is a frequent speaker on employee benefits issues ranging from fiduciary responsibility to ESOPs. Bruce is a regularly featured speaker at conferences of ASPPA, the Western Pension & Benefits Conference and various other organizations.

In general

Bruce earned his J.D. from Southern Methodist University, where he was a member of the Order of the Coif, Phi Alpha Delta and a Roy R. Ray Scholar. He was a recipient of the Johnson, Bromberg, Leeds & Riggs Award and the Arthur Stedley Hansen Consulting Actuaries of Dallas Award. He was a member (1968–1970), note and comment editor (1969–1970) and acting index editor (1970) of the *Journal of Air Law & Commerce*. He received his B.A. from Rice University.

Contact JPMorgan Distribution Services, Inc. at 1-800-480-4111 for a fund prospectus. You can also visit us at www.jpmorganfunds.com. Investors should carefully consider the investment objectives and risks as well as charges and expenses of the mutual fund before investing. The prospectus contains this and other information about the mutual fund. Read the prospectus carefully before investing.

Target date funds are funds with the target date being the approximate date when investors plan to start withdrawing their money. Generally, the asset allocation of each fund will change on an annual basis with the asset allocation becoming more conservative as the fund nears the target retirement date. The principal value of the fund(s) is not guaranteed at any time, including at the target date.

Certain underlying funds of the target date funds may have unique risks associated with investments in foreign/emerging market securities and/or fixed income instruments. International investing involves increased risk and volatility due to currency exchange rate changes, political, social or economic instability, and accounting or other financial standards differences. Fixed income securities generally decline in price when interest rates rise. Real estate funds may be subject to a higher degree of market risk because of concentration in a specific industry, sector or geographical sector, including but not limited to, declines in the value of real estate, risk related to general and economic conditions, changes in the value of the underlying property owned by the trust and defaults by the borrower. The fund may invest in futures contracts and other derivatives. This may make the fund more volatile. The gross expense ratio of the fund includes the estimated fees and expenses of the underlying funds. A fund of funds is normally best suited for long-term investors.

C. Frederick Reish and Bruce Ashton are partners in the Drinker Biddle & Reath Employee Benefits & Executive Compensation Practice Group. The firm has been compensated by J.P. Morgan Asset Management to provide advice and to give an opinion regarding the ERISA fiduciary implications of using a re-enrollment strategy when adding target date funds to an investment line up.

IRS Circular 230 Disclosure: JPMorgan Chase & Co. and its affiliates do not provide tax advice. Accordingly, any discussion of U.S. tax matters contained herein (including any attachments) is not intended or written to be used, and cannot be used, in connection with the promotion, marketing or recommendation by anyone unaffiliated with JPMorgan Chase & Co. of any of the matters addressed herein or for the purpose of avoiding U.S. tax-related penalties.

Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. We believe the information provided here is reliable, but do not warrant its accuracy or completeness. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. The views and strategies described may not be suitable for all investors. This material has been prepared for informational purposes only and is not intended to provide, and should not be relied on for, accounting, legal or tax advice. References to future returns are not promises or even estimates of actual returns a client portfolio may achieve. Any forecasts contained herein are for illustrative purposes only and are not to be relied upon as advice or interpreted as a recommendation.

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WP-RE-ENROLL

A Building Futures Report: Q1 2016 Trends

Before investing in any mutual fund, please carefully consider the investment objectives, risks, charges, and expenses. For this and other information, call or write Fidelity for a free prospectus or, if available, a summary prospectus. Read it carefully before you invest.

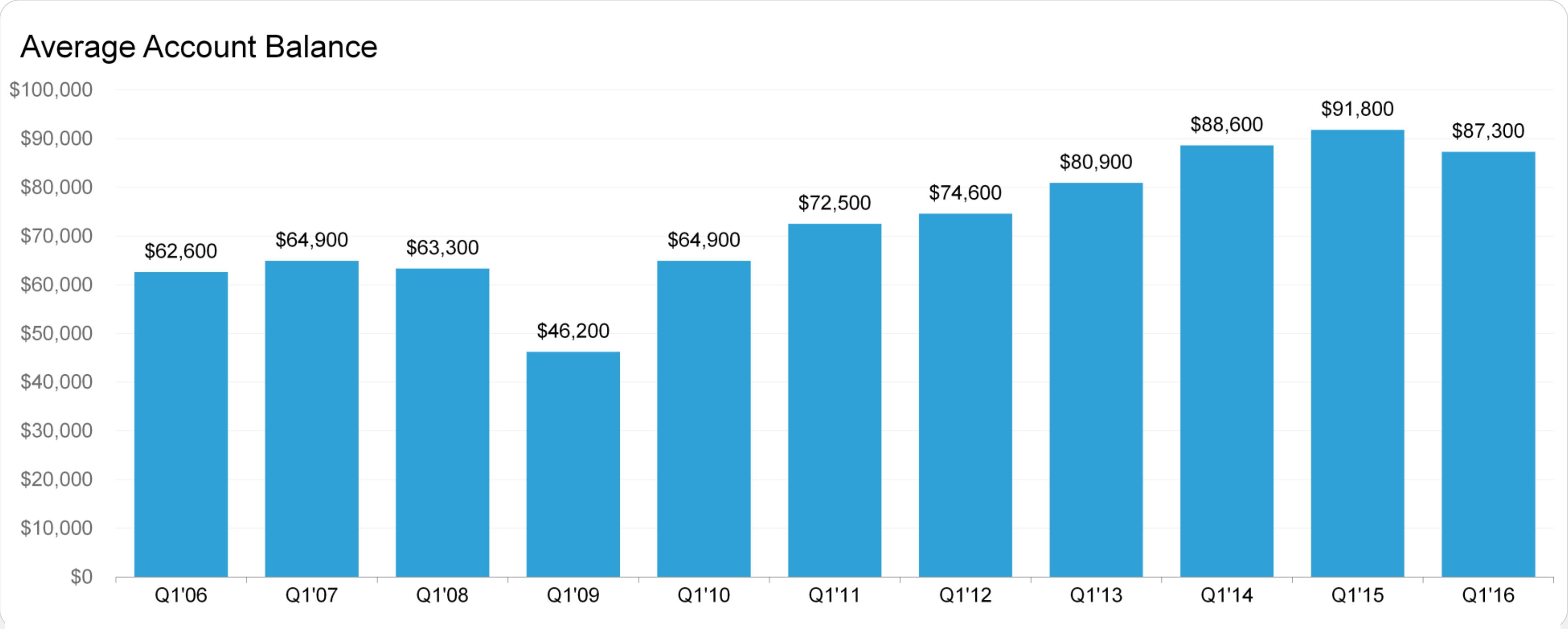
Fidelity Investments: An industry leading retirement provider

Fidelity's recordkept database is one of the industry's most comprehensive proprietary collections of defined contribution plan and participant information.

- Based on recordkept data of corporate defined contribution (DC) plans:
  - 21,800 plans
  - 13.9 million participants
- Data as of March 31, 2016 unless otherwise noted[1]

1 Data in this presentation exclude tax-exempt plans, nonqualified plans, and the FMR Co. plan. This analysis includes data from the Fidelity Advisor 401(k) Program.

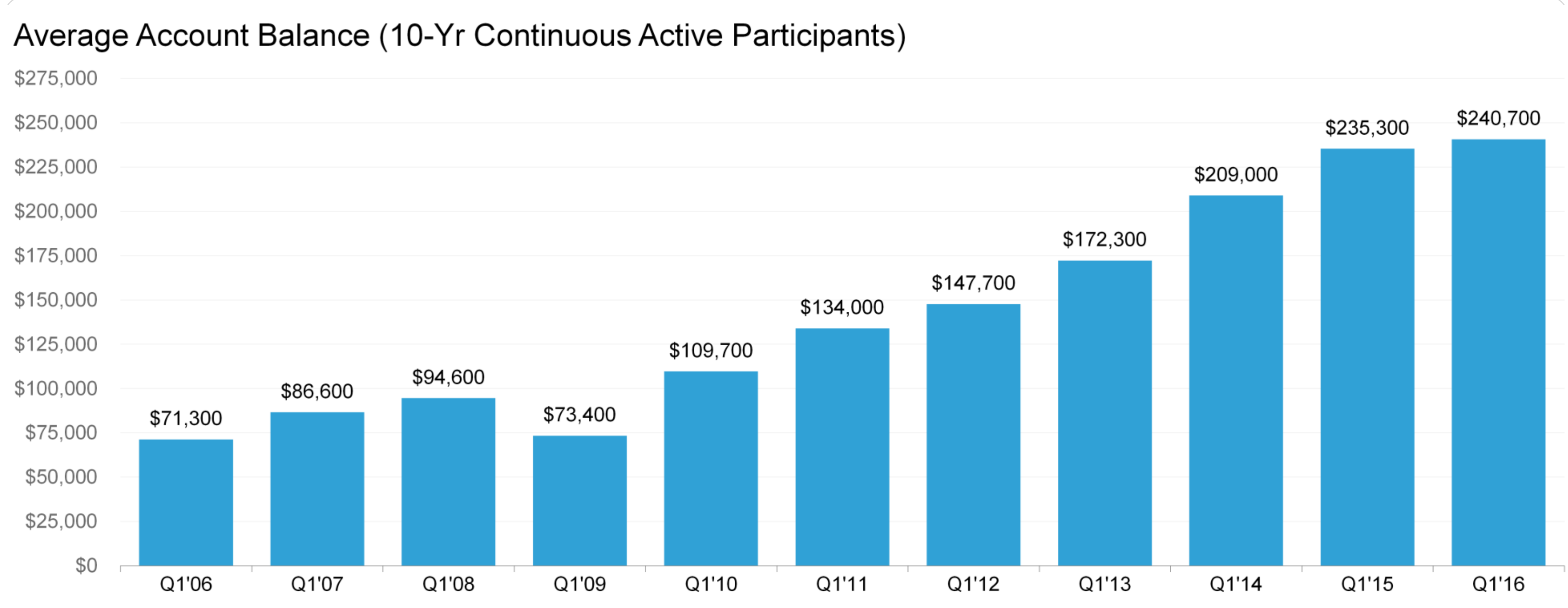
Account Balance



Key Insights

- Currently, the average account balance is $87,300, a decrease of 4.8% from one year prior.
- The median participant account balance is $22,000.
- Account balances are impacted by participant action (contributions, withdrawals, etc.) and market action.
- Account balances are also impacted by new participants having *lower* account balances than departing participants who may roll out their assets.

Account Balance (10-Yr Continuous Active Participants)

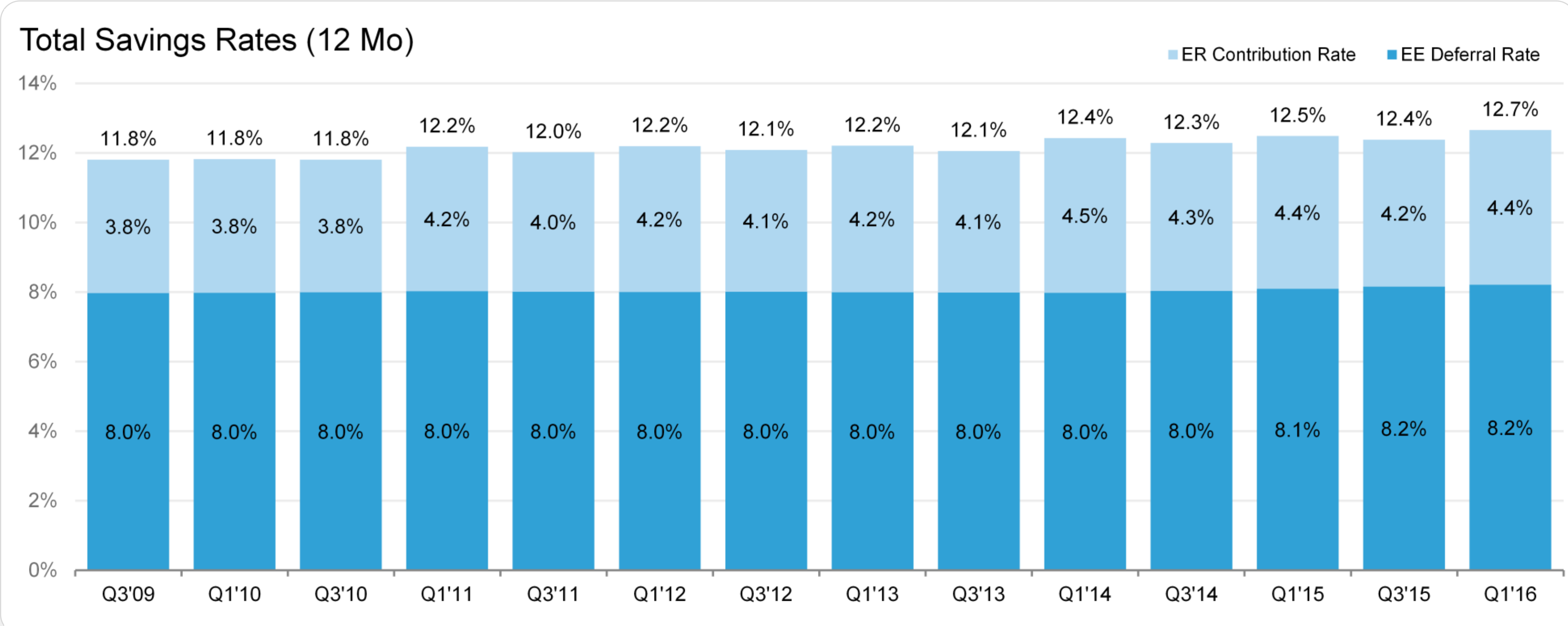


Key Insights

- The 10-Year Continuous Active Account Balance follows the same participants over time to show what they experienced during the last ten years.
- These participants had a $240,700 average account balance, up from $71,300 ten years prior (12.9% annual increase).
- This account balance increase was 51% due to participant action (net contributions) and 49% due to market increases.

Continuous Active Participants are actively employed with a balance for each year endpoint during the 10-year period.

Deferral Rates

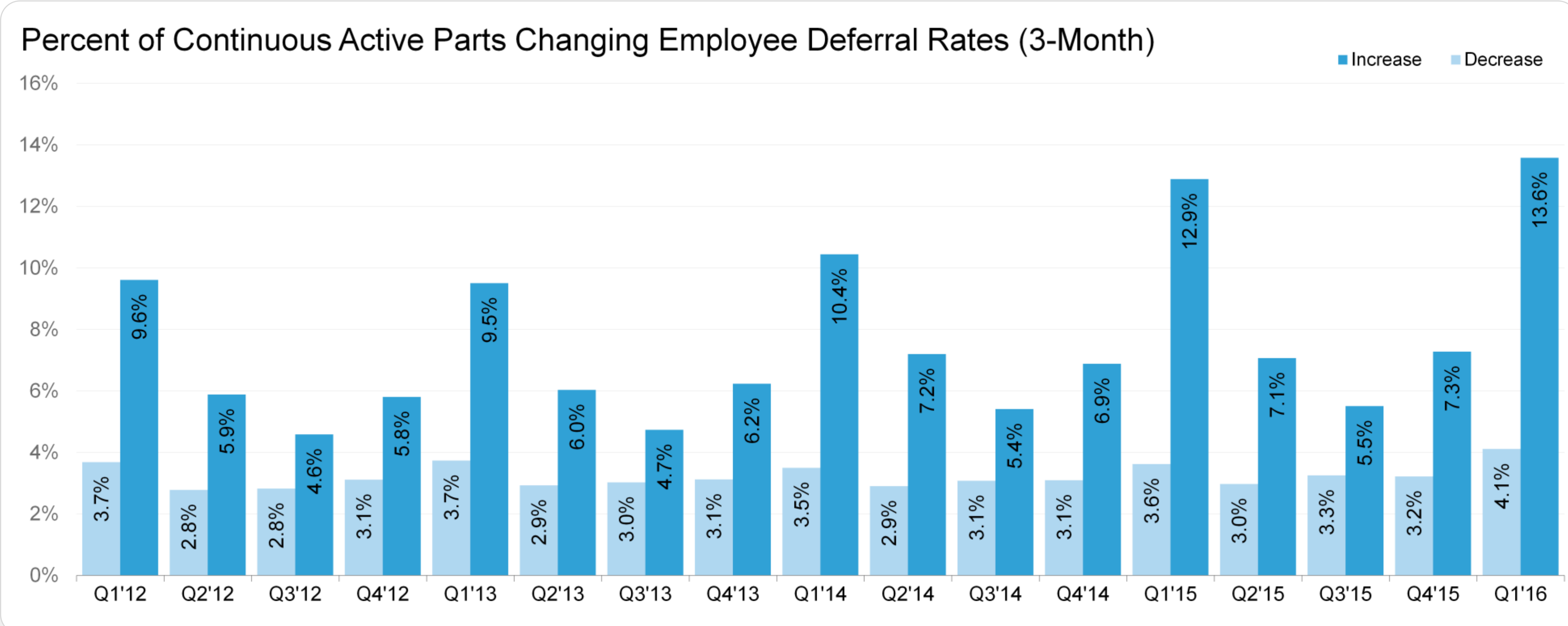


Key Insights

- Currently, the average employee deferral rate is 8.2%.
- Other than participant actions of increasing/decreasing deferrals (next slide), this figure is impacted by new participants joining the plan having lower deferral rates than departing participants leaving the plan.

Active Participants Only. Mean elective total deferral rates (point-in-time). Some figures may not add due to rounding.

Changes to Employee Deferral Rates

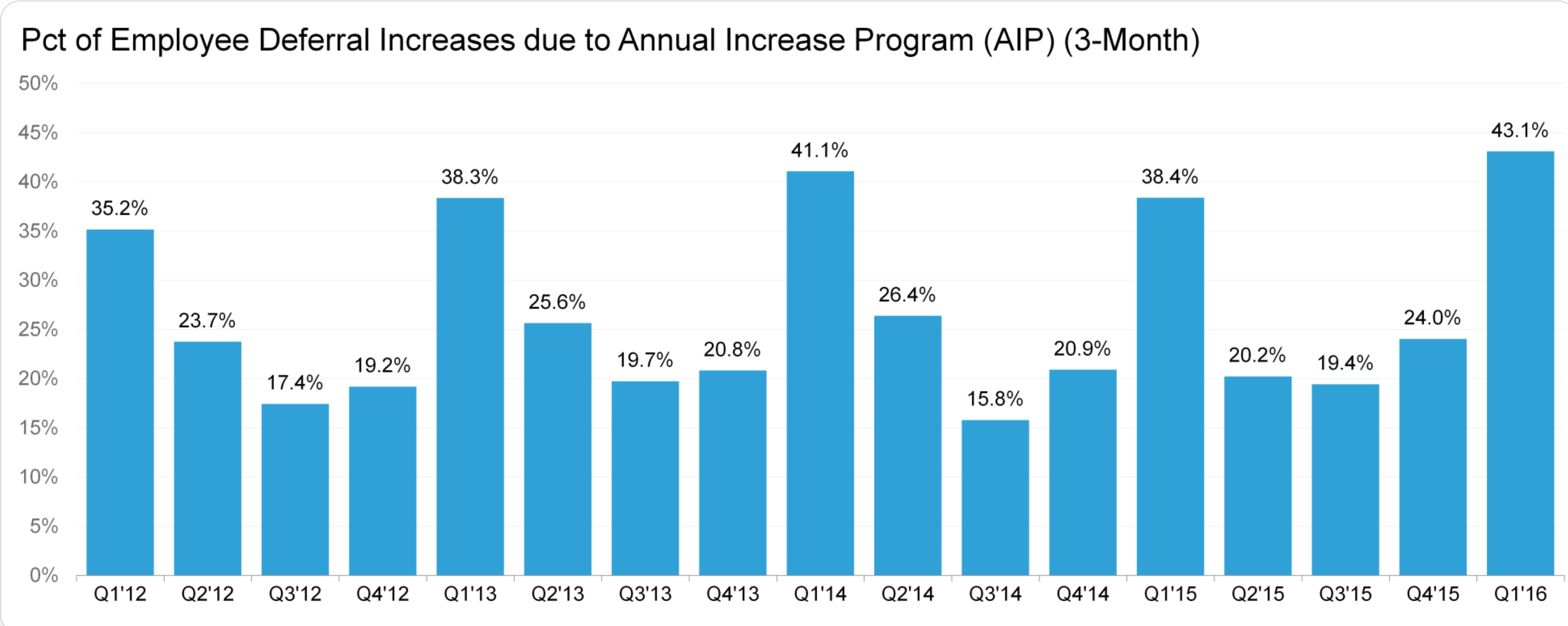


Key Insights

- Overall, 13.6% of participants made an employee deferral increase in the prior 3-months.
- In plans that offer Auto-AIP, 19.9% of participants had employee deferral increases in the prior 3-months.
- The long-term trend of more employee deferral increases than decreases was interrupted during Q3’08 - Q1’09, but has resumed since (27 consecutive quarters).
- Annual Increase Program (AIP) is a big driver of this trend, see “Deferral Increases due to AIP” slide.

Continuous Active Participants Only (3-month). Mean elective total deferral rates (point-in-time).

Employee Deferral Increases due to AIP

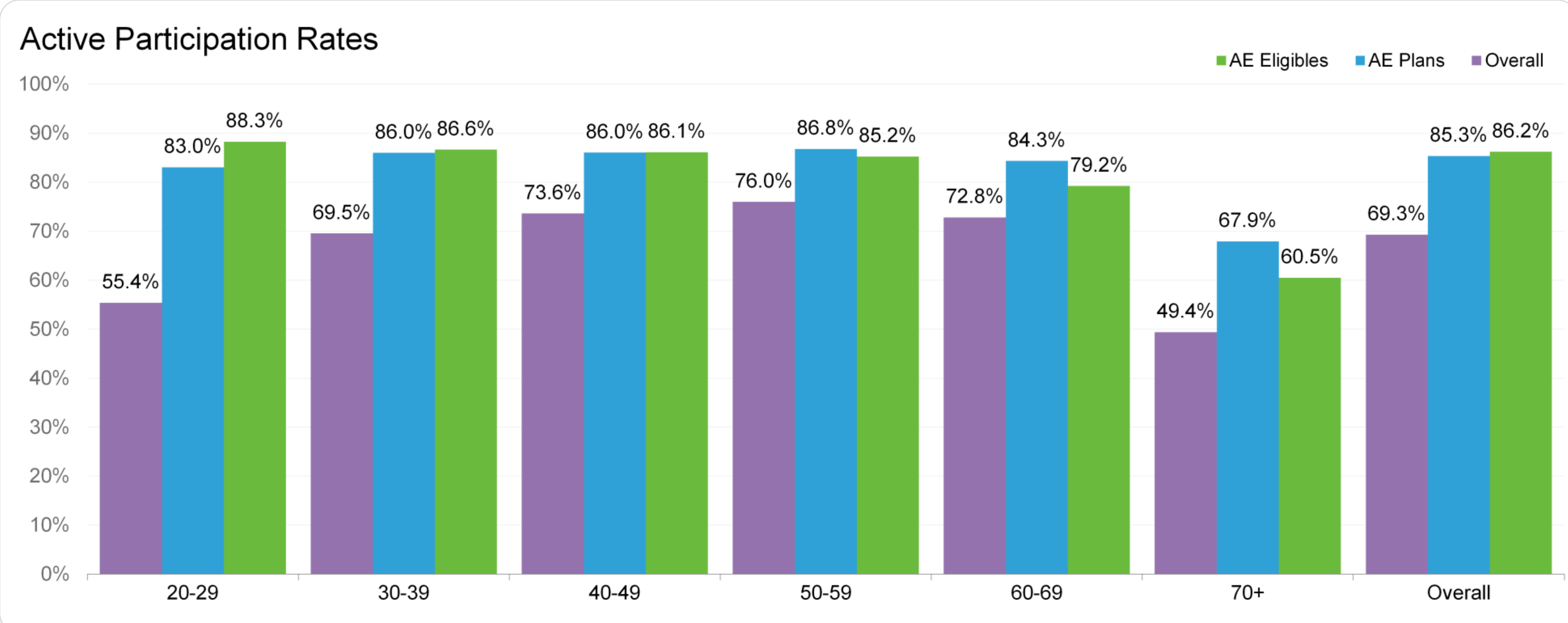


Key Insights

- Annual Increase Program (AIP) was responsible for 43.1% of deferral increases made in the prior quarter.
- AIP represented almost half (45.3%) of all deferral increases in prior 12-months.
- The seasonality is due to the majority of AIP increases occurring in Q1.

Continuous Active Participants Only (3-month).

Auto-Enrollment (AE) Impact to Participation Rate

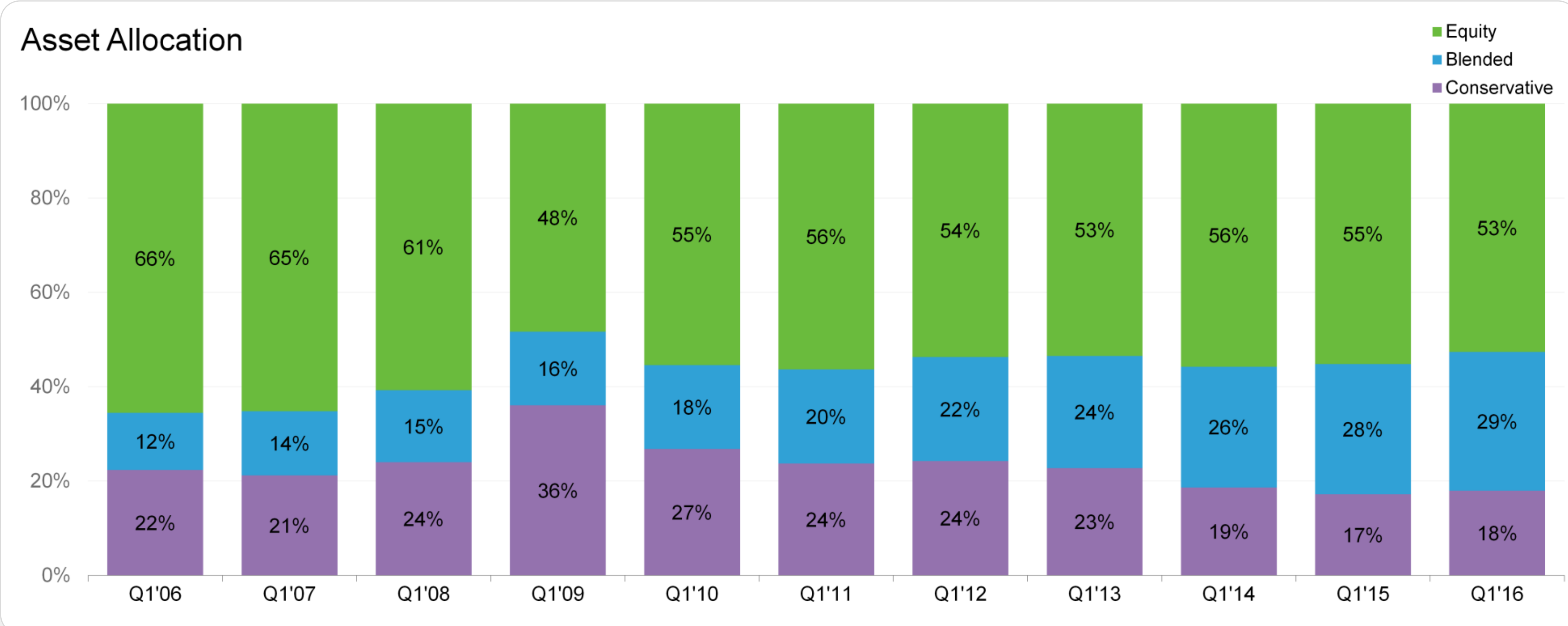


Key Insights

- Younger, less well-compensated employees benefit from Auto-Enrollment (AE).
- The overall active participation rate is 69.3%, up from 64.1% seven years prior due to impact of AE.
- In plans who offer AE, the participation rate is 85.3%, which has also increased as more employees become eligible for AE within those plans.
- Further, those employees who are eligible for Auto-Enrollment in AE Plans have a participation rate of 86.2% (i.e. only 13.8% opt-out).

Data as of 12/31/2014. Active Eligible Employees Only.

Asset Allocation

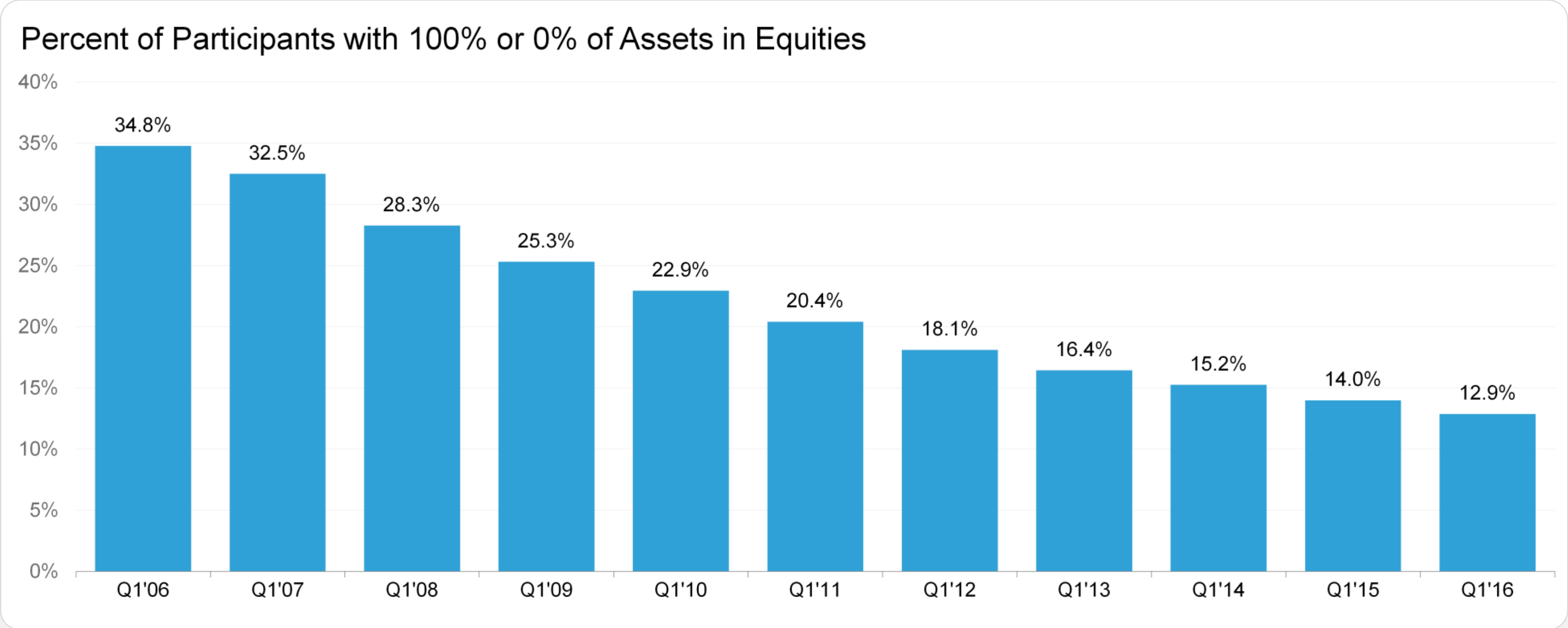


Key Insights

- Changes in asset allocation can be driven by market fluctuations, as well as by exchange, contribution, and withdrawal activity.
- Equity = Domestic Equity, International Equity, Company Stock, Specialty, Self-Directed Brokerage
- Blended = Target Date Funds, Target Risk Funds, Balanced Funds
- Conservative = Short-Term, Stable Value, Fixed Income, Annuity

Fidelity INVESTMENTS

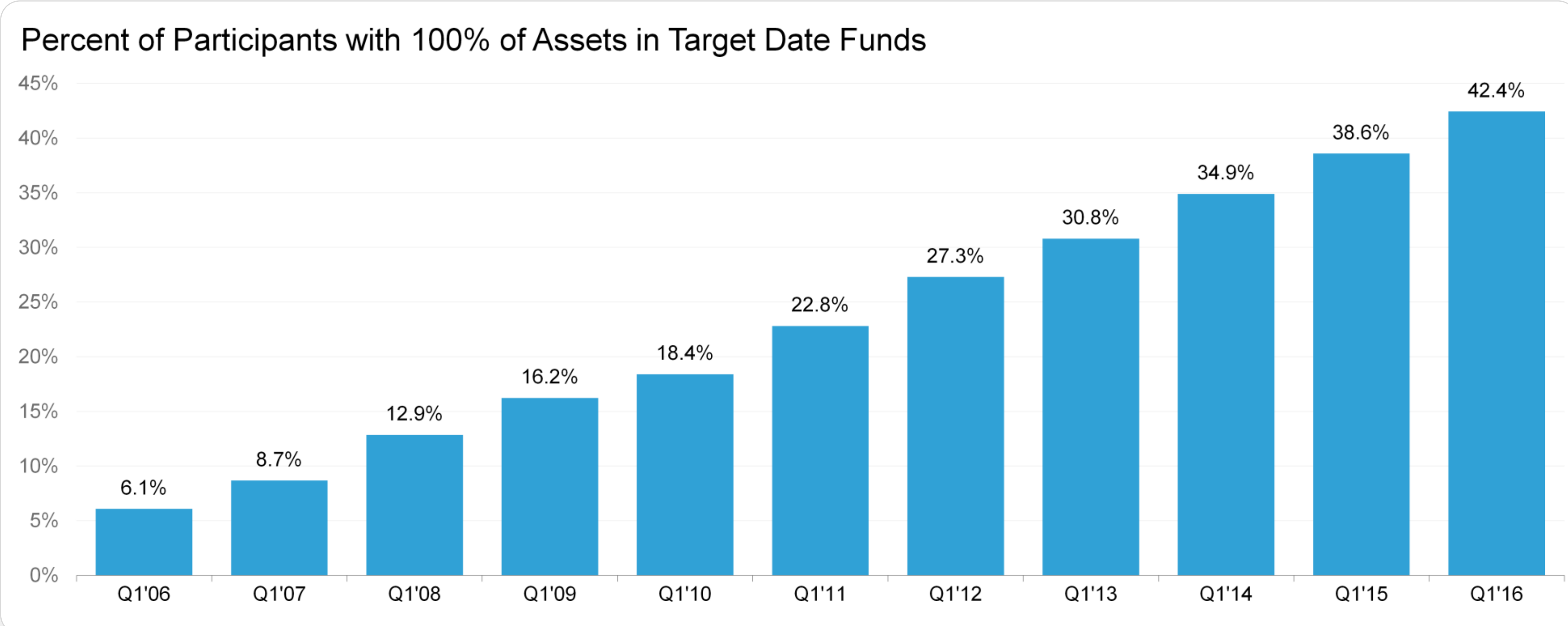
100% or 0% Equity Allocations



Key Insights

- For many participants, equity allocation was an “all-or-nothing” decision.
- Mainly through the increased use of Target Date Funds, fewer participants now hold such extreme portfolios.
- Less than one-in-seven participants (12.9%) hold 100% or 0% equity allocations.

Target Date Fund Adoption

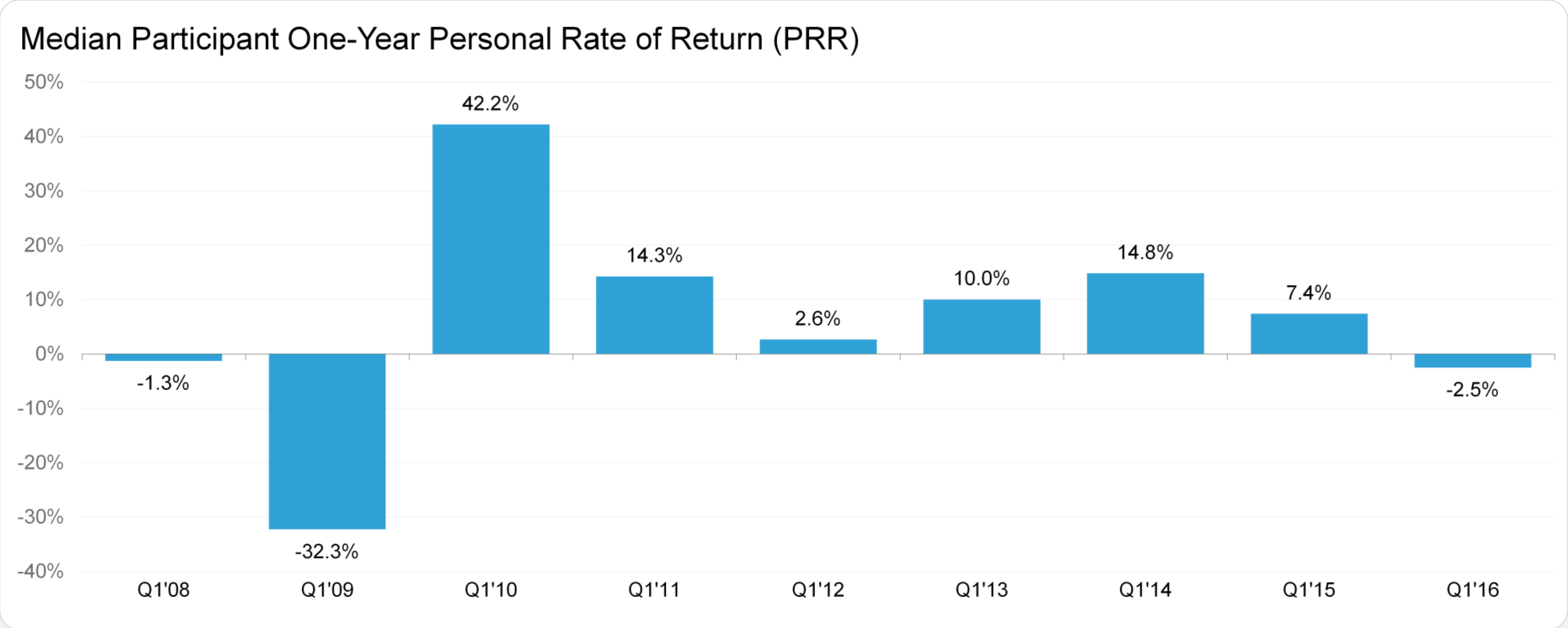


Key Insights

- About two-in-five total participants (42.4%) holds 100% of their assets in Target Date Funds.
- For Millennials, this figure is 63.8%.
- This trend has been chiefly driven by the use of Target Date Fund (TDF) Default.
- Default options have a sizeable impact on aggregate participant behavior.

Millennials were born between 1981 – 1997.

Personal Rate of Return (PRR)*



Key Insights

- The median cumulative participant 1-year personal rate of return (PRR) is -2.5%.
- The median cumulative participant 3-year personal rate of return (PRR) is 20.1% (6.3% annualized).
- The median cumulative participant 5-year personal rate of return (PRR) is 35.3% (6.2% annualized).
- The median cumulative participant 10-year personal rate of return (PRR) is 62.6% (5.0% annualized).

* See Important Additional Information for more details.

Personal Rate of Return (PRR)*

10-Year Participant Performance vs. Applicable Fidelity Freedom Fund®

10-Year Risk*

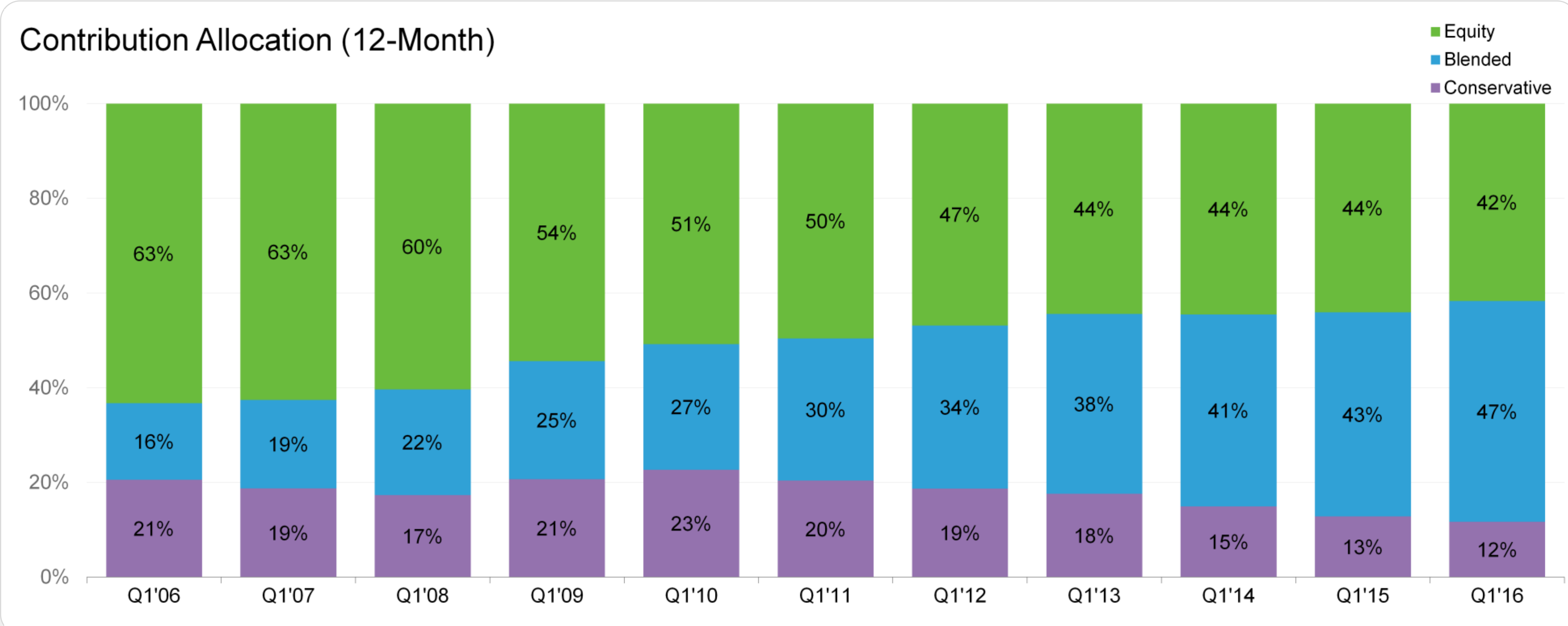
10-Year Return	Lower	Higher	
Higher	**28.8%** of Participants	**38.2%** of Participants	**67.0%** of Participants
Lower	**21.8%** of Participants	**11.2%** of Participants	**33.0%** of Participants
	50.6% of Participants	**49.4%** of Participants	

Key Insights

- Balanced portfolios such as the Fidelity Freedom Funds® outperformed 33.0% of participants over the 10-year return period.
- Also, 53.0% of participants took on more risk. Of those with higher risk, 22.7% underperformed against their age-based Freedom Fund (11.2% / 49.4%).
- During the 10-year return period, the median participant cumulative return was 62.6% (or 5.0% annualized).

"Return" is the time-weighted 10-year cumulative return. "Risk" is the standard deviation of returns, a measure of the volatility of returns.
"Applicable" Freedom Fund is the one with the closest target date given the participant's date of birth, assuming a retirement age of 65.
How to read: the top left box would indicate the percent of participants who had higher returns and lower risk (standard deviation of returns) than their applicable Freedom Fund over the 10-year return period.
* See Important Additional Information for more details.

Contribution Allocation

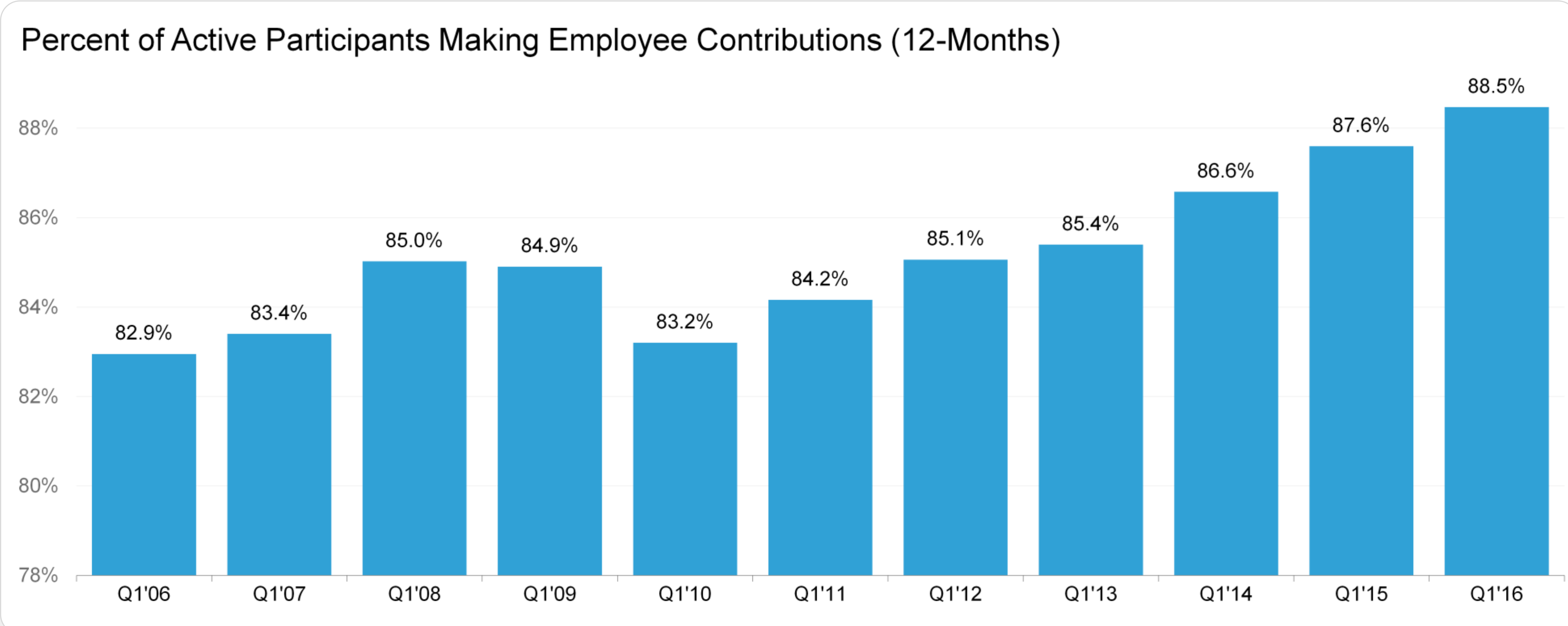


Key Insights

- Changes in contribution allocation are driven by participant behavior, whereas asset allocation is heavily impacted by market movement.
- Equity = Domestic Equity, International Equity, Company Stock, Specialty, Self-Directed Brokerage (SDB)
- Blended = Target Date Funds, Target Risk Funds, Balanced Funds
- Conservative = Short-Term, Stable Value, Fixed Income, Annuity

Active Participants Only.

Employee Contributions

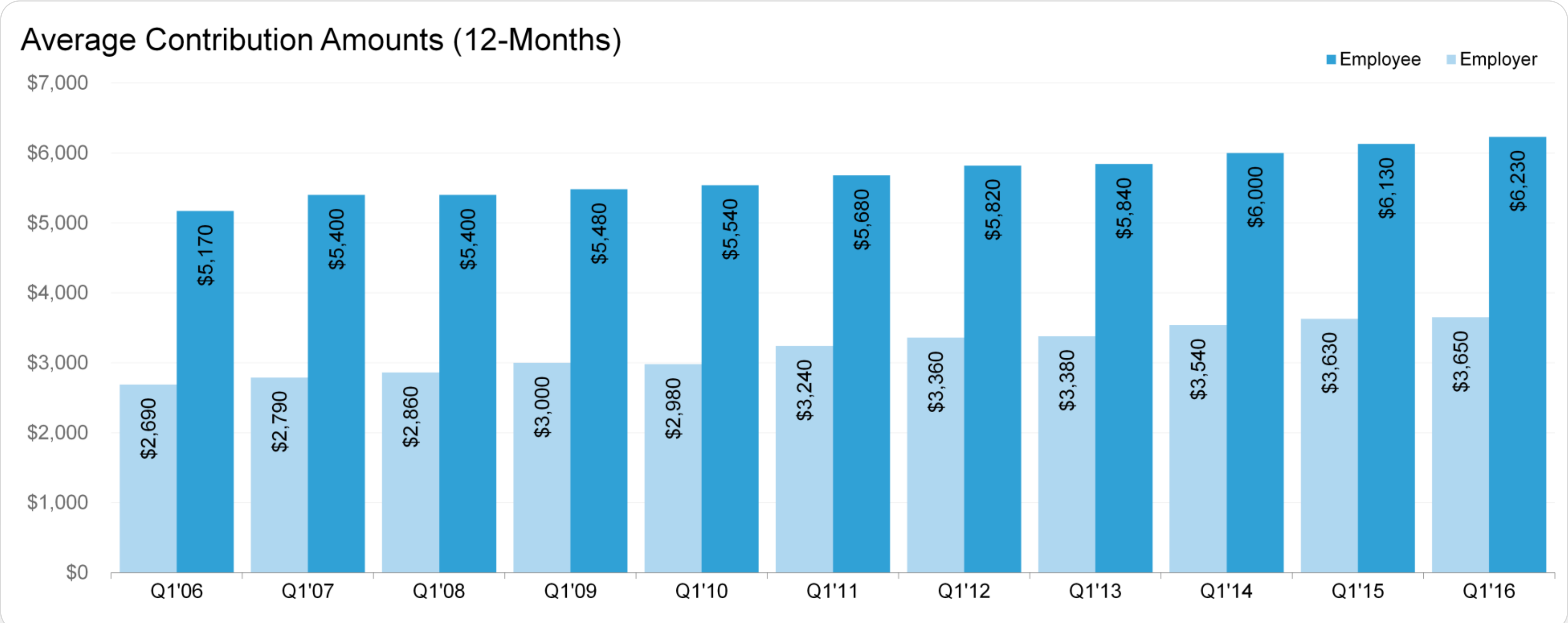


Key Insights

- In the prior 12-months, 88.5% of active participants made employee contributions, up from 82.9% ten years prior.
- Also, 85.8% of active participants received employer contributions in the prior 12-month period (not graphed).
- Overall, 94.4% of active participants made contributions (employee, employer, or roll-in) in the prior 12-month period (not graphed).

Active Participants Only.

Average Contribution Amounts

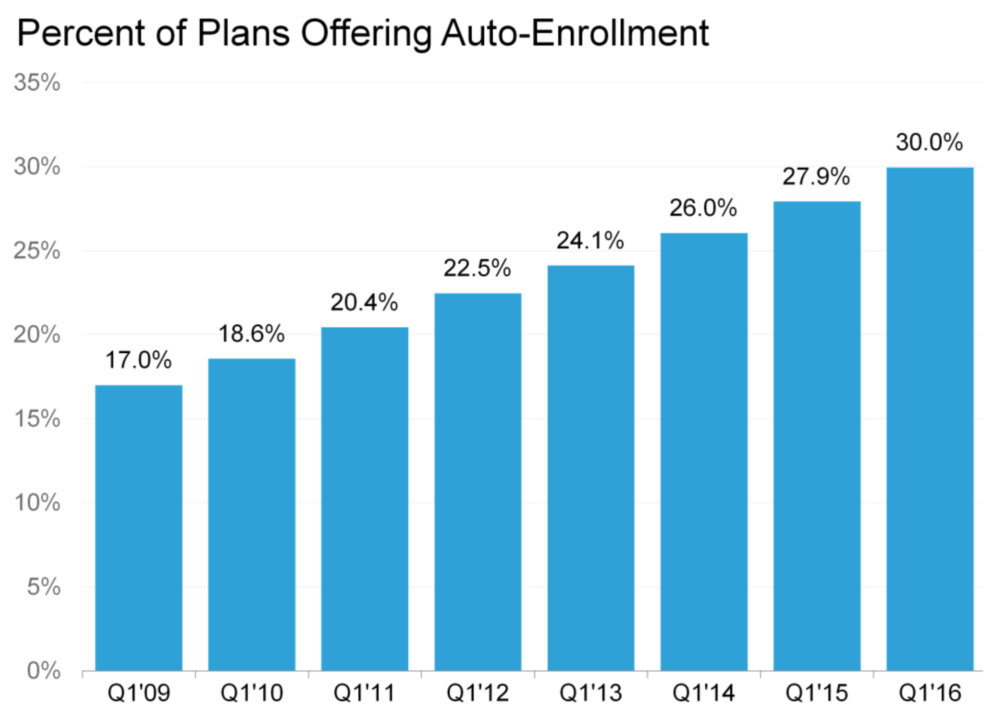


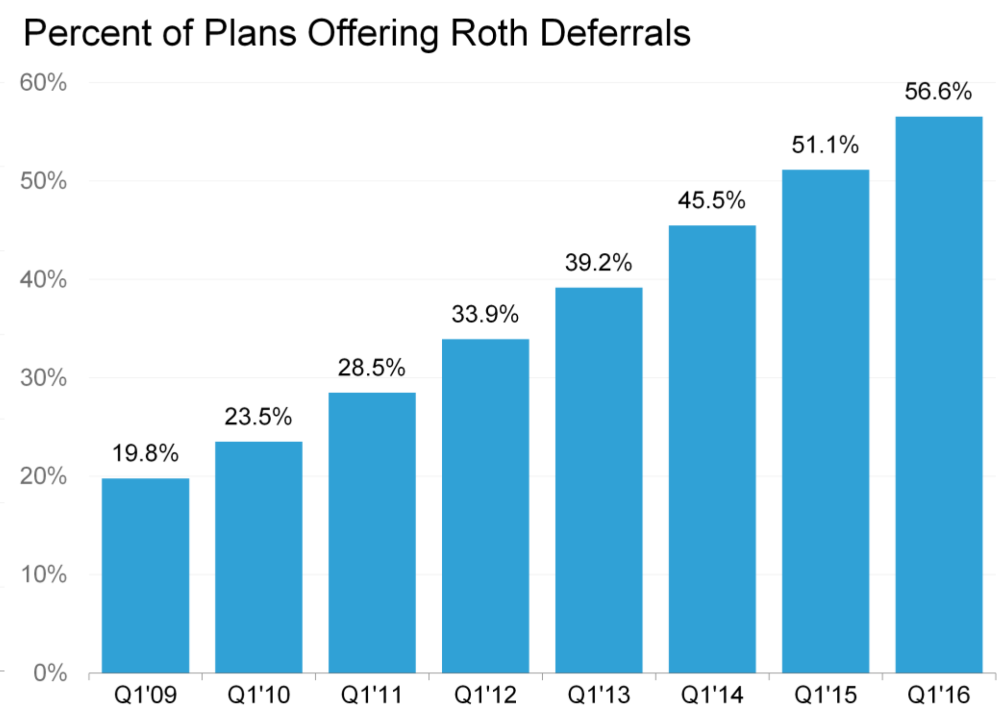
Key Insights

- The average 12-month employee contribution was $6,230, up from $5,170 ten years prior (per participant making >$0 employee contributions).
- This represents a 1.9% annual increase in employee contribution amounts.
- The average 12-month employer contribution was $3,650, up from $2,690 ten years prior (per participant receiving >$0 employer contributions).
- This represents a 3.1% annual increase in employer contribution amounts.

Active Participants Only.

Plan Design

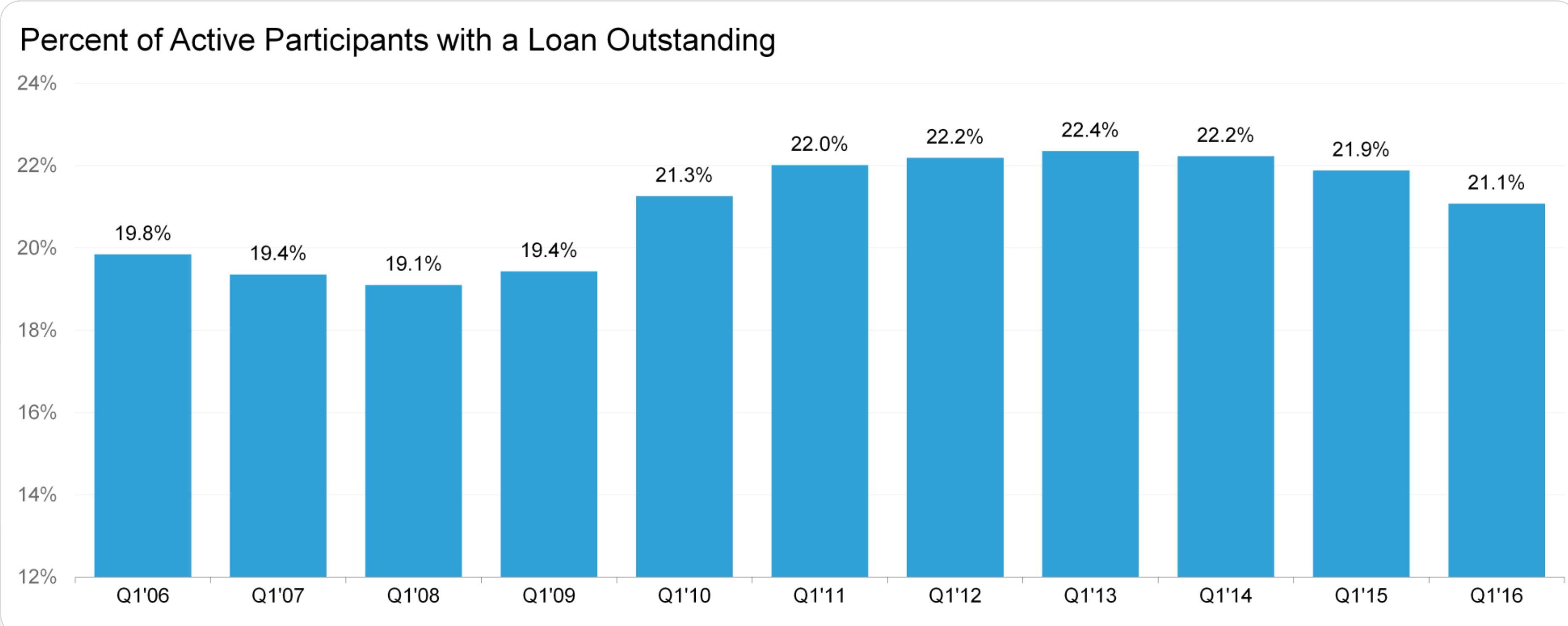




Key Insights

- Plans offering Auto-Enrollment (AE) has increased to 30.0% of plans, representing 64.3% of the participant base.
- Plans offering Roth Deferrals has increased to 56.6% of plans, representing 74.0% of the participant base.
- Also, 75.8% of plans offer Annual Increase Program (AIP) and 14.5% of plans offer Auto-AIP (not graphed).
- Also, 86.2% of plans have Target Date Fund (TDF) Default, up from 71.7% five years prior (not graphed).

Loans Outstanding

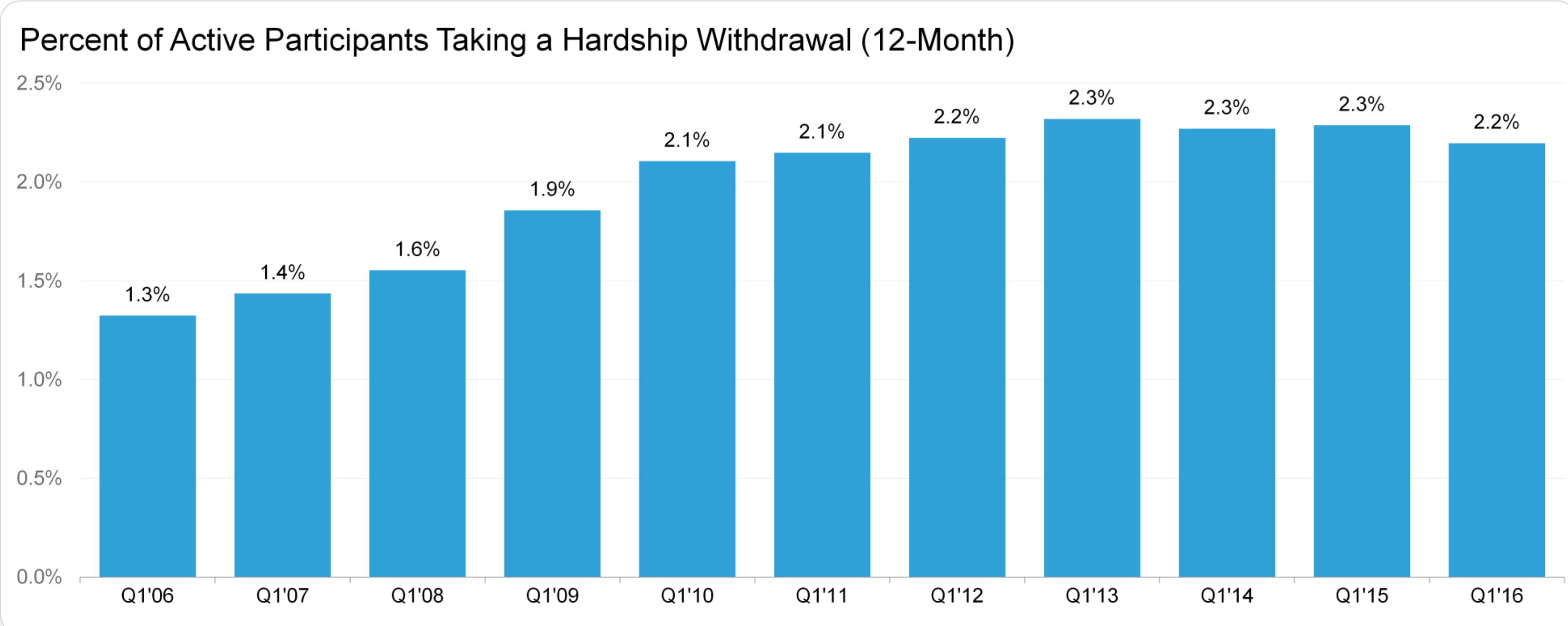


Key Insights

- The percent of active participants with a loan outstanding is 21.1%.
- The percent of active participants initiating a loan in the prior 12-months is 9.6%.

Active Participants Only.

Hardship Withdrawals

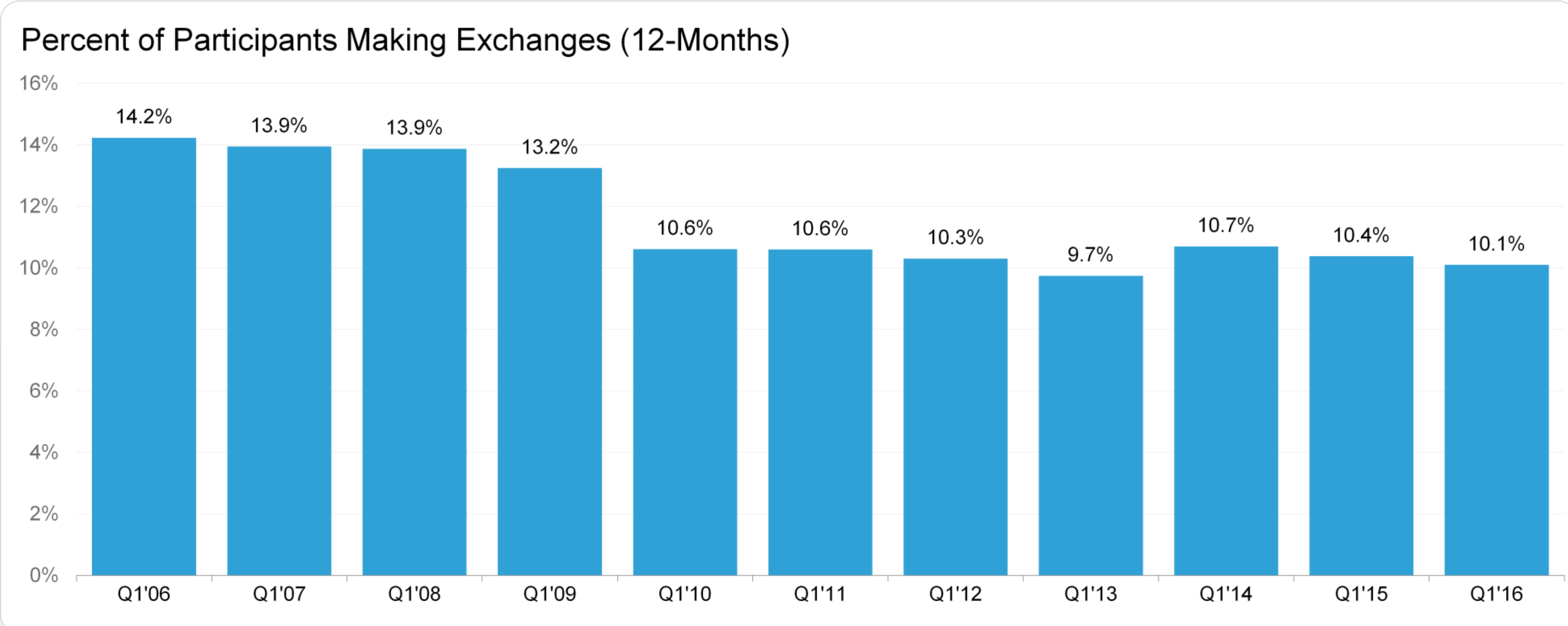


Key Insights

- While hardship withdrawals (HWs) continue to increase, they represent a very small portion of active participants.
- The percent of active participants taking a hardship withdrawal was 2.2% in the prior 12-months.
- In order to take a hardship withdrawal, you have to prove a financial need.
- Examples of reasons for HWs: 1) foreclosure, 2) tuition, 3) purchase of primary residence, 4) medical expenses.

Active Participants Only.

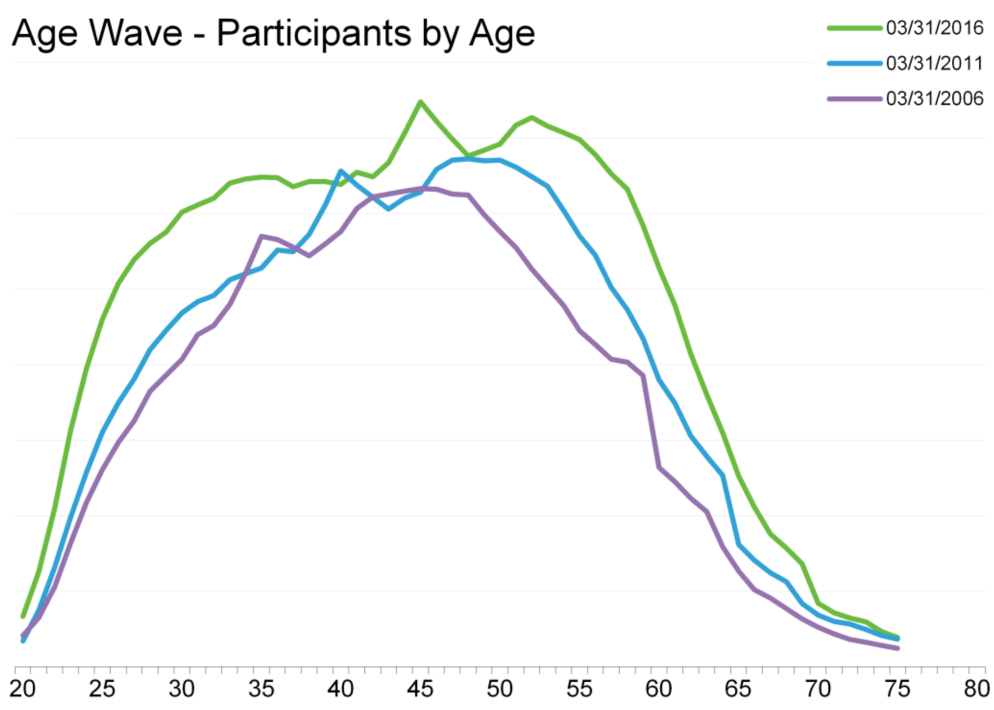
Exchanges

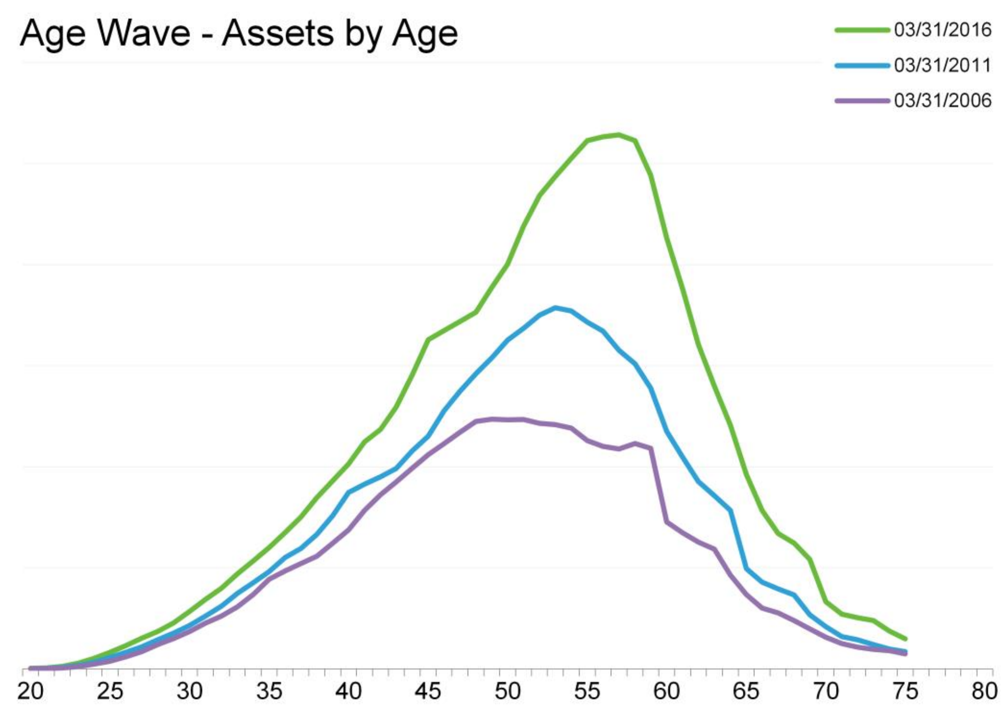


Key Insights

- In the prior 12-months, 10.1% of participants made an exchange.
- One reason for this long-term decline is the continued adoption of Target Date Funds (TDF).
- Only 1.3% of participants who held 100% of assets in TDFs made an exchange in the prior 12-months.
- See Target Date Fund Adoption slide for more.

Participant Demographics – Age Wave





Key Insights

- The median age for participants was 45.3 up from 44.4 ten years prior.
- The median tenure for active participants is 6.9 years, while the mean tenure is 10.0 years.
- The median salary for active participants is $68,200, while the mean salary is $94,600.

Active Participants only for tenure and salary figures.

Important Additional Information

Before investing, consider the funds' investment objectives, risks, charges, and expenses. Contact your investment professional or visit advisor.fidelity.com for a prospectus or, if available, a summary prospectus containing this information. Read it carefully.

As with all your investments through Fidelity, you must make your own determination whether an investment in any particular security or securities is consistent with your investment objectives, risk tolerance, financial situation and your evaluation of the security.

Dollar cost averaging does not ensure a profit or protect against loss in a declining market. For the strategy to be effective, you must continue to purchase shares in both up and down markets.

Personal Rate of Return (PRR): A measure of portfolio performance that indicates the return earned over a given time period. Personal rate of return used in our analyses (unless otherwise noted) is time weighted, which means it was calculated by subtracting beginning market value from ending market value and dividing by beginning market value for each sub-period. A new sub-period began each time there was cash flow. The sub-period returns were then geometrically linked together to calculate the return for the entire period. All returns shown are historical and include change in share value and reinvestment of dividends and capital gains, if any. Risk is defined as the volatility of historical portfolio returns; it measures the average deviation of a series of historical returns from its mean. Large values of risk indicate large volatility in the historical return series, and small values indicate low volatility.

Stock markets, especially foreign markets, are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments.

Keep in mind investing involves risk. The value of your investment will fluctuate over time and you may gain or lose money.

Past performance is no guarantee of future results.

Fidelity INVESTMENTS

Important Additional Information

Fidelity Freedom Funds® are designed for investors expecting to retire around the year indicated in each fund's name. Except for the Freedom Income Fund the funds' asset allocation strategy becomes increasingly conservative as it approaches the target date and beyond. Ultimately, they are expected to merge with the Freedom Income Fund. The investment risk of each Fidelity Freedom Fund changes over time as its asset allocation changes. These risks are subject to the asset allocation decisions of the Investment Adviser. Pursuant to the Adviser's ability to use an active asset allocation strategy, investors may be subject to a different risk profile compared to the fund's neutral asset allocation strategy shown in its glide path. The funds are subject to the volatility of the financial markets, including that of equity and fixed income investments in the U.S. and abroad, and may be subject to risks associated with investing in high-yield, small-cap, commodity-linked, and foreign securities. No target date fund is considered a complete retirement program and there is no guarantee any single fund will provide sufficient retirement income at or through retirement. Principal invested is not guaranteed at any time, including at or after the funds' target dates.

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Designing Plans for Better Outcomes

Secular changes in the retirement industry have compromised the three-legged retirement stool (Social Security, pension plans, and personal savings).

As many organizations eliminate their defined benefit plans, defined contribution plans are emerging as the primary source for retirement income.[1]

At the same time, the economy and markets are changing, and history is not a reliable guide for building plan menus. Looking forward, Fidelity experts believe:*

- Equities should provide opportunities for capital appreciation and should outperform fixed-income.
- Some bond market indicators suggest interest rates may rise over time.
- Volatility will always be a consideration, and a prudent target date approach is important.

Target an income replacement rate

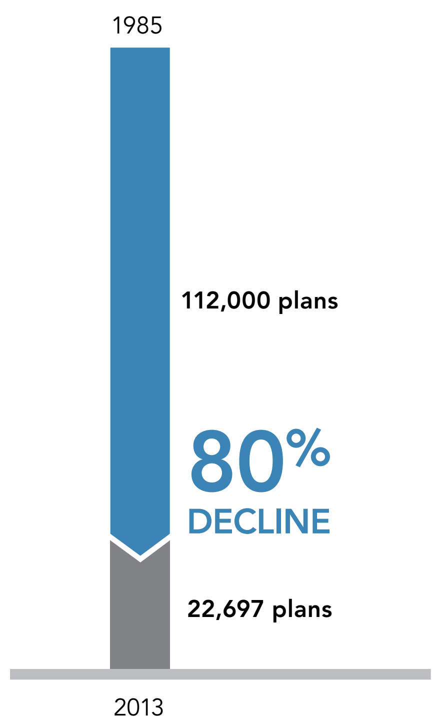
Defined contribution plans have become central to retirement savings, yet few plan sponsors understand the amount of savings their participants may accumulate. In fact, about two-thirds of plan sponsors do not design defined contribution plans to help plan participants target a specific savings rate while working, or level of income in retirement.[2] Given the greater reliance on defined contribution plans and changing market dynamics, designing plans to improve retirement readiness has become increasingly important.

Fidelity believes that plans should be designed to achieve a specific income replacement rate during retirement – and suggests 45% of participants' final pre-retirement salary as a reasonable starting point for a typical defined contribution plan.

State of readiness

The number of private sector defined benefit plans has been shrinking since the early 1980s.

PENSION PLANS HIT ALL-TIME LOW



Figures represent insured defined benefit plans in the private sector. Source: Pension Benefit Guaranty Corp.

Even more worrisome, EBRI projects an estimated **$4.3 trillion retirement income shortfall.**[3]

* Source: "Capital Market Assumptions: A Comprehensive Global Approach for the Next 20 Years," Fidelity Investments (AART), July 2013.

FOR PLAN SPONSORS

Fidelity INVESTMENTS

Consider these Three Steps to Help Improve Retirement Readiness:

1

Enhance plan features

Raise the automatic enrollment deferral rate to 6%

Fidelity suggests implementing automatic enrollment with a default deferral rate of 6% as one way to improve participant savings rates. Many plan sponsors think that a rate higher than the industry standard of 3% will prompt participants to opt out. However, our research indicates that:

- Almost ninety percent of participants do not opt out, regardless of the default deferral rate[4]
- Eighty-one percent of participants auto-enrolled at 6% maintain or increase that deferral rate[4]

Restructure matching contributions if possible

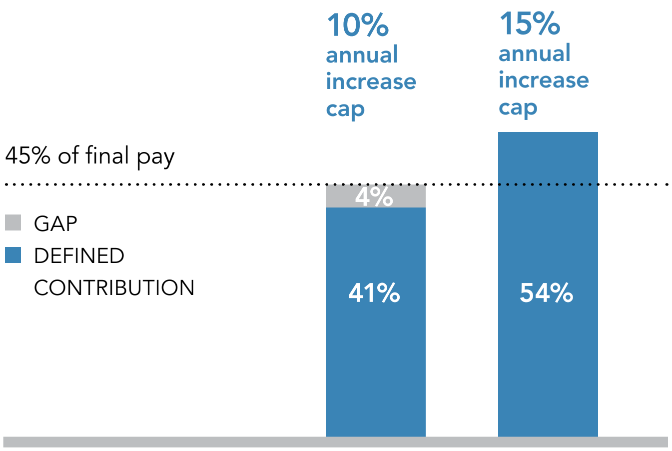
Plan sponsors should consider modifying matching contributions to encourage higher deferral rates – for example, modifying a common 100% match on 3% of employee compensation to a 50% match on a 6% contribution. The effective match is still 3%; however, using a 50% match on a 6% contribution encourages participants to save more.

Implement an automatic annual increase program (AIP)

Fidelity also suggests automatically increasing participant deferrals by 1% each year, up to 15%.

IMPACT OF INCREASING THE AIP CAP

HYPOTHETICAL EXAMPLE



Each example illustrates what the plan design could potentially yield based on the following participant profile: starting age: 25; retirement age: 67; life expectancy to age 93; starting salary: $40,000; ending salary: $73,649; real salary growth rate: 1.5% annually; 3% annual employer contribution; starting deferral rate: 6% with an annual 1% increase; assumed annual rate of return: 5.7% (3.2% net of inflation); assumes no loans or withdrawals until retirement. This hypothetical example is based on monthly contributions to a tax-deferred retirement plan and illustrates the percentage of ending salary that annual distributions lasting to age 93 would equal. A participant's account may earn more or less than this example. Tax-deferred earnings and taxable contributions will be taxed at the time of withdrawal at the federal income tax rate in effect at that time. Investing in this manner does not ensure a profit or guarantee against loss in declining markets. Past performance is no guarantee of future results.

2

Partner with participants

Engaging participants is a crucial step. Without prudent participant behavior, a well-designed plan has a low likelihood of success. Plan sponsors should encourage participants to:

- Start saving earlier
- Establish an appropriate asset allocation
- Increase their contribution rate
- Understand expected income replacement level

In general, employees should have saved at least 10 times their salary by the time they reach age 67 in order to generate sufficient income in retirement.[5]

3 Adapt investment menus for the new reality

Equities

Help enhance long-term growth potential

Fidelity experts believe that stocks will outperform bonds. Strong corporate productivity, modest margin pressures, and continued U.S. innovation should fuel earnings growth and upside potential.[6]

Fixed-Income

Utilize fixed-income to help manage risk

One-third of all 401(k) assets are in fixed-income[9] – an important category that hasn't received the same attention as equities. We believe changing demographic and investment landscapes mean the traditional approach needs to evolve.

Target date

Help simplify asset allocation decisions

Fidelity's target date funds' strategic asset allocation, or glide path, is designed to help increase the likelihood of investors achieving their retirement income replacement goals.

Possible plan menu options:

Focus on growth options beyond the "growth" style box

Most investment menus provide a range of equity options around the Morningstar Style Box categories. But a focus on growth shouldn't be limited to the "growth" boxes – volatility and downside protection can't be ignored.

A key to providing the returns participants need to reach their income goals is an investment menu with options across all large-cap categories – which represent 71% of flows[7] – that focus on generating long-term performance.

And don't forget international. Non-U.S. stocks represent 75% of publicly traded companies, and they can be an important diversifier.[8]

Options for income and total return potential

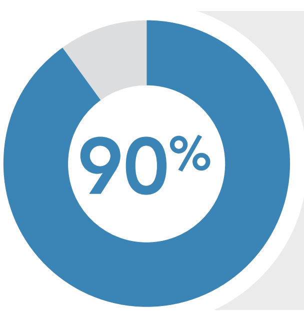
Consider providing fixed-income options that pursue income and risk-adjusted returns.

At a minimum, existing options need to be examined to ensure that traditional offerings, like a high-quality core fund, meet the needs of plan participants.

But to provide participants with the opportunity to achieve better outcomes, we believe it's time to move beyond traditional offerings. For example, a strategic multisector fund may offer diversification and total return potential. Diversification does not guarantee against a loss.

Retirement income from target date options

Think about adding target date funds like Fidelity's, designed to help provide approximately 50% of an investor's pre-retirement salary during retirement.[10] Our glide path is informed by our views on risk capacity, capital market assumptions, and actual participant experiences. Our ability to meet the stated goal is dependent on both investment performance as well as participant contribution and withdrawal behavior.



Fidelity targets a strategic allocation that balances return and risk at each point in the time horizon, starting at 90% equities during an investor's accumulation phase – age 25 to mid-40s.*

* Source: "Target Date Evolution: Enhancement to Fidelity's Strategies," Fidelity (AART), February 2014.

Committed to the DCIO market

- Bringing Fidelity's retirement and investment expertise to defined contribution professionals
- Offering a comprehensive institutional lineup that includes Fidelity Advisor funds, commingled pools, and subadvised accounts† across asset classes, market caps, and styles
- Providing world-class client support through our dedicated DCIO team of 40 experienced professionals

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† Subject to a minimum size.

1. "EBRI Databook on Employee Benefits," Employee Benefit Research Institute, 2013. **2.** Plan Sponsor Attitudes, 2015, an online survey of 952 plan sponsors conducted on behalf of Fidelity in March 2015. **3.** "Retirement Income Adequacy for Boomers and Gen Xers: Evidence from the 2012 Employee Benefit Research Institute Retirement Security Projection Model," Employee Benefit Research Institute (EBRI), May 2012. **4.** Building Futures data as of September 30, 2014. **5.** Fidelity Investments Viewpoint, "How Much Do You Need to Retire?" as of October 24, 2013. **6.** "Capital Market Assumptions: A Comprehensive Global Approach for the Next 20 Years," Fidelity Investments (AART), through July 2013. **7.** Strategic Insights, as of December 2013. Fidelity defined contribution mutual fund data was used as a proxy for industry data. **8.** FMR Co., FactSet, using MSCI All Country World Index (ACWI) Investable Market Index (IMI) data, as of April 30, 2014. **9.** Employee Benefit Research Institute, Issue brief No. 394, December 2013. **10.** "Target Date Evolution: Enhancements to Fidelity's Strategies," Fidelity Investments (AART), February 2014. Fidelity's glide path targets a 50% income replacement goal. This is informed by our views on risk capacity, capital market assumptions, and actual participant experiences. It also takes into account other key assumptions, including a contribution starting age of 25, a retirement age at or near 65, and beginning contributions of 8% that gradually increase to 13% during one's working years. These assumptions do not reflect the behavior of any specific participant. The stated goal may not be applicable or appropriate due to varying investor circumstances. Fidelity's ability to meet the stated goal is dependent on investment performance as well as contribution and withdrawal behavior. Deviation from the stated assumptions may contribute to income replacement levels lower than the stated goal. Note: No income replacement rate is guaranteed by any Fidelity target date fund.

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INVESTMENT INSIGHT

INVESTING AND EMOTIONS

The Ups and Downs of the Market

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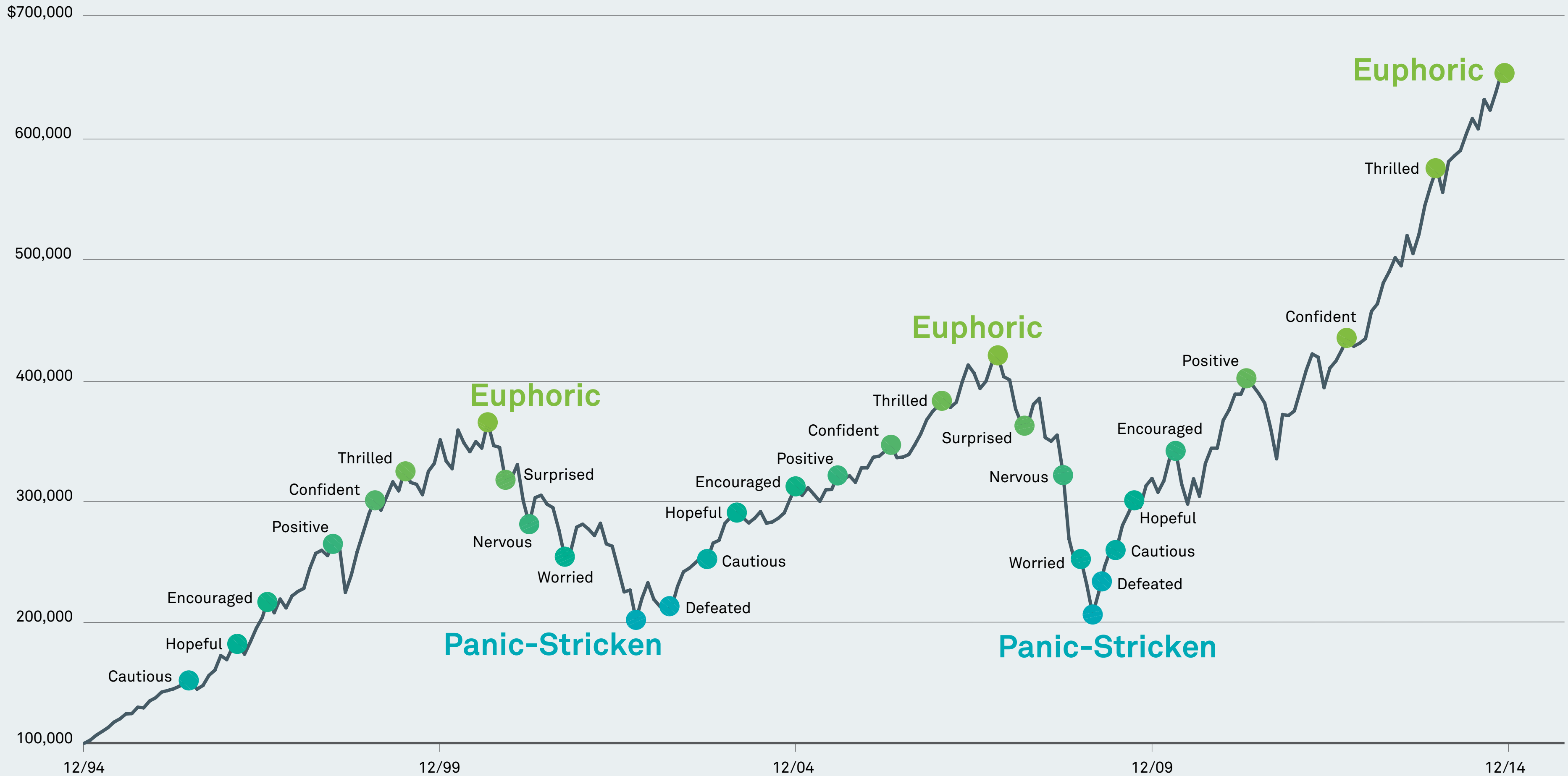
DO YOUR EMOTIONS LEAD YOU ASTRAY?

Growth of a Hypothetical $100,000 Investment in the S&P 500 Index Over the Last 15 Years (1995–2014)



Sources: BlackRock; Informa Investment Solutions. Emotions are hypothetical and for illustrative purposes only. The S&P 500 Index is an unmanaged index that consists of the common stock of 500 large-capitalization companies, within various industrial sectors, most of which are listed on the New York Stock Exchange. Returns assume reinvestment of dividends. It is not possible to invest directly in an index. Past performance is no guarantee of future results. The information provided is for illustrative purposes only.

INVESTMENT INSIGHT

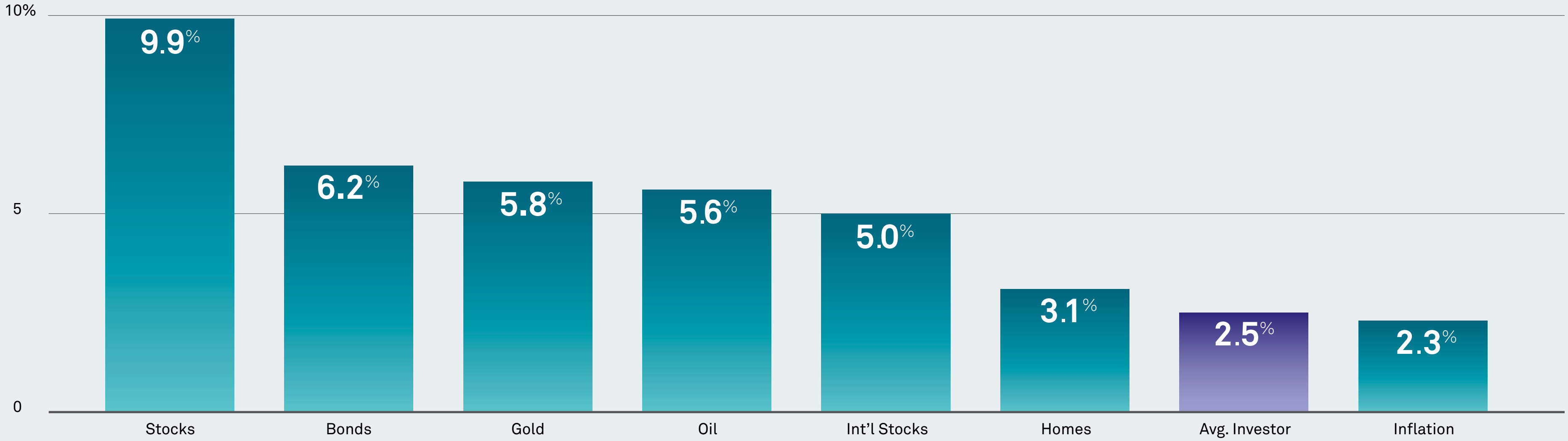
INVESTING AND EMOTIONS

How the Average Investor Stacks Up

BLACKROCK®

THE AVERAGE INVESTOR UNDERPERFORMS

20-Year Annualized Returns by Asset Class (1995–2014)



Want to know more?

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Sources: BlackRock; Bloomberg; Informa Investment Solutions; Dalbar. Past performance is no guarantee of future results. It is not possible to directly invest in an index. **Oil** is represented by the change in price of the NYMEX Light Sweet Crude Future contract. Contract size is 1,000 barrels with a contract price quoted in US Dollars and Cents per barrel. Delivery dates take place every month of the year. **Gold** is represented by the change in the spot price of gold in USD per ounce. **Homes** are represented by the National Association of Realtors' (NAR) Existing One Family Home Sales Median Price Index. **Stocks** are represented by the S&P 500 Index, an unmanaged index that consists of the common stocks of 500 large-capitalization companies, within various industrial sectors, most of which are listed on the New York Stock Exchange. **Bonds** are represented by the Barclays US Aggregate Bond Index, an unmanaged market-weighted index that consists of investment-grade corporate bonds (rated BBB or better), mortgages and US Treasury and government agency issues with at least 1 year to maturity. **International Stocks** are represented by the MSCI EAFE Index, a broad-based measure of international stock performance. **Inflation** is represented by the Consumer Price Index. **Average Investor** is represented by Dalbar's average asset allocation investor return, which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total return where applicable) and represent the 20-year period ending 12/31/14 to match Dalbar's most recent analysis.

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Understanding re-enrollment

Benefits for participants and plan sponsors

IN BRIEF

A plan re-enrollment is a process by which participants are notified that their existing assets and future contributions will be invested in the plan's qualified default investment alternative (QDIA), which usually is a target date fund (TDF), based on their date of birth. All participant assets are automatically moved into the QDIA on a certain date unless they make a new investment election during a specified time period.

Participant benefits

- Potential for improved asset allocation
- Helps new and existing participants

Plan sponsor benefits

- Potentially stronger protection from investing liability
- Better participant experience

MANY PLAN SPONSORS HAVE ADDED TDFs TO THEIR DEFINED CONTRIBUTION (DC) plans to help better position employees—especially those who don't have the time, interest or knowledge to make investment decisions—for retirement success.

But even when coupled with robust education efforts, participant inertia often leaves plan sponsors feeling disappointed with the low TDF adoption rates.

How TDFs are implemented, however, can have a significant impact on whether employees use the particular investment option. To combat participant inertia, more plan sponsors are considering re-enrollment. In fact, plan sponsors that conduct a re-enrollment typically see a 49% to 97% adoption rate of TDFs. By contrast, plans that just add TDFs as a new option in their lineups see an adoption rate of less than 5%, even a few years later.[1]

[1] J.P. Morgan retirement research, 2015.

WHY CONDUCT A RE-ENROLLMENT?

Get participants on the appropriate path

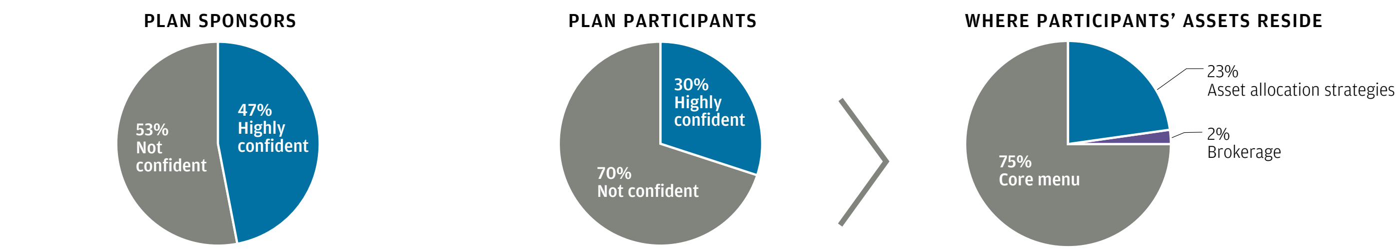
Despite participant education efforts and the availability of simplified investment decision-making options, there is a general lack of confidence that participants are appropriately diversified within their 401(k) plans. As **EXHIBIT 1** illustrates, less than half of plan sponsors are highly confident that the majority of participants has an appropriate asset allocation. Participants are even less confident on this measure, with only 30% being highly confident in their ability to appropriately allocate across available investment options. Despite these measures, the majority of DC assets remain in core menu options that require participants to build an appropriate allocation and manage it over time. Conducting a re-enrollment not only helps get participants into a diversified portfolio, but also helps to ensure their asset allocation changes with them over time.

Address diversification for existing participants

While plan sponsors can put new hires on an appropriate retirement path by automatically enrolling and defaulting them into a TDF, what can they do about existing participants? In **EXHIBIT 2**, each gray dot represents the equity allocation of an actual participant while the blue and purple lines represent a 10% range over and under the J.P. Morgan target date glide path. Given the wide dispersion of gray dots, the illustration clearly depicts that participants' equity exposure can vary widely. A re-enrollment uses participant inertia to help delegators who could benefit from professionally managed solutions by defaulting them into age-appropriate portfolios, while still allowing more sophisticated and active participants to make their own investment decisions.

The lack of confidence in participants' ability to allocate does not align with how investment decisions are made

EXHIBIT 1: CONFIDENCE IN PARTICIPANTS' ASSET ALLOCATION VS. WHERE ASSETS RESIDE



Plan sponsor confidence that majority of participants have the appropriate asset allocation

Note: Total n = 756.
Source: J.P. Morgan Plan Sponsor Research 2015.

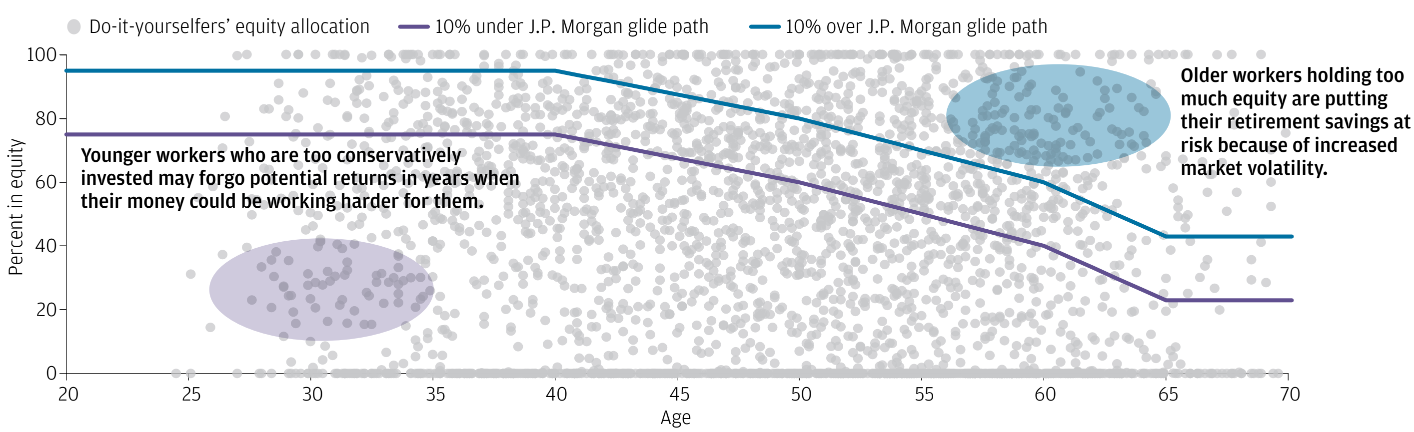
Participants' confidence in knowing which 401(k) plan investment options they should invest in

Note: Total n = 1,001.
Source: J.P. Morgan Plan Participant Research 2016.

Source: J.P. Morgan retirement research, September 30, 2015.

Participants making their own asset allocation choices often have too much or not enough equity exposure

EXHIBIT 2: DO-IT-YOURSELFERS' EQUITY POSITIONS VS. J.P. MORGAN SMARTRETIREMENT GLIDE PATH



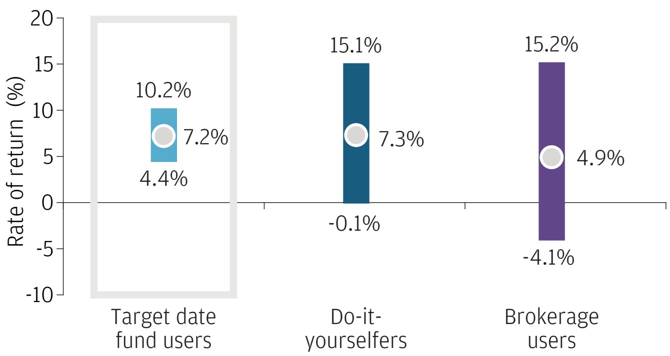
Source: J.P. Morgan retirement research. Representative sampling of 3,000 do-it-yourself participants, December 31, 2015. For illustrative purposes only.

Keep participants on track

Re-enrolling participants into investment options that provide professional management and increasingly conservative risk/return profiles as retirement approaches not only helps to improve asset allocation, but also maintains an appropriate allocation over time. These options may help minimize extreme outcomes—which may provide participants with a more consistent investment experience than the portfolios individually constructed by most "do-it-yourselfers" (see **EXHIBIT 3**).

TDF investors have a tighter range of outcomes than "do-it-yourselfers"

EXHIBIT 3: STANDARDIZED FIVE-YEAR RETURNS—HIGHS, LOWS AND AVERAGES BY INVESTMENT STRATEGY



Source: J.P. Morgan retirement research. Analysis measurement period is December 31, 2010 through December 31, 2015. The above data represents a sampling of participant data. It does not represent the returns of any individual product or portfolio. Exclusive reliance on the above is not advised. This information is not intended as a recommendation to invest in any particular manner. Rate of return for the measurement period is aggregated by investment strategy. Historical rate of return is not a guarantee of and may not be indicative of future results. See "Important Disclosures for Personal Rate of Return Methodology" for additional information.

FIDUCIARY CONSIDERATIONS

Plan sponsors may gain safe harbor protection for defaulted assets assuming the below notification requirements are met. The re-enrollment approach typically results in a higher percentage of plan assets that are considered defaulted.

Remember, as a fiduciary, plan sponsors may be granted QDIA safe harbor protection by satisfying the following requirements:

- **Initial opt-out notification:** Participants must be given the opportunity to make a new investment election before they are defaulted into the plan's QDIA. The initial notice must be provided at least 30 days before the beginning of the re-enrollment window to satisfy the legal requirement. Reminder notices, although not required, are often sent before the re-enrollment window ends to ensure that no participant is inadvertently defaulted.
- **Annual notices:** Annual notices must be provided to remind participants that they were defaulted into the QDIA and that they have the right to direct the investments in their accounts.

Research corner

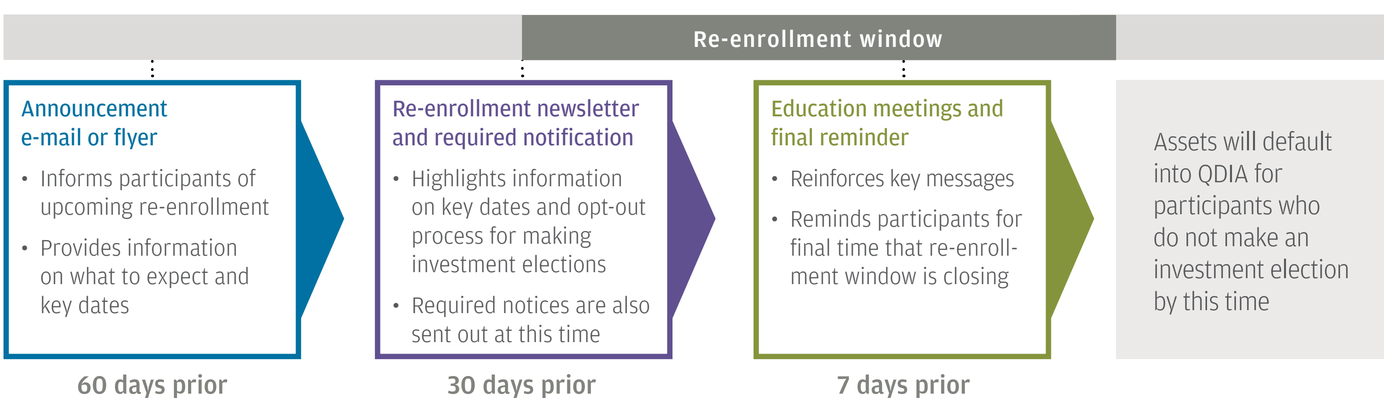
54% OF PLAN SPONSORS aren't aware of the potential to receive fiduciary protection for participant assets that were defaulted into their plans' QDIA during a re-enrollment.[2]

[2] Source: J.P. Morgan Plan Sponsor Research 2015.

WONDERING WHAT ACTUALLY HAPPENS WHEN YOU CONDUCT A RE-ENROLLMENT?

The illustration in Exhibit 4 represents a typical re-enrollment process timeline. Specifics, of course, vary by recordkeeper.

EXHIBIT 4: COMMUNICATIONS BEST PRACTICES FOR CREATING AN OPTIMAL PARTICIPANT EXPERIENCE



J.P. Morgan Asset Management cannot provide legal or tax advice to any Plan Sponsor. Plan Sponsors are advised to consult with their own legal and other professional advisors before making a decision to implement plan re-enrollment.

IMPORTANT DISCLOSURES FOR PERSONAL RATE OF RETURN METHODOLOGY. Rate of return is calculated for active participants by an investment strategy using the Modified Dietz method and is based upon volatility between the highest rate of return and the lowest rate of return associated with each investment strategy among such participants. Services associated with the identified investment strategies were available as of the last day of the measurement period, but may not have been available throughout the measurement period.

Target date fund users are participants with at least 70% of their account balance invested in target date funds as of the first and last day of the measurement period. Do-it-yourselfers are participants with less than 70% of their account balance invested in target date funds as of the first and last day of the measurement period and also includes participants using online advice services, if applicable. Managed account users are participants with at least 70% of their account balance managed by a discretionary investment service as of the first and last day of the measurement period. Brokerage users are participants with at least $1 in a brokerage account as of the last day of the measurement period.

TARGET DATE FUNDS. Target date funds are funds with the target date being the approximate date when investors plan to start withdrawing their money. Generally, the asset allocation of each fund will change on an annual basis with the asset allocation becoming more conservative as the fund nears the target retirement date. The principal value of the fund(s) is not guaranteed at any time, including at the target date.

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RI-REENROLL 4/16

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How America Saves 2015

A report on Vanguard 2014 defined contribution plan data

CONTENTS

Defined contribution (DC) retirement plans are the centerpiece of the private-sector retirement system in the United States. More than 90 million Americans are covered by DC plan accounts, with assets now in excess of $6.5 trillion.

Martha King
Managing Director
Institutional Investor Group

June 2015

Defined contribution (DC) retirement plans are the centerpiece of the private-sector retirement system in the United States. More than 90 million Americans are covered by DC plan accounts, with assets now in excess of $6.5 trillion.[1]

Vanguard is among the leaders in the DC marketplace with more than $670 billion in DC assets under management as of March 31, 2015. In our DC recordkeeping business, we serve more than 4,700 plan sponsors and more than 3.9 million participants. As an industry leader, Vanguard recognizes the importance of having a detailed understanding of DC plans and the role they play in the U.S. retirement system. Accordingly, we are pleased to present *How America Saves 2015: A report on Vanguard 2014 defined contribution plan data*. In this 14th edition of *How America Saves*, we update our analysis of DC plans and participant behavior based on 2014 Vanguard recordkeeping data.

Participants' adoption of professionally managed allocations continues to grow. In 2014, 45% of all Vanguard participants had their entire account balance invested in either a single target-date fund, a single target-risk or traditional balanced fund, or a managed account advisory service. These professionally managed investment options have the potential to reshape retirement savings outcomes for these participants. They signal a shift in responsibility for investment decision-making away from the participant and back to employer-selected investment and advice programs. We predict that sometime during 2015, half of all Vanguard participants will be using a professionally managed allocation.

The first edition of *How America Saves* was published in 2000. In 2011, we introduced a series of benchmark data supplements for selected industry sectors. In 2015, we expanded the industry sector benchmark series to 16 industries. These industry sector supplements have been very well received and a list of the sectors covered is on page 106.

In 2014, we introduced a supplement dedicated to Vanguard Retirement Plan Access™ clients and are pleased to present an expanded analysis of these plans in 2015. Vanguard Retirement Plan Access (VRPA) is a comprehensive service for retirement plans with up to $20-plus million in assets.

We are confident this report will continue to serve as a valuable reference tool and that our observations will prove useful as your organization continues to develop its retirement programs.

Sincerely,

Martha

1 U.S. Department of Labor, *Private Pension Plan Bulletin Historical Tables and Graphs*, December 2014; and Investment Company Institute, *Quarterly Retirement Market Data, Fourth Quarter 2014*, March 2015.

Executive summary

During the past three years, the U.S. and global stock markets rose by double-digit rates, with U.S. stocks gaining 11% in 2014. The five-year period from 2008 to 2014 was marked by a sharp market downturn in 2008–2009 followed by a subsequent market recovery. During this period, as in prior periods of market turbulence, the saving and investment behavior of DC plan participants changed modestly, with neither large-market rallies nor sharp downturns affecting long-term behaviors substantially. As we look to the future, the main concerns affecting retirement savings plans remain largely the same—improving plan participation and contribution rates and enhancing portfolio diversification—although increasingly these changes are occurring through plan and investment menu design decisions made by sponsors, rather than by participants' own decisions.

Professionally managed allocations

An important development in DC plans is the rising prominence of professionally managed allocations. Participants with professionally managed allocations are those who have their entire account balance invested in a single target-date or balanced fund or a managed account advisory service. At year-end 2014, 45% of all Vanguard participants were solely invested in an automatic investment program—compared with 25% at the end of 2009. Thirty-nine percent of all participants were invested in a single target-date fund; another 2% held one other balanced fund; and 4% used a managed account program. These diversified, professionally managed investment portfolios dramatically improve portfolio diversification compared with participants making choices on their own. Among new plan entrants (participants entering the plan for the first time in 2014), 8 in 10 were solely invested in a professionally managed allocation.

Because of the growing use of target-date options, we anticipate that sometime during 2015, half of participants will be entirely invested in a professionally managed allocation—and by 2018 that percentage will reach 63%.

Growth in use of target-date funds

Use of target-date strategies in DC plans continues to grow. Eighty-eight percent of plan sponsors offered target-date funds at year-end 2014, up 17% compared with year-end 2009. Nearly all Vanguard participants (97%) are in plans offering target-date funds. Sixty-four percent of all participants use target-date funds. Sixty percent of participants owning target-date funds have their entire account invested in a single target-date fund. Four in 10 Vanguard participants are wholly invested in a single target-date fund, either by voluntary choice or by default.

An important factor driving use of target-date funds is their role as an automatic or default investment strategy. The qualified default investment alternative (QDIA) regulations promulgated under the Pension Protection Act of 2006 (PPA) continue to influence adoption of target-date funds. That said, voluntary choice is still important, with half of single target-date investors choosing the funds on their own, not through default.

High-level savings metrics

High-level metrics of participant savings behavior remained steady in 2014. The plan participation rate was 77% in 2014. The average deferral rate was 6.9% and the median was unchanged at 6.0%. However, average deferral rates have declined slightly from their peak of 7.3% in 2007. The decline in average contribution rates is attributable to increased adoption of automatic enrollment. While automatic enrollment increases participation rates, it also leads to lower contribution rates when default deferral rates are set at low levels, such as 3% or lower.

These figures reflect the level of employee-elective deferrals. Most Vanguard plans also make employer contributions. Taking into account both employee and employer contributions, the average total participant contribution rate in 2014 was 10.4% and the median was 9.5%. Aggregate contribution rates have also declined slightly from 2007, again likely because of the impact of low default contribution rates for automatic enrollment.

Growth of automatic savings features

The adoption of automatic enrollment has grown by 50% since year-end 2009. At year-end 2014, 36% of Vanguard plans had adopted automatic enrollment, up two percentage points from 2013. In 2014, however, because larger plans were more likely to offer automatic enrollment, 60% of new plan entrants in 2014 were enrolled via automatic enrollment.

More than half of all contributing participants in 2014 were in plans with automatic enrollment. The automatic enrollment feature, while initially applied only to new hires, has now been applied to eligible nonparticipants in half of Vanguard plans with the feature. Seven in 10 automatic enrollment plans have implemented automatic annual deferral rate increases. Almost all plans with automatic enrollment—98%—default participants into a balanced investment strategy—with 95% choosing a target-date fund as the default.

Roth 401(k) adoption

At year-end 2014, the Roth feature was adopted by 56% of Vanguard plans and 14% of participants within these plans had elected the option. We anticipate steady growth in Roth adoption rates, given the feature's tax diversification benefits.

Account balances and returns

In 2014, the median participant account balance was $29,603 and the average was $102,682. Vanguard participants' median account balances declined by 6% and average account balances rose by 1% during 2014. The decline in the median account balance is due to the rising adoption of automatic enrollment which results in more individuals saving, but also a growing number of smaller balances. During the five-year 2009–2014 period, both median and average balances rose by 49% and 28%, respectively.

Reflecting strong stock market performance in 2014, the median one-year participant total return was 7.2%. Five-year participant total returns averaged 9.9% per year.

Among continuous participants—those with a balance at year-end 2009 and 2014—the median account balance rose by 137% over five years, reflecting both the effect of ongoing contributions and market returns during this period. More than 90% of continuous participants saw their account balance rise during the five-year period ended December 31, 2014.

Presence of index core options

Given the growing focus on plan fees, there is increased interest among plan sponsors in offering a wider range of low-cost passive or index funds. A "passive core" is a comprehensive set of low-cost index options that span the global capital markets. In 2014 half (52%) of Vanguard plans offered a set of options providing an index core. Over the past decade the number of plans offering an index core has grown by nearly 90%. Because large plans have adopted this approach more quickly, about two-thirds of all Vanguard participants were offered an index core as part of the overall plan investment menu. Factoring in passive target-date funds, 82% of participants hold equity index investments.

Shift in participant investment allocations

The percentage of plan assets invested in equities rose to 72%, essentially unchanged from 71% in 2013. Equity allocations continue to vary dramatically among participants. One in 8 participants has taken an extreme position, holding either 100% in equities (8% of participants) or no equities (5% of participants), although these extreme allocations have fallen in recent years as a result of the rise of target-date funds and other professionally managed allocations.

Participant contributions to equities rose modestly in 2014 to 74% compared with 71% in 2013. In 2014, 4 in 10 of all new contributions to these plans were directed to target-date funds.

Participant trading muted

During 2014, only 10% of DC plan participants traded within their accounts, while 90% did not initiate any exchanges. On a net basis, there was a shift of 0.6% of assets to fixed income in 2014, with most traders making small changes to their portfolios. Less than 1% (0.3%) of all participants actually abandoned equities during the year—that is, shifted from a portfolio with some equity exposure to a portfolio with no equity exposure.

Over the past decade we have observed a decline in participant trading. The decline in participant trading is partially attributable to participants' increased adoption of target-date funds. Only 2% of participants holding a single target-date fund traded in 2014.

Drop in company stock exposure

A shift away from company stock holdings first observed in 2006 continued into 2014. Among plans offering company stock, the number of participants holding a concentrated position of more than 20% of their account balance fell from 30% in 2009 to 28% in 2014. In addition, the number of plans actively offering company stock to participants declined to 10% in 2014 from 11% in 2009. As a result, only 8% of all Vanguard participants held concentrated company stock positions in 2014, compared with 10% at the end of 2009.

Loan activity flat

There was a slight decrease in new loans issued in 2014, down 4% compared with 2013. In 2014, 17% of participants had a loan outstanding (essentially no change from 2013) and the average loan balance was $9,700. Only about 2% of aggregate plan assets were borrowed by participants.

In-service withdrawals

During 2014, 4% of participants took an in-service withdrawal, withdrawing about 30% of their account balances. All in-service withdrawals during 2014 amounted to 1% of aggregate plan assets. Weak economic conditions appeared to be affecting the withdrawal behavior of a very small group of participants.

Assets largely preserved for retirement

Participants separating from service largely preserved their assets for retirement. During 2014, about 30% of all participants could have taken their account as a distribution because they had separated from service in the current year or prior years. The majority of these participants (85%) continued to preserve their plan assets for retirement by either remaining in their employer's plan or rolling over their savings to an IRA or new employer plan. In terms of assets, 97% of all plan assets available for distribution were preserved and only 3% were taken in cash.

Figure 1. Highlights at a glance

Vanguard recordkeeping statistics	*How America Saves 2015* reference	2010	2011	2012	2013	2014
Number of participant accounts (millions)		3.4	3.4	3.4	3.4	3.6
Number of plans (thousands)		2.1	2.0	2.0	1.9	1.9
Median participant age		46	46	46	46	46
Median participant tenure		8	8	8	8	7
Percentage male		59%	59%	59%	59%	59%
Median eligible employee income (thousands)		$57	$60	$61	$63	$67
Median participant income (thousands)		$65	$68	$67	$70	$77
Median nonparticipant income (thousands)		$41	$45	$46	$45	$49
1. Accumulating						
Plan design—page 13						
Plans offering immediate eligibility for employee contributions	Figure 3	54%	58%	58%	55%	58%
Plans requiring one year of service for matching contributions	Figure 3	25%	25%	26%	28%	27%
Plans providing an employer contribution	Figure 5	88%	91%	92%	91%	94%
Plans with automatic enrollment	Figure 15	27%	29%	32%	34%	36%
Plans with automatic enrollment with automatic annual increases	Figure 16	69%	69%	69%	69%	70%
Plans offering catch-up contributions	Text page 37	96%	95%	97%	97%	97%
Plans offering Roth contributions	Text page 38	42%	46%	49%	52%	56%
Plans offering after-tax contributions	Text page 39	19%	19%	19%	19%	18%
Participation rates*—page 27						
Plan-weighted participation rate	Figure 21	76%	77%	78%	78%*	77%*
Participant-weighted participation rate	Figure 21	72%	74%	74%	75%*	69%*
Voluntary enrollment participant-weighted participation rate	Figure 27	70%	71%	71%	70%	61%
Automatic enrollment participant-weighted participation rate	Figure 27	86%	88%	88%	89%	89%
Participants using catch-up contributions (when offered)	Figure 37	13%	14%	13%	14%	16%
Participants using Roth (when offered)	Figure 38	9%	9%	10%	12%	14%
Participants using after-tax (when offered)	Figure 39	7%	7%	7%	8%	7%
Employee deferrals—page 32						
Average participant deferral rate	Figure 29	6.9%	6.9%	6.9%	7.0%	6.9%
Median participant deferral rate	Figure 29	6.0%	6.0%	6.0%	6.0%	6.0%
Percentage of participants deferring more than 10%	Figure 30	22%	20%	20%	20%	22%
Voluntary enrollment plan average participant deferral rate	Figure 35	7.3%	7.3%	7.3%	7.5%	7.3%
Automatic enrollment plan average participant deferral rate	Figure 35	5.0%	5.2%	5.1%	5.6%	6.2%
Participants reaching 402(g) limit ($17,500 in 2014)	Figure 36	10%	11%	10%	11%	10%
Average total contribution rate (participant and employer)	Figure 40	10.4%	10.5%	10.8%	10.9%	10.4%
Median total contribution rate (participant and employer)	Figure 40	9.6%	9.8%	10.0%	10.0%	9.5%
Account balances—page 42						
Average balance	Figure 43	$79,077	$78,276	$86,212	$101,650	$102,682
Median balance	Figure 43	$26,926	$25,550	$27,843	$31,396	$29,603
2. Managing						
Asset and contribution allocation—page 49						
Average plan asset allocation to equities	Figure 50	68%	65%	66%	71%	72%
Average plan contribution allocation to equities	Figure 51	70%	71%	70%	71%	74%
Average plan asset allocation to target-date funds	Figure 50	12%	14%	17%	19%	23%
Average plan contribution allocation to target-date funds	Figure 51	22%	27%	31%	34%	41%
Participants with balanced strategies	Figure 78	57%	61%	63%	66%	69%
Extreme participant asset allocations (100% fixed income or equity)	Figure 76	22%	18%	16%	14%	13%

*The 2014 data is preliminary. The previously reported plan- and participant-weighted participation rates for 2013 were 76% and 67%, respectively.

(Continued)

Figure 1. Highlights at a glance

2. Managing (continued)

Plan investment options—page 52	*How America Saves 2014* reference	2010	2011	2012	2013	2014
Average number of funds offered	Figure 55	18.6	18.9	18.4	18.2	18.3
Average number of funds used	Figure 55	3.3	3.2	3.1	3.1	2.9
Plans offering an index core	Figure 59	40%	44%	46%	49%	52%
Participants offered an index core	Figure 60	48%	53%	56%	59%	64%
Percentage of plans designating a QDIA	Figure 61	61%	64%	67%	70%	71%
Among plans designating a QDIA, percentage target-date fund	Figure 61	89%	90%	90%	91%	94%
Plans offering target-date funds	Figure 68	79%	82%	84%	86%	88%
Participants using target-date funds (when offered)	Figure 65	42%	47%	58%	61%	66%
Plans offering managed account program	Figure 80	13%	14%	16%	19%	22%
Participants offered managed account program	Figure 80	41%	44%	47%	52%	55%
Participants with professionally managed allocations	Figure 66	29%	33%	36%	40%	45%
Participants using a single target-date fund	Figure 66	20%	24%	27%	31%	39%
Participants using a single risk-based balanced fund	Figure 66	6%	6%	6%	6%	2%
Participants using a managed account program	Figure 66	3%	3%	3%	3%	4%
Plans actively offering company stock	Figure 65	11%	10%	10%	10%	10%
Participants using company stock	Figure 65	20%	17%	16%	15%	14%
Participants with >20% company stock	Text page 76	10%	9%	9%	9%	8%
Investment returns—page 78						
Average 1-year participant total return rate	Figure 83	12.3%	0.0%	12.4%	20.4%	7.0%
Average 1-year participant personal return rate	Figure 83	13.1%	(0.4%)	12.0%	19.9%	6.8%
Trading activity—page 82						
Participant-directed trading	Figure 87	10%	10%	9%	10%	10%
Recordkeeping assets exchanged to equities (fixed income)	Figure 87	(1.1%)	(2.5%)	(1.7%)	0.2%	(0.6%)
3. Accessing						
Loans—page 89						
Plans offering loans	Text page 89	75%	75%	76%	77%	77%
Participants with an outstanding loan (when offered)	Figure 95	18%	18%	18%	18%	17%
Recordkeeping assets borrowed	Text page 91	2%	2%	2%	2%	1%
Plan withdrawals—page 94						
Plans offering hardship withdrawals	Figure 99	81%	81%	82%	83%	83%
Participants using withdrawals (when offered)	Figure 100	4%	4%	4%	4%	4%
Recordkeeping assets withdrawn	Figure 100	1%	1%	1%	1%	1%
Participant account balance withdrawn	Figure 100	30%	33%	33%	32%	31%
Plan distributions and rollovers—page 96						
Terminated participants preserving assets	Figure 109	81%	83%	82%	85%	85%
Assets preserved that were available for distribution	Figure 109	96%	96%	96%	97%	97%
Participant access methods—page 102						
Participants not contacting Vanguard during the year	Figure 110	47%	45%	43%	40%	37%
Participants registered for internet account access	Figure 114	64%	66%	68%	70%	71%
Participant account transactions processed via the web	Figure 115	80%	81%	82%	83%	87%

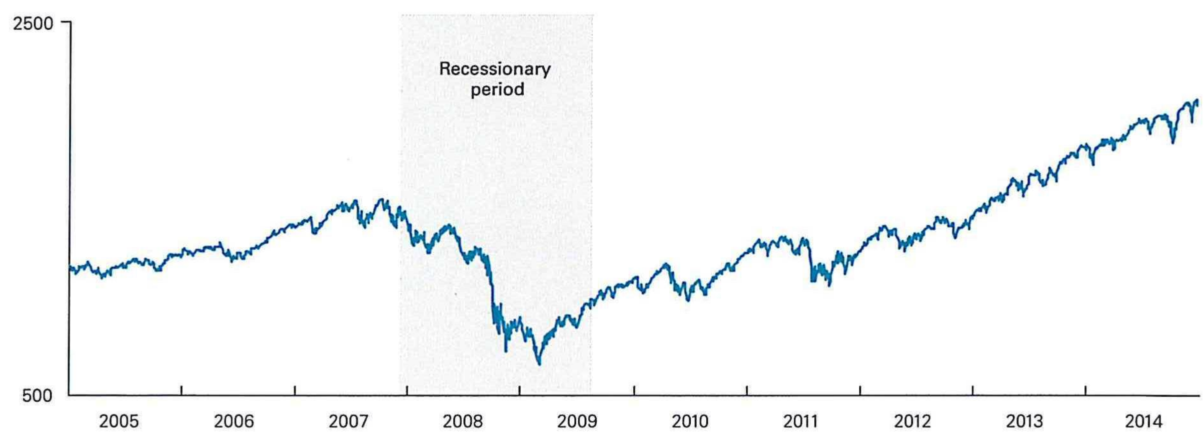
Source: Vanguard, 2015.

Market overview

Since the cyclical low in March 2009, stocks have rebounded by 181% through year-end 2014 (**Figure 2**). In 2014, stock prices rose 11% for the year, and the year was characterized by volatility more in line with historical norms and was not as volatile as in recent years. As of year-end 2014, the S&P 500 Index had risen 32% above its October 2007 peak before the financial crisis.[2] Double-digit returns have occurred in each of the last three years.

During the crisis, stock prices were exceptionally volatile. In 2008, 16.8% of trading days had a change in stock prices greater than +/–3%. The comparable figure was 8.7% in 2009, 3.2% in 2010, and 4.8% in 2011. However, in 2012, 2013 and 2014, no trading days exhibited this level of volatility. Historically, 1% of stock market trading days are associated with a change in stock prices of greater than +/–3%.

Figure 2. S&P 500 daily close



Source: Standard & Poor's 500.

Past performance is no guarantee of future results. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

2 These changes reflect on the price-index level; the total return of buy-and-hold stock market investors would have also included reinvested dividends.

DC retirement plans

DC plans are the dominant type of retirement plan sponsored by private-sector employers in the United States, covering nearly half of all private-sector workers. Although there is still a significant minority of individuals eligible for such plans who fail to participate in them, DC plans have nonetheless enabled millions of American workers to accumulate savings for retirement.

The performance of DC plans can be measured in several ways:

Accumulating plan assets. The level of plan contributions is fundamental to retirement savings adequacy. Plan contributions are affected by employee participation rates, participant deferral rates, and the value of employer contributions. Participant deferral behavior is increasingly influenced by employers' automatic enrollment and autoescalation default designations. Overall, retirement plan design varies substantially across employers—and variation in the level of employer contributions does impact the employee contributions needed to accumulate sufficient retirement savings.

Managing participant accounts. After deciding to contribute to a retirement savings plan, participants' most important decision is how to allocate their holdings among the major asset classes.

As with deferral decisions, many such investment decisions are increasingly influenced by employer-established defaults, as well as the growing use of all-in-one portfolio strategies such as target-date funds and managed account programs. These investment decisions—including the types of investment options offered by the plan and the choices participants or employers make from among those options—have a direct impact on account performance over time. Thus, investment choices, in conjunction with the level of plan contributions, ultimately influence participants' level of retirement readiness.

Accessing plan assets. Participants may be able to take a loan or in-service withdrawal to access their savings while working. When changing jobs or retiring, they typically have the option of remaining in the plan, rolling over to another plan or IRA, or taking a cash lump sum.

Our analysis shows that, despite a volatile market and economic environment in recent years, most Vanguard DC plan participants have seen their retirement savings grow over one- and five-year periods. Meanwhile, most metrics of participant behavior have returned to prerecession levels.

1 Accumulating plan assets

Historically, employees have had to decide whether to participate and at what rate to save. Increasingly employers are making these decisions through automatic enrollment.

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Plan design

Nine in 10 Vanguard-administered DC plans permit pre-tax elective deferrals by eligible employees. Employee deferral decisions are shaped by the design of the DC plan sponsored by their employer.

DC plans with employee-elective deferrals can be grouped into four categories based on the type of employer contributions made to the plan: (1) plans with matching contributions, (2) plans with nonmatching employer contributions, (3) plans with both matching and nonmatching contributions, and (4) plans with no employer contributions at all. Nonmatching contributions are typically structured as a variable or fixed profit-sharing contribution, or less frequently as an employee stock ownership plan (ESOP) contribution.

In employee-contributory DC plans, employer contributions are typically a secondary source of plan funding. Both the type and size of employer contributions vary substantially across plans.

Eligibility

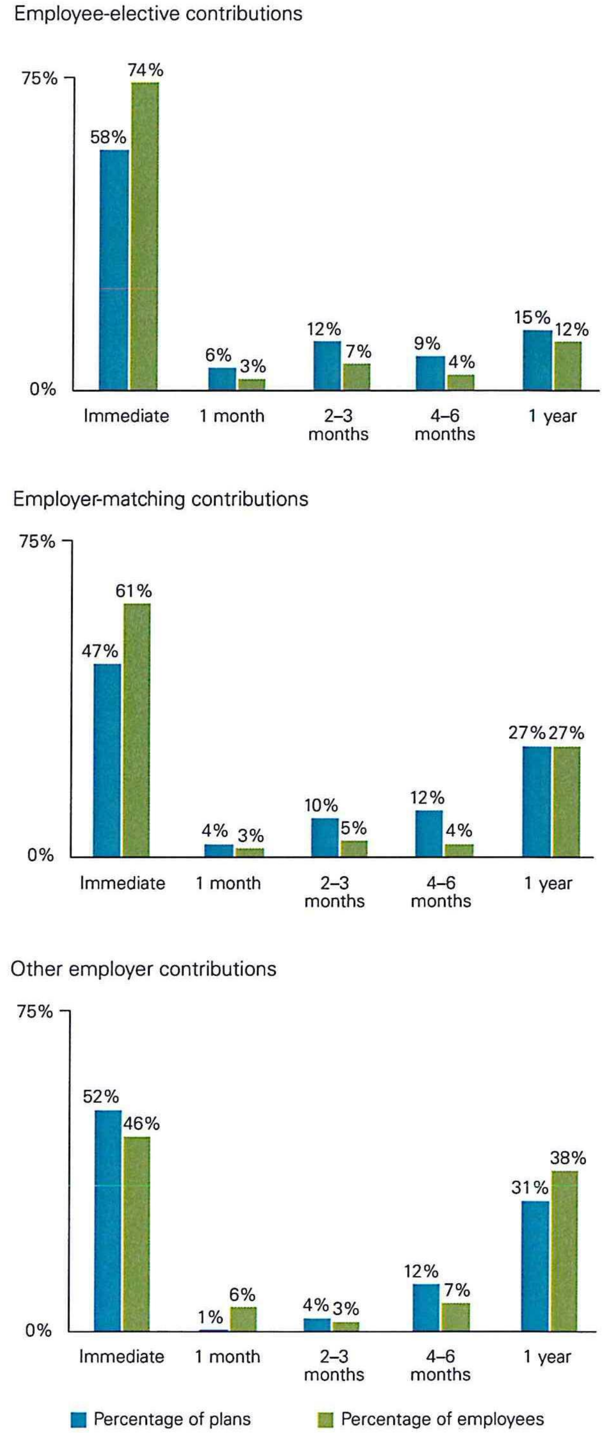
In 2014, 6 in 10 Vanguard plans allowed employees to make voluntary contributions immediately after they joined their employer (**Figure 3**). Larger plans were more likely to offer immediate eligibility than smaller plans. As a result, three-quarters of employees qualified for immediate eligibility in 2014.

At the other extreme, 15% of plan sponsors required eligible employees to have one year of service before they could make employee-elective contributions to their plan. Smaller plans were more likely to impose the one-year wait. As a result, only 12% of total eligible employees were subject to this restriction.

Eligibility rules are more restrictive for employer contributions, including matching contributions and other types of employer contributions, such as profit-sharing or ESOP contributions. A one-year eligibility rule is much more common for employer contributions, presumably because employers want to minimize compensation costs for short-tenured employees.

Figure 3. Eligibility, 2014

Vanguard defined contribution plans permitting employee-elective deferrals



Source: Vanguard, 2015.

Vesting

In 2014, 45% of plans immediately vested participants in employer-matching contributions (Figure 4). Large plans are slightly more likely to offer immediate vesting and about half (47%) of participants are in plans with immediate vesting of employer-matching contributions. Smaller plans are more likely to use longer vesting schedules. One-third of plans with employer-matching contributions use a 5- or 6-year graded vesting schedule. One in 5 participants (21%) with employer-matching contributions is in a plan with a longer vesting schedule.

In 2014, 4 in 10 plans immediately vested participants for other employer contributions, such as profit-sharing or ESOP contributions. On the other hand, 4 in 10 plans (37%) with other employer contributions use a 5- or 6-year graded vesting schedule and 3 in 10 participants receiving other employer contributions are in plans with longer vesting schedules.

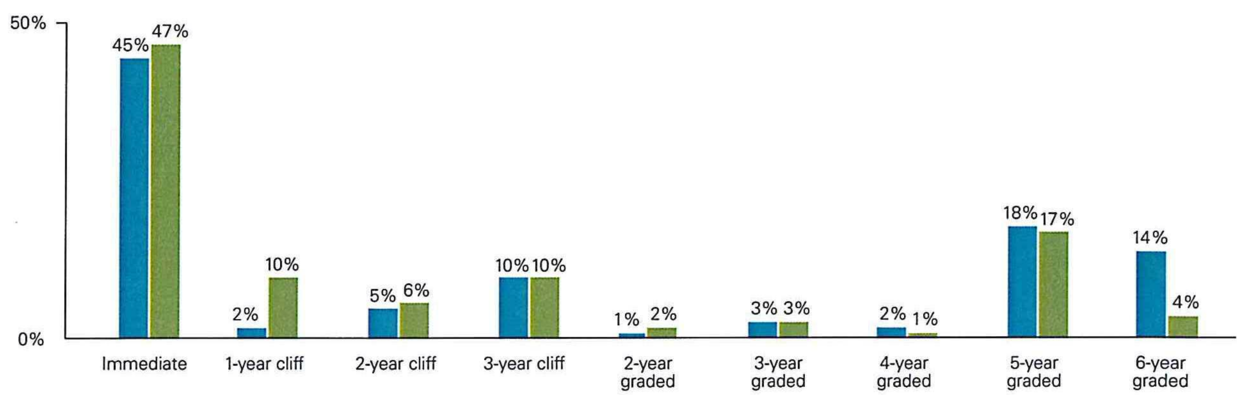
Employer contributions

Forty-six percent of Vanguard plans provided only a matching contribution in 2014, and this type of design covered 46% of participants (Figure 5).

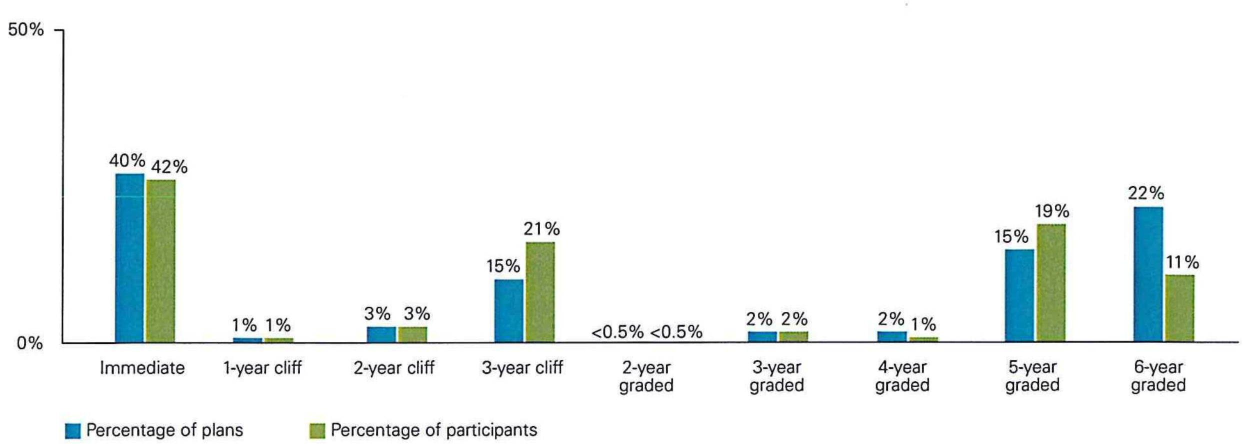
Figure 4. Vesting, 2014

Vanguard defined contribution plans with employer contributions

Employer-matching contributions



Other employer contributions



Source: Vanguard, 2015.

More than one-third of plans (37%), covering half of participants, provided both a matching and a nonmatching employer contribution. Eleven percent of plans provided only a nonmatching employer contribution, and 2% of participants were in this type of design. Finally, 6% of plans made no employer contributions of any kind in 2014, and 1% of participants were in this category.

As noted previously, eligibility for employer contributions is typically more restrictive than eligibility for employee-elective deferrals. In 2014, a higher proportion of plans imposed a one-year waiting period on employer contributions, whether in the form of a matching or other type of contribution, than imposed a one-year waiting period on employee-elective deferrals.

These statistics summarize the incidence of employer contributions to a DC plan that accepts employee deferrals. They do not necessarily reflect the entire retirement benefits program funded by certain employers. Some employers may offer a companion employer-funded plan—such as a defined benefit (DB) plan, a stand-alone profit-sharing, ESOP, or a money purchase DC plan—in addition to an employee-contributory DC plan.

Matching contributions

The wide variation in employer contributions is most evident in the design of employer-matching formulas. In 2014, Vanguard administered more than 225 distinct match formulas for plans offering an employer match. Among plans offering a matching contribution in 2014, three-quarters (covering 74% of participants) provided a single-tier match formula, such as $0.50 on the dollar on the first 6% of pay (Figure 6). Less common, used by 13% of plans (covering 11% of participants), were multitier match formulas, such as $1.00 per dollar on the first 3% of pay and $0.50 per dollar on the next 2% of pay.

Another 8% of plans (covering 13% of participants) had a single- or multitier formula but imposed a maximum dollar cap on the employer contribution, such as $2,000. Finally, a very small percentage of plans used a match formula that varied by age, tenure, or other variables.

The matching formula most commonly cited as a typical employer match is $0.50 on the dollar on the first 6% of pay. This is the match most commonly offered among Vanguard DC plans and most commonly received by Vanguard DC plan participants. In fact, among plans offering a match, 25% provided exactly this match formula in 2014, covering 19% of participants.

Figure 5. Types of employer contributions, 2014

Vanguard defined contribution plans permitting employee-elective deferrals

Type of employer contribution	Percentage of plans	Percentage of participants
Matching contribution only	46%	46%
Nonmatching contribution only	11	2
Both matching and nonmatching contribution	37	51
Subtotal	**94%**	**99%**
No employer contribution	6%	1%

Source: Vanguard, 2015.

Figure 6. Types of matching contributions, 2014

Vanguard defined contribution plans with matching contributions

Match type	Example	Percentage of plans	Percentage of participants
Single-tier formula	$0.50 per dollar on 6% of pay	75%	74%
Multitier formula	$1.00 per dollar on first 3% of pay; $0.50 per dollar on next 2% of pay	13	11
Dollar cap	Single- or multitier formula with $2,000 maximum	8	13
Other	Variable formulas based on age, tenure, or similar variables	4	2

Source: Vanguard, 2015.

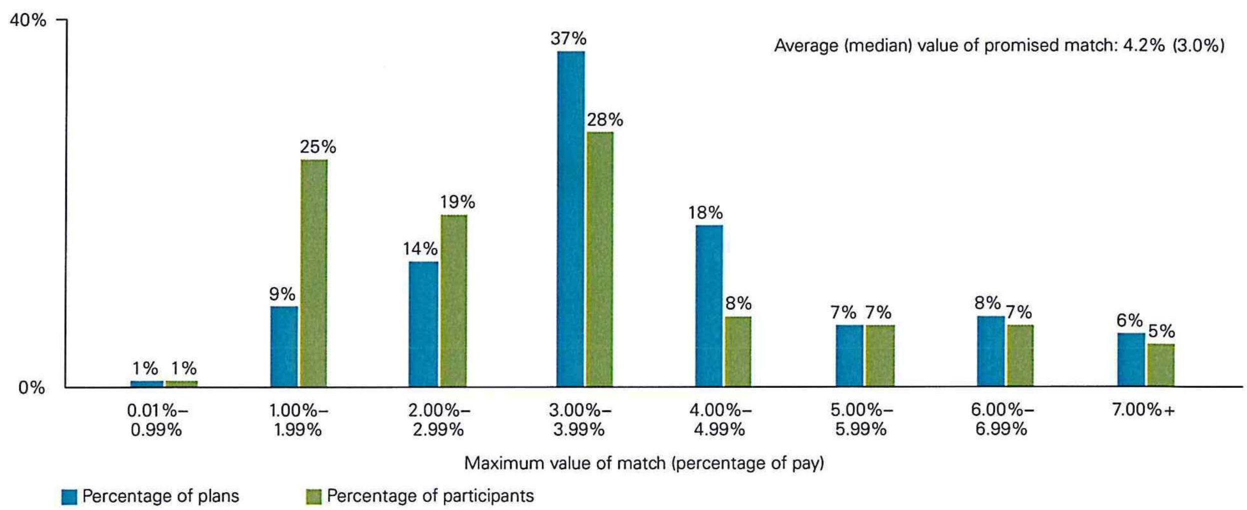
Given the multiplicity of match formulas, one way to summarize matching contributions is to calculate the maximum value of the match promised by the employer. For example, a match of $0.50 on the dollar on the first 6% of pay promises the same matching contribution—3% of pay—as a formula of $1.00 per dollar on the first 3% of pay.

The promised value of the match varies substantially from plan to plan. Among plans with single- or multitier match formulas, 6 in 10 (covering 43% of participants) promised a match of between 3% and 6% of pay (**Figure 7**). Most promised matches ranged from 1% to 6% of pay. The average value of the promised match was 4.2% of pay; the median value, 3.0%. Average promised matches dipped a bit in 2009 following the recession, as some sponsors reduced matches. Average and median promised matches have remained fairly stable between 2005 and 2014 (**Figure 8**).

Another way to assess matching formulas is to calculate the employee-elective deferral needed to realize the maximum value of the match.[3] In 2014, 8 in 10 plans (covering 7 in 10 participants) required participants to defer between 4% and 7% of their pay to receive the maximum employer-matching contribution (**Figure 9**). The average employee-elective deferral required to maximize the match was 7.3% of pay; the median value, 6.0%.

Figure 7. Distribution of promised matching contributions, 2014

Vanguard defined contribution plans permitting employee-elective deferrals with a single- or multitier match formula

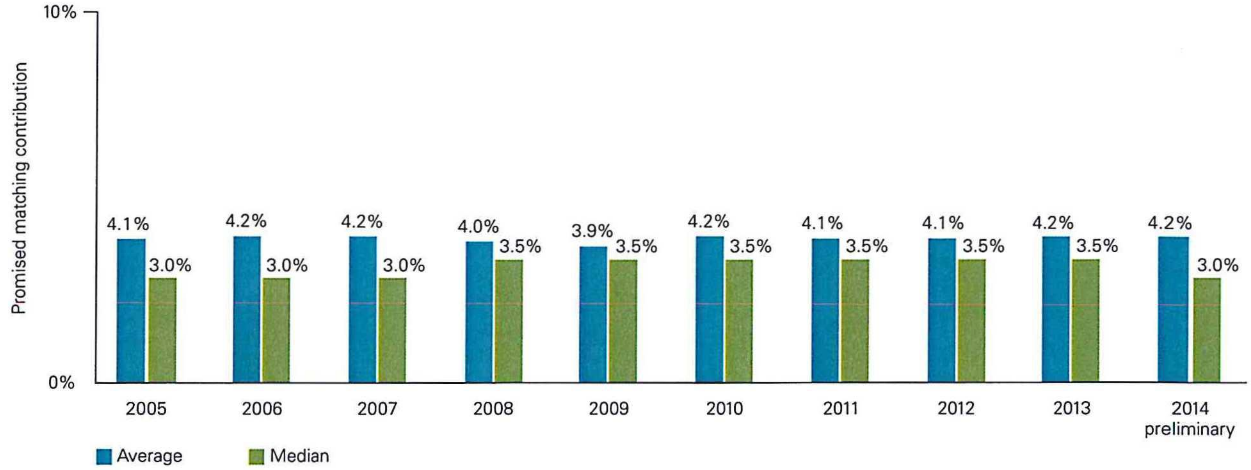


Source: Vanguard, 2015.

3 For an in-depth analysis of whether or not participants receive the full match, see Jeffrey W. Clark, Stephen P. Utkus, and Jean A. Young, 2015, *Maximizing the match in DC plans*, Vanguard research, institutional.vanguard.com.

Figure 8. **Promised matching contributions**

Vanguard defined contribution plans permitting employee-elective deferrals with a single- or multitier match formula

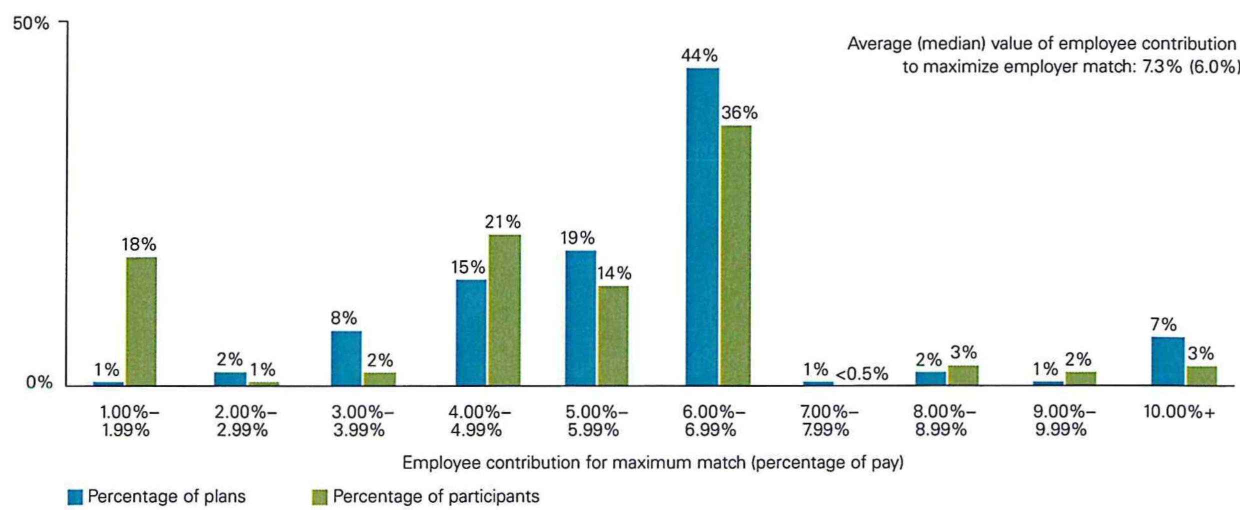


Note: The 2014 employer contribution data are drawn from a subset of plans that had completed nondiscrimination testing by March 2015 and represents approximately half of the clients for whom we perform testing. When testing has been completed for all plans, that analysis is performed again and the data is restated for prior years. Plans that complete testing by March generally have lower participation rates and include plans with concerns related to passing nondiscrimination testing. The previously reported average and median promised matching contributions rates for 2013 were 4.1% and 3.0%, respectively.

Source: Vanguard, 2015.

Figure 9. **Employee contributions for maximum match, 2014**

Vanguard defined contribution plans permitting employee-elective deferrals with a single- or multitier match formula



Source: Vanguard, 2015.

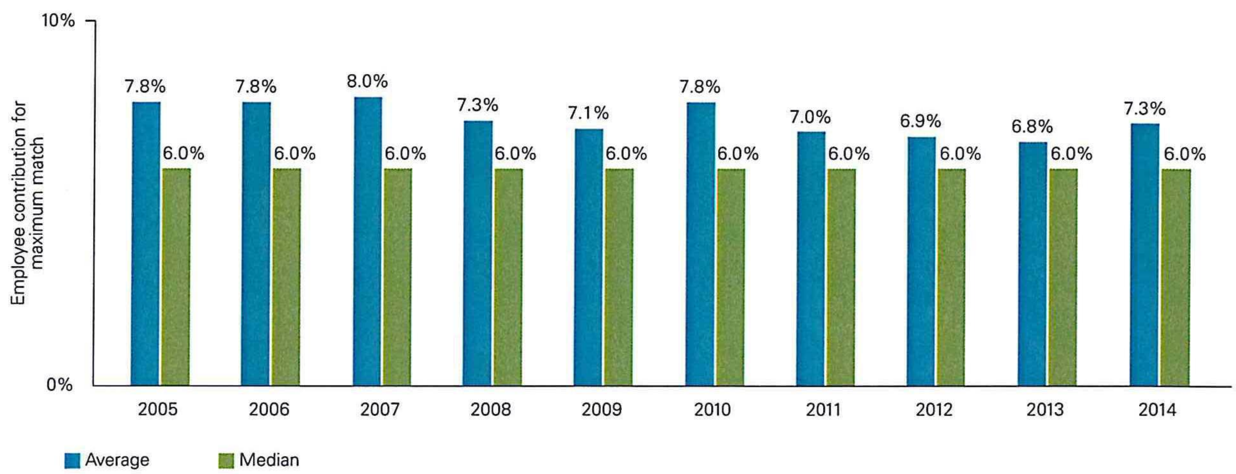
The average employee-elective deferral required to maximize the match declined in 2008 and 2009 and again in 2011 and 2013 before rising in 2014; however, the median deferral required remained constant at 6.0% (Figure 10).

Other employer contributions

As noted previously, in a minority of plan designs, employers may make another contribution to the accounts of eligible employees in the form of a variable or fixed profit-sharing contribution or an ESOP contribution. These contributions, unlike matching contributions, may be made on behalf of eligible employees whether or not they actually contribute any part of their pay to the plan. As with matching contributions, eligibility is more restrictive for these types of employer contributions—many employees are not entitled to receive these contributions until they complete one year of service.

Figure 10. Employee contributions for maximum match

Vanguard defined contribution plans permitting employee-elective deferrals with a single- or multitier match formula

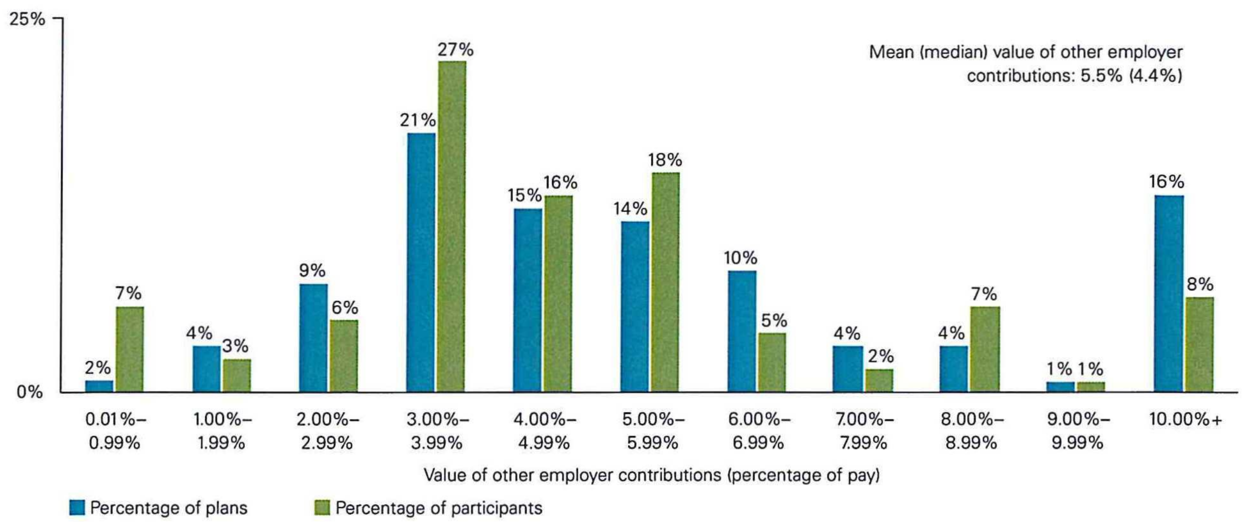


Source: Vanguard, 2015.

The value of other employer contributions also varies significantly from plan to plan. Among plans offering such contributions in 2014, half provided all participants with a contribution based on the same percentage of pay, while the other half varied the contribution by age and/or tenure. These nonmatching contributions varied in value from about 1% of pay to more than 10% of pay (**Figure 11**). Among plans with a nonmatching employer contribution, the average contribution was equivalent to 5.5% of pay; the median contribution, 4.4% of pay.

Figure 11. **Other employer contributions, 2014**

Vanguard defined contribution plans with other employer contributions



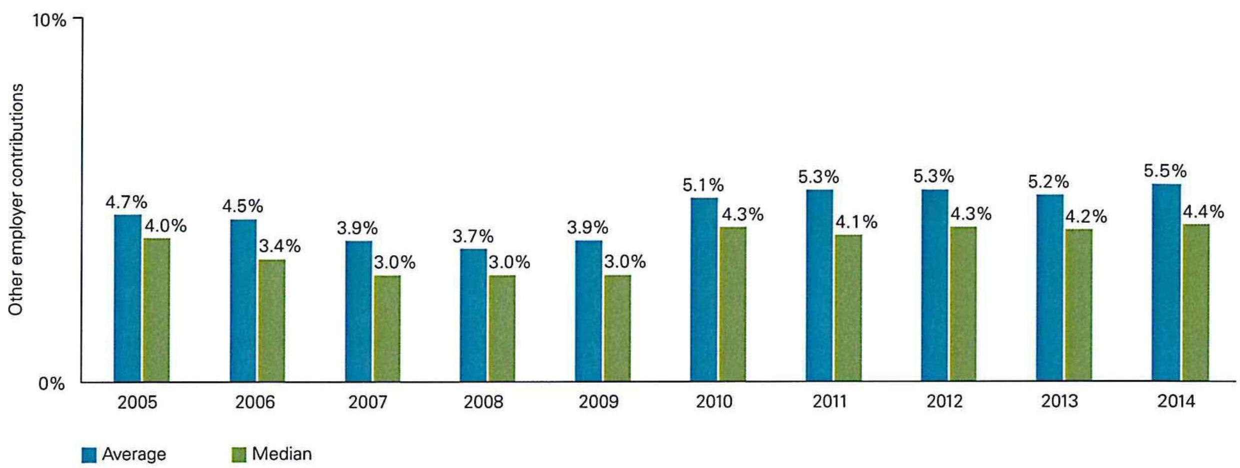
Source: Vanguard, 2015.

Between 2007 and 2009, the average value of other employer contributions was about 20% lower than in 2005 and 2006. We attribute this to reductions in variable profit-sharing contributions—consistent with the economic environment during the period. Between 2010 and 2014, the average value of other employer contributions rebounded and surpassed prerecession levels (**Figure 12**).

As noted previously, more than one-third of plans (37%), covering half of participants, provided both a matching and a nonmatching employer contribution. In 2014 the average combined value of the promised match and the other employer contribution was 8.2% (**Figure 13**).

Figure 12. Other employer contributions

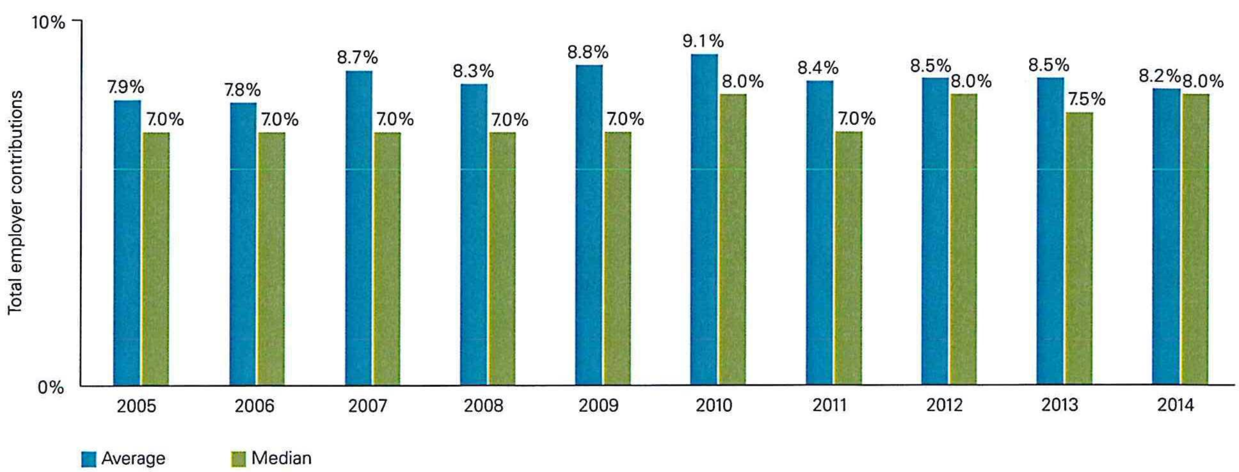
Vanguard defined contribution plans with other employer contributions



Source: Vanguard, 2015.

Figure 13. Match and other employer contributions

Vanguard defined contribution plans with both match and other employer contributions



Source: Vanguard, 2015.

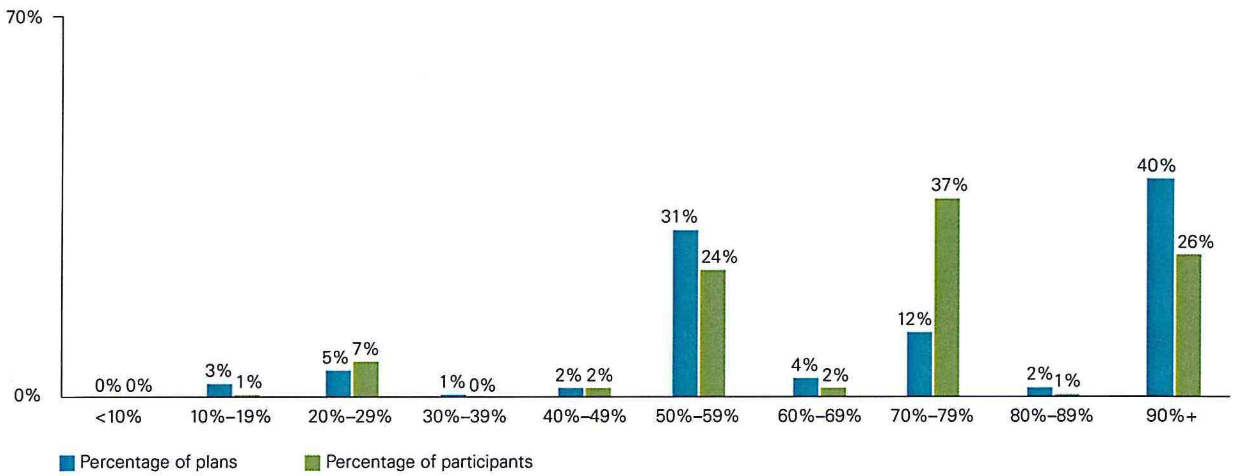
Maximum employee contribution limit

Many plans have incorporated expanded contribution limits authorized in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).

Eighty-nine percent of DC plans (covering 90% of participants) have raised to 50% or more the maximum percentage of pay that employees can contribute to their plans (Figure 14).

Figure 14. Maximum employee-elective contribution limit, 2014

Vanguard defined contribution plans permitting employee-elective deferrals



Source: Vanguard, 2015.

Automatic enrollment designs

In a typical 401(k) or 403(b) plan, employees must make an active choice to join the plan. The enrollment decision is framed as a positive election: "Decide if you'd like to join the plan." Why do employees fail to take advantage of their employers' plans? Research in the field of behavioral finance provides a number of explanations:

- **Lack of planning skills.** Some employees are not active, motivated decision-makers when it comes to retirement planning. They have weak planning skills and find it difficult to defer gratification.
- **Default decisions.** Faced with a complex choice and unsure what to do, many individuals often take the default or "no decision" choice. In the case of a voluntary savings plan, which requires that a participant take action in order to sign up, the "no decision" choice is a decision not to contribute to the plan.
- **Inertia and procrastination.** Many individuals deal with a difficult choice by deferring it to another day. Eligible nonparticipants, unsure of what to do, decide to postpone their decision. While many employees know they are not saving enough and express an interest in saving more, they simply never get around to joining the plan or, if they do join, to increasing their contribution rates over time.

Automatic enrollment or autopilot plan designs reframe the savings decision. With an autopilot design, individuals are automatically enrolled into the plan, their deferral rates are automatically increased each year, and their contributions are automatically invested in a balanced investment strategy. Under an autopilot plan, the decision to save is framed negatively: "Quit the plan if you like." In such a design, "doing nothing" leads to participation in the plan and investment of assets in a long-term retirement portfolio.

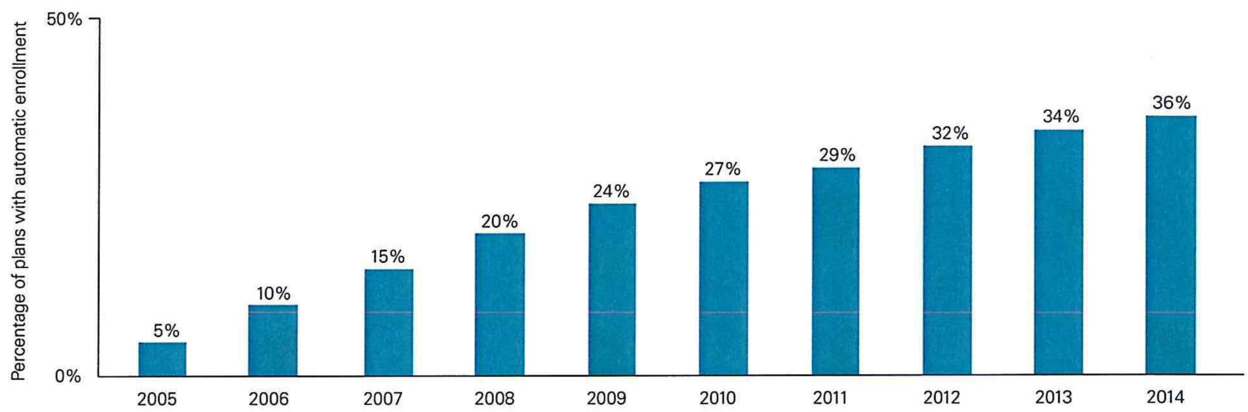
As of December 2014, 36% of Vanguard plans permitting employee-elective deferrals had adopted components of an autopilot design **(Figure 15).** Large plans are more likely to implement automatic enrollment, with more than half of midsized and large plans using the feature. As a result, 6 in 10 participants are now in plans with autopilot designs, although automatic enrollment itself may only apply to newly eligible participants **(Figure 16).**

Approximately half of these plans have now "swept" eligible nonparticipants—they implemented automatic enrollment for all nonparticipating employees.[4] The remaining half have implemented automatic enrollment for new hires only. Adoption of automatic enrollment designs grew only modestly in 2014, and by the end of 2014, 6 in 10 large plans had added the feature.

4 For an in-depth analysis of automatic enrollment, see Jeffrey W. Clark, Stephen P. Utkus, and Jean A. Young, 2015, *Automatic enrollment: The power of the default,* Vanguard research, institutional.vanguard.com.

Figure 15. Automatic enrollment adoption

Vanguard defined contribution plans with employee-elective contributions



Source: Vanguard, 2015.

Figure 16. Automatic enrollment design by plan size, 2014

Vanguard defined contribution plans with automatic enrollment

		Number of participants		
	All	<1,000	1,000–4,999	5,000+
Percentage of plans with employee-elective contributions offering	36%	26%	61%	58%
Percentage of participants in plans offering	60%	38%	62%	62%
For plans offering automatic enrollment				
Percentage of plans with automatic enrollment, automatic savings rate increases, and a balanced default fund	70%	65%	78%	68%
Percentage of plans with automatic enrollment and a balanced default fund	28	32	22	32
Percentage of plans with automatic enrollment and a money market or stable value default fund	2	3	0	0

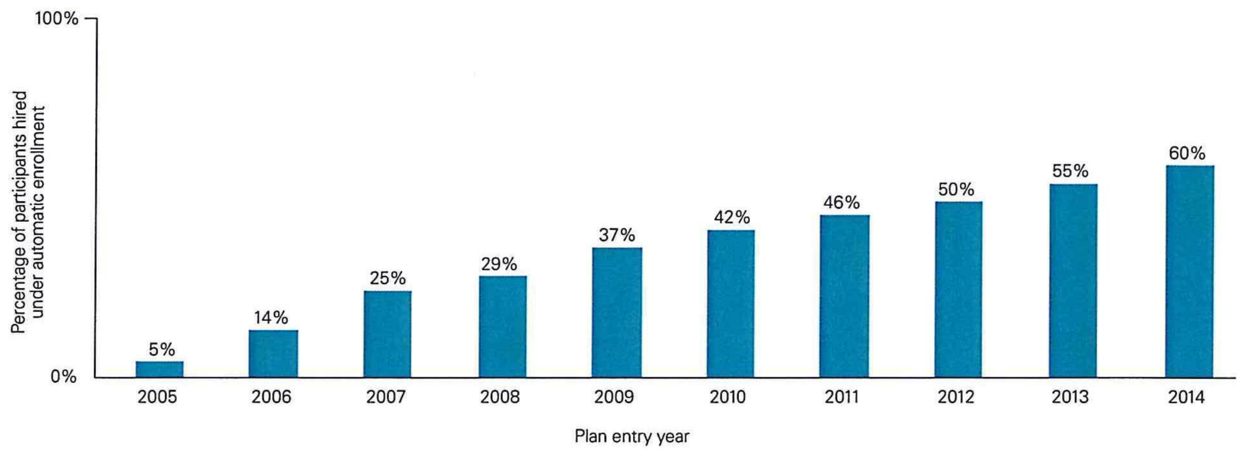
Source: Vanguard, 2015.

Among plans automatically enrolling employees, 7 in 10 use all three features of an autopilot design. These plan sponsors automatically enroll employees, automatically increase the deferral rate annually, and invest participants' assets in a balanced fund. Another 28% of plan sponsors automatically enroll employees and invest participants' assets in a balanced fund but do not automatically increase participant deferral rates. In 2014, 6 in 10 new plan entrants—participants contributing to the plan for the first time in 2014—were in plans that had adopted automatic enrollment (**Figure 17**).

Forty-nine percent of these plans automatically enroll participants at a 3% contribution rate (**Figure 18**). Seven in 10 plans automatically increase the contribution rate annually. Ninety-eight percent of these plans use a target-date or other balanced investment strategy as the default fund, with 95% choosing a target-date fund as the default. The design of automatic enrollment plans is improving. In 2014, 39% of plans chose a default of 4% or higher, compared with 2005 when only 27% did.

Figure 17. **Participants hired under automatic enrollment adoption**

Vanguard defined contribution plans with employee-elective contributions



Source: Vanguard, 2015.

Figure 18. Automatic enrollment design trends

Vanguard defined contribution plans with automatic enrollment

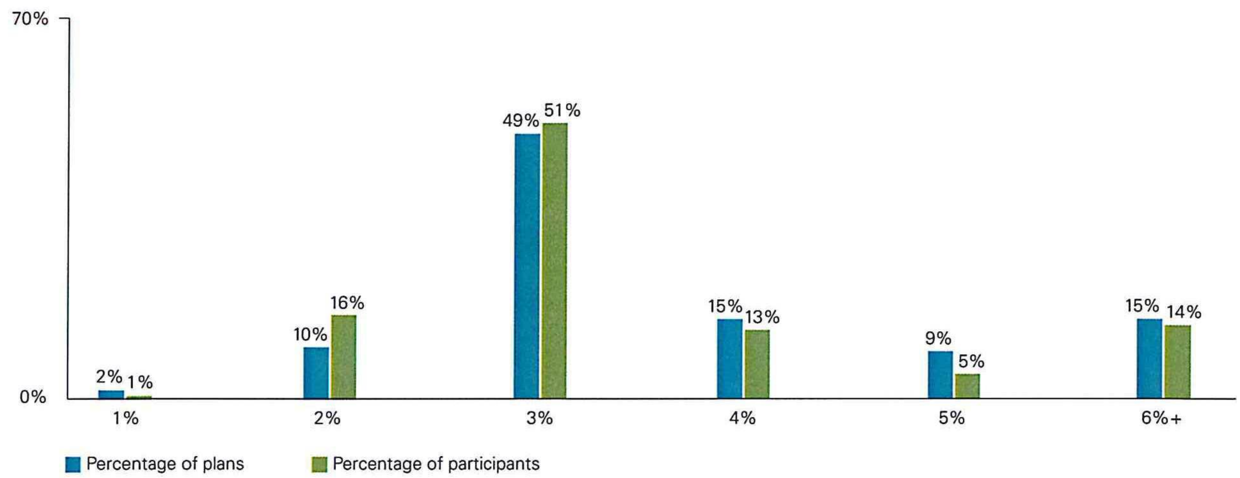
Default automatic enrollment rate	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
1 percent	4%	3%	3%	2%	3%	2%	2%	2%	2%	2%
2 percent	23	20	17	13	14	13	13	13	12	10
3 percent	46	52	56	60	56	57	55	53	51	49
4 percent	12	10	10	10	11	11	11	12	13	15
5 percent	10	8	7	7	7	7	8	8	9	9
6 percent or more	5	7	7	8	9	10	11	12	13	15
Default automatic increase rate										
1 percent	31%	57%	66%	73%	68%	68%	67%	67%	67%	68%
2 percent	0	2	2	2	1	1	2	2	2	2
Voluntary election	44	27	23	16	15	16	16	17	17	18
Service feature not offered	25	14	9	9	16	15	15	14	14	12
Default fund										
Target-date fund	42%	63%	81%	87%	87%	89%	90%	91%	93%	95%
Other balanced fund	33	26	15	11	10	8	7	6	5	3
Subtotal	75%	89%	96%	98%	97%	97%	97%	97%	98%	98%
Money market or stable value fund	25%	11%	4%	2%	3%	3%	3%	3%	2%	2%

Source: Vanguard, 2015.

Thirty-nine percent of these plans automatically enroll participants at a contribution rate of 4% or more (Figure 19). One-third of participants in these plans are defaulted to a contribution rate of 4% or more. Four in 10 plans with automatic enrollment and annual increases cap the annual increase at 10% and half of annual-increase participants are capped at 10% (Figure 20). However, one-quarter of plans use caps between 12% and 50%. Six percent of plans have no cap—likely an error. We recommend plan sponsors set the cap at a level where participants are saving 12% to 15% or more, factoring in employer contributions.

Figure 19. Automatic enrollment deferral rate

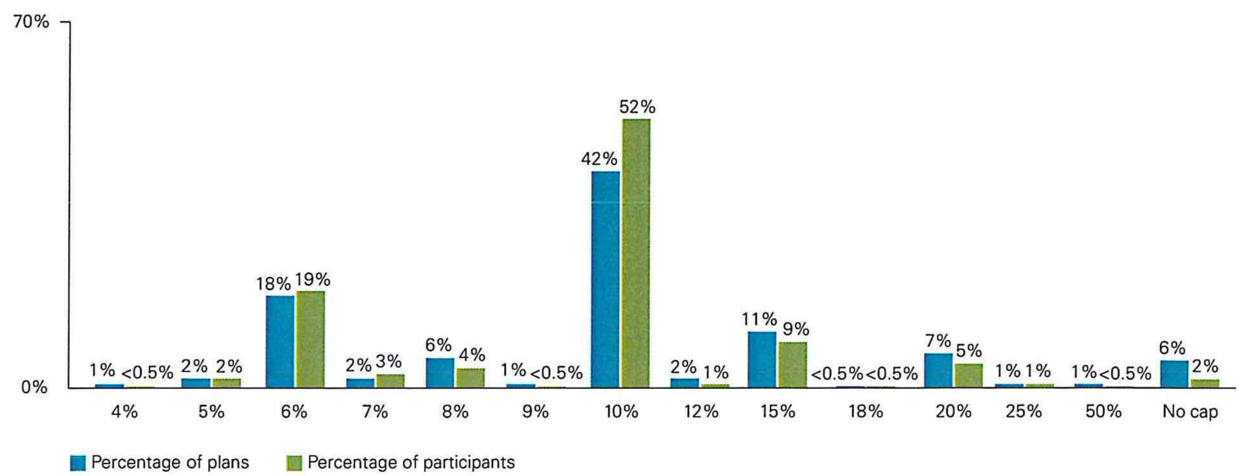
Automatic enrollment plans with an automatic annual increase as of December 31, 2014



Source: Vanguard, 2015.

Figure 20. Automatic increase plan caps

Automatic enrollment plans with an automatic annual incease as of December 31, 2014



Source: Vanguard, 2015.

Participation rates

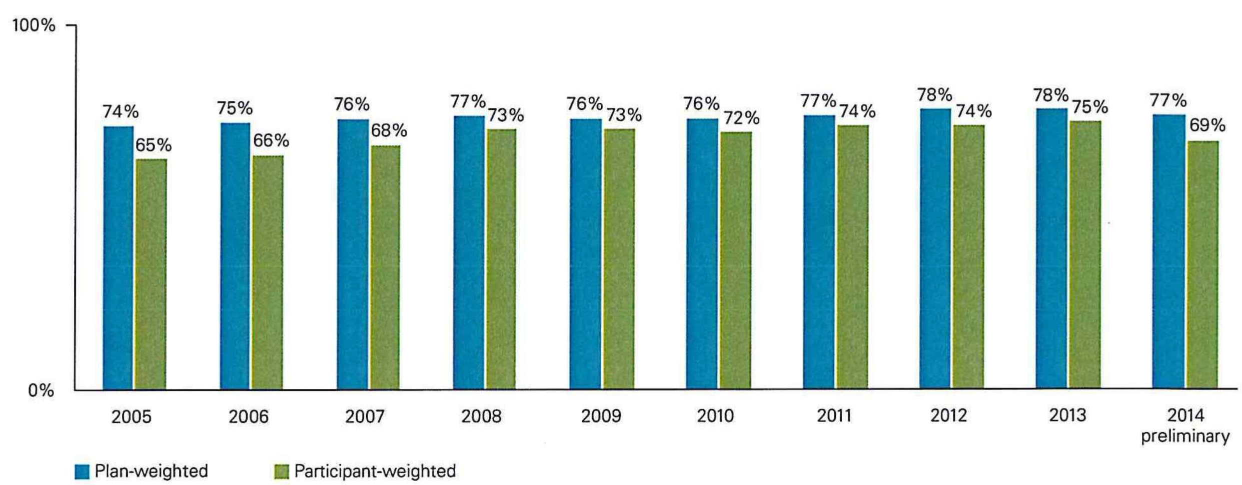
A plan's participation rate—the percentage of eligible employees who choose to make voluntary contributions—remains the broadest metric for gauging 401(k) plan performance. The most common measure of participation rates is calculated by taking the average of participation rates among a group of plans. We refer to this as the plan-weighted participation rate. In 2014, Vanguard's plan-weighted participation rate was 77% and has risen modestly compared with 2005 (Figure 21).

A second measure of participation rates considers all employees in Vanguard-administered plans as if they were in a single plan. We refer to this as the participant-weighted participation rate. Across the universe of Vanguard participants, 69% (preliminary, see Figure 21 note) of eligible employees are enrolled in their employer's voluntary savings program. This broader measure of plan participation has risen in recent years from two-thirds to three-quarters. This increase reflects the adoption of automatic enrollment by larger plan sponsors.

These two measures provide different views of employee participation in their retirement savings plans, although with the rising adoption of automatic enrollment these two metrics are converging. The first measure indicates that, in the average plan, about one-fifth of eligible employees fail to contribute. The second measure, however, shows that within the entire employee universe, about one-quarter of employees fail to take advantage of their employer's plan. The first measure is a useful benchmark for an individual plan sponsor because it is calculated at the plan level; the second is a valuable measure of the progress of 401(k) plans as a whole because it looks at all eligible employees across all plans.

Figure 21. Plan participation rates

Vanguard defined contribution plans permitting employee-elective deferrals



Note: The 2014 participation rates are drawn from a subset of plans that had completed nondiscrimination testing by March 2015 and represent approximately half of the clients for whom we perform testing. When testing has been completed for all plans, the data is restated. Plans that complete testing by March generally have lower participation rates and include plans with concerns related to passing nondiscrimination testing. The previously reported plan- and participant-weighted participation rates for 2013 were 76% and 67%, respectively.

Source: Vanguard, 2015.

Distribution of participation rates

Participation rates vary considerably across plans (Figure 22). In 2014, more than half of plans had a participation rate of 80% or higher, while 1 in 10 plans had a participation rate of less than 50%.

Participation rates also vary by plan size, with larger plans historically having lower participation rates than other plans (Figure 23). One reason for lower participation rates at large companies may be the presence of another retirement plan benefit, such as an employer-funded DB plan, employer profit-sharing, or ESOP contributions to a DC plan.

Figure 22. Distribution of participation rates

Vanguard defined contribution plans permitting employee-elective deferrals

Percentage of plans

Plan participation rate	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014 preliminary
90%–100%	16%	17%	20%	24%	23%	21%	24%	29%	31%	30%
80%–89%	26	28	31	30	29	31	31	28	30	26
70%–79%	25	23	20	20	20	19	17	17	14	18
60%–69%	15	16	14	11	11	12	12	10	9	10
50%–59%	9	8	8	8	7	7	7	7	7	6
<50%	9	8	7	7	10	10	9	9	9	10
Average plan participation rate	74%	75%	76%	77%	76%	76%	77%	78%	78%	77%

Note: The previously reported plan-weighted participation rate for 2013 was 76% (see Figure 21 note).
Source: Vanguard, 2015.

Figure 23. Participation rates by plan size

Vanguard defined contribution plans permitting employee-elective deferrals

Number of participants

Plan-weighted participation rate	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014 preliminary
<1,000	75%	75%	76%	77%	75%	75%	76%	77%	77%	77%
1,000–4,999	71	73	75	78	79	78	79	80	81	80
5,000+	69	71	73	78	76	78	80	81	81	74
All plans	74%	75%	76%	77%	76%	76%	77%	78%	78%	77%
Participant-weighted participation rate										
<1,000	68%	68%	72%	74%	71%	71%	73%	74%	74%	74%
1,000–4,999	64	66	67	71	72	69	70	72	72	73
5,000+	64	65	67	74	73	75	76	76	77	67
All participants	65%	66%	68%	73%	73%	72%	74%	74%	75%	69%

Note: The previously reported plan- and participant-weighted participation rates for 2014 were 76% and 67%, respectively (see Figure 21 note).
Source: Vanguard, 2015.

Other possible reasons include the inherent difficulty of communicating across many locations in a large firm and the fact that large firms often outsource the enrollment process to their provider, while small firms may tend to rely on an in-house human resources representative. With larger plans most likely to add automatic enrollment, there is now less variation in participation rates by plan size.

Participation rates by employee demographics

Participation rates also vary considerably by employee demographics (**Figure 24**). Income is one of the primary determinants of plan participation rates. About half of eligible employees with income of less than $30,000 contributed to their employer's DC plan in 2014, while 89% of employees with income of more than $100,000 elected to participate. Even among the highest-paid employees, 11% of eligible workers still failed to take advantage of their employer's DC plan.

Participation rates were lowest for employees younger than 25. Only about half of employees younger than 25 made employee-elective deferrals to their employer's plan in 2014, while about 7 in 10 eligible employees between ages 35 and 64 saved for retirement in their employer's plan. Tenure had a significant influence on plan participation. In 2014, only about 6 in 10 eligible employees with less than two years on the job participated in their employer's plan, while three-quarters of employees with tenure of ten years or more participated.

Figure 24. Participation rates by participant demographics

Vanguard defined contribution plans permitting employee-elective deferrals

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014 preliminary
All	65%	66%	68%	73%	73%	72%	74%	74%	75%	69%
Income										
<$30,000	43%	43%	45%	56%	55%	53%	56%	57%	57%	46%
$30,000–$49,999	64	63	66	71	70	69	70	71	71	65
$50,000–$74,999	75	74	76	78	76	76	75	75	76	68
$75,000–$99,999	83	84	84	85	84	83	82	82	82	74
$100,000+	90	91	91	91	90	91	90	90	91	89
Age										
<25	30%	33%	38%	49%	49%	44%	51%	52%	53%	46%
25–34	57	58	61	68	68	68	69	70	71	67
35–44	68	69	70	75	74	74	74	75	76	70
45–54	71	71	74	78	77	77	78	78	79	72
55–64	71	72	74	77	76	76	78	79	80	75
65+	58	57	62	67	68	67	71	74	74	70
Gender										
Male	65%	66%	69%	75%	73%	73%	74%	73%	75%	66%
Female	64	64	67	73	72	71	75	74	77	73
Job tenure (years)										
0–1	42%	45%	49%	58%	55%	56%	61%	61%	62%	57%
2–3	56	58	61	69	69	66	69	71	72	68
4–6	66	67	68	73	72	72	72	73	75	71
7–9	73	73	74	79	77	76	76	78	78	73
10+	77	79	80	82	81	81	81	82	83	76

Note: The previously reported participant-weighted participation rate for 2013 was 67% (see Figure 21 note).

Source: Vanguard, 2015.

Men and women appear to participate at about the same level. But these overall averages fail to account for the income differences between men and women. At most income levels, women are significantly more likely than men to join their employer's plan (**Figure 25**). For example, in 2014, 81% of women earning $50,000 to $74,999 participated in their employer's plan—compared with 62% of men in the same income group.

Participation rates also vary by industry group (**Figure 26**). Employees in the agriculture, mining, and construction and the finance, insurance, and real estate industry groups had the highest participation rate, with more than 9 in 10 workers participating in their employer's plan, while employees in the wholesale and retail trade group had the lowest participation rate at 60%.

Figure 25. Participation by income and gender, 2014

Vanguard defined contribution plans permitting employee-elective deferrals

	Female	Male	All
<$30,000	50%	41%	46%
$30,000–$49,999	70	61	65
$50,000–$74,999	81	62	68
$75,000–$99,999	86	70	74
$100,000+	91	87	89

Source: Vanguard, 2015.

Figure 26. Participation rates by industry sector, 2014

Vanguard defined contribution plans permitting employee-elective deferrals

	Plan-weighted	Participant-weighted
Overall	77%	69%
Industry group		
Finance, insurance, and real estate	87	91
Agriculture, mining, and construction	72	91
Manufacturing	76	78
Education and health	77	74
Media, entertainment, and leisure	72	53
Business, professional, and nonprofit	80	76
Transportation, utilities, and communications	75	58
Wholesale and retail trade	78	60

Source: Vanguard, 2015.

Impact of automatic enrollment on plan participation

Reflecting increased adoption of automatic enrollment designs, there has been a dramatic improvement in participation rates between 2005 and 2014 among demographic groups that traditionally have lower voluntary participation rates. Employees subjected to an automatic enrollment feature have an overall participation rate of 89%, compared with a participation rate of only 61% for employees hired under plans with voluntary enrollment (Figure 27).[5]

Plans with automatic enrollment have higher participation rates across all demographic variables. For individuals earning less than $30,000 in plans with automatic enrollment, the participation rate is more than double that of individuals with voluntary enrollment.

Figure 27. Participation rates by plan design, 2014

Vanguard defined contribution plans permitting employee-elective deferrals

	Voluntary enrollment	Automatic enrollment	All
All	61%	89%	69%
Income			
<$30,000	32%	83%	46%
$30,000–$49,999	55	89	65
$50,000–$74,999	62	92	68
$75,000–$99,999	69	95	74
$100,000+	85	97	89
Age			
<25	29%	78%	46%
25–34	54	88	67
35–44	62	88	70
45–54	66	90	75
55–64	70	92	75
65+	64	89	70
Gender			
Male	58%	89%	66%
Female	66	89	73
Job tenure (years)			
0–1	37%	82%	57%
2–3	56	90	68
4–6	62	92	71
7–9	66	93	73
10+	72	93	76

Source: Vanguard, 2015.

5 In prior editions of *How America Saves* we categorized plans and participants based on whether or not the plan had adopted automatic enrollment at the end of the year. As noted previously, about half of plans have implemented automatic enrollment for all eligible employees, by either "sweeping" these nonparticipants when automatic enrollment was initially adopted or at a later date. In 2014 we have refined our analysis to segregate individuals hired under voluntary enrollment design from those individuals subjected to an automatic enrollment design. Participants in plans with automatic enrollment that were not subjected to automatic enrollment are included in the voluntary enrollment category.

Aggregate plan participation rates

As noted previously, some plan sponsors make other nonmatching contributions for all eligible employees, whether or not these employees actually defer any part of their pay to the plan. When these contributions are factored in, both the plan- and participant-weighted participation rates improve. The plan-weighted participation rate rises to 84% and the participant-weighted rate to 73% (**Figure 28**). In other words, across all Vanguard plans, about 80% of employees either make their own contributions, receive an employer contribution, or both.

Employee deferrals

In a typical DC plan, employees are the main source of funding, while employer contributions play a secondary role. Thus, the level of participant deferrals is a critical determinant of whether the DC plan will generate an adequate level of savings for retirement.

Vanguard participants saved 6.9% of their income on average in their employer's plan in 2014 (**Figure 29**). The median participant deferral rate was 6.0%, meaning that half of participants were saving above this rate and half were saving below it.

Vanguard deferral rates are drawn from recordkeeping data and exclude eligible employees not contributing to their plans. Industry deferral rates sometimes include eligible employees not contributing to their plan and are generally self-reported by plan sponsors.

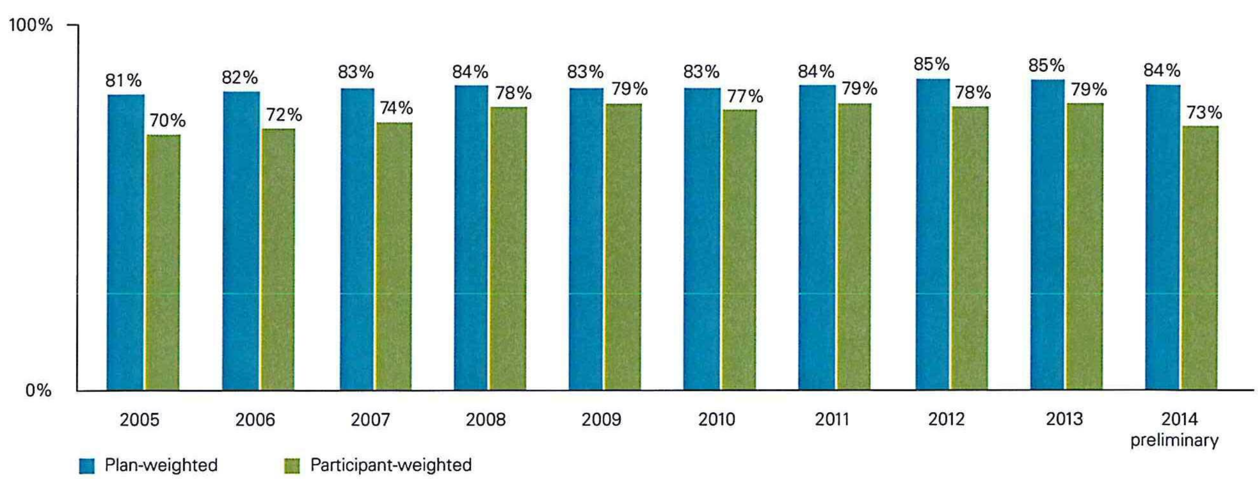
Median deferral rates are unchanged since 2005. However, average deferral rates declined slightly in 2009 by 0.5 percentage points compared with 2007. This slight decline is attributable to the growth in automatic enrollment, where the dominant default deferral rate is 3%.

Distribution of deferral rates

Individual deferral rates vary considerably among participants (**Figure 30**). One in 5 participants had a deferral rate of 10% or higher in 2014, while 3 in 10 had a deferral rate of less than 4%. During 2014, only 10% of participants saved the statutory maximum of $17,500 ($23,000 for participants age 50 or older) (see page 37). In plans offering catch-up contributions, only 16% of participants age 50 or older took advantage of this feature in 2014 (see page 30).

Figure 28. **Aggregate participation rates**

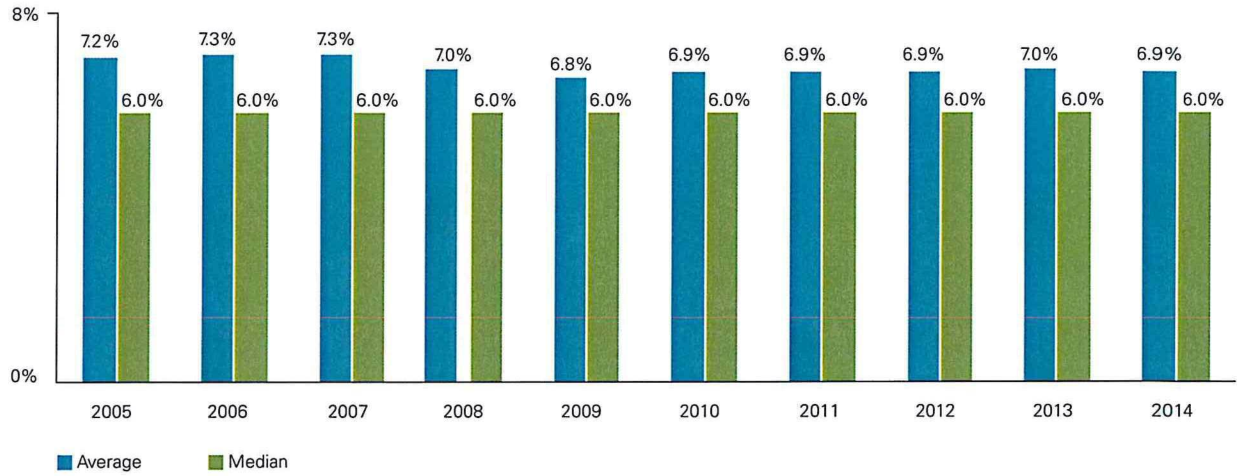
Vanguard defined contribution plans permitting employee-elective deferrals



Note: The previously reported plan- and participant-weighted participation rates for 2013 were 82% and 70%, respectively (see Figure 21 note).
Source: Vanguard, 2015.

Figure 29. **Participant employee-elective deferral rates**

Vanguard defined contribution plans permitting employee-elective deferrals



Source: Vanguard, 2015.

Figure 30. **Distribution of participant employee-elective deferral rates**

Vanguard defined contribution plans permitting employee-elective deferrals

Percentage of participants

Deferral rate	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
0.1%–3.9%	26%	26%	27%	30%	32%	28%	28%	29%	28%	31%
4.0%–6.0%	25	24	23	22	22	23	25	23	23	22
6.1%–9.9%	26	26	27	26	25	27	27	28	29	25
10.0%–14.9%	16	16	15	15	14	15	14	14	14	15
15.0%+	7	8	8	7	7	7	6	6	6	7

Source: Vanguard, 2015.

Plan size has little effect on participant deferral rates (Figure 31). In 2014, plans with 5,000 or more participants had an average deferral rate of 7.1%—only modestly higher than the overall average rate of 6.9%. Employees at large firms typically have more generous compensation packages and so arguably should have a higher propensity to save than employees at small companies. But the presence of automatic enrollment and other employer-funded retirement benefits as part of that package may dilute this effect.

Deferral rates by employee demographics

As with plan participation rates, employee demographics have a strong influence on deferral rates (Figure 32). Income is the primary determinant of deferral rates, which generally rise with income, but then decline as highly paid participants reach either the statutory maximum contribution level or plan-imposed caps on contributions related to nondiscrimination testing. The statutory maximum contribution was $17,500 ($23,000 for participants 50 and older), and a highly compensated employee was one who earned $115,000 or more in 2013 (based on the prior year for 2014).

In 2014, participants with incomes of less than $30,000 had deferral rates averaging 4.6%, while participants earning $75,000 to $99,999 had deferral rates of 7.8%—a savings rate that is 70% higher. Deferral rates were 8.4% for participants earning $100,000 or more.

Age is another important variable influencing savings. In 2014, deferral rates were lowest for participants younger than 25. This group saved only 4.6% of income. Deferral rates for participants ages 55 to 64 were nearly twice as high, averaging 8.7%. Deferral rates also rose directly with employee tenure.

Figure 31. Participant employee-elective deferral rates by plan size

Vanguard defined contribution plans permitting employee-elective deferrals

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Average—all plans	7.2%	7.3%	7.3%	7.0%	6.8%	6.9%	6.9%	6.9%	7.0%	6.9%
Median	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Average by plan size (number of participants)										
<1,000	7.2%	7.2%	7.3%	7.1%	6.9%	6.9%	6.9%	6.9%	6.9%	6.8%
1,000–4,999	7.3	7.2	7.2	7.0	6.8	6.9	6.8	6.8	6.9	6.7
5,000+	7.2	7.4	7.4	6.9	6.7	7.0	6.9	6.8	7.0	7.1

Source: Vanguard, 2015.

Figure 32. Employee-elective deferral rates by participant demographics

Vanguard defined contribution plans permitting employee-elective deferrals

Average deferral rate	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
All	7.2%	7.3%	7.3%	7.0%	6.8%	6.9%	6.9%	6.9%	7.0%	6.9%
Income										
<$30,000	6.0%	6.0%	5.7%	4.8%	4.7%	4.8%	4.8%	4.7%	4.8%	4.6%
$30,000–$49,999	6.4	6.3	6.2	5.9	5.6	5.8	5.8	5.7	5.8	5.7
$50,000–$74,999	7.7	7.7	7.6	7.4	7.0	7.1	7.0	6.9	7.0	6.9
$75,000–$99,999	8.7	8.9	8.9	8.6	8.4	8.4	8.2	8.1	8.1	7.8
$100,000+	7.6	8.1	8.5	8.1	8.2	8.2	8.1	8.1	8.3	8.4
Age										
<25	4.7%	4.6%	4.5%	4.1%	4.0%	4.2%	4.2%	4.0%	4.4%	4.6%
25–34	6.0	5.9	5.9	5.6	5.5	5.7	5.6	5.4	5.8	5.6
35–44	6.7	6.8	6.7	6.4	6.2	6.4	6.1	6.3	6.4	6.3
45–54	7.6	7.8	7.8	7.5	7.2	7.3	7.2	7.2	7.3	7.3
55–64	9.0	9.1	9.2	8.9	8.5	8.6	8.6	8.5	8.6	8.7
65+	10.4	10.7	10.8	10.4	9.8	9.9	9.8	9.8	9.8	10.2
Gender										
Male	7.2%	7.3%	7.3%	7.0%	6.7%	6.9%	6.9%	6.9%	7.0%	6.8%
Female	7.3	7.3	7.2	6.9	6.8	6.9	6.9	6.8	7.0	7.0
Job tenure (years)										
0–1	5.9%	5.7%	5.6%	5.0%	4.9%	4.8%	4.8%	4.7%	4.9%	4.7%
2–3	6.6	6.6	6.7	6.3	6.1	6.3	6.3	6.0	6.3	6.2
4–6	7.0	7.1	7.1	6.8	6.5	6.8	6.8	6.8	7.0	7.0
7–9	7.2	7.4	7.4	7.1	6.9	7.0	7.0	7.0	7.2	7.2
10+	7.9	8.1	8.2	8.0	7.7	7.8	7.8	7.9	8.0	8.1
Account balance										
<$10,000	4.4%	4.2%	4.1%	4.1%	3.6%	3.8%	3.9%	3.8%	3.8%	3.7%
$10,000–$24,999	6.3	6.4	6.5	6.8	5.8	5.7	5.9	5.8	5.9	6.1
$25,000–$49,999	7.4	7.3	7.4	7.9	7.1	6.8	6.8	6.7	6.9	7.1
$50,000–$99,999	8.8	8.5	8.6	9.1	8.4	8.2	8.1	7.8	7.7	8.1
$100,000–$249,999	9.8	10.1	10.2	10.5	10.0	9.8	9.8	9.6	9.2	9.6
$250,000+	9.3	10.1	10.6	10.1	10.6	10.4	10.3	10.4	10.4	10.7

Source: Vanguard, 2015.

Deferral rates also are correlated with account balances. Participants with account balances of less than $10,000 had the lowest average deferral rate, 3.7% in 2014. As account balances rose, average deferral rates also rose. Overall, men and women appear to save at similar rates. But, as with participation rates, the overall averages understate the difference because they fail to account for women's lower incomes. Across every income group, women saved at rates that are 7% to 16% higher than those of men (**Figure 33**).

Deferral rates also vary—by about one-third—by industry group (**Figure 34**). Participants in the agriculture, mining, and construction industry group had the highest median deferral rates in 2014, while participants in the wholesale and retail trade group had the lowest deferral rates.

Impact of automatic enrollment

As noted previously, the increased adoption of automatic enrollment contributed to a deterioration in deferral rates in 2009 as compared with 2007. Plan design, specifically the predominant use of a 3% default deferral rate, means participants in plans with automatic enrollment are saving less.

Participants joining a plan under an automatic enrollment feature have an average deferral rate of 6.2%, compared with 7.3% for participants under plans with voluntary enrollment—a deferral rate that is about 15% lower overall (**Figure 35**). This is especially remarkable in light of the fact that participants earning less than $30,000 save about 30% more on average under voluntary enrollment designs. This suggests that higher default deferral rates would be amenable to plan participants in automatic enrollment designs. Our research on automatic enrollment indicates that "quit rates" do not deteriorate when higher default percentages are used to enroll employees.

Maximum contributors

During 2014, only 10% of participants saved the statutory maximum dollar amount of $17,500 ($23,000 for participants age 50 or older) (**Figure 36**). Participants who contributed the maximum dollar amount tended to have higher incomes, were older, had longer tenures with their current employer, and had accumulated substantially higher account balances.

One-third of participants with incomes of more than $100,000 contributed the maximum allowed. Similarly, nearly half of participants with account balances of more than $250,000 contributed the maximum allowed in 2014. One-quarter of participants older than 65 contributed the maximum.

Figure 33. Deferral rates by income and gender, 2014

Vanguard defined contribution plans permitting employee-elective deferrals

Average deferral rate

	Female	Male	All
<$30,000	4.7%	4.4%	4.6%
$30,000–$49,999	5.9	5.5	5.7
$50,000–$74,999	7.2	6.7	6.9
$75,000–$99,999	8.6	7.4	7.8
$100,000+	9.0	7.9	8.4

Source: Vanguard, 2015.

Figure 34. Deferral rates by industry sector, 2014

Vanguard defined contribution plans permitting employee-elective deferrals

Average deferral rate

	Mean	Median
Overall	6.9%	6.0%
Industry group		
Agriculture, mining, and construction	8.2%	7.5%
Media, entertainment, and leisure	6.4	4.7
Education and health	7.8	6.6
Business, professional, and nonprofit	8.3	7.2
Transportation, utilities, and communications	6.8	6.0
Manufacturing	6.7	5.9
Finance, insurance, and real estate	6.6	6.0
Wholesale and retail trade	6.0	4.7

Source: Vanguard, 2015.

Figure 35. Participant deferral rates by plan design, 2014

Vanguard defined contribution plans permitting employee-elective deferrals

Average deferral rates

	Voluntary enrollment	Automatic enrollment	All
All	7.3%	6.2%	6.9%
Income			
<$30,000	5.4%	3.7%	4.6%
$30,000–$49,999	6.2	5.1	5.7
$50,000–$74,999	7.0	6.7	6.9
$75,000–$99,999	7.8	8.1	7.8
$100,000+	8.4	8.3	8.4
Age			
<25	5.4%	3.8%	4.6%
25–34	5.9	5.0	5.6
35–44	6.6	5.7	6.3
45–54	7.5	6.8	7.3
55–64	8.9	8.2	8.7
65+	10.6	9.1	10.2
Gender			
Male	7.1%	6.2%	6.8%
Female	7.5	5.9	7.0
Job tenure (years)			
0–1	5.7%	4.0%	4.7%
2–3	6.3	6.1	6.2
4–6	7.1	6.9	7.0
7–9	7.2	7.1	7.2
10+	8.1	8.2	8.1
Account balance			
<$10,000	4.0%	3.4%	3.7%
$10,000–$24,999	5.9	6.1	6.1
$25,000–$49,999	7.2	6.9	7.1
$50,000–$99,999	8.2	7.8	8.1
$100,000–$249,999	9.8	9.0	9.6
$250,000+	10.7	10.6	10.7

Source: Vanguard, 2015.

Figure 36. Participants contributing the maximum by participant demographics, 2014

Vanguard defined contribution plans permitting employee-elective deferrals

	2014
All	10%
Income	
<$30,000	0%
$30,000–$49,999	1
$50,000–$74,999	2
$75,000–$99,999	6
$100,000+	34
Age	
<25	1%
25–34	3
35–44	8
45–54	13
55–64	18
65+	24
Gender	
Male	10%
Female	9
Job tenure (years)	
0–1	3%
2–3	6
4–6	9
7–9	10
10+	16
Account balance	
<$10,000	0%
$10,000–$24,999	1
$25,000–$49,999	5
$50,000–$99,999	9
$100,000–$249,999	17
$250,000+	45
Industry group	
Agriculture, mining, and construction	20%
Media, entertainment, and leisure	9
Education and health	16
Business, professional, and nonprofit	12
Finance, insurance, and real estate	12
Transportation, utilities, and communications	8
Manufacturing	7
Wholesale and retail trade	6

Source: Vanguard, 2015.

Catch-up contributions

EGTRRA authorized a higher catch-up contribution limit for participants age 50 and older to be adopted by plan sponsors at their discretion. More than 90% of Vanguard plans offered catch-up contributions in 2014. Sixteen percent of age-50-and-older participants eligible for catch-up contributions took advantage of this feature in 2014 (**Figure 37**). Participants earning less than $100,000 would need deferral rates higher than 20% of income in order to make catch-up contributions, suggesting that adoption of catch-up contributions by participants is actually quite strong.

The characteristics of participants making catch-up contributions are similar to those of participants making the maximum contribution to their plan. They tended to have higher incomes and had accumulated substantially higher account balances.

Four in 10 participants with incomes of more than $100,000 made catch-up contributions. Similarly, 4 in 10 participants with account balances of more than $250,000 made catch-up contributions in 2014.

Roth contributions

Roth contributions were originally introduced in EGTRRA and made permanent in PPA. At year-end 2014, the Roth feature was offered by 56% of Vanguard plans and had been adopted by 14% of participants in plans offering the feature (**Figure 38**). Those who used this feature tended to be younger and shorter-tenured participants.

Ten percent of plans offered Roth in-plan conversions, and less than 1% (0.6%) of participants with access to the option converted assets between 2010 and 2014.

After-tax contributions

After-tax employee-elective deferrals are available to participants in one-fifth of Vanguard plans. The after-tax feature is more likely to be offered by large plans and 4 in 10 participants have access to this feature. In 2014, only 7% of employees offered the after-tax deferral feature took advantage of it (**Figure 39**). Those who used the feature also tended to have higher incomes and were older, longer-tenured employees.

Figure 37. Catch-up contribution participation rates by participant demographics, 2014

Vanguard defined contribution plans permitting catch-up contributions

	2014
Percentage of plans offering	97%
Percentage of participants offered	98%
Percentage of participants using if offered	16%
Income	
<$30,000	0%
$30,000–$49,999	1
$50,000–$74,999	3
$75,000–$99,999	9
$100,000+	42
Gender	
Male	16%
Female	15
Job tenure (years)	
0–1	6%
2–3	11
4–6	13
7–9	14
10+	18
Account balance	
<$10,000	1%
$10,000–$24,999	2
$25,000–$49,999	5
$50,000–$99,999	8
$100,000–$249,999	15
$250,000+	42
Industry group	
Education and health	27%
Media, entertainment, and leisure	15
Business, professional, and nonprofit	18
Agriculture, mining, and construction	30
Transportation, utilities, and communications	14
Finance, insurance, and real estate	15
Manufacturing	8
Wholesale and retail trade	10

Source: Vanguard, 2015.

Figure 38. Roth participation rates by participant demographics, 2014

Vanguard defined contribution plans permitting Roth contributions

	2014
Percentage of plans offering	56%
Percentage of participants offered	64%
Percentage of participants using if offered	14%

Income	
<$30,000	13%
$30,000–$49,999	13
$50,000–$74,999	15
$75,000–$99,999	16
$100,000+	13

Age	
<25	21%
25–34	19
35–44	14
45–54	12
55–64	9
65+	6

Gender	
Male	14%
Female	14

Job tenure (years)	
0–1	17%
2–3	18
4–6	15
7–9	14
10+	10

Account balance	
<$10,000	16%
$10,000–$24,999	17
$25,000–$49,999	14
$50,000–$99,999	13
$100,000–$249,999	12
$250,000+	12

Industry group	
Business, professional, and nonprofit	14%
Agriculture, mining, and construction	18
Wholesale and retail trade	4
Education and health	13
Media, entertainment, and leisure	18
Transportation, utilities, and communications	14
Manufacturing	10
Finance, insurance, and real estate	23

Source: Vanguard, 2015.

Figure 39. After-tax participation rates by participant demographics, 2014

Vanguard defined contribution plans permitting after-tax contributions

	2014
Percentage of plans offering	18%
Percentage of participants offered	37%
Percentage of participants using if offered	7%

Income	
<$30,000	2%
$30,000–$49,999	4
$50,000–$74,999	5
$75,000–$99,999	6
$100,000+	12

Age	
<25	4%
25–34	6
35–44	7
45–54	7
55–64	8
65+	7

Gender	
Male	7%
Female	4

Job tenure (years)	
0–1	3%
2–3	6
4–6	7
7–9	7
10+	8

Industry group	
Agriculture, mining, and construction	26%
Finance, insurance, and real estate	2
Manufacturing	5
Business, professional, and nonprofit	8
Media, entertainment, and leisure	10
Education and health	2
Transportation, utilities, and communications	6
Wholesale and retail trade	14

Source: Vanguard, 2015.

Aggregate contributions

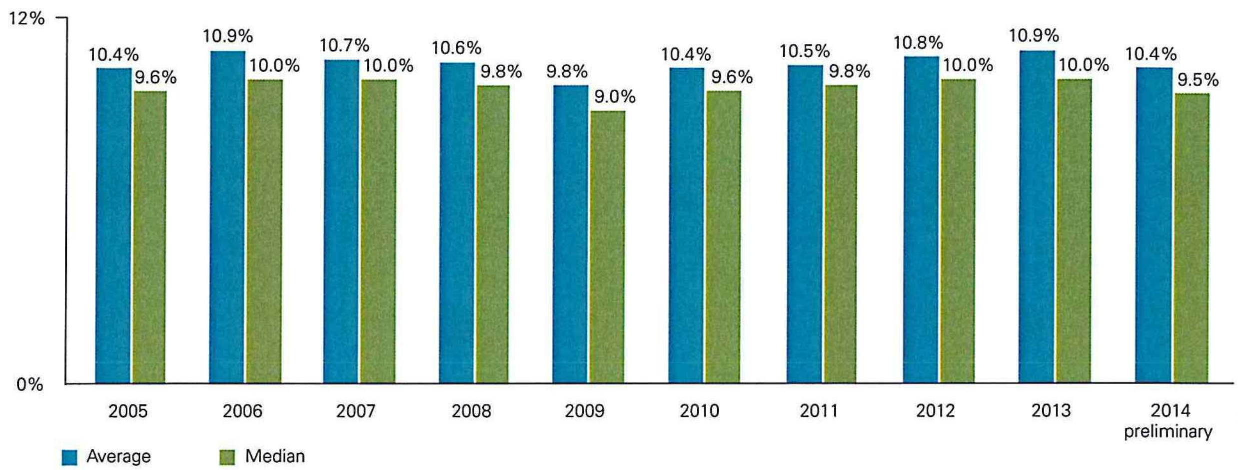
Taking into account both employee and employer contributions, the average total participant contribution rate in 2014 was 10.4% and the median was 9.5% (**Figure 40**). These rates exclude eligible nonparticipants. When eligible nonparticipants, with their 0% contribution rate, are included, the average aggregate contribution rate is 7.6% and the median is 6.2% (**Figure 41**). Aggregate contribution rates are generally rising over the 10-year period reflecting the rising adoption of automatic enrollment which results in fewer individuals deferring zero.

Distribution of aggregate contribution rates

Vanguard estimates that a typical participant should target a total contribution rate of 12% to 15%, including both employee and employer contributions. Four in 10 participants in 2014 had total employee and employer savings rates that met those thresholds or reached the statutory contribution limit (**Figure 42**). For participants with lower wages, Social Security is expected to replace a higher percentage of income and so a lower retirement savings rate may be appropriate. For higher-wage participants, Social Security replaces a lower percentage of income and savings rates may need to be higher. In fact, higher-wage participants may not be able to achieve sufficient savings rates within the plan because of statutory contribution limits.

Figure 40. Aggregate participant and employer contribution rates

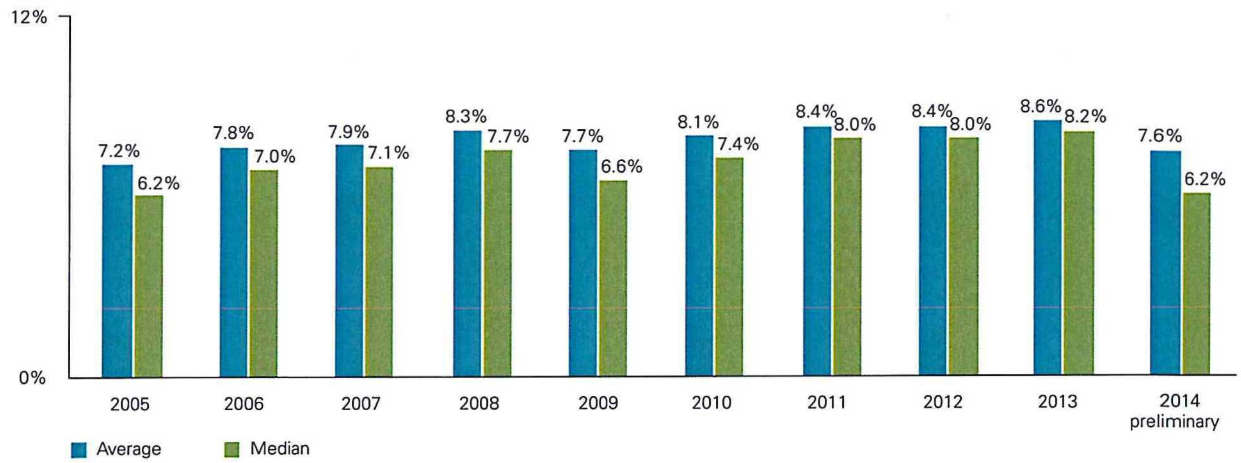
Vanguard defined contribution plans permitting employee-elective deferrals



Note: The previously reported average and median aggregate contribution rates for 2014 were 10.2% and 9.2%, respectively (see Figure 21 note).
Source: Vanguard, 2015.

Figure 41. Aggregate employee and employer contribution rates

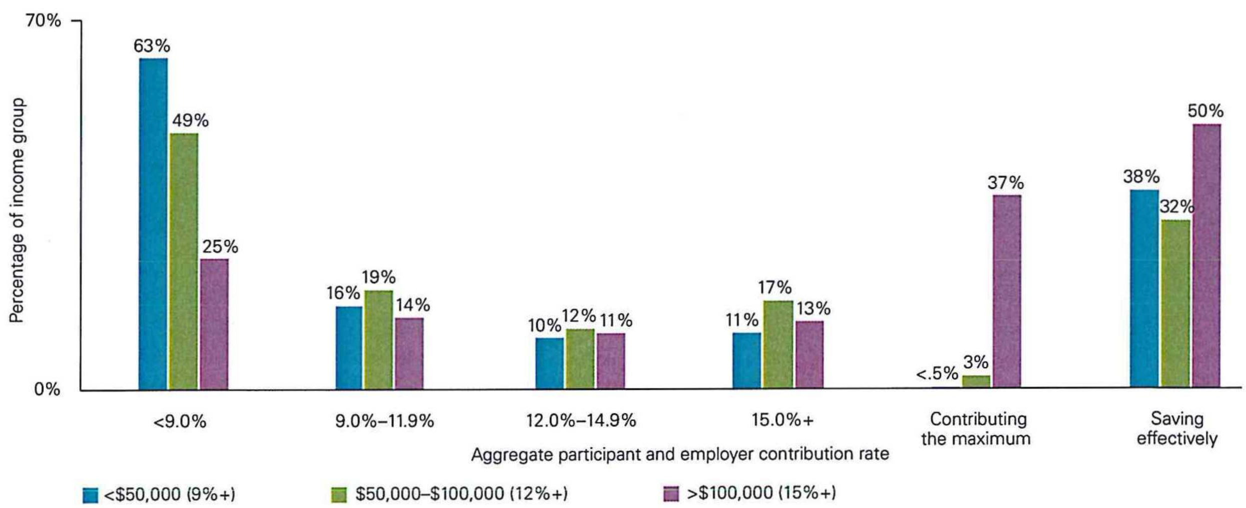
Vanguard defined contribution plans permitting employee-elective deferrals



Note: The previously reported average and median aggregate contribution rates for 2014 were 7.1% and 6.0%, respectively (see Figure 21 note).
Source: Vanguard, 2015.

Figure 42. Distribution of aggregate participant and employer contribution rates, 2014

Vanguard defined contribution plans permitting employee-elective deferrals



Note: The percentage noted after the income range is the total contribution rate recommended for effective savings.
Source: Vanguard, 2015.

Account balances

Account balances are a widely cited measure of the overall effectiveness of DC plans and are determined by contribution levels and investment performance over time.

Vanguard account balances are a measure of how much plan participants have accumulated for retirement at a given employer. In the United States, DC plans are not a closed system. When participants change jobs or retire, their plan assets may remain with the plan of the employer they are leaving, may be rolled over to another employer plan or to an IRA, or may be cashed out. As a result, current DC plan balances often do not reflect lifetime savings and are only a partial measure of retirement preparedness for most participants.

Average versus median balances

In 2014, the average account balance for Vanguard participants was $102,682; the median balance was $29,603 **(Figure 43)**. In 2014, Vanguard participants' average account balances rose by 1% and median account balances fell by 6%. The average 1-year participant total return was 7.0% in 2014 (see page 79).

The wide divergence between the median and the average balance is due to a small number of very large accounts that significantly raises the average above the median **(Figure 44)**. Three in 10 participants had a 2014 account balance of less than $10,000, while 27% had balances in excess of $100,000.

Because of the skewed distribution of assets, average balances are indicative of participants at about the 75th percentile (i.e., about 75% of all participants have balances below, and 25% have balances above the average). Average balances are more indicative of the results experienced by longer-tenured, more affluent, or older participants. The median balance represents the typical participant: Half of all participants have balances above the median, half have balances below.

Average account balances also vary somewhat by plan size, with smaller plans having slightly higher balances than larger plans **(Figure 45)**. Automatic enrollment is one factor driving differences in average balances—larger plans have been more likely to adopt automatic enrollment.

Figure 43. Account balances

Vanguard defined contribution plans

Source: Vanguard, 2015.

Figure 44. Distribution of account balances

Vanguard defined contribution plans

Percentage of accounts

Range of balance	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
<$10,000	33%	32%	33%	39%	34%	31%	32%	31%	30%	31%
$10,000–$19,999	13	13	12	14	13	13	13	12	12	11
$20,000–$39,999	15	15	14	14	15	15	14	14	14	13
$40,000–$59,999	9	9	9	8	9	9	9	9	8	8
$60,000–$79,999	6	6	6	6	6	6	6	6	6	6
$80,000–$99,999	5	4	4	4	4	5	4	4	4	4
>$100,000	19	21	22	15	19	21	22	24	26	27

Source: Vanguard, 2015.

Figure 45. Account balances by plan size

Vanguard defined contribution plans

Number of participants

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Average										
<1,000	$73,032	$81,124	$83,988	$63,065	$77,875	$87,637	$88,834	$99,294	$117,680	$123,472
1,000–4,999	$61,997	$69,118	$72,811	$52,516	$66,210	$75,038	$76,613	$85,385	$99,389	$101,376
>5,000	$70,068	$78,234	$80,127	$56,331	$68,648	$79,178	$77,030	$84,285	$99,883	$100,070
All Plans	$67,856	$75,791	$78,411	$56,030	$69,084	$79,077	$78,276	$86,212	$101,650	$102,682
Median										
<1,000	$25,882	$27,770	$27,095	$20,403	$26,729	$30,816	$30,755	$33,474	$37,749	$37,418
1,000–4,999	$22,859	$24,753	$24,254	$16,834	$22,824	$26,427	$23,217	$29,283	$32,603	$30,710
>5,000	$23,945	$26,216	$25,260	$17,102	$22,593	$26,401	$24,414	$26,453	$30,024	$28,197
All plans	$23,851	$25,953	$25,196	$17,399	$23,140	$26,926	$25,550	$27,843	$31,396	$29,603

Source: Vanguard, 2015.

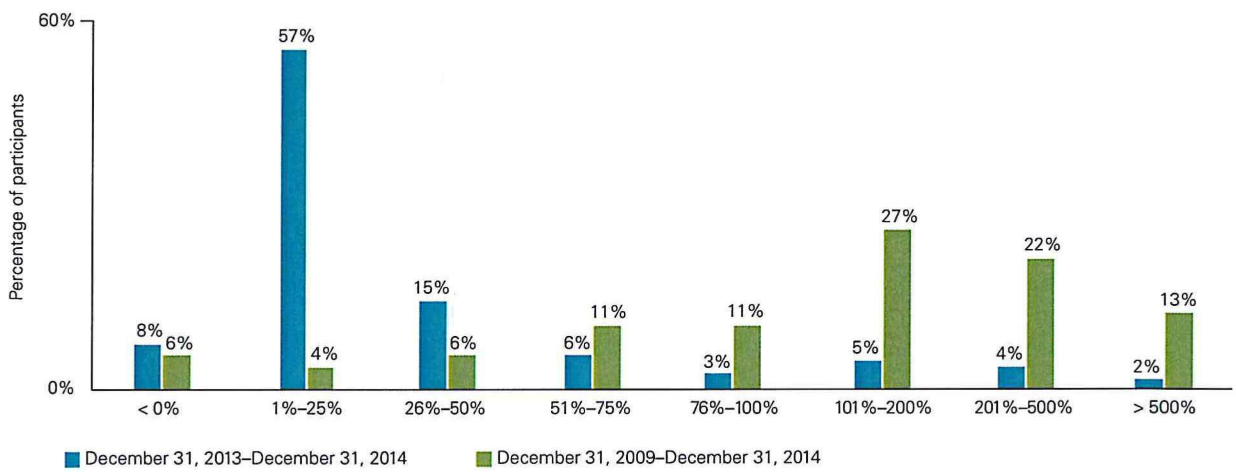
Change in account balances

The change in average and median account balances in 2014 is the result of evolution in the participant base and market performance. When we examine continuous participants—those with an account balance in both December 2013 and December 2014—the median account balance rose by 16% (**Figure 46**). Ninety-two percent of these continuous participants saw their balances rise because of equity-oriented asset allocations and/or ongoing contributions. Among continuous participants with a balance in both December 2009 and December 2014—the median account balance rose 137%, and 94% of continuous participants had a higher account balance in 2014 than in 2009.

Account balances are widely available on statements and websites, and are often cited as participants' principal tool for monitoring investment results. Because of ongoing contributions, account balances will appear to be less negatively impacted during falling markets. This "contribution effect" may mask the psychological impact of falling stock prices on participants.

Figure 46. Change in account balances, continuous participants

Vanguard defined contribution plan participants with a balance at both the beginning and end of the period



	December 31, 2013–December 31, 2014	December 31, 2009–December 31, 2014
Median change	16%	137%
Percentage of participants with positive changes	92	94

Source: Vanguard, 2015.

Account balances by participant demographics

Median and average account balances vary considerably by participant demographics (Figure 47). Among the factors influencing account balances are income, age, and job tenure. These three factors are intertwined. Not only do incomes, on average, tend to rise somewhat with age, making saving more affordable, but older participants generally save at higher rates. Also, the longer an employee's tenure with a firm, the more likely the employee is to earn a higher salary, participate in the plan, and contribute at higher levels. Longer-tenured participants also have higher balances because they have been contributing to their employer's plan for a longer period.

Gender also influences current balances. Sixty percent of Vanguard participants are male, and men have average and median balances that are about 50% higher than those of women. Gender is often a proxy for other factors, such as income and job tenure. Women in our sample tend to have lower incomes and shorter job tenure than men. However, as noted earlier in this report, women tend to save more than men at the same income level.

Figure 47. Account balances by participant demographics, 2014

Vanguard defined contribution plans

	All participants	
	Average	Median
All	$102,682	$29,603
Income		
<$30,000	$11,383	$1,390
$30,000–$49,999	$30,849	$9,038
$50,000–$74,999	$60,322	$24,680
$75,000–$99,999	$102,610	$47,798
>$100,000	$226,654	$125,519
Age		
<25	$4,141	$1,430
25–34	$24,378	$9,313
35–44	$65,767	$26,681
45–54	$124,287	$50,925
55–64	$186,404	$76,618
>65	$208,158	$72,845
Gender		
Male	$123,262	$36,875
Female	$79,572	$24,446
Job tenure (years)		
0–1	$10,567	$2,308
2–3	$25,867	$11,005
4–6	$51,193	$24,583
7–9	$81,421	$41,396
>10	$195,609	$99,379

Source: Vanguard, 2015.

A different picture emerges when account balances are compared based on income. When income is less than $100,000, women generally have average and median account balances higher than those of men (Figure 48). For example, female participants with income between $30,000 and $49,999 have average account balances that are 18% higher than their male counterparts, and median balances that are about 50% higher.

Balances by industry group

There are significant variations in account balances by industry sector, which reflect a complex mixture of firm characteristics (influencing employer contributions) and workforce demographics (influencing participant savings rates). Participants employed in the agriculture, mining, and construction industry group have average and median account balances that are about three to four times higher than other participants (Figure 49). Participants employed in the education and health industry group have the lowest average and median account balances.

Figure 48. Account balances by income and gender, 2014

Vanguard defined contribution plans permitting employee-elective deferrals

Average	Female	Male	All
<$30,000	$12,169	$11,686	$11,383
$30,000–$49,999	$34,520	$29,178	$30,849
$50,000–$74,999	$60,184	$60,411	$60,322
$75,000–$99,999	$106,194	$97,660	$102,610
$100,000+	$191,877	$225,872	$226,654
Median			
<$30,000	$1,693	$1,244	$1,390
$30,000–$49,999	$11,641	$7,714	$9,038
$50,000–$74,999	$25,977	$24,427	$24,680
$75,000–$99,999	$54,483	$45,678	$47,798
$100,000+	$118,283	$129,794	$125,519

Source: Vanguard, 2015.

Figure 49. Balances by industry sector, 2014

Vanguard defined contribution plans

	Average	Median
All	$102,682	$29,603
Agriculture, mining, and construction	$229,220	$67,367
Manufacturing	$106,171	$37,031
Business, professional, and nonprofit	$117,987	$36,237
Finance, insurance, and real estate	$100,447	$33,795
Transportation, utilities, and communications	$89,744	$27,397
Wholesale and retail trade	$84,005	$22,654
Media, entertainment, and leisure	$75,327	$21,796
Education and health	$69,264	$17,191

Source: Vanguard, 2015.

2 Managing participant accounts

Participant investment decisions are a critical determinant of long-term retirement savings growth.

2 Managing participant accounts

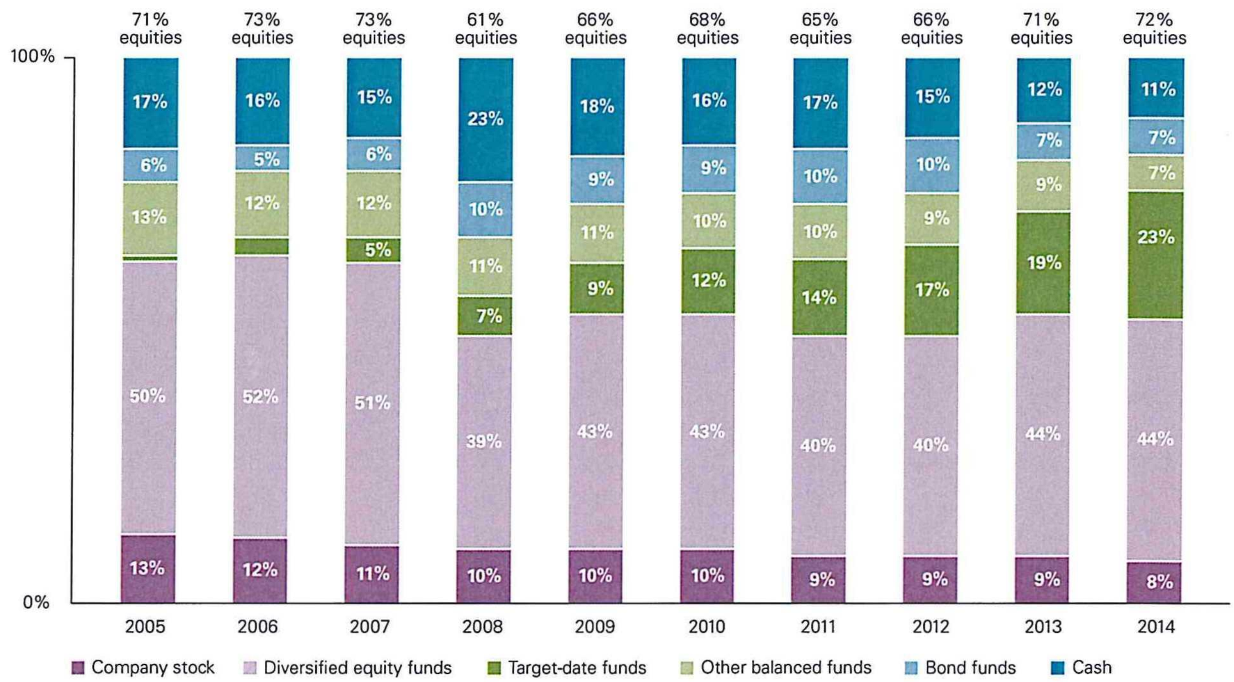
Participant investment decisions are a critical determinant of long-term retirement savings growth.

Asset and contribution allocations

The percentage of plan assets invested in equities stood at 72% in 2014 (**Figure 50**). The allocation to equities includes the equity component of balanced strategies. The overall equity allocation is up from 61% in 2008, a shift of 11 percentage points, due to the rise in equity markets from the 2008–2009 downturn as well as improved participant portfolio construction. Equity allocations have nearly returned to their pre-recession peak of 73%. In 2014, investment in balanced strategies reached 30%, including 23% in target-date funds and 7% in other balanced options. The growth of target-date funds in particular is dramatically reshaping investment patterns in DC plans, increasing age-appropriate equity allocations and reducing extreme allocations.

Figure 50. Plan asset allocation summary

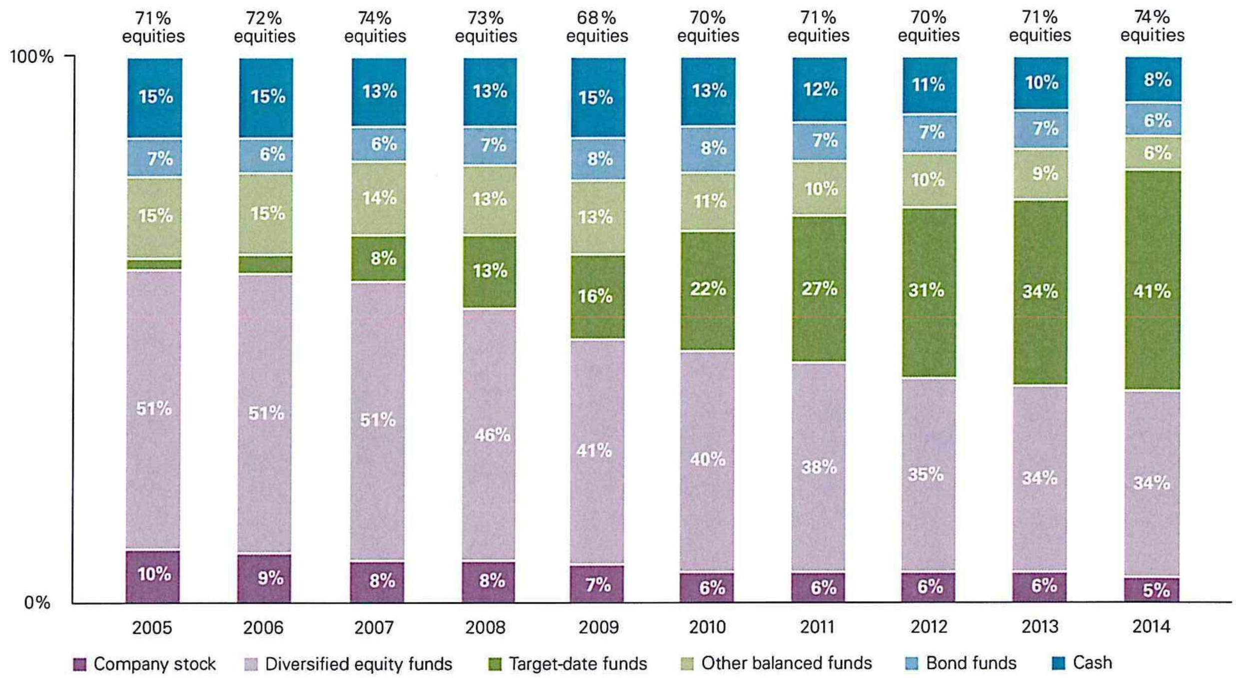
Vanguard defined contribution plans



Source: Vanguard, 2015.

Figure 51. Plan contribution allocation summary

Vanguard defined contribution plans



Source: Vanguard, 2015.

Three-quarters of plan contribution dollars were invested in equities during 2014 and 4 in 10 plan contribution dollars were invested in target-date funds (**Figure 51**). Participant contribution allocations to equities returned to their pre-recession peak of 74%.

Asset allocation by participant demographics

The average participant-weighted asset allocation to equities was 74% in 2014 and asset allocation decisions vary somewhat by participant demographics (**Figure 52**). In the past, higher-income participants tended to take on somewhat more equity market risk on average than lower-income participants. However, with the rising adoption of target-date funds, the differences are no longer discernible. In 2014, participants with household incomes of less than $30,000 had 71% of their average account balance allocated to equities; for participants with household incomes of more than $100,000, the figure was 72%.

Participants younger than age 45 had the highest equity exposure, with nearly 90% of plan assets, at the median, invested in equities in 2014. Equity allocations were lowest for participants older than age 65, many of whom are currently retired or will soon retire. Participants older than age 65 had a median equity allocation of 51%. The age-related variation in equity exposure has changed markedly due to the rising use of target-date funds (see page 70).

Figure 52. Asset allocation by participant demographics, 2014

Vanguard defined contribution plans

	Company stock	Diversified equity funds	Target-date funds	Other balanced funds	Bond funds	Cash	Average equity participant-weighted	Median equity participant-weighted
All asset-weighted	8%	44%	23%	7%	7%	11%		
Average participant-weighted	4%	26%	50%	6%	5%	9%	74%	83%
Household income								
<$30,000	10%	37%	25%	7%	7%	14%	71%	83%
$30,000–$49,999	8	39	25	8	7	13	72	83
$50,000–$74,999	8	42	24	7	7	12	72	82
$75,000–$99,999	8	44	22	7	8	11	72	80
$100,000+	7	48	19	8	8	10	72	80
Age								
<25	5%	14%	73%	4%	2%	2%	87%	90%
25–34	5	31	52	5	4	3	84	90
35–44	5	47	31	7	5	5	80	88
45–54	7	49	22	7	7	8	72	76
55–64	9	41	19	8	9	14	61	64
65+	9	35	15	8	10	23	49	51
Gender								
Male	9%	44%	22%	7%	7%	11%	74%	83%
Female	6	43	25	8	8	10	73	83
Job tenure (years)								
0–1	4%	32%	50%	4%	4%	6%	81%	90%
2–3	4	32	50	4	5	5	79	90
4–6	5	36	42	5	6	6	76	84
7–9	6	43	32	6	6	7	74	83
10+	9	46	17	7	8	13	67	75
Account balance								
<$10,000	4%	12%	71%	4%	3%	6%	77%	90%
$10,000–$24,999	4	21	57	5	4	9	74	83
$25,000–$49,999	4	28	47	6	5	10	73	83
$50,000–$99,999	5	35	36	7	6	11	72	80
$100,000–$149,999	5	40	29	8	7	11	72	80
$150,000–$199,999	5	44	25	8	7	11	72	80
$200,000–$249,999	5	46	23	8	7	11	72	79
$250,000+	10	48	16	7	8	11	72	78

Source: Vanguard, 2015.

Asset allocation by plan size and industry sector

The average allocation to equities does not vary significantly by plan size (Figure 53). However among larger plans, there is a substitution of company stock holdings for diversified equity funds and a modestly larger allocation to equities overall. Large plans are more likely than small plans to offer company stock and are more likely to make employer-matching or other contributions in stock. As a result, certain large firms have significantly higher exposure to company stock as an asset class.

Company stock accounted for 8% of assets for all DC plans at Vanguard in 2014. Among large plans, 11% of assets were allocated to company stock at year-end 2014, compared with a 1% allocation among small plans. These averages include plans offering—and plans not offering—company stock. The averages for those plans actively offering company stock to participants were higher (see page 76).

Figure 53. **Asset allocation by plan size, 2014**

Vanguard defined contribution plans

	Plan participants			
	<1,000	1,000–4,999	5,000+	All plans
Total equity asset-weighted	70%	70%	73%	72%
Company stock	1%	3%	11%	8%
Diversified equity	47	45	42	44
Target-date funds	23	8	7	23
Other balanced funds	10	25	22	7
Bond funds	8	7	7	7
Cash	11	12	11	11

Source: Vanguard, 2015.

Balanced funds, including target-date funds, accounted for 30% of assets for all DC plans at Vanguard in 2014. Among small plans, one-third of assets were allocated to balanced funds at year-end 2014, compared with 29% among large plans.

Overall asset allocations also vary by industry group (Figure 54). Participants in the manufacturing industry group have the most conservative allocations, while participants in the agriculture, mining, and construction industry group have the most aggressive allocations and the highest allocations to company stock.

Plan investment options

Participant investment decisions in DC plans occur within the context of a set or a menu of choices offered by the employer.

Number of options offered

The average Vanguard plan offered 27.3 investment options in 2014, essentially unchanged from 26.9 investment options in 2013 but up from 18.6 options in 2005—an increase of 47% (Figure 55).

The growth in the number of funds offered has been influenced by the increased use of "all-in-one" funds such as target-date funds, which are offered as a series of options. When each distinct target-date (or target-risk) fund is counted as a single offering, the average number of investment options for 2014 is 27. But when an entire series of such funds is counted as a single offering, the average number of investment options offered falls to 18. By this measure, sponsors have added one series of target-date (or target-risk) funds and one or two other investment options since 2005—not the nine additional options implied by the aggregate number.

Despite the modest expansion of funds offered—the number of funds used by participants has declined.

Figure 54. Asset allocation by industry sector, 2014

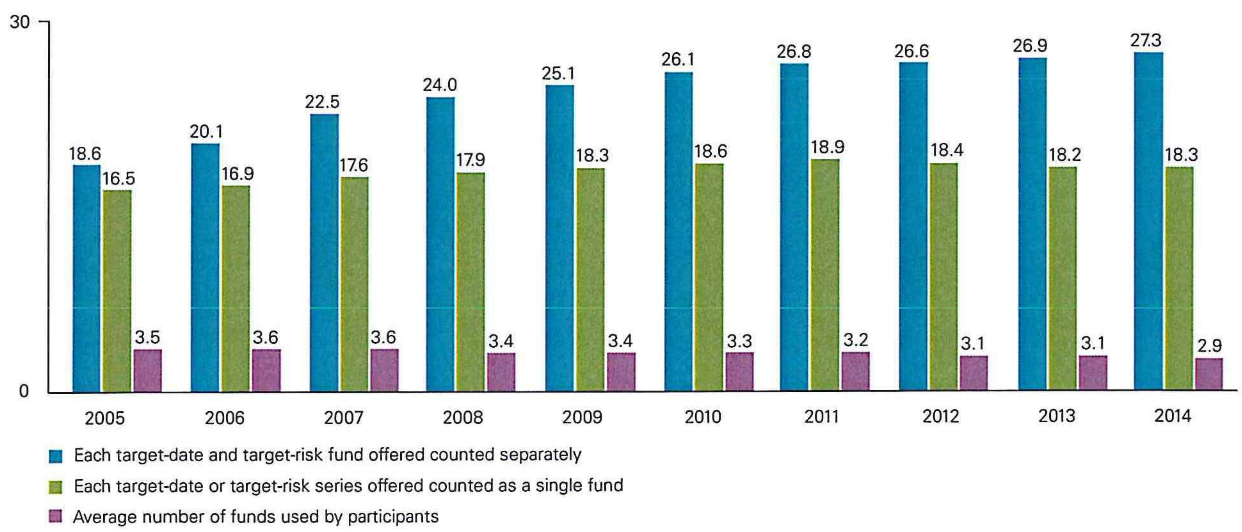
Vanguard defined contribution plans

	Company stock	Diversified equity funds	Target-date funds	Other balanced funds	Bond funds	Cash	Average equity participant-weighted	Median equity participant-weighted
All asset-weighted	8%	44%	23%	7%	7%	11%		
Average participant-weighted	4%	26%	50%	6%	5%	9%	74%	83%
Industry group								
Agriculture, mining, and construction	31%	32%	15%	3%	7%	12%	77%	88%
Business, professional, and nonprofit	5	48	23	7	8	9	75	84
Transportation, utilities, and communications	9	45	18	8	7	13	76	83
Media, entertainment, and leisure	2	46	26	11	7	8	75	83
Finance, insurance, and real estate	3	47	25	5	9	11	73	83
Education and health	0	47	26	9	10	8	73	83
Wholesale and retail trade	2	44	27	6	7	14	72	83
Manufacturing	6	43	25	8	6	12	72	82

Source: Vanguard, 2015.

Figure 55. Average number of investment options offered and used

Vanguard defined contribution plans



Source: Vanguard, 2015.

Counting a target-date or target-risk series as a single fund offering, the median plan sponsor offered 16 investment options in 2014. In 2014, 11% of plans offered more than 25 distinct investment options, while 12% of plans offered 10 or fewer (Figure 56).

Types of options offered

Virtually all Vanguard DC plans offer an array of investment options covering four major investment categories: equities, bonds, balanced (including target-date and target-risk strategies), and money market or stable value options (Figure 57). Given most sponsors' desire to promote equity-oriented portfolios for retirement, diversified equity funds continued to be the most popular type of fund offered. Equity offerings typically included both indexed and actively managed U.S. stock funds, including large-capitalization and mid- or small-capitalization stocks, as well as one or more international funds.

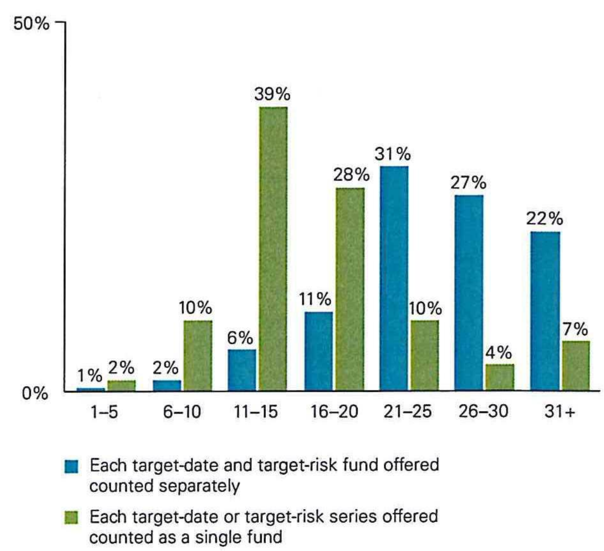
Virtually all plans offered international equity funds, but only 29% offered separate emerging markets funds. Many of the broader international funds include emerging markets exposure already, as do target-date and some balanced strategies. One-third of plans offered sector funds, such as technology or health care funds. One in 7 plans offered a self-directed brokerage feature. Meanwhile, plan sponsor interest in target-date funds continued to grow. At year-end 2014, 88% of plans offered target-date funds.

The types of investment options offered do not vary substantially by plan size. However, large plans are much more likely than small plans to offer company stock, self-directed brokerage accounts, and managed account programs. In addition, larger plans have been quicker than smaller plans to add target-date and inflation-protected securities funds.

Figure 56. **Number of options offered, 2014**

Vanguard defined contribution plans

Percentage of plans offering



Source: Vanguard, 2015.

Figure 57. Type of investment options offered, 2014

Vanguard defined contribution plans

Percentage of plans offering

		Number of participants		
	All	<1,000	1,000–4,999	5,000+
Cash	99%	98%	>99.5%	>99.5%
Money market	71	73	68	73
Stable value/Investment contract	57	55	64	57
Bond funds	98%	98%	99%	99%
Active	69	67	74	75
Index	89	89	87	92
Inflation-protected securities	33	32	34	45
High-yield	18	18	19	22
International	13	12	15	13
Balanced funds	99%	99%	99%	100%
Traditional balanced	74	75	70	69
Target-risk	21	23	16	17
Target-date	88	85	96	98
Equity funds	99%	99%	>99.5%	100%
Domestic equity funds	99%	99%	>99.5%	100%
Active domestic	94	94	96	93
Index domestic	98	98	99	99
Large-cap value	92	92	93	86
Large-cap growth	92	91	95	86
Large-cap blend	98	98	99	99
Mid-cap	89	88	91	86
Small-cap	87	87	91	80
Socially responsible	9	8	10	21
International equity funds	97%	97%	98%	98%
Active international	85	84	87	86
Index international	62	60	65	75
Emerging markets	29	28	30	37
Sector funds	33%	35%	30%	27%
REIT	28	29	27	26
Health care	12	13	9	13
Energy	8	8	6	10
Precious metals	5	4	4	9
Technology	2	2	2	3
Communications	1	1	<0.5	3
Natural resources	1	1	<0.5	2
Utilities	1	1	1	1
Financials	<0.5	1	<0.5	1
Company stock	10%	4%	20%	35%
Self-directed brokerage	16%	12%	16%	27%
Managed account program	22%	11%	45%	55%

Source: Vanguard, 2015.

Index core

A newer development in investment menu design is offering a passive (or index) "core." A passive core is a comprehensive set of low-cost index options that span the global capital markets. At a minimum, a passive core in our definition consists of four options covering U.S. equities, non-U.S. equities, U.S. taxable bonds, and cash. A passive core of these four options offers participants broad diversification, varying levels of risk exposure, and very low investment costs.

In 2014, half of Vanguard plans offered at least four options within a passive core (Figure 58). Because larger plans have been quicker to offer this approach, nearly two-thirds of Vanguard participants were offered a passive core in 2014. In addition, many of these plans also offered a passive target-date fund to further simplify participant portfolio construction. Nearly half of plans offered both a passive core and passive target-date funds, and 6 in 10 participants had access to these fund lineups. In 2005, about 3 in 10 plans offered a passive core and only 1 in 10 offered both a passive core and passive target-date funds (Figure 59). In 2005, one-third of participants were offered a passive core and only 1 in 10 was offered both a passive core and passive target-date funds (Figure 60).

Figure 58. Index core offered, 2014

Vanguard defined contribution plans

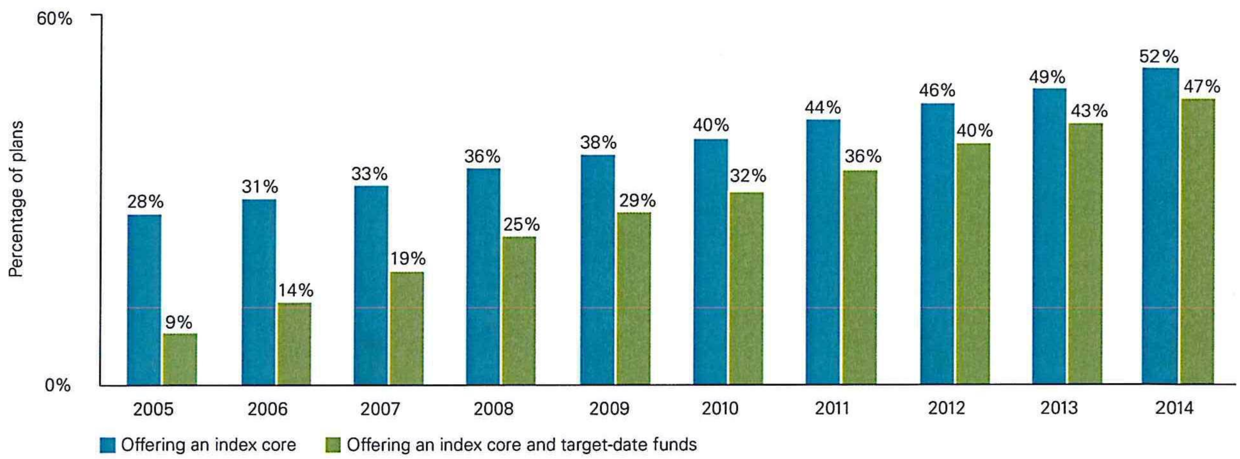
		Number of participants		
	All	<1,000	1,000–4,999	5,000+
Percentage of plans offering an index core	52%	49%	55%	71%
Percentage of plans offering an index core and target-date funds	47	43	53	69
Percentage of participants offered an index core	64	53	55	69
Percentage of participants offered an index core and target-date funds	62	49	53	68

An index core includes broadly diversified index funds for U.S. stocks, U.S. bonds, and international stocks. At a minimum, the definition includes index funds for large-cap U.S. stocks, intermediate or long-term bonds, and developed markets.

Source: Vanguard, 2015.

Figure 59. Index core offered trend, plans

Vanguard defined contribution plans

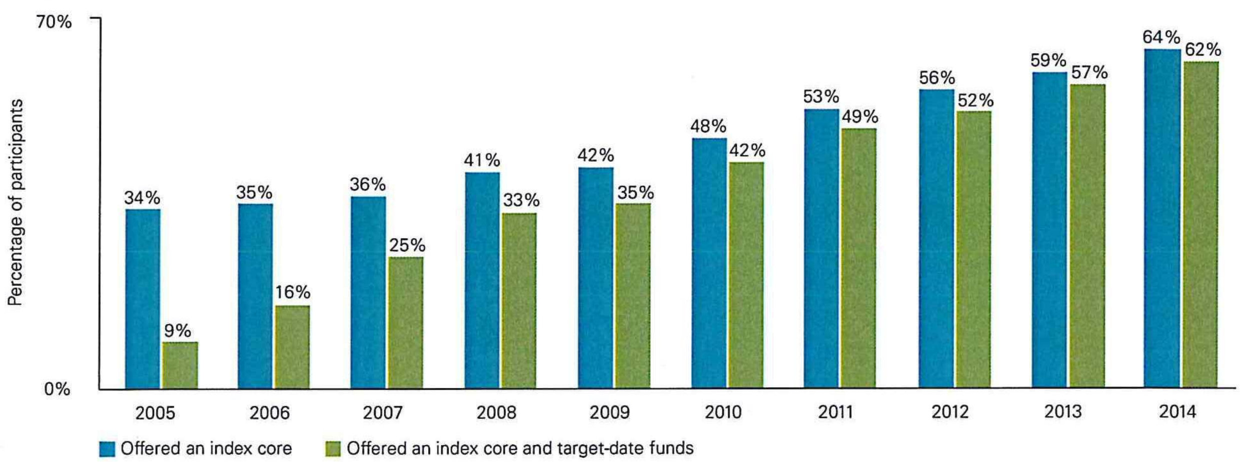


An index core includes broadly diversified index funds for U.S. stocks, U.S. bonds, and international stocks.

Source: Vanguard, 2015.

Figure 60. Index core offered trend, participants

Vanguard defined contribution plans



An index core includes broadly diversified index funds for U.S. stocks, U.S. bonds, and international stocks.

Source: Vanguard, 2015.

Default funds

Increasingly, participants are being directed into default investments selected by the plan sponsor, rather than making active investment choices on their own. Default investing is rising in importance in response to concerns about the lack of investment knowledge among participants, as well as the growing use of automatic enrollment. In response to these developments, the U.S. Department of Labor (DOL), acting under the PPA, authorized three types of default investments as eligible for special fiduciary protection. These options, known as QDIAs, include target-date funds, other balanced funds, and managed account advisory services.

Nearly all Vanguard plans have designated a default fund and 8 in 10 had selected a target-date or balanced fund option as the default option in 2014 (Figure 61). In 2005, 6 in 10 plan sponsors had designated a money market or stable value fund as the default option (Figure 62).

Seventy-one percent of plans in 2014 had specifically designated a QDIA under the DOL's regulations. Typically, these were plans with automatic enrollment or employer contributions other than a match. Among plans choosing a QDIA, 94% of designated QDIAs were target-date funds and 6% were balanced funds. Less than 1% of plans selected a managed account advisory service as a QDIA.

Number of options used

Although sponsors tend to offer a large menu of investment choices, nearly half of participants used only one fund (Figure 63). The average Vanguard participant used 2.9 options in 2014 and the median participant used 2.0 options—fewer than the 3.5 options used on average in 2005 and the median of 3.0 in 2005.

Figure 61. Default fund designations, 2014

Vanguard defined contribution plans

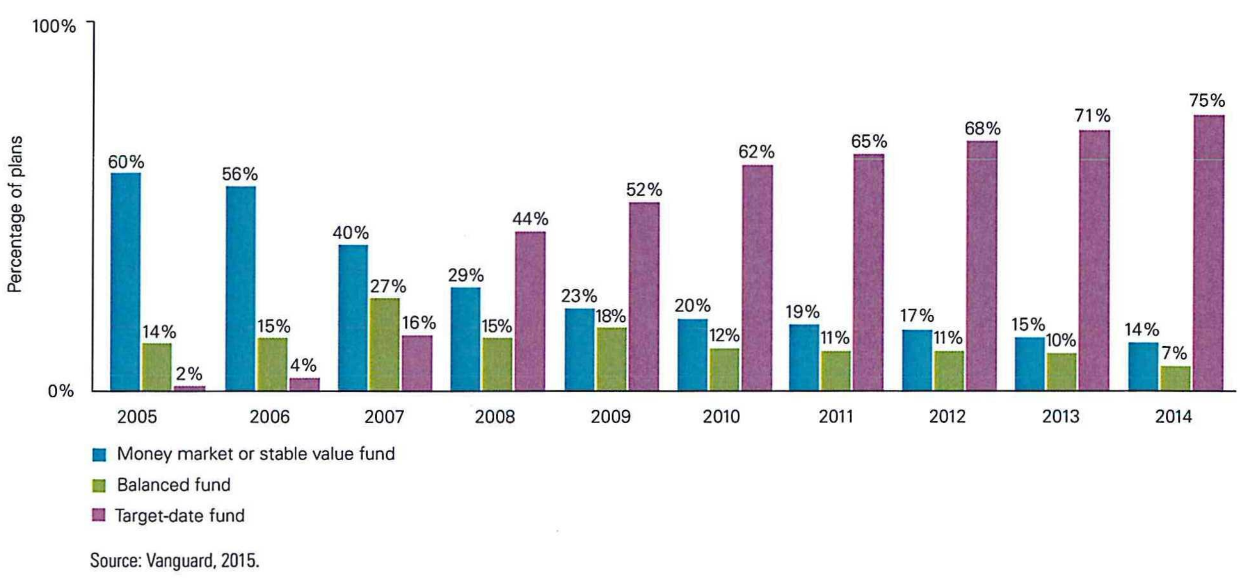
	QDIA plans	Non-QDIA plans	All plans
Among all plans			
Target-date fund	67%	8%	75%
Balanced fund	4	3	7
Money market or stable value		14	14
Total plans designating default	**71%**	**25%**	**96%**

Among plans designating a QDIA	
Target-date fund	94%
Balanced fund	6
Total plans designating a QDIA	**100%**

Source: Vanguard, 2015.

Figure 62. Default fund designation trend

Vanguard defined contribution plans



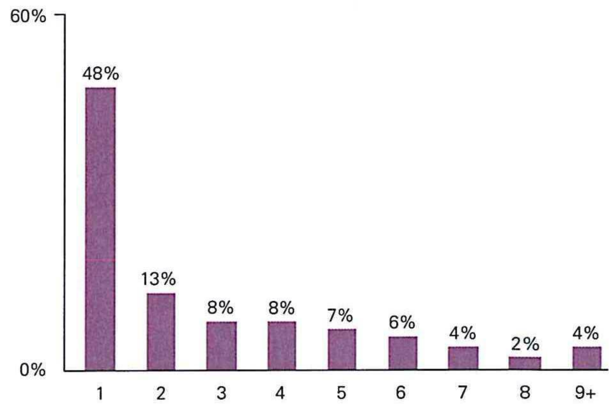
Source: Vanguard, 2015.

One reason for this change is the growing number of single target-date fund investors. In 2014, nearly half of participants held a single-fund option in their account (Figure 64). Eight in 10 of these participants were invested in a single target-date fund and 5% were invested in either traditional balanced funds or target-risk funds. Since 2005, the percentage of single-fund investors holding cash investments has declined from 42% to 8% due to the growth of automatic enrollment, the availability of target-date funds, and a shift in default fund designations by employers.

Figure 63. **Number of options used, 2014**

Vanguard defined contribution plans

Percentage of participants using

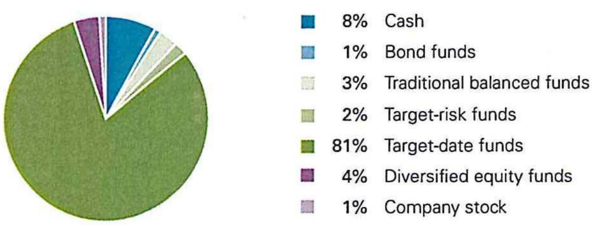


Source: Vanguard, 2015.

Figure 64. **Single-fund holders, 2014**

Vanguard defined contribution plans

Percentage of single-fund participants using



Vanguard defined contribution plans

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Percentage of participants holding a single fund	27%	28%	30%	34%	35%	37%	41%	43%	44%	48%
Percentage of single-fund participants using										
Cash	42%	41%	33%	27%	23%	18%	16%	14%	11%	8%
Bond funds	3	2	2	2	2	1	1	1	1	1
Traditional balanced funds	8	9	8	6	6	5	5	4	3	3
Target-risk funds	15	15	16	14	13	11	10	9	10	2
Target-date funds	6	13	25	39	45	53	59	64	69	81
Diversified equity funds	16	15	12	9	8	7	5	4	4	4
Company stock	10	5	4	3	3	5	4	4	2	1

Source: Vanguard, 2015.

Types of options used

Among the options offered by DC plans, which do participants actually use? In 2014, a balanced fund (including target-date and other balanced funds) was the most common participant holding (76% of participants), followed by a diversified domestic equity fund (41% of participants) (Figure 65). Among the balanced options held, target-date funds were overwhelmingly more likely to be held (two-thirds of participants offered) than traditional balanced funds (21% of participants offered) or target-risk funds (13% of participants offered). Before 2008, participants were most likely to hold a diversified domestic equity fund. This trend shift was first observed in 2009.

Nearly all participants were offered a U.S. equity index fund, yet only one-third used that option. However, participants holding balanced strategies (whether traditional, target-date, or target-risk) are often holding substantial equity index exposure. When participants holding index investments through all balanced options are factored in, 82% of Vanguard participants hold some U.S. equity index exposure.

Only about one-quarter of participants chose to hold a bond fund and about one-quarter also chose a money market or stable value cash investment.

Most Vanguard DC participants were offered a stand-alone international equity fund, but only one-quarter of participants chose to use one. Emerging markets funds were offered and used even less frequently; 3 in 10 participants had access to them and only 7% of those chose to use one. Increasingly, international equity exposure is occurring through packaged investment programs, such as target-date funds.

Sector funds were offered to almost one-quarter of participants in 2014 and were also used infrequently; only 12% of participants who were offered these funds used them.

Three in 10 Vanguard participants were offered a self-directed brokerage feature. Self-directed brokerage accounts allow participants to choose investments from thousands of individual stocks, bonds, and mutual funds. In plans offering a self-directed brokerage feature, only 1% of these participants used the feature in 2014. In these plans, about 1% of plan assets were invested in the self-directed brokerage feature in 2014.

Figure 65. Type of investment options offered and used, 2014

Vanguard defined contribution plans

	Percentage of plans offering	Percentage of participants offered	Percentage of participants offered using	Percentage of all participants using
Cash	99%	>99.5%	23%	23%
Money market	71	70	15	11
Stable value/Investment contract	57	63	21	13
Bond funds	98%	99%	23%	23%
Active	69	75	12	9
Index	89	91	18	16
Inflation-protected securities	33	41	4	2
High-yield	18	17	6	1
International	13	12	3	<0.5
Balanced funds	99%	>99.5%	76%	76%
Traditional balanced	74	72	21	15
Target-risk	21	15	13	2
Target-date	88	97	66	64
Equity funds	99%	>99.5%	43%	43%
Domestic equity funds	99%	>99.5%	41%	41%
Active domestic	94	95	29	27
Index domestic	98	98	33	32
Large-cap value	92	91	16	15
Large-cap growth	92	91	19	18
Large-cap blend	98	98	28	27
Mid-cap	89	82	19	16
Small-cap	87	80	15	12
Socially responsible	9	19	3	<0.5
International equity funds	97%	98%	24%	24%
Active international	85	87	18	16
Index international	62	69	15	11
Emerging markets	29	30	7	2
Sector funds	33%	24%	12%	3%
REIT	28	23	8	2
Health care	12	9	9	1
Energy	8	7	7	1
Precious metals	5	5	2	<0.5
Technology	2	3	9	<0.5
Communications	1	2	5	<0.5
Natural resources	1	2	3	<0.5
Utilities	1	1	5	<0.5
Financials	<0.5	2	3	<0.5
Company stock	10%	27%	52%	14%
Self-directed brokerage	16%	28%	1%	<0.5%
Managed account program	22%	55%	7%	4%

Source: Vanguard, 2015.

Professionally managed allocations

The most notable effect of plan investment menus on participant choices is the expanded offering and use of professionally managed allocations. Participants with professionally managed allocations have their entire account balance invested solely in a single target-date, target-risk, or traditional balanced fund, or a managed account advisory service.

In 2014, 45% of Vanguard participants were invested in a professionally managed allocation (**Figure 66**). Driving this development is the growing use of target-date funds. A total of 39% of participants were invested in a single target-date fund in 2014. Among new plan entrants (those entering the plan for the first time), three-quarters of participants were invested in a single target-date fund (**Figure 67**).

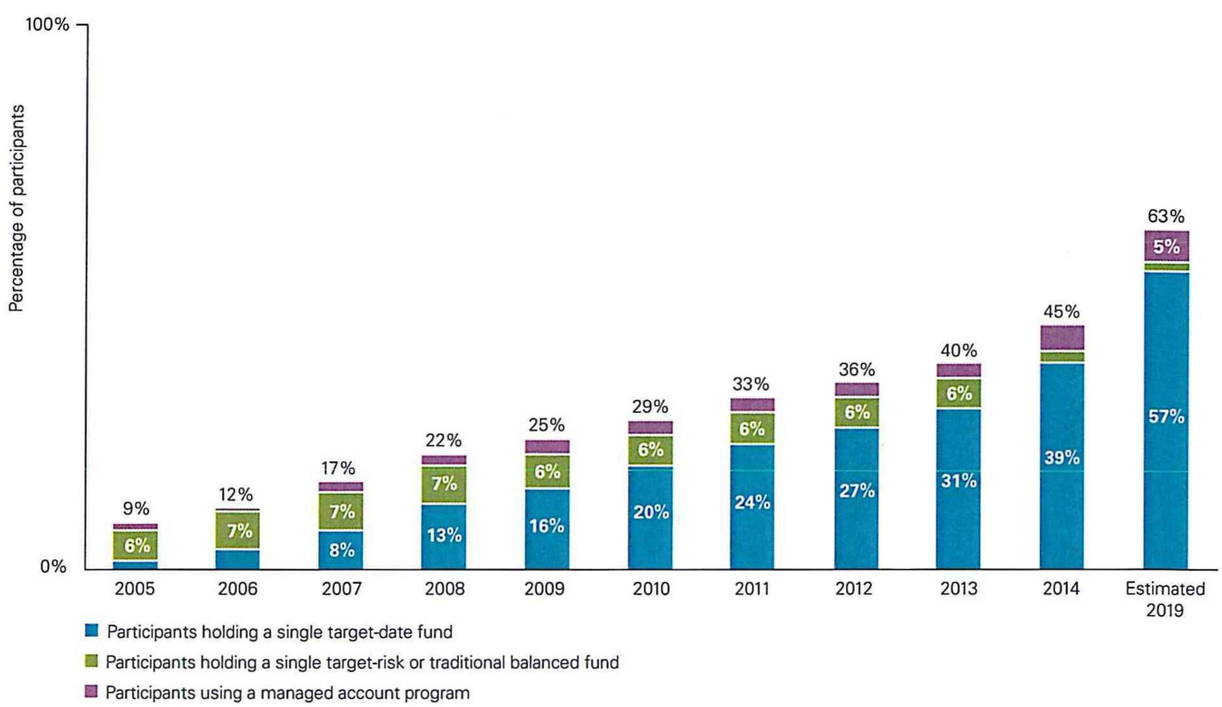
Due to the growing use of the target-date option, we anticipate that 63% of all participants will be solely invested in a professionally managed option by 2019. These professionally managed investment options signal a shift in responsibility for investment decision-making away from the participant and toward employer-selected investment and advice programs.

Target-date funds

Target-date funds base portfolio allocations on an expected retirement date; allocations grow more conservative as the participant approaches the fund's target year. Target-date fund use has accelerated from 28% of plans in 2005 to 88% of plans in 2014 (**Figure 68**). At year-end 2014, nearly all participants were in plans offering target-date funds. Sixty-four percent of all participants had all or part of their account invested in target-date funds in 2014. Four in 10 contribution dollars were directed to target-date funds in 2014.

Figure 66. **Participants with professionally managed allocations**

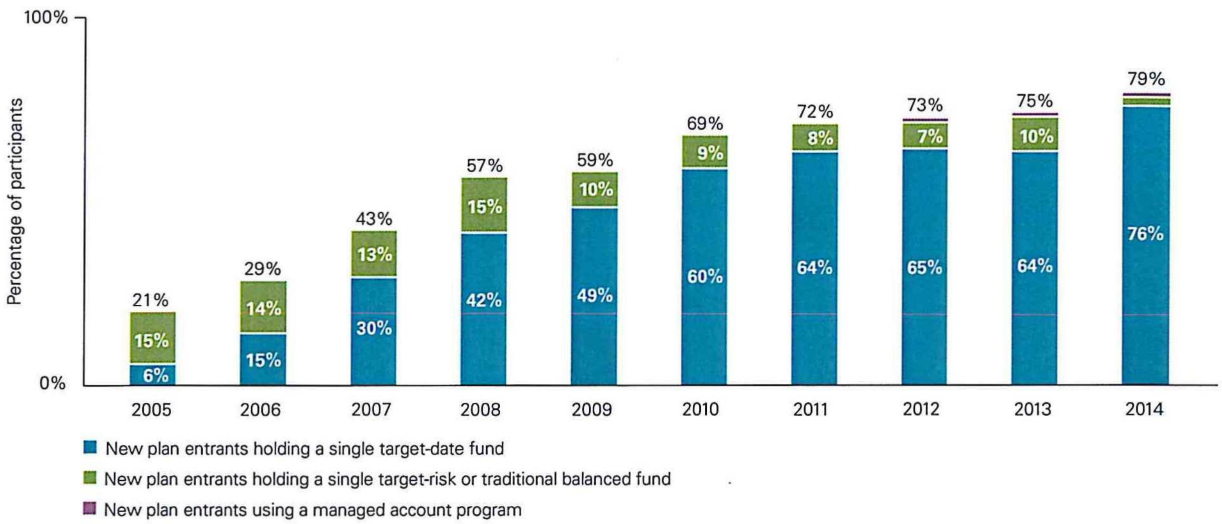
Vanguard defined contribution plans



Source: Vanguard, 2015.

Figure 67. Participants with professionally managed allocations, new plan entrants during the year

Vanguard defined contribution plans



Source: Vanguard, 2015.

Figure 68. Use of target-date funds

Vanguard defined contribution plans

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Percentage of all plans offering target-date funds	28%	43%	58%	68%	75%	79%	82%	84%	86%	88%
Percentage of recordkeeping assets in target-date funds	1	3	5	7	9	12	14	17	19	23
Percentage of all contributions directed to target-date funds	2	4	8	13	16	22	27	31	34	41
Percentage of all participants offered target-date funds	29	46	67	76	81	86	87	88	90	97
Percentage of all participants using target-date funds	5	10	18	28	34	42	47	51	55	64

Source: Vanguard, 2015.

Note: Investments in target-date funds are subject to the risks of their underlying funds. The year in the fund name refers to the approximate year (the target date) when an investor in the fund would retire and leave the workforce. The fund will gradually shift its emphasis from more aggressive investments to more conservative ones based on its target date. An investment in target-date funds is not guaranteed at any time, including on or after the target date.

Among plans offering the strategy, target-date options accounted for one-quarter of plan assets in 2014 (Figure 69). In these plans, 42% of all contributions in 2014 were directed to target-date funds.

Target-date funds are replacing target-risk funds, which maintain a static risk allocation (Figure 70). Since 2005, the fraction of plans offering target-risk funds as an investment option has fallen by more than half, from 45% of plans to 21% of plans. However, 15% of plans maintain both target-risk and target-date funds, although for some of these plans, new contributions into the target-risk funds may be restricted.

Figure 69. Plan use of target-date funds

Vanguard defined contribution plans offering target-date funds

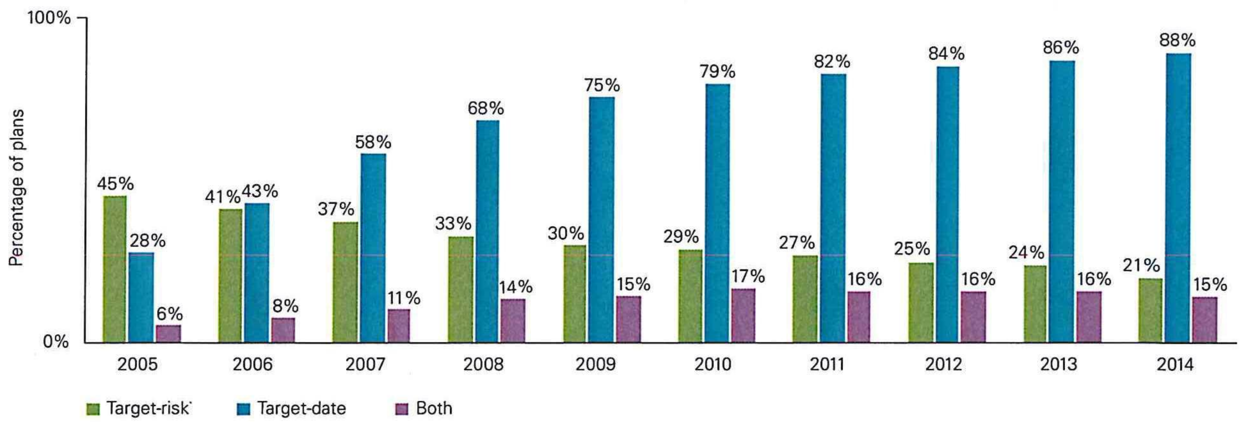
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Percentage of plan assets invested in target-date funds	5%	6%	7%	9%	12%	15%	17%	19%	20%	24%
Percentage of plan contributions invested in target-date funds	6%	9%	12%	17%	21%	26%	31%	35%	38%	42%
Distribution of percentage of plan assets in target-date funds										
<10%	75%	71%	63%	55%	48%	38%	31%	25%	21%	16%
10%–19%	13	14	20	25	27	32	34	34	31	28
20%–29%	5	6	8	10	11	14	17	20	23	25
30%–39%	2	3	3	3	5	6	7	8	10	11
40%–49%	1	2	2	2	3	3	4	4	5	7
50%+	4	4	4	5	6	7	7	9	10	13
Distribution of percentage of plan contributions to target-date funds										
<10%	66%	54%	41%	27%	23%	17%	13%	9%	7%	6%
10%–19%	18	24	29	32	29	25	20	17	14	10
20%–29%	7	10	14	19	23	25	25	23	21	17
30%–39%	4	5	6	10	11	16	19	21	22	22
40%–49%	1	2	4	5	5	7	10	13	16	17
50%+	4	5	6	7	9	10	13	17	20	28

Source: Vanguard, 2015.

Figure 70. **Trend in plan adoption of target-date and target-risk funds**

Vanguard defined contribution plans

Percentage of plans offering



Source: Vanguard, 2015.

Participant use of target-date funds

Among participants using target-date funds, half of account balances were invested in these funds (Figure 71). These target-date participants directed three-quarters of their 2014 total contributions to target-date funds. Participants invest in target-date funds in one of two ways. "Pure" investors hold a single target-date fund. They accounted for 60% of all target-date investors in 2014. The remaining target-date investors are "mixed" investors. They hold a target-date fund in combination with other investments (or, less commonly, multiple target-date funds and/or other options).

Pure target-date investors are more likely to be younger, lower-wage, shorter-tenured participants with lower 401(k) account balances than other investors. Meanwhile, mixed investors appear very much like non-target-date investors in terms of their demographic and portfolio characteristics. Sixty-three percent of single target-date fund investors were younger than 45, compared with only 45% of mixed investors (Figure 72). More than 60% of plan participants younger than 35 hold a single target-date fund.

Figure 71. Participant use of target-date funds

Vanguard defined contribution plan participants using target-date funds

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Percentage of all participants offered target-date funds	29%	46%	67%	76%	81%	86%	87%	88%	90%	97%
Percentage of participants using target-date funds when offered	19%	22%	27%	37%	42%	48%	54%	58%	61%	66%
Percentage of participant account balances in target-date funds	36%	36%	38%	37%	38%	41%	43%	46%	48%	50%
Percentage of total participant and employer contributions in target-date funds	37%	48%	52%	57%	63%	67%	71%	72%	74%	75%
Distribution of percentage of participant assets in target-date funds										
1%–24%	38%	32%	28%	26%	26%	24%	21%	19%	17%	15%
25%–49%	17	15	13	12	12	11	10	10	10	9
50%–74%	7	8	8	7	8	8	8	8	8	7
75%–99%	5	7	7	6	7	8	8	7	7	7
100%	33	38	44	49	47	49	53	56	58	62
Distribution of percentage of total participant and employer contributions in target-date funds										
1%–24%	41%	28%	24%	19%	16%	14%	11%	11%	9%	9%
25%–49%	18	16	14	13	11	11	9	9	8	8
50%–74%	8	7	7	7	7	6	7	7	7	6
75%–99%	5	4	4	5	4	5	4	4	5	8
100%	28	45	51	56	62	64	69	69	71	69
Percentage of participants owning										
One target-date fund only	32%	37%	43%	46%	46%	48%	52%	54%	56%	60%
One target-date fund plus other funds	58	54	48	46	46	44	41	38	36	33
Two or more target-date funds only	1	1	1	2	2	2	1	2	2	2
Two or more target-date funds plus other funds	9	8	8	6	6	6	6	6	6	5

Source: Vanguard, 2015.

Figure 72. Participant use of target-date funds by age

Vanguard defined contribution plan participants using target-date funds

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Distribution of pure target-date fund holders by age										
<25	8%	11%	11%	11%	9%	8%	8%	7%	7%	6%
25–34	28	30	30	31	31	31	32	32	32	31
35–44	28	26	26	25	26	26	26	26	26	26
45–54	23	21	21	21	21	22	21	21	21	21
55–64	11	10	10	10	11	11	11	12	12	13
65+	2	2	2	2	2	2	2	2	2	3
Distribution of mixed target-date fund holders by age										
<25	3%	3%	3%	3%	2%	2%	1%	2%	2%	2%
25–34	26	24	24	22	21	20	19	18	18	17
35–44	31	30	28	28	27	27	27	26	26	26
45–54	26	28	28	29	30	30	30	30	29	29
55–64	13	14	15	16	17	18	20	20	21	22
65+	1	1	2	2	3	3	3	4	4	4
Percentage of participants holding a single target-date fund by age										
<25	6%	15%	27%	42%	50%	62%	69%	69%	71%	76%
25–34	3	6	12	21	25	33	40	46	51	60
35–44	2	3	7	12	15	20	24	28	31	41
45–54	1	3	5	9	11	15	18	21	23	31
55–64	1	2	5	7	9	12	14	16	19	25
65+	1	2	3	6	7	9	11	13	15	20
Percentage of mixed target-date fund participants by age										
<25	5%	8%	11%	14%	14%	14%	12%	14%	14%	14%
25–34	5	9	13	18	20	23	22	22	22	22
35–44	4	7	11	16	19	23	24	24	25	27
45–54	3	6	10	15	19	22	24	25	26	28
55–64	3	5	9	14	17	21	22	24	25	28
65+	2	3	5	10	12	15	17	18	20	22

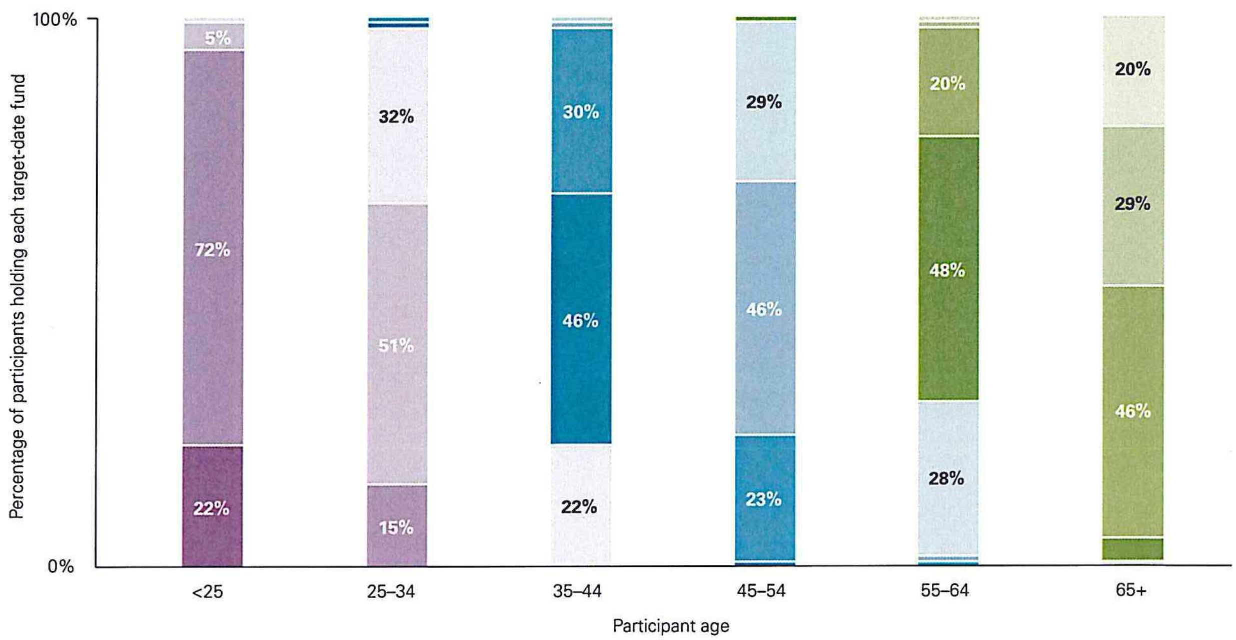
Source: Vanguard, 2015.

Half of all mixed target-date investors arise through sponsor action and the other half through participant choice. Sponsor actions leading to mixed investors include employer contributions in company stock; nonelective contributions to the plan's default fund; recordkeeping corrections applied to the plan's default fund; or mapping of assets from an existing investment option to the default fund because of a plan menu change. Mixed investors who choose to combine a target-date fund with other plan options appear to pursue a range of reasonable diversification strategies, although they do not fit within the "all-in-one" portfolio approach of the target-date concept.

Single target-date fund investors appear to select, or are defaulted into, a target-date fund with an appropriate target date (**Figure 73**). Half of participants age 25 to 34 are invested in a 2050 target-date fund, with most of the other participants using either a 2045 or 2055 target-date fund. Similarly, about half of participants age 55 to 64 are invested in a 2020 target-date fund, with most of the other participants using either a 2015 or 2025 target-date fund.

Figure 73. **Target-date fund utilization by age, 2014**

Vanguard defined contribution plan participants holding a single target-date fund (39% of all participants)



Distribution of single target-date fund holders

<25	25–34	35–44	45–54	55–64	65+
6%	31%	26%	21%	13%	3%

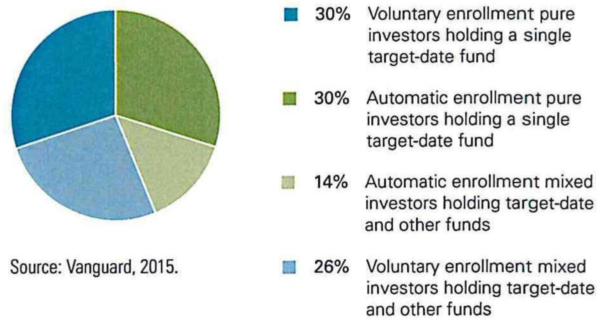
2060 2055 2050 2045 2040 2035 2030 2025 2020 2015 2010 Income

Source: Vanguard, 2015.

Automatic enrollment into a target-date fund default is one important factor explaining the increase in the fraction of pure target-date investors. However, a large fraction of pure investors select target-date options voluntarily. Of the 60% of participants who were pure investors in 2014, a large portion of participants were in plans not offering automatic enrollment. Half of pure investors were in plans where participants made the choice to select the fund (Figure 74).

Figure 74. **Plan design and target-date funds, 2014**

Vanguard defined contribution plan participants holding target-date funds



Source: Vanguard, 2015.

Note: In prior editions of How America Saves, *we categorized plans and participants based on whether or not the plan had adopted automatic enrollment at the end of the year. As noted previously, about half of plans have implemented automatic enrollment for all eligible employees by either "sweeping" these nonparticipants when automatic enrollment was initially adopted or at a later date. In 2015, we have refined our analysis for this figure to segregate individuals hired under voluntary enrollment design from those individuals subjected to an automatic enrollment design. Participants in plans with automatic enrollment that were not subjected to automatic enrollment are included in the voluntary enrollment category.*

Participant equity allocations

Equities are the dominant asset class holding of many plan participants. From an investment perspective, an asset allocation to equities of 80% or more may appear appropriate in light of the long-term retirement objectives of most DC plan participants.

The growing use of professionally managed allocations within DC plans, including target-date funds, is reshaping equity allocations by age and reducing extreme allocations.

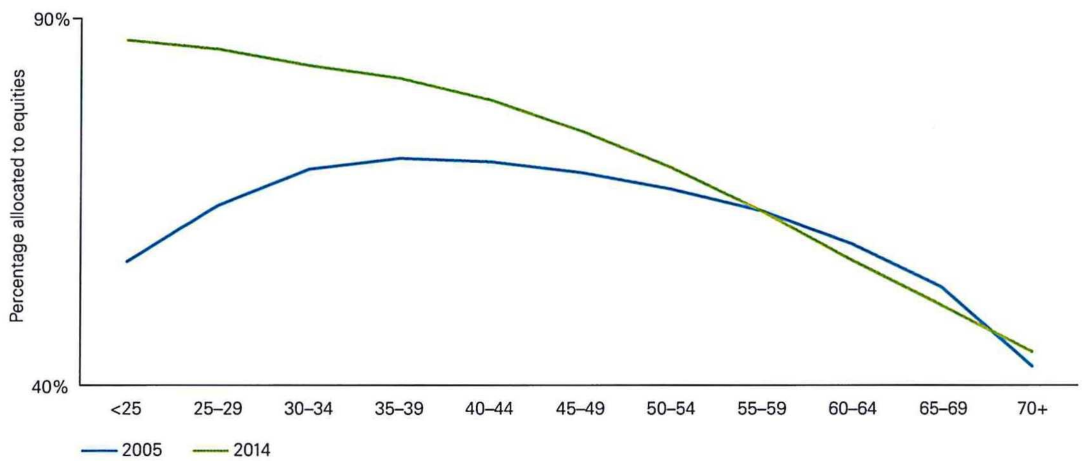
Equity allocations by age

In prior reports we have noted that participants' age-based equity allocation was hump-shaped, with younger participants adopting more conservative allocations, middle-aged participants holding the highest equity exposure, and then older participants having equity exposure on par with younger participants (**Figure 75**). In 2014, the equity allocation among Vanguard DC participants is downward sloping by age. This phenomenon is tied directly to the growing use of target-date funds, along with managed account advice, both of which provide for a declining equity exposure with age.

Figure 75. Trend in asset allocation by participant age

Vanguard defined contribution plans

Average equity allocation participant-weighted



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Equity allocation by age										
<25	57%	61%	67%	73%	77%	82%	84%	85%	85%	87%
25–29	64	66	69	70	73	77	79	81	83	86
30–34	69	70	72	70	72	75	76	78	80	84
35–39	71	72	73	71	72	75	75	76	79	82
40–44	70	71	72	69	71	73	73	74	76	79
45–49	69	70	70	66	68	70	69	70	73	75
50–54	67	67	68	62	64	66	64	65	68	70
55–59	64	64	63	57	58	60	59	59	63	64
60–64	59	59	59	52	53	54	52	53	56	57
65–69	53	54	54	47	48	49	48	48	51	51
70+	43	44	44	39	40	41	40	41	44	45

Source: Vanguard, 2015.

One development influencing this change is the growth in default funds under automatic enrollment and the designation of target-date funds as the most common type of default investment. However, participants choosing target-date funds on a voluntary basis are also contributing in a meaningful way to this change.

A transition is under way in the factors influencing age-related equity exposure in DC plans. On the one hand, existing participants make few changes in their allocations as they age because of inertia in financial decision-making. On the other hand, the growing use of professionally managed allocations, particularly among new entrants to plans, is contributing to a sharper delineation of equity risk-taking by age.

Extreme equity allocations

The rising use of professionally managed allocations is also influencing extreme portfolio allocations (Figure 76). The fraction of participants with no allocation to equities has fallen by more than half, from 13% in 2005 to 5% in 2014. At the other extreme, the fraction of participants investing exclusively in equities has fallen from 21% to 8% over the same period.

Figure 76. Distribution of equity exposure

Vanguard defined contribution plan participants

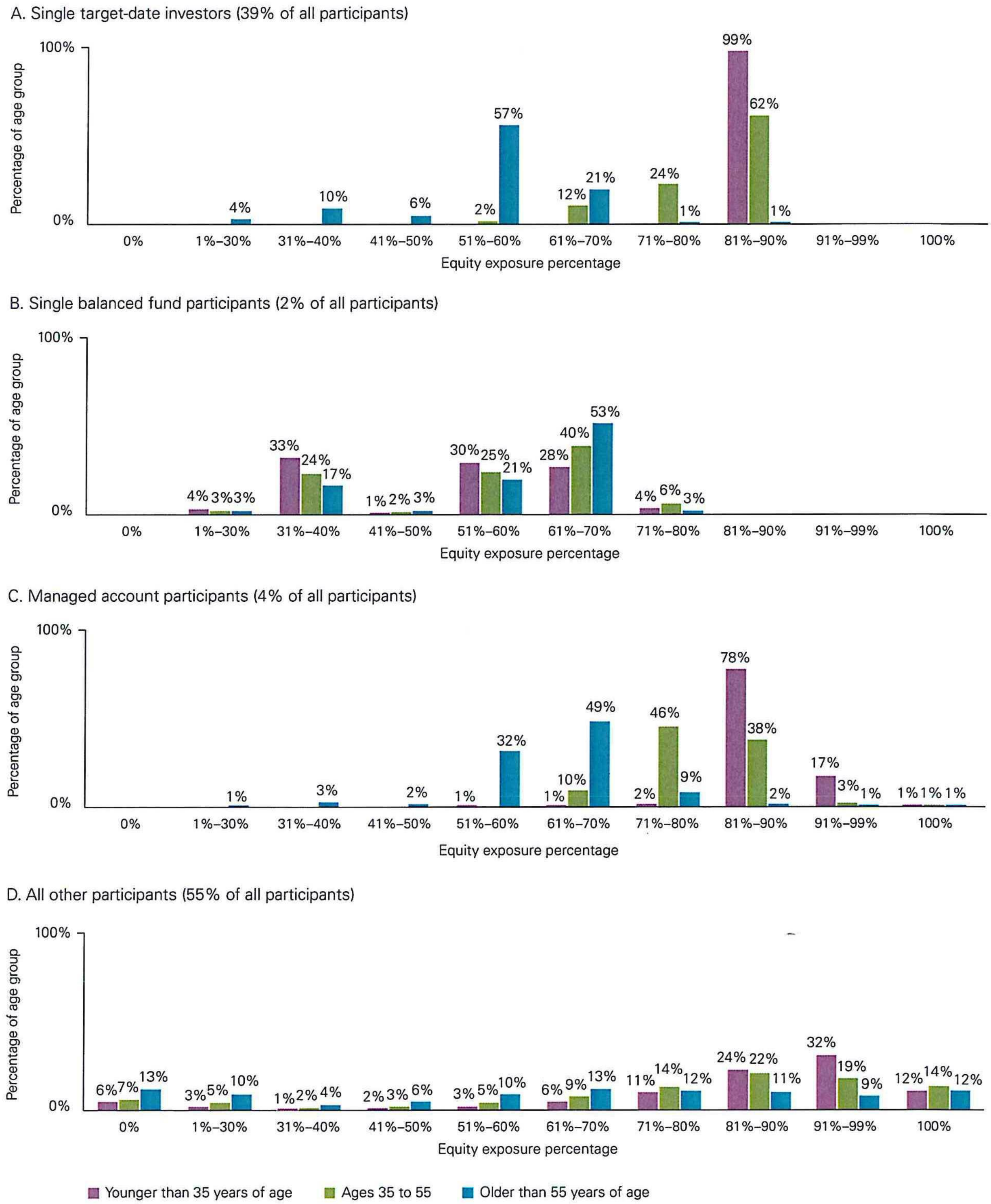
Percentage of participants

Percentage of account balances in equities	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Percentage of contributions to equities, 2014
0%	13%	13%	11%	11%	11%	9%	8%	7%	6%	5%	5%
1%–10%	2	2	1	2	2	2	2	2	2	1	0
11%–20%	2	2	2	2	2	2	3	2	1	1	1
21%–30%	2	2	2	3	2	2	2	2	2	2	1
31%–40%	3	3	2	4	3	3	5	5	6	3	2
41%–50%	6	5	6	4	6	6	4	4	2	2	3
51%–60%	6	5	5	9	7	6	7	7	6	8	9
61%–70%	10	10	11	12	11	10	10	10	12	10	11
71%–80%	9	11	11	11	11	12	14	15	12	13	13
81%–90%	14	16	19	18	22	26	26	28	33	37	40
91%–99%	12	12	13	8	9	9	9	9	10	10	7
100%	21	19	17	16	14	13	10	9	8	8	8
Average equity participant-weighted	67%	68%	68%	65%	66%	68%	68%	69%	72%	74%	75%
Median equity participant-weighted	78%	79%	80%	74%	76%	79%	79%	79%	82%	83%	83%

Source: Vanguard, 2015.

Figure 77. Distribution of equity exposure by investor type, 2014

Vanguard defined contribution plan participants



Source: Vanguard, 2015.

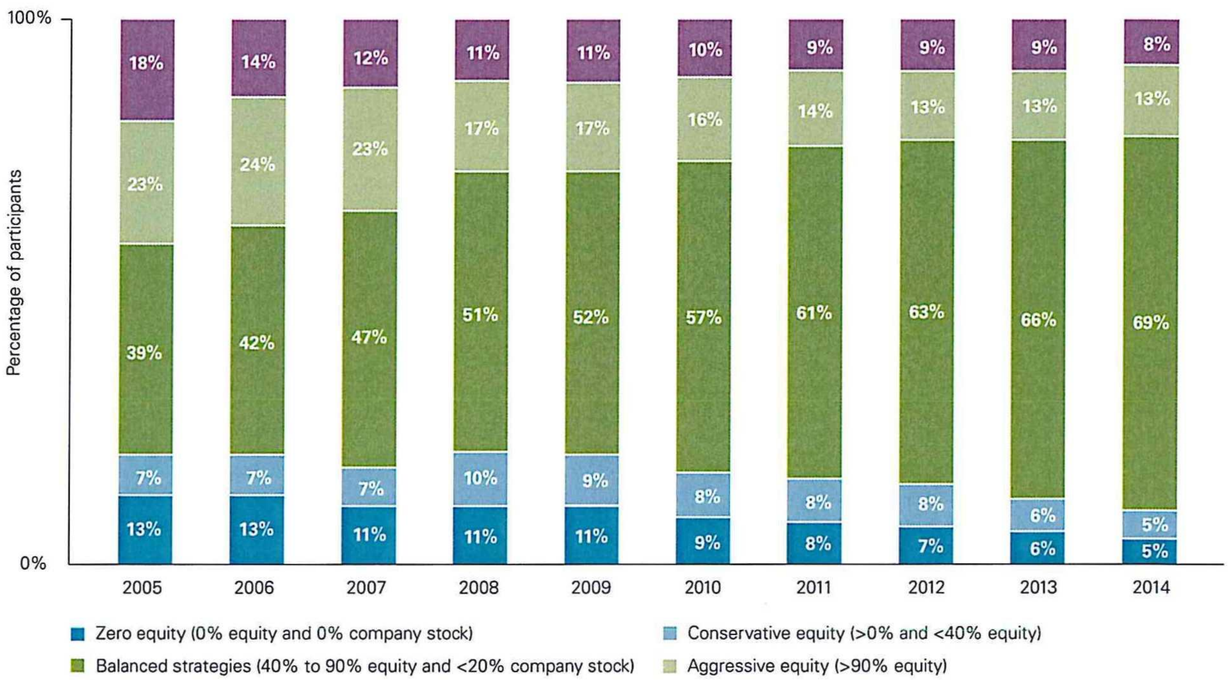
One of the benefits of target-date funds is that they eliminate extreme equity allocations. Non-target-date participants tend to hold greater extremes in equity exposure (**Figure 77, Panel D**). Twenty-two percent of "do-it-yourself" investors hold extreme portfolios (9% with no equities, 13% with only equities). Professionally managed investors cannot hold extreme positions because professionally managed options include both equity and fixed income assets.

Among pure target-date investors, virtually all have equity allocations ranging from 51% to 90% of their portfolios. A large group of pure target-date investors has equity allocations in the 81%-to-90% range. This phenomenon reflects two facts: (1) automatic enrollment into target-date funds typically applies to new hires who are disproportionately younger than 40; and (2) in voluntary enrollment plans, a single target-date fund is a popular strategy among new hires. Among pure target-date investors, there is also age-appropriate variation in the equity allocation.

This rising use of professionally managed allocations is also contributing to a reduction in portfolio construction errors (**Figure 78**). The fraction of participants holding broadly diversified portfolios rose from 39% in 2005 to 69% in 2014. Participants holding concentrated stock positions fell by more than half, along with reductions in extreme portfolio positions.

Figure 78. Participant portfolio construction

Vanguard defined contribution plans



Source: Vanguard, 2015.

Initial equity allocations

We analyzed how participants are currently allocating their contributions, based on the year they entered their employer's retirement plan. Participants who enrolled during 2008–2009 were allocating 74% of contributions to equities, only slightly below those enrolling during 2007 (**Figure 79**).[6] Participants who enrolled during 2013–2014 were allocating about 80% of their contributions to equities. New plan entrants in 2014 allocated three-quarters of their total contributions to target-date funds.

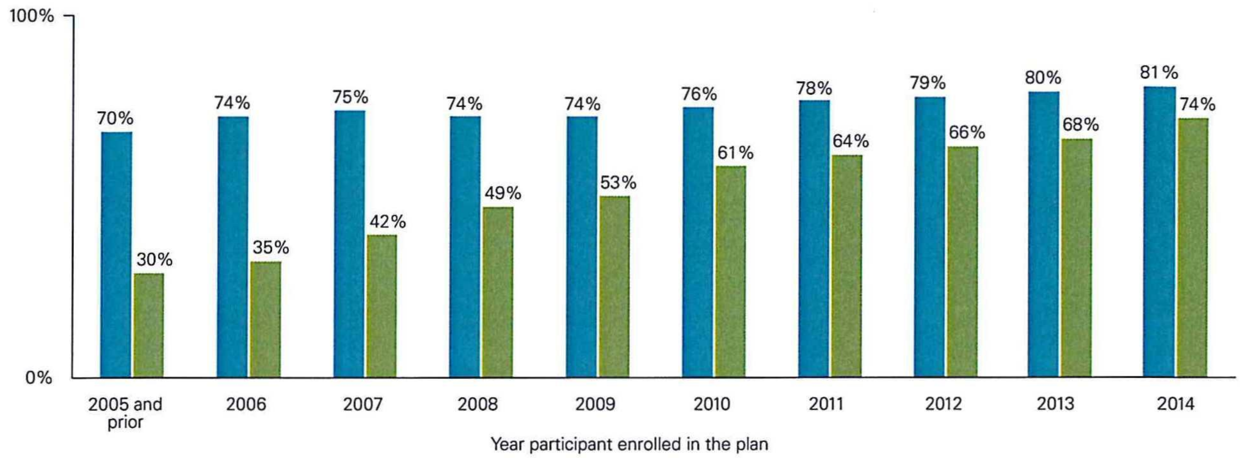
Advice

Many participants in DC plans may lack the financial planning skills, time, or interest to make appropriate investment decisions. To address participants' need for assistance with investment decisions, plan sponsors using Vanguard as recordkeeper offer a range of advice programs, including an online advice service, Personal Online Advisor; a managed account advisory service, Vanguard Managed Account Program; and Vanguard Financial Planning Services.

Figure 79. Current contribution allocation by plan entry date, 2014

Vanguard defined contribution plans

Contributions from January 1, 2014, through December 31, 2014



Distribution of all participants with contributions in 2014 by year of plan entry

2005 and prior	2006	2007	2008	2009	2010	2011	2012	2013	2014
34%	4%	5%	6%	4%	5%	7%	8%	12%	15%

■ Percentage of total 2014 contributions allocated to equity ■ Percentage of total 2014 contributions allocated to target-date funds

Source: Vanguard, 2015.

6 We do not have ready access to contribution allocations over time and so instead focus on current contribution allocations by date of plan entry.

The online advice service and managed account program are provided by Financial Engines, a third-party advisor; the financial planning services are provided by Vanguard Advisers, Inc. Each of these programs allows participants to include information about assets they have outside the plan, which may affect the selection of in-plan investments.

Online advice is targeted toward participants who want to manage their investments themselves. Thirty-seven percent of plans offer online advice, which assists participants in developing and managing optimal portfolios and continues to recommend portfolio changes over time (Figure 80). Participants need to take action to implement online advice. Because large plans are more likely to offer advice, 7 in 10 participants have access to the online advice service.

Managed account advice is targeted toward participants who prefer professional investment management. The managed account program includes development of customized portfolios using the funds offered in the plan, and ongoing monitoring and rebalancing. It also offers customized retirement savings projections. Participants may also further personalize the advice according to risk tolerance or other holdings. Twenty-two percent of plans offer managed account advice—and again, because larger plans are more likely to offer advice, slightly more than half of participants have access to the service.

Financial planning services are offered to all participants with plan sponsor authorization, but a fee may apply. However, the service is available at no charge to participants age 55 and older who are in or nearing retirement if their plan sponsor authorizes the offer. Sixty-nine percent of plans offer this service to their participants, and three-quarters of participants in this age group have access to the program.

Overall, 17% of participants offered one of these advice programs have used one of the programs. Participants were most likely to adopt the online advice program or the managed account service.

Figure 80. Advice offered, 2014

Vanguard defined contribution plans

		Number of participants		
	All	<1,000	1,000–4,999	5,000+
Online advice				
Percentage of plans offering online advice	37%	25%	63%	69%
Percentage of participants offered online advice	70	35	66	76
Percentage of participants offered online advice accessing	7	10	7	7
Managed account advice				
Percentage of plans offering managed account advice	22%	11%	45%	55%
Percentage of participants offered managed account advice	55	17	49	63
Percentage of participants offered managed account advice accessing	7	6	7	7
Financial planning services				
Percentage of plans offering financial plans	69%	66%	78%	75%
Percentage of participants offered financial plans	75	73	80	73
Percentage of participants offered financial plans accessing	3	3	3	3

Source: Vanguard, 2015.

Company stock

Company stock is more likely to be offered as an investment option by a large plan—35% of Vanguard plans with 5,000 or more participants offered company stock, compared with only 4% of plans with fewer than 1,000 participants. In most plans that offer company stock, participants can choose whether or not to invest their own contributions in this option.

Employer contributions—which may be 401(k) matching, profit-sharing, or ESOP contributions—are either directed to company stock by the employer, invested at the participant's discretion, or a combination of the two.

As of 2014, only 10% of Vanguard recordkeeping plans offered company stock as an investment option. However, because large plans are more likely to offer company stock, 27% of Vanguard recordkeeping participants had access to company stock in their employer's plan. Among all Vanguard participants:

- 86% had no company stock investments in 2014—either because their employer did not offer company stock (73%) or because they chose not to invest in it (13%).
- 6% had company stock holdings of 1% to 20% of their account balances in 2014.
- 8% had concentrated positions exceeding 20% of their account balances as of 2014.

Among Vanguard plans actively offering company stock, 79% had 20% or less of plan assets invested in company stock (Figure 81). The remaining 21% had concentration levels of more than 20%. This is an improvement from 2005, when nearly one-third of these plans had concentration levels of more than 20%.

Figure 81. Company stock exposure for plans and participants

Vanguard defined contribution plans actively offering company stock

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Balance of plan in company stock—percentage of plans										
1%–20%	68%	73%	77%	82%	79%	80%	75%	77%	78%	79%
21%–40%	21	19	17	10	15	13	17	16	16	15
41%–60%	7	5	4	6	5	6	7	6	6	6
61%–80%	1	1	1	1	0	0	0	0	0	0
>80%	3	2	1	1	1	1	1	1	0	0
Balance in company stock—percentage of participants										
0%	35%	37%	42%	44%	45%	43%	45%	45%	47%	50%
1%–20%	23	25	26	26	25	26	25	24	22	22
21%–40%	15	15	13	12	12	12	12	13	14	14
41%–60%	8	9	7	6	6	6	5	5	7	6
61%–80%	4	5	4	3	3	3	3	3	4	3
>80%	15	9	8	9	9	10	10	10	6	5

Source: Vanguard, 2015.

In 2014, half of Vanguard participants who were offered company stock in their plan chose not to invest their contributions—or their employer's contributions—in company stock. If they received employer stock contributions, they diversified these assets. At the other extreme, 3 in 10 participants in plans actively offering company stock had more than 20% of their account balance invested in company stock, and 5% had more than 80% of their account balance in company stock.

During 2014, the modest shift away from participant company stock holdings persisted. The number of participants in plans with company stock and holding a concentrated position of more than 80% of their account balance in company stock fell from 15% in 2005 to 5% in 2014, and fewer plans are offering company stock.[7]

Despite this shift, why do 3 in 10 participants in plans offering company stock continue to hold a concentrated position in their employer's stock? One reason is that most participants view company stock as a safer investment than a diversified equity fund. Another factor encouraging concentrated stock holdings is the plan sponsor's decision to make an employer contribution in company stock. This implied endorsement often leads participants to invest more of their own savings in the stock as well.

The effect is evident in the average company stock allocation for plans making employer contributions in cash compared with those making employer contributions in stock. In 2014, plans offering company stock as an investment option but making employer contributions in cash had an average of 13% of plan assets invested in company stock (Figure 82). Meanwhile, plans offering company stock as an investment option and making employer contributions in stock had an average of 36% of plan assets in company stock.

Figure 82. **Impact of company stock employer contributions on asset allocation, 2014**

Vanguard defined contribution plans

		All Vanguard 401(k) plans with an employer contribution		
	Vanguard defined contribution plans	Plans making employer contributions in cash	Plans offering company stock making employer contributions in cash	Plans offering company stock making employer contributions in company stock
Company stock	8%	1%	13%	36%
Diversified equity funds	44	47	39	34
Balanced funds	30	33	30	15
Bond funds	7	8	6	8
Cash	11	11	12	7

Source: Vanguard, 2015.

7 For an in-depth analysis of the factors driving company stock concentration, see Stephen P. Utkus and Jean A. Young, 2014, *The evolution of company stock in defined contribution plans*, Vanguard Center for Retirement Research, institutional.vanguard.com; and John A. Lamancusa and Jean A. Young, 2014, *Company stock in defined contribution plans: An update*, Vanguard Center for Retirement Research, institutional.vanguard.com.

Investment returns

There are two categories of investment returns: total returns and personalized returns. Total rates of return reflect time-weighted investment performance and allow comparison of results to benchmark indexes. Personal rates of return are dollar-weighted returns, reflecting account investment performance, adjusted for each participant's unique pattern of contributions, exchanges, and withdrawals. They are not directly comparable to time-weighted performance data for market indexes or mutual funds. Both return measures are influenced by market conditions; however, only total rates of return can be compared with published benchmark indexes.

Participant returns

Due to rising U.S. equity markets in 2014, average total and personal returns for DC participants were 7.0% and 6.8% for the 1-year period ended December 31, 2014 (Figure 83). Reflecting the market recovery in 2010, a flat market in 2011, and strong markets in 2012, 2013, and 2014, average total and personal returns for DC participants were more than 12% across the 3-year period and around 10% for the 5-year period ended December 31, 2014.

Five-year participant total returns averaged 9.9% per year or 61% cumulatively (personalized total returns rose 10.2% per year or 63% cumulatively).

Distribution of returns

As of December 2014, 5-year personalized annual returns were positive for nearly all Vanguard DC plan participants. There was wide variation in returns among participants (Figure 84). Participants at the fifth percentile had 5-year personalized returns of 2.4% per year in 2014. At the other extreme, participants above the 95th percentile had 5-year personalized returns greater than 15.9% per year. The variation in returns is largely due to the variation in participant asset allocations and their individual account holdings.

Figure 83. Participant rates of return, December 2014

Vanguard defined contribution plans

Market returns ended December 31, 2014	1 year	3 years	5 years
60/40 Balanced*	10.6%	13.1%	11.2%
70/30 Balanced*	11.4	14.9	12.3
S&P 500	13.7	20.4	15.5
Barclays US Aggregate	6.0	2.7	4.4
FTSE Global All Cap ex US	(3.4)	9.5	4.9

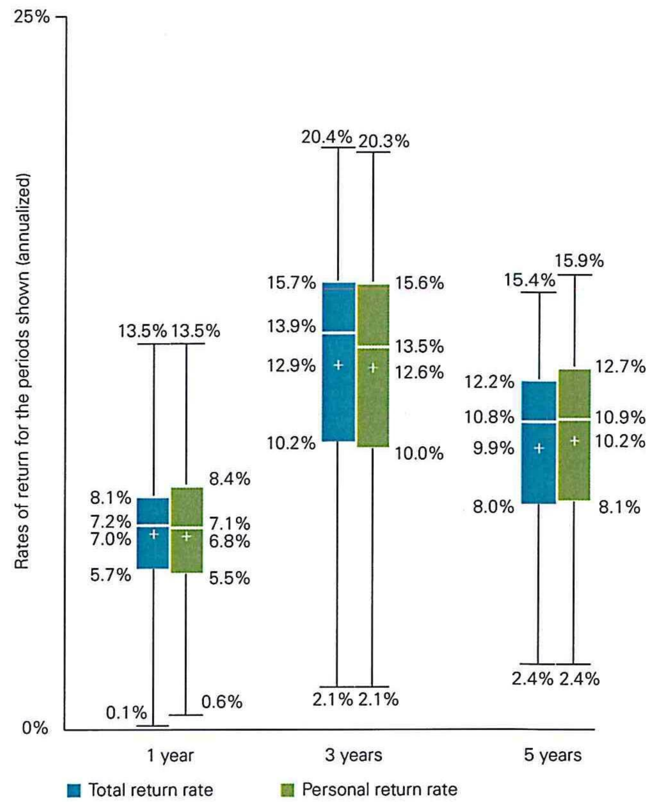
Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

*Balanced composites based on S&P 500 and Barclays US Aggregate Indexes for periods and percentages shown; rebalanced monthly.

Source: Vanguard, 2015.

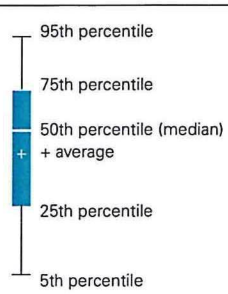
Figure 84. Variation in participant total and personal return rates, 2014

Vanguard defined contribution plans



Note: Based on 3.0 million observations for 1 year; 2.4 million for 3 years; and 1.9 million for 5 years.

Source: Vanguard, 2015.



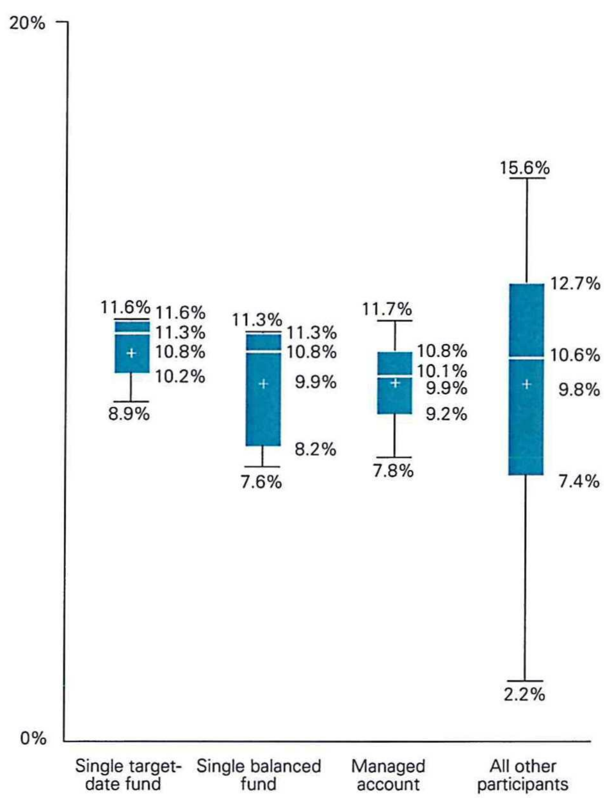
How to read a box and whisker chart:

This box and whisker chart shows the range of outcomes. Plot values represent the 95th, 75th, 50th, 25th, and 5th percentile values. The average value is represented by a white + and the median value by a white line. An example of how to interpret the data in **Figure 84** is: For the 1-year period, 5% of participants had total return rates (TRR) greater than 13.5%; 25% had TRRs greater than 8.1%; half had TRRs greater than 7.2%; 75% had TRRs greater than 5.7%; 95% had TRRs greater than 0.1%; and 5% had TRRs less than 0.1%. The average 1-year TRR was 7.0%.

Participants with managed allocations—notably target-date funds and managed account advisory services—had less dispersion in outcomes. Total 5-year returns for single target-date investors ranged from 8.9% per year for the 5th percentile to 11.6% for the 95th percentile, a difference of approximately 3 percentage points (Figure 85). For the single balanced fund and managed account participants, the 5th-to-95th percentile differences were approximately 4 percentage points. The managed account is a customized portfolio approach and so results are accordingly more dispersed than with target-date funds.

Figure 85. Distribution of 5-year total returns by strategy, 2014

Vanguard defined contribution plans



Note: Based on 238,000 observations for single target-date fund investors; 38,000 for balanced fund investors; 52,000 for managed account investors; and 1.5 million for all other participants.

Source: Vanguard, 2015.

By comparison, among all other participants, realized returns for those making their own choices ranged from 2.2% per year for the 5th percentile to 15.6% for the 95th percentile, a difference of more than 13 percentage points.

Dispersion of outcomes

These differences are also apparent when examining both return and risk outcomes in scatter plots. For ease in presentation, we created a random sample of 1,000 participants for each group of investors.

During the 5-year period ended 2014, outcomes for single target-date investors were distributed among major market indexes (Figure 86, Panel A), and upward sloping reflecting a positive equity risk premium. These results are consistent with the fact that most of the target-date portfolios in our sample are a specific combination of indexed U.S. equities, international equities, and U.S. bonds. In the target-date scatter plot (in Panel A), younger participants (represented by blue dots and in long-dated portfolios) are to the right of the chart; older participants (represented by purple dots and in near-dated portfolios) are to the left.

The figure includes about 1,000 observations, although there appear to be far fewer. The reason is that while there are many observations in our sample, they are all invested in a limited set of target-date portfolios, which means that portfolio outcomes are also limited. For example, if a plan offered 12 target-date options, then 1,000 participants invested solely in a single target-date fund would have 12 outcomes, not 1,000.

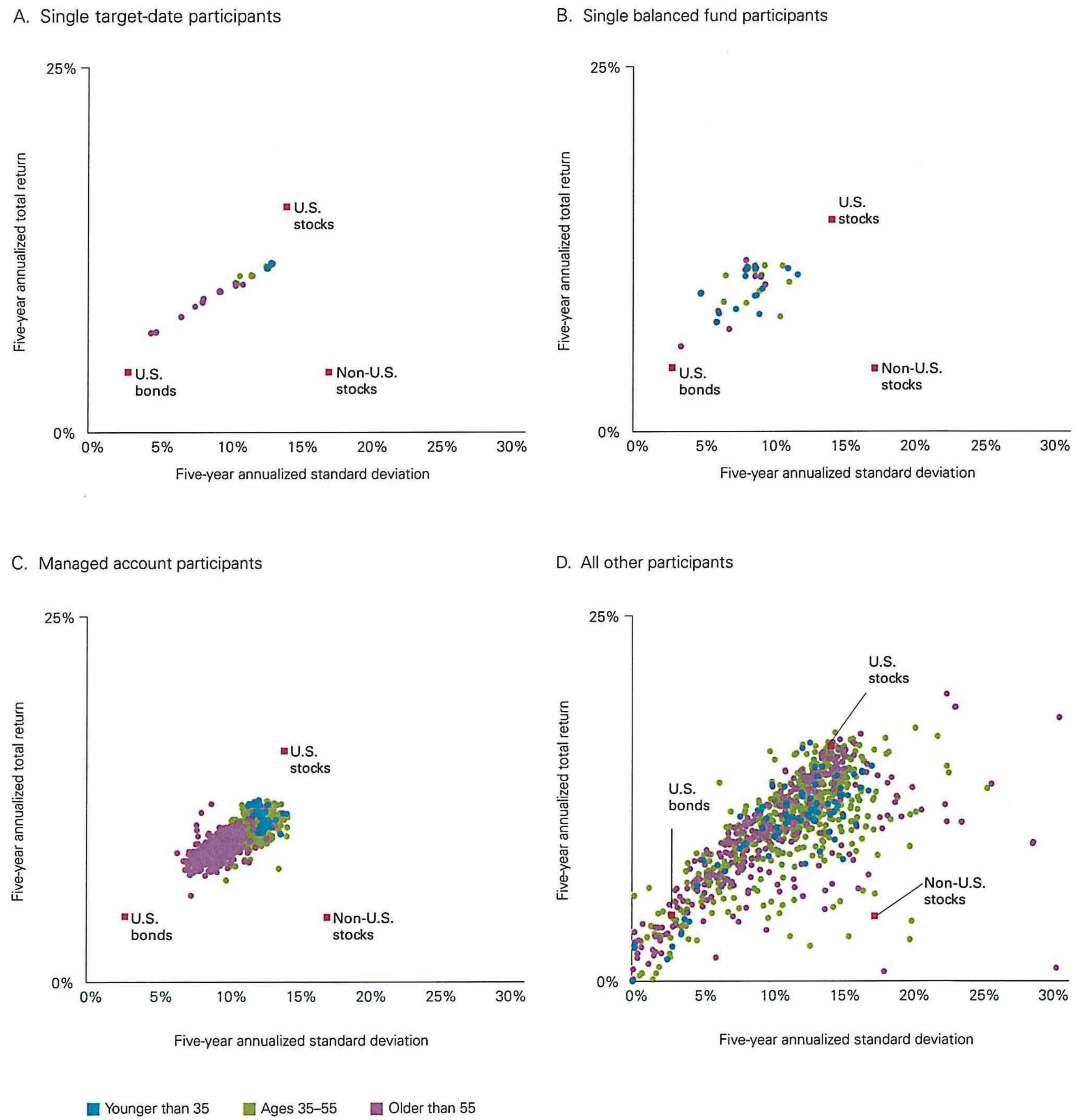
The results for single balanced fund investors reflect the fact that most balanced funds have similar equity allocations, typically around 35% to 65% of assets (Figure 86, Panel B). Managed account investors are more dispersed, reflecting the customized nature of managed account advice (Figure 86, Panel C).[8]

The greatest dispersion of risk/return outcomes is among participants making their own investment choices (Figure 86, Panel D). Over time, due to the growing use of professionally managed allocations in DC plans, this population is expected to decline.

8 For an in-depth analysis of portfolio outcomes, see John A. Lamancusa, Stephen P. Utkus, and Jean A. Young, 2013, *Professionally managed allocations and the dispersion of participant portfolios*, Vanguard research, institutional.vanguard.com.

Figure 86. Risk and return characteristics, 2010–2014

Vanguard defined contribution plan participants for the five-year period ended December 31, 2014



Note: Includes 1,000 random samples of participant accounts drawn from respective samples.
Excludes 0.05% top and 0.05% bottom outliers for both risk and return, for a net sample of 980 observations.
Source: Vanguard, 2015.

Trading activity

Participant trading or exchange activity is the movement of existing account assets from one plan investment option to another. This transaction is distinct from a contribution allocation decision, in which participants decide how future contributions to the plan should be invested. Exchange activity is a proxy for a participant's holding period for investments, as well as a measure of the participant's willingness to change their portfolio in response to short-term market volatility.

Exchange provisions

Daily trading is nearly universal for Vanguard DC plans, with virtually all plan sponsors allowing it. While assets can be traded daily, Vanguard and other investment companies serving DC plans typically have "round-trip" restrictions designed to thwart the minority of individual participants who seek to engage in active market-timing or day-trading.

Volume of exchanges

Despite the ongoing market volatility of 2014, only 13% of participants made one or more portfolio trades or exchanges during the year, down from 16% in 2008 (Figure 87).[9] When participants using the managed account program are excluded, only 10% of participants initiated an exchange. As in prior years, most participants did not trade. Not only did participant trading activity remain low during 2014, trading activity between 2009 and 2013 was lower than the trading activity during 2005, when markets were more benign.

Another measure of trading is the volume of dollars traded. We measure dollar volume movements as a fraction of total recordkeeping assets in order to scale them to growth in assets and growth in the underlying recordkeeping business. In effect, the fraction of assets traded is a measure of portfolio turnover.

In 2014, traders exchanged the dollar equivalent of 11.6% of average DC recordkeeping assets at Vanguard. On a net basis, 0.6% of assets were shifted from equities to fixed income in 2014, compared with a 0.2% shift from fixed income to equities in 2013.

Since 2005, dollar-trading levels have generally remained stable, with the exception of periods of high market volatility (Figure 88). The most notable spikes in dollars traded occurred in months of high market volatility: January, September, and October 2008; March 2009; and August 2011.

9 Our trading statistics are generally adjusted for sponsor-initiated trading—e.g., replacement of one plan option with another. On the date the option is eliminated and the balances are moved to a different fund, we are able to capture and adjust for the fund replacement effect. However, some participants initiate exchanges either before or after the fund is eliminated. We are not able to isolate this participant activity but estimate that it could account for up to one-third of the trading activity.

Figure 87. **Participant trading summary**

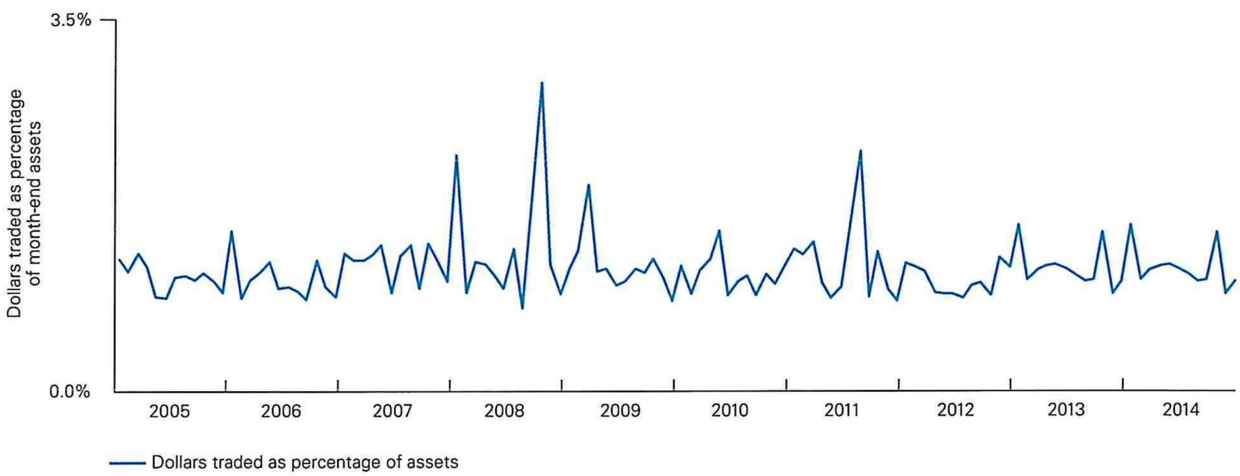
Vanguard defined contribution plans

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Percentage of participants										
Percentage trading including managed account investors	19%	14%	15%	16%	13%	12%	11%	12%	13%	13%
Percentage with participant-directed exchanges	18	13	14	14	11	10	10	9	10	10
Percentage of average recordkeeping assets										
Percentage traded	13.0%	12.7%	14.7%	16.6%	14.1%	13.4%	14.8%	12.6%	14.0%	11.6%
Percentage moved to equities (fixed income)	(0.7)	(0.6)	(1.5)	(3.9)	(0.6)	(1.1)	(2.5)	(1.7)	0.2	(0.6)
Dollar flows (in billions)										
Dollars traded	$23.6	$27.0	$36.2	$39.7	$29.0	$32.5	$40.6	$36.2	$44.8	$41.8
Dollars moved to equities (fixed income)	(1.3)	(1.3)	(3.7)	(9.3)	(1.2)	(2.8)	(6.9)	(4.9)	0.5	(2.3)
S&P 500 Index volatility										
Percentage of days up or down 3% or more	0.0%	0.0%	0.4%	16.8%	8.7%	3.2%	4.8%	0.0%	0.0%	0.0%
Percentage of days up or down 1% or more	12	12	26	54	46	30	37	20	15	31

Source: Vanguard, 2015.

Figure 88. **Trading activity, January 2005–December 2014**

Vanguard defined contribution participants



Source: Vanguard, 2015.

Direction of money movement

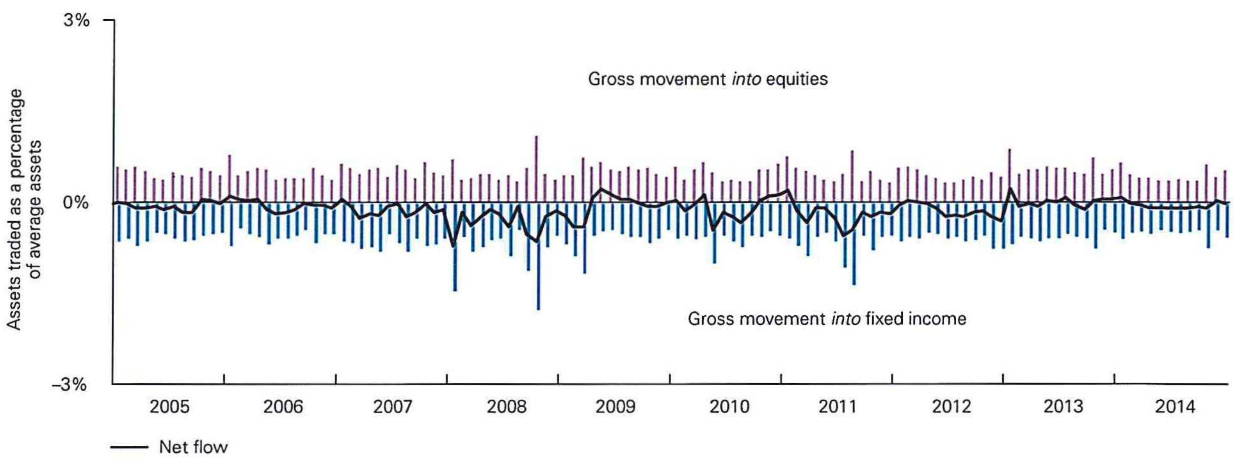
Summary statistics may sometimes give the impression that all participant trading is in one particular direction. However, in any given month, participants who trade are trading meaningful dollar amounts both into and out of equities (Figure 89). Even in volatile markets, as some traders shift their portfolios toward fixed income assets, there are others who shift toward equities.

During the past decade, which includes the 2008–2009 bear market, the net movement of money among participants trading in their accounts has been generally toward fixed income investments. Nonetheless, even at the height of the recent market volatility, there were significant gross flows toward equities among some participants.

Figure 89. **Direction of money movement, January 2005–December 2014**

Vanguard defined contribution participants

Money movement as a percentage of average assets



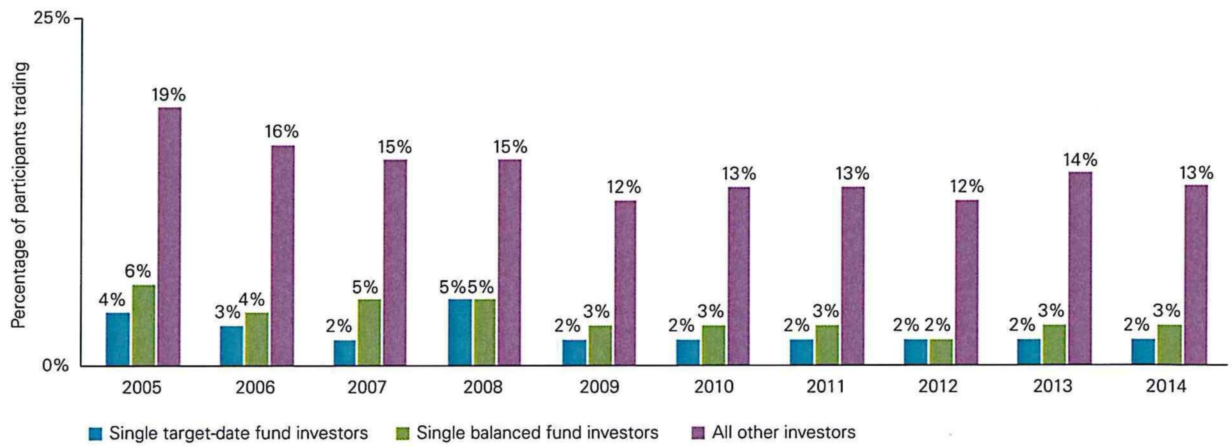
Source: Vanguard, 2015.

The growing reliance on single-fund investment programs, such as target-date funds, has likely contributed to lower trading levels by participants. Pure target-date and single balanced fund investors trade much less frequently than all other participants, although their portfolios are rebalanced daily by the fund managers (Figure 90).

Men are more likely to trade than women (Figure 91). However, participants enrolled in the managed account program trade much more frequently than all other participants as their investments are rebalanced periodically to the target asset allocation.

Figure 90. Participant trading by investor type

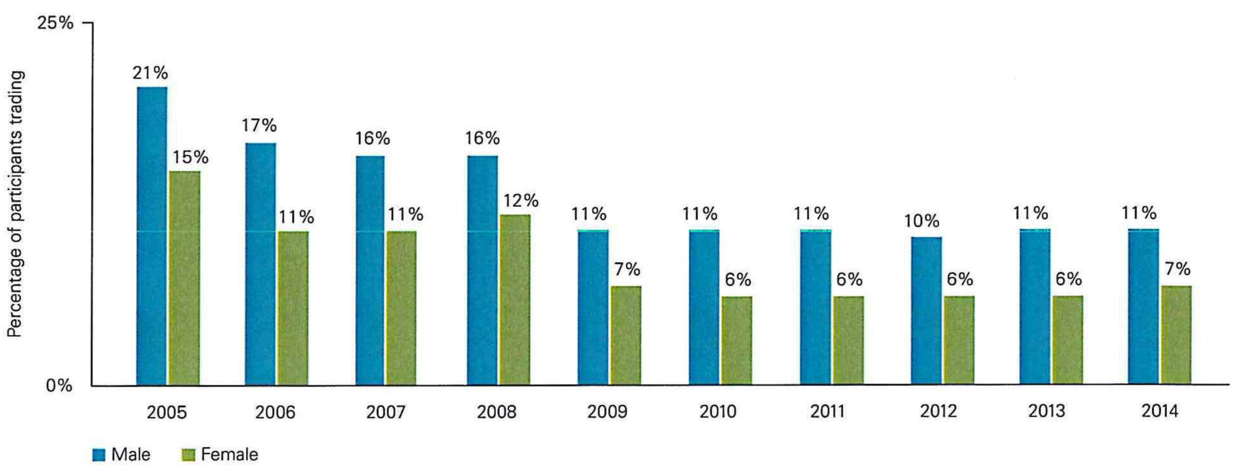
Vanguard defined contribution plan participants



Source: Vanguard, 2015.

Figure 91. Participant trading by gender

Vanguard defined contribution plan participants



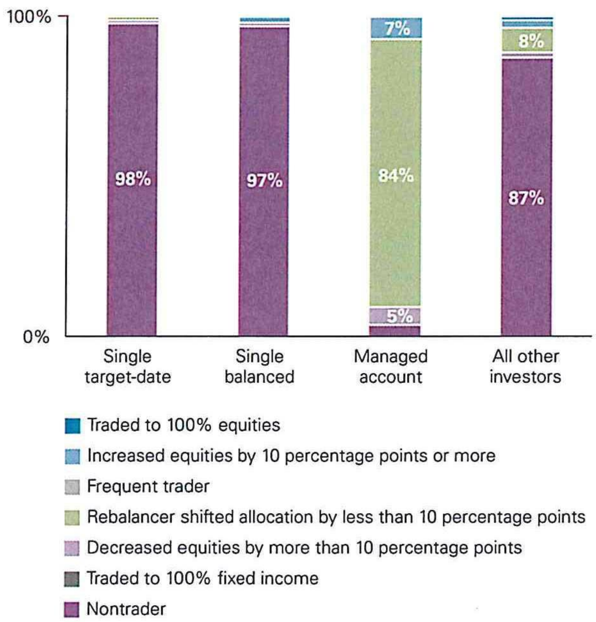
Source: Vanguard, 2015.

Types of trading activity

Among participants who trade in their accounts, the types of changes made by participants are varied. In 2014, 98% of single target-date investors and 97% of single balanced fund investors did not trade to other fund options and instead retained their single holding (Figure 92).

Figure 92. Participant trading decisions, 2014

Vanguard defined contribution plan participants



Source: Vanguard, 2015.

However, the fund managers for these strategies rebalanced the underlying assets of the funds daily.

On the other hand, nearly all participants using a managed account had exchanges. In a managed account, the advisor oversees multiple fund holdings in a typical participant's account. The trading activity reflects the advisor rebalancing the participant's portfolio (or, with those initially signing up for the service, portfolio changes needed to arrive at the target portfolio strategy).

Among "do-it-yourself" investors, most participants do not trade—not even to rebalance their account. In 2014, less than 1% of all other participants abandoned equities.[10] Even among all other investors, most participants trading were rebalancing their portfolios.

Over a longer time frame, 2010–2014, 29% of participants initiated trades. Seven in 10 participants (excluding managed account investors) made no trades in their workplace retirement plan account, not even to rebalance to a target asset allocation. Again, single target-date and balanced fund investor portfolios are rebalanced by the fund managers. However, 55% of participants were making their own investment decisions in 2014.

10 A participant who abandoned equities is one who shifted his or her entire portfolio into fixed income investments during the year. Only participants with some equity exposure in their portfolio who shifted to all fixed income assets during 2014 are included in this category.

3 Accessing plan assets

Participants can access their plan assets by taking a loan or a withdrawal while they are working, or through a withdrawal or rollover when they change jobs or retire.

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Plan loans

If permitted by the plan, participants can borrow up to 50% of their balance (up to a maximum of $50,000) from their DC plan account. Plan loans allow DC participants to access their plan savings before retirement without incurring income taxes or tax penalties. Loans are more common for plans accepting employee contributions and less common for employer-funded DC plans, such as money purchase or profit-sharing plans.

Offering loans appears to have a beneficial effect on retirement savings, raising contribution rates above what they would otherwise be. Yet they also come with risks. Cash that has been borrowed earns fixed income rather than equity market returns. Also, participants who leave their employer must typically repay any loan balance immediately—or risk paying taxes and a penalty and incurring a reduction in retirement savings by the amount of the loan outstanding.[11]

Loan availability

Loans are widely offered by employee-contributory DC plans. In 2014, 77% of Vanguard 401(k) plans permitted participants to borrow from their plan and 88% of active participants had access to a loan feature. The availability of loans tends to depend on plan size. Large plans tend to offer loans; small plans often do not. Loans are expensive to administer, and loan origination and maintenance fees are increasing. With loan fees, sponsors can allocate costs directly to those participants incurring loan-related expenses.

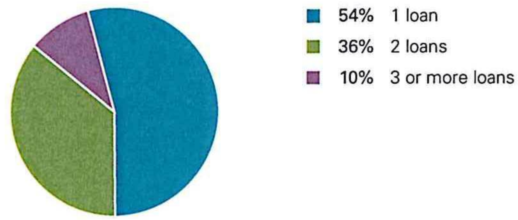
Most plans allow participants to have only one loan outstanding. In 2014, 54% of Vanguard 401(k) plans offering loans permitted only one loan at a time (Figure 93). Thirty-six percent of plans allowed two, and 10% of plans allowed three or more.

Loan use by participant demographics

Less than 1 in 5 participants had a loan outstanding at year-end 2014 (Figure 94).[12]

Figure 93. Number of loans allowed, 2014

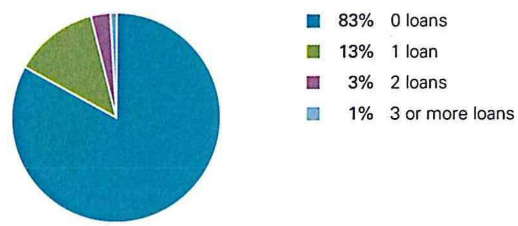
Vanguard defined contribution plans offering loans



Source: Vanguard, 2015.

Figure 94. Participant loan use, 2014

Vanguard defined contribution plans offering loans



Source: Vanguard, 2015.

11 For a comprehensive analysis of loans, see Timothy (Jun) Lu, Olivia S. Mitchell, Stephen P. Utkus, and Jean A. Young, *Borrowing from the Future: 401(k) Plan Loans and Loan Defaults*. www.pensionresearchcouncil.org/publications

12 Our analysis of the percentage of participants with loans considers all participants with an account balance in plans offering loans. Some of these participants no longer work for the plan sponsor and are not eligible for a new loan. Some participants with loans also no longer work for the plan sponsor but are repaying loans. Loan use would likely be about five percentage points higher if based solely on active employees.

Figure 95. Participant loan demographics, 2014

Vanguard defined contribution plans offering loans

			Participants with loans			Participants with no loans
	Percentage of participants with loans	Percentage of account balance in loans	Average loan amount	Average account balance	Total average account balance including loans	Average account balance
All	17%	10%	$9,737	$89,869	$99,606	$110,088
Household income						
<$30,000	24%	12%	$7,317	$55,112	$62,429	$69,427
$30,000–$49,999	24	11	$8,089	$62,994	$71,083	$75,970
$50,000–$74,999	21	10	$9,640	$82,880	$92,520	$99,452
$75,000–$99,999	17	9	$11,517	$116,496	$128,013	$139,771
>$100,000	12	7	$13,592	$168,588	$182,180	$204,421
Age						
<25	4%	21%	$2,386	$9,157	$11,543	$3,966
25–34	13	18	$6,296	$28,893	$35,189	$25,114
35–44	21	14	$9,555	$61,170	$70,725	$71,664
45–54	21	9	$10,992	$109,714	$120,706	$135,949
55–64	16	7	$11,033	$152,651	$163,684	$202,662
>65	5	6	$9,882	$151,385	$161,267	$214,817
Gender						
Male	18%	9%	$10,457	$104,549	$115,006	$132,432
Female	17	11	$8,717	$70,393	$79,110	$85,574
Job tenure (years)						
0–1	3%	19%	$5,582	$23,416	$28,998	$12,359
2–3	11	18	$5,040	$22,334	$27,374	$31,780
4–6	16	16	$7,325	$37,590	$44,915	$63,120
7–9	23	14	$9,094	$54,751	$63,845	$100,737
>10	25	8	$11,632	$130,271	$141,903	$238,333
Account balance						
<$10,000	10%	31%	$2,464	$5,380	$7,844	$3,105
$10,000–$24,999	22	25	$5,534	$16,890	$22,424	$16,659
$25,000–$49,999	24	21	$9,328	$36,136	$45,464	$36,130
$50,000–$99,999	23	15	$12,677	$71,666	$84,343	$72,114
$100,000–$249,999	19	9	$15,301	$156,940	$172,241	$160,926
>$250,000	12	4	$17,709	$452,155	$469,864	$539,137

Source: Vanguard, 2015.

On average, the outstanding loan account balance equaled 10% of the participant's account balance, including the loan, and the average participant had borrowed about $9,700 (**Figure 95**). Outstanding loans are typically excluded from measures of plan and participant assets because these assets have, in effect, been withdrawn from the plan and are not currently available as a retirement resource. However, more than 90% of loans are repaid and outstanding loans represent participant and plan assets. Only about 2% of aggregate plan assets were borrowed by participants.

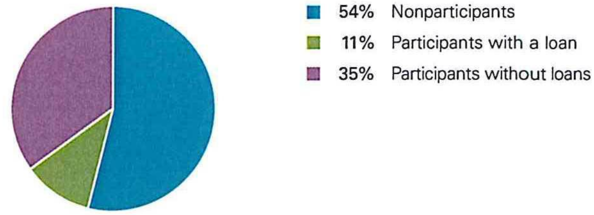
Loans are sometimes criticized as a form of revolving credit for younger, lower-income workers. While that may be partly true, loan use by age follows a hump-shaped profile, with loan use highest among participants in their prime working years. Among workers age 35–54, loan use averaged slightly more than 20% in 2014. Men and women used loans at the same rate.

Income appears to have a larger influence on loan use than age does. In 2014, 24% of participants with household incomes of less than $30,000 had a loan, while only 12% of participants with household incomes of more than $100,000 did. This difference reflects liquidity constraints among those with low wealth and income—i.e., higher-income households have less need for borrowing because of their higher income or other savings.

In 2014, loans were most common among participants with a balance between $10,000 and $100,000. Participants with account balances of less than $10,000 were actually somewhat less likely to have a loan, yet they borrowed the largest percentage of their account balances. Only 10% of participants in this group had a loan, but the loan accounted for 31% of their account balance on average.

Figure 96. **Participation and loans, 2014**

All employees earning less than $30,000



Source: Vanguard, 2015.

Across many demographic groups, participants with no loans outstanding in 2014 appear to have accumulated more in retirement savings than participants with loans. However, among participants younger than 35, participants with outstanding loans appear to have greater retirement savings accumulations. These differences in part reflect the interplay of demographic differences in terms of age, income, and tenure between borrowers and nonborrowers.

Loan use is highest among participants who earn less than $30,000—almost 1 in 4 of these participants has a loan outstanding. However, earlier in this report, we noted that participation rates are lowest among this group, with only 46% of these workers joining their plan. Arguably, participants who earn less than $30,000 but have borrowed from their retirement savings (11% of these workers) are better off than those employees who earn less than $30,000 and do not participate in their employer plan (**Figure 96**).

Loan use by industry group

Loan use varies significantly by industry group (Figure 97). Participants in the media, entertainment, and leisure fields, as well as those in the business, professional, and nonprofit industries, use loans at a lower rate than other participants, suggesting that more highly educated participants might use loans less frequently.

Trends in new loan issuance

Among Vanguard plans, the fraction of participants taking loans from their DC plans fell between 2005 and 2008 (Figure 98). However, in 2009, the rate of new borrowing rose by 19%, approaching 2006 levels. In 2010, the fraction of participants taking loans rose again by 14%, returning to 2005 levels. In 2011, loan-taking was on par with the level in 2010, and it declined modestly in 2012. Loan-taking grew again in 2013, and then declined modestly in 2014.

There is a pronounced seasonality to loan-taking, with borrowing typically peaking in the summer months. The reasons for this pattern, as well as the reasons for the decline and then rise in loan use in recent years, are not well understood. We speculate that loan use first fell with the overall decline in consumer spending in the economic downturn, along with the decline in housing transactions (loans are often used for housing-related expenses). Loan use may have jumped sharply in 2009 and 2010 as the effects of the recession wore on. Recent loan use also may partly reflect improving economic conditions and a resumption in consumer spending.

Figure 97. Participant loans by industry sector, 2014

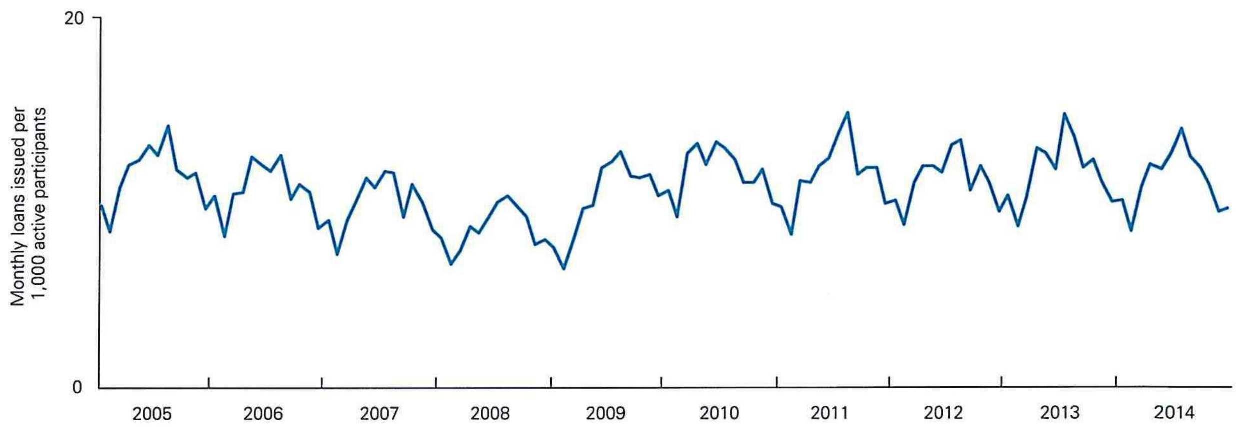
Vanguard defined contribution plans offering loans

			Participants with loans			Participants with no loans
	Percentage of participants with loans	Percentage of account balance in loans	Average loan amount	Average account balance	Total average account balance including loans	Average account balance
All	17%	10%	$9,737	$89,869	$99,606	$110,088
Industry group						
Transportation, utilities, and communications	23%	10%	$8,632	$74,281	$82,913	$95,797
Finance, insurance, and real estate	20	12	10,511	80,389	90,900	105,112
Agriculture, mining, and construction	20	7	14,121	177,887	192,008	253,111
Manufacturing	19	9	9,100	87,540	96,640	113,395
Wholesale and retail trade	18	9	8,527	82,557	91,084	87,134
Education and health	15	13	8,561	56,261	64,822	65,151
Media, entertainment, and leisure	12	11	9,539	79,384	88,923	75,166
Business, professional, and nonprofit	10	9	11,157	117,471	128,628	126,555

Source: Vanguard, 2015.

Figure 98. Loan origination trend

Vanguard defined contribution active participants in plans offering loans



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Monthly average (per 1,000 participants)	11.3	10.6	9.8	8.5	10.1	11.5	11.4	11.1	11.5	11.0
Annual increase (decrease) in loans issued per 1,000 participants	(6%)	(7%)	(7%)	(14%)	19%	14%	(1%)	(3%)	4%	(4%)

Source: Vanguard, 2015.

Plan withdrawals

Plan withdrawals allow participants to access their plan savings before a job change or retirement. Withdrawals are optional plan provisions and availability varies from plan to plan. They can be broadly classified into two categories—hardship and nonhardship withdrawals.

Hardship withdrawals allow participants to access a portion of their savings when they have a demonstrated financial hardship, such as receipt of an eviction or home foreclosure notice, but may also be used for such purposes as college education and purchase of a first home.

Nonhardship withdrawals include both post-age-59½ withdrawals and other withdrawals. Post-age-59½ withdrawals allow participants age 59½ and older to access their savings while they are working and are exempt from the 10% penalty on premature distributions. Some plans may also allow participants to withdraw employer profit-sharing contributions, after-tax contributions, or rollover assets while they are working.

Among all Vanguard DC plans in 2014, 83% allowed hardship withdrawals and 84% allowed plan withdrawals for those who have reached age 59½ (Figure 99). In 2014, less than 4% of Vanguard participants in plans offering any type of withdrawal used the feature, and the average portion of account balance withdrawn was about one-third (Figure 100). About one-fifth were for hardship and four-fifths for nonhardship reasons. Assets withdrawn totaled 1% of Vanguard recordkeeping assets.

Of the participants who took withdrawals, 92% took the money in cash, withdrawing on average about one-sixth of account savings. They had a median age of 51. Meanwhile, 8% of participants taking withdrawals rolled over their assets from the plan to an IRA. A major contributor to this is likely participants older than 59½ rolling over their plan savings even as they continue to work and participate in the plan. Participants choosing a rollover had a median age of 62 and on average they rolled over 75% of their account balances. These participants rolling over assets account for more than half of the assets being withdrawn.

In the aftermath of the recent recession, the rate of new nonhardship withdrawals, such as post-age-59½ in-service or other withdrawals, has more than doubled from 2005 to 2014 (Figure 101). Nonhardship withdrawals also have a seasonal pattern and often spike in the first quarter of the year. This spike in activity is likely due to the withdrawal of employer profit-sharing contributions, which are frequently made early in the calendar year.

Over the same 2005-to-2014 period, the rate of new hardship withdrawals was also up about one-third, while remaining at a low absolute level of 2% of participants. One of the reasons a participant can take a hardship withdrawal is to avoid foreclosure or eviction from a home. We believe that the surge in foreclosures in recent years is, in part, driving this increase. Hardship withdrawals have fluctuated within a relatively narrow range from 2008 to 2014.

Plan withdrawals are used infrequently in the aggregate. However, about 4 in 10 participants taking a withdrawal in 2014 had also taken plan withdrawals in 2013, and 1 in 10 in this group had taken a plan withdrawal in each of the past five years. Certain participants could, over time, jeopardize their retirement program if they continue to rely on this feature throughout their working careers.

Figure 99. Plan withdrawals

Vanguard defined contribution plans

Percentage of plans offering	2014
Hardship withdrawals	83%
Withdrawals after age 59½	84

Source: Vanguard, 2015.

Figure 100. Use of plan withdrawals, 2014

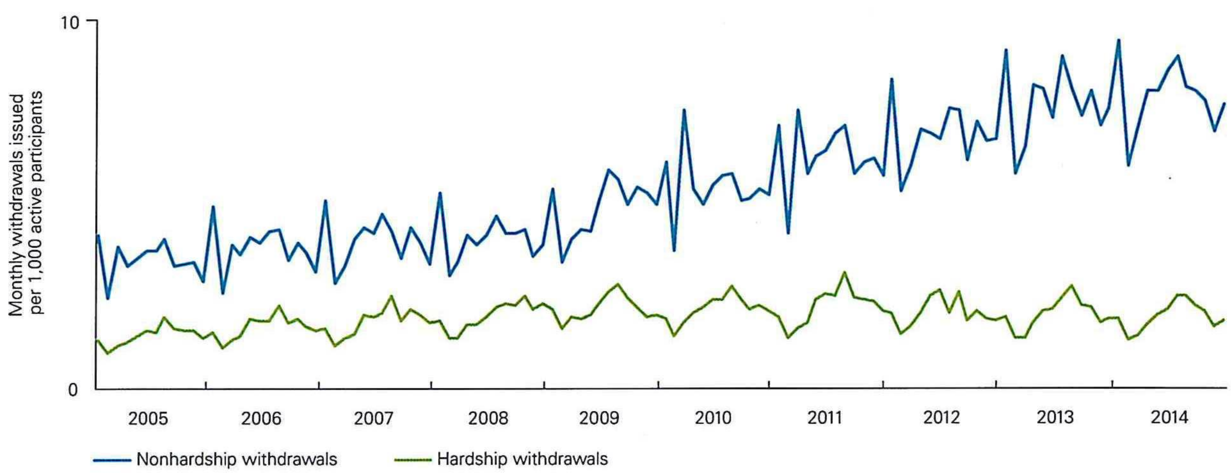
Vanguard defined contribution plans

	All	Cash	Rollover
Percentage of participants using	3.6%	3.3%	0.3%
Percentage of assets withdrawn	0.9	0.4	0.5
Percentage of participant account assets withdrawn	31.4	17.2	75.1
Median age	51	51	62

Source: Vanguard, 2015.

Figure 101. In-service withdrawal trend

Vanguard defined contribution active participants in plans offering in-service withdrawals



Average per 1,000 active participants	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Nonhardship withdrawals	3.6	3.9	4.1	4.2	5.0	5.6	6.4	7.0	7.8	8.0
Hardship withdrawals	1.5	1.7	1.8	2.0	2.2	2.2	2.2	2.1	2.0	2.0

Annual increase (decrease) per 1,000 active participants										
Nonhardship withdrawals	3%	8%	3%	2%	19%	12%	15%	9%	11%	3%
Hardship withdrawals	7	13	6	11	10	0	0	(5)	(5)	0

Source: Vanguard, 2015.

Plan distributions and rollovers

When changing jobs or retiring, DC plan participants have the choice of preserving their savings for retirement (by retaining them in the plan or rolling them over to an IRA or another DC plan) or taking a cash lump sum (and spending or investing it). If they choose to roll over their savings to an IRA or another qualified retirement plan, participants avoid paying taxes on the accumulated balance. If participants spend the lump-sum distribution or invest it in a taxable account, they incur a possible income tax liability (and a 10% penalty if they are younger than 59½).

The problem of leakage from the retirement system—the spending of plan savings before retirement—is a concern for the future retirement security of plan participants. In the short run, participants incur taxes and possibly penalties on any amounts they spend. In the long run, because of the lost opportunity for compound earnings, they significantly increase the amount they need to save during the remainder of their working years.

Policymakers have attempted to discourage leakage in several ways. Generally, participants may keep their plan savings in their employer's plan if their account balance is more than $5,000. Also, plan distributions between $1,000 and $5,000 are generally rolled over automatically to an IRA, unless the participant elects otherwise. Balances less than $1,000 may be distributed to the terminated participant. Most plans have adopted these provisions—only 5% of plans permit deferral within the plan when balances are less than $1,000 (Figure 102). In some cases, the sponsor may allow participants to retain a balance of $1,000 or more in the plan—17% of plans permit these balances to remain in the plan.

Figure 102. Frequency of automatic distributions, 2014

Vanguard defined contribution plans

		Number of participants		
	All	<1,000	1,000–4,999	>5,000
Percentage of plans				
Remain in plan (no automatic distribution)	5%	4%	5%	6%
Automatic cash out if balance is <$1,000, remain in plan if balance is higher	17	16	17	27
Automatic cash out if balance is <$1,000, roll over if balance is $1,000+ or <$5,000	78	80	78	67
Percentage of participants offered				
Remain in plan (no automatic distribution)	5%	4%	6%	4%
Automatic cash out if balance is <$1,000, remain in plan if balance is higher	30	18	16	38
Automatic cash out if balance is <$1,000, roll over if balance is $1,000+ or <$5,000	65	78	78	58

Note: This analysis excludes approximately 100 403(b) plans and approximately 360,000 participants in those plans. Most 403(b) plan sponsors retain the right to execute these automatic distributions within their plan documents. However, due to the multiprovider environment many 403(b) plans operate within and the coordination required to process these distributions, most 403(b) plan sponsors do not process these distributions.

Source: Vanguard, 2015.

Most sponsors permit indefinite deferral of savings, meaning that participant balances can remain in the employer plan as long as they are above the $5,000 (or $1,000) threshold. However, 4% of sponsors require terminated participants to leave the plan by age 65 or age 70 (Figure 103).

Six in 10 sponsors allow participants to establish installment payments and about one-quarter offer an annuity option for at least a portion of the plan assets. Eight percent of plans offered an annuity for a grandfathered source only and these annuity features are mostly associated with plan assets relating to a prior money purchase plan. Fifteen percent of plans offered an annuity as a general distribution option and one-third of these plans offered the annuity for statutory reasons or as a general market practice such as with 403(b) plans. Finally, 13% of sponsors permit terminated participants to take partial ad hoc cash distributions. These plans allowing ad hoc distributions cover 3 in 10 participants. If a plan does not offer ad hoc distributions, it requires any terminated participant seeking to use any part of retirement savings to withdraw or roll over the entire account balance.

When it offers an ad hoc distribution feature, a plan can be used directly as a flexible source of income and withdrawals.

Figure 103. **Distribution options, 2014**

Vanguard defined contribution plans

		Number of participants		
	All	<1,000	1,000–4,999	>5,000
Percentage of plans				
Deferral	99%	99%	100%	98%
Deferral only to age 65	3	3	4	5
Deferral only to age 70	1	0	1	1
Installments other than RMDs	58	59	55	66
Annuity	15	16	11	18
Annuity grandfathered source only	8	9	8	5
Ad hoc partial distributions	13	7	22	36
Percentage of participants offered				
Deferral	99%	99%	100%	99%
Deferral only to age 65	3	3	3	3
Deferral only to age 70	6	1	1	9
Installments other than RMDs	59	60	55	60
Annuity	17	15	12	19
Annuity grandfathered source only	1	3	2	1
Ad hoc partial distributions	30	11	24	35

Source: Vanguard, 2015.

Participant and asset flows

Plan distributions can occur somewhat frequently as participants change jobs or retire, and they represent a large portion of total plan and participant assets. In 2014, 9% of participants left their employer and were eligible for a distribution. Their assets totaled 6% of Vanguard recordkeeping assets.

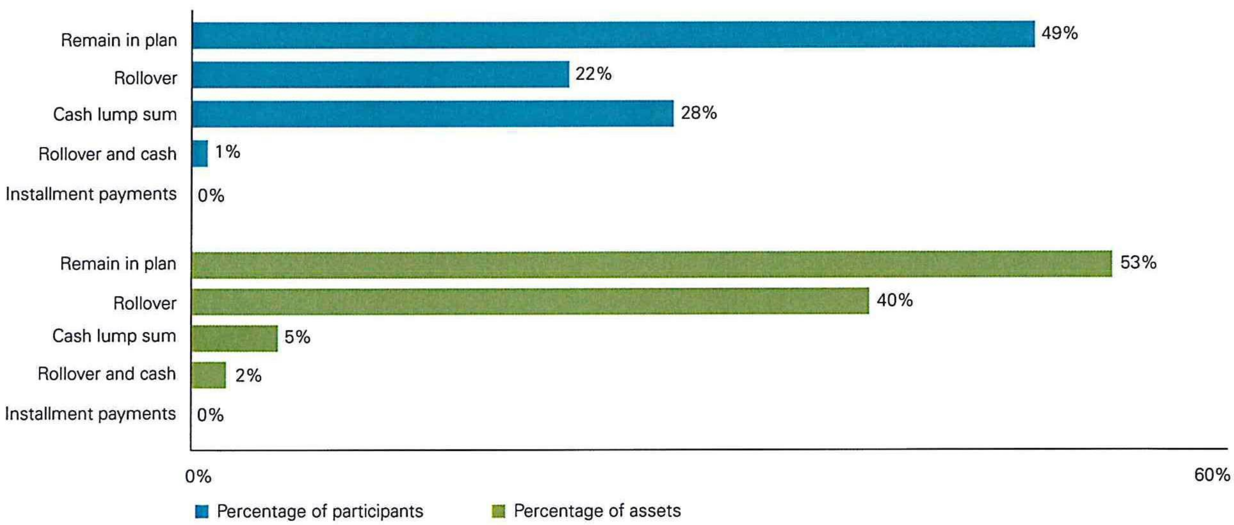
In 2014, 71% of participants terminating employment preserved their assets and 29% took a cash distribution (Figure 104). More than 90% of the assets available for distribution were preserved for retirement because they were either retained in the prior employer's plan, were rolled over to an IRA, or rolled over to a new employer's plan. The percentage of participants choosing to take cash and presumably spending their savings has returned to prerecession levels (Figure 105).

These figures differ from other reported statistics on plan distributions because they include participants who chose to retain their assets in their prior employer's plan when they change jobs or retire. Among only those participants who took a distribution from their plan, more took cash distributions (29%) than rolled over their assets to another plan or IRA (22%). But in our view, a full assessment of plan distribution behavior must include participants who kept their assets within their prior employer's plan at the time of a job change or retirement.

Figure 104. Plan distributions, 2014

Vanguard defined contribution plans

Participants with termination dates in 2014



Source: Vanguard, 2015.

Figure 105. Trends in distribution of plan assets

Vanguard defined contribution plans

Participants with termination dates in the given year

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Percentage of participants choosing										
Remain in plan	47%	47%	47%	48%	48%	48%	49%	48%	49%	49%
Rollover	24	24	24	21	21	22	21	21	22	22
Installment payments	0	0	0	0	0	0	0	0	0	0
Participants preserving assets	71%	71%	71%	69%	69%	70%	70%	69%	71%	71%
Cash lump sum	27%	27%	28%	30%	30%	28%	28%	29%	28%	28%
Rollover and cash	2	2	1	1	1	2	2	2	1	1
Percentage of assets available for distribution										
Remain in plan	52%	53%	51%	50%	59%	55%	54%	53%	54%	53%
Rollover	39	39	42	42	33	37	38	39	39	40
Installment payments	0	0	0	0	0	0	0	0	0	0
Assets preserved for retirement	91%	92%	93%	92%	92%	92%	92%	92%	93%	93%
Cash lump sum	7%	6%	5%	6%	6%	6%	5%	5%	5%	5%
Rollover and cash	2	2	2	2	2	2	3	3	2	2

Source: Vanguard, 2015.

Determinants of distribution behavior

Age has a significant impact on distribution behavior. Younger participants are more likely than older participants to cash out, rather than save, their plan distributions. Yet most of the assets available for distribution are still preserved for retirement, even by younger individuals. In 2014, 35% of participants in their 20s chose to cash out their plan assets, compared with 19% of participants in their 60s (Figure 106). In terms of assets, 85% of assets owned by participants in their 20s and 96% of assets owned by participants in their 60s were preserved.

Account balances also have a significant impact on distribution behavior. Participants with smaller account balances are less likely to preserve their assets for retirement. Only 47% of participants with balances of less than $1,000 kept their balance in a tax-deferred account (Figure 107). However, once balances reach $100,000, more than 90% of participants chose to preserve their assets.

A more nuanced view emerges when you consider both age and account balance. At most asset levels, younger participants are more likely to preserve their assets (Figure 108). While participants in their 40s did overwhelmingly preserve their assets for retirement, at most asset levels they are slightly more likely than any other age group to cash out their DC plan when changing jobs.

Our analysis thus far reflects the behavior of individuals who terminated employment in a given year, either by changing jobs or retiring. But it is also true that participants who terminated in previous years retain the right to withdraw their plan assets from their prior employer's plan at any time and roll over or spend the money.

Figure 106. **Plan distribution behavior by age, 2014**

Vanguard defined contribution plans

Participants with termination dates in 2014

	20s	30s	40s	50s	60s	70s	All ages
Percentage of participants choosing							
Remain in plan	51%	51%	49%	49%	41%	18%	49%
Rollover	14	18	20	26	39	42	22
Installment payments	0	0	0	0	1	14	0
Participants preserving assets	**65%**	**69%**	**69%**	**75%**	**81%**	**74%**	**71%**
Cash lump sum	35%	30%	30%	23%	17%	24%	28%
Rollover and cash	0	1	1	2	2	2	1
Percentage of assets available for distribution							
Remain in plan	63%	64%	61%	56%	46%	24%	53%
Rollover	22	26	30	38	50	69	40
Installment payments	0	0	0	0	0	1	0
Assets preserved for retirement	**85%**	**90%**	**91%**	**94%**	**96%**	**94%**	**93%**
Cash lump sum	14%	9%	7%	4%	2%	3%	5%
Rollover and cash	1	1	2	2	2	3	2

Source: Vanguard, 2015.

Figure 107. Plan distribution behavior by account balance, 2014

Vanguard defined contribution plans

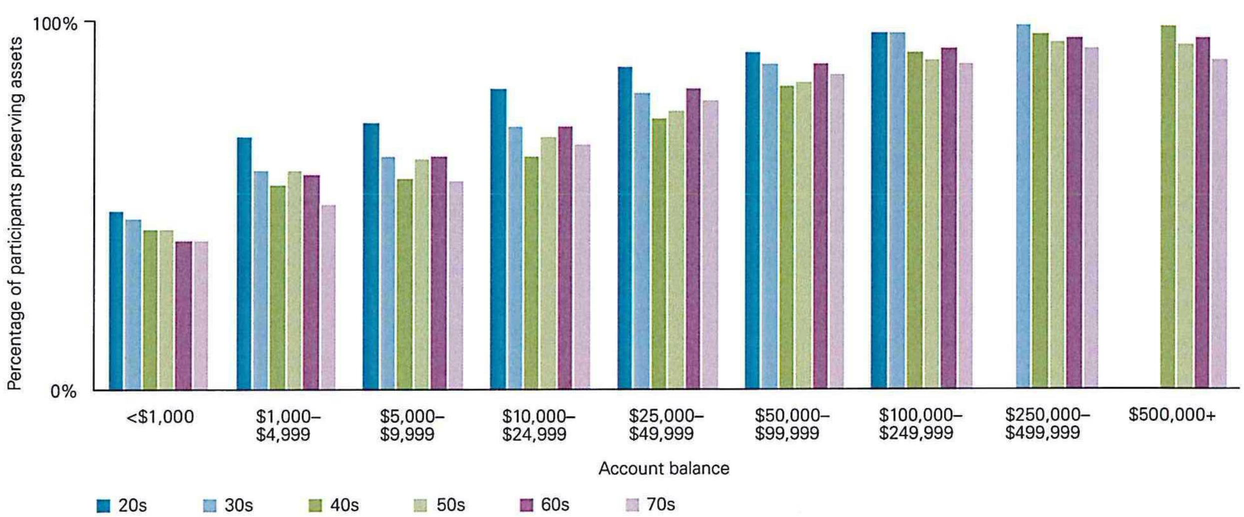
Participants with termination dates in 2014

Source: Vanguard, 2015.

Figure 108. Plan distribution behavior by age and account balance, 2014

Vanguard defined contribution plans

Participants with termination dates in 2014



Note: Cells with less than 100 data points are omitted.

Source: Vanguard, 2015.

A more optimistic picture of plan distribution behavior emerges if we analyze the total plan assets available for distribution at any given time. During 2014, 30% of all Vanguard qualified plan participants could have taken their plan account as a cash distribution because they had separated from service in the current year or prior years. However, just 15% of participants eligible for a cash distribution took one, while the vast majority (85%) continued to preserve their plan assets for retirement (**Figure 109**). In terms of assets, 97% of all plan assets available for distribution were preserved—either rolled over to an IRA or other qualified plan, or left in the former employer's plan. Only 3% of assets were distributed in cash.

Access methods and the internet

Within DC plans, a variety of services have evolved to foster participant control over plan savings and to facilitate savings, investment, and withdrawal decisions—including phone associates, voice-response systems, and internet and mobile access.

Participant access to retirement accounts is quite varied, ranging from those who do not contact their provider using one of these services at all in a given year to those who do so multiple times a month.

Frequency of account access

In 2014, 37% of plan participants never contacted Vanguard regarding their plan account (**Figure 110**). However, 63% did contact Vanguard—a ratio that has improved from 2005, when 53% of participants contacted Vanguard (**Figure 111**). One reason for this may be the dissemination of internet and mobile access; another may be the strong equity markets in 2013 and 2014, which led to higher levels of investor attention to their accounts. For participants who did not contact Vanguard, their sole method for reviewing plan balances was quarterly account statements. These participants also received Vanguard's participant electronic newsletter, fee and other regulatory disclosures, and education or communication programs in print or via electronic means.

Figure 109. Alternative view of distribution of plan assets

Vanguard defined contribution plans

All terminated participants with access to plan savings in the given year

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Percentage of participants choosing										
Remain in plan	65%	66%	65%	66%	67%	65%	68%	67%	68%	68%
Rollover	16	16	16	14	13	14	13	13	14	14
Installment payments	2	2	2	2	2	2	2	2	3	3
Participants preserving assets	**83%**	**84%**	**83%**	**82%**	**82%**	**81%**	**83%**	**82%**	**85%**	**85%**
Cash lump sum	16%	15%	16%	17%	17%	18%	16%	16%	14%	14%
Rollover and cash	1	1	1	1	1	1	1	2	1	1
Percentage of assets available for distribution										
Remain in plan	76%	75%	74%	72%	78%	75%	75%	75%	76%	76%
Rollover	20	21	22	23	17	20	20	20	20	20
Installment payments	1	1	1	1	1	1	1	1	1	1
Assets preserved for retirement	**97%**	**97%**	**97%**	**96%**	**96%**	**96%**	**96%**	**96%**	**97%**	**97%**
Cash lump sum	2%	2%	2%	3%	3%	3%	3%	3%	2%	2%
Rollover and cash	1	1	1	1	1	1	1	1	1	1

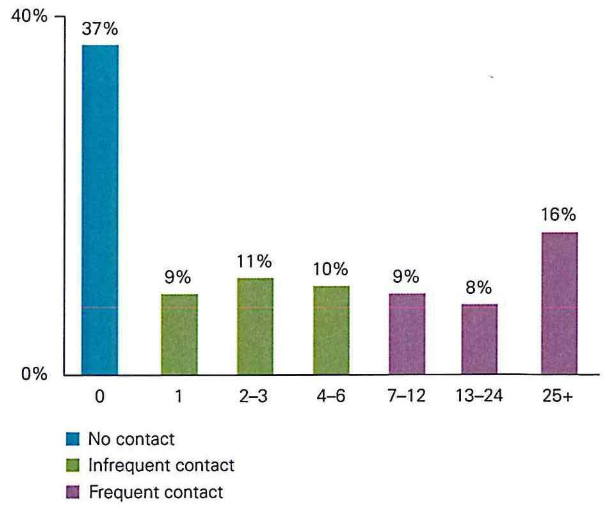
Source: Vanguard, 2015.

Three in ten participants contacted Vanguard intermittently. This group interacted with Vanguard between one and six times per year through a phone associate, an automated voice-response system, mobile application, or the internet. One-third of participants contacted Vanguard frequently. This group, using all channels, contacted Vanguard at least monthly, if not two or three times a month or more. This level of contact may seem high, but keep in mind, for those using a mobile application or the internet, a brief logon to examine account balances constitutes a unique contact event.

Account balances are a strong influence on contact behavior. The larger a participant's balance, the more likely they are to be proactive in obtaining information about their Vanguard plan account. Participants with account balances of more than $100,000—about 25% of all Vanguard participants—contacted Vanguard at least monthly, if not more, compared with a median level of two contacts per year for the entire participant population.

Figure 110. **Participant contact frequency, 2014**

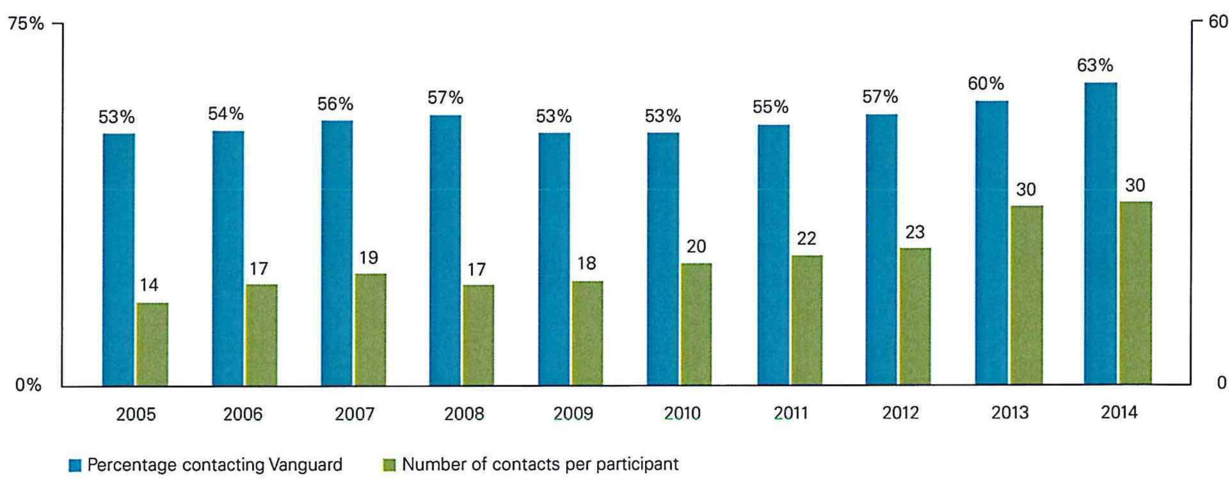
Vanguard defined contribution plans



Source: Vanguard, 2015.

Figure 111. **Participant contact trend**

Vanguard defined contribution plans



Source: Vanguard, 2015.

Types of account access

Participants have four access channels at their disposal: toll-free phone calls to telephone associates, toll-free phone calls to an automated voice-response system, a mobile application, and the internet. When measured in terms of total participant use, the internet remained the most widely used channel in 2014—56% used the internet, compared with 19% who used telephone associates (**Figure 112**). Introduced between 2009 and 2011, mobile applications were used by 8% of participants.

In terms of total contacts, the internet clearly dominates. Web interactions accounted for 88% of all participant contacts in 2014. Participants using this contact method averaged about 48 web interactions per year. Each distinct logon is counted as a unique contact event. Mobile access, though relatively new, was the second most common channel, accounting for 9% of all contacts—or nine times the number of phone contacts.

The portion of participants selecting the internet as an access channel has grown by about 50% since 2005 (**Figure 113**). During this interval, the portion of participants selecting a phone associate as an access channel has declined by nearly 40%, and the portion choosing the voice-response system has stayed about the same. Given current trends, the dominance of the internet as a contact channel is likely to continue. We expect adoption of the mobile applications will grow dramatically over the next few years.

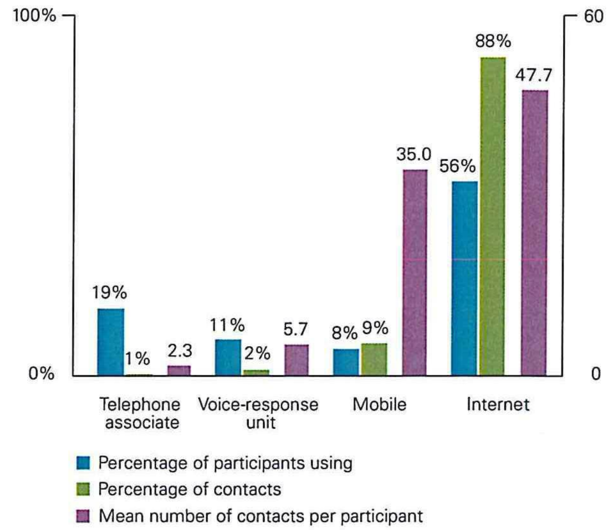
Participant registration for internet access to their DC plan account has fueled this growth. Seventy-one percent of participants were registered for the internet in 2014, about 60% higher than in 2005 (**Figure 114**).

Increasingly, participants are choosing the internet as the preferred access channel for transactions, as 78% of all transactions were processed via the internet during 2014, and another 7% were processed via mobile devices (**Figure 115**). Moreover, 90% of all exchanges, payroll deferral, and contribution allocation changes occurred on the internet or mobile devices.

Figure 112. Account access methods, 2014

Vanguard defined contribution plans

Participant account access



Source: Vanguard, 2015.

Figure 113. Account access trend

Vanguard defined contribution plans

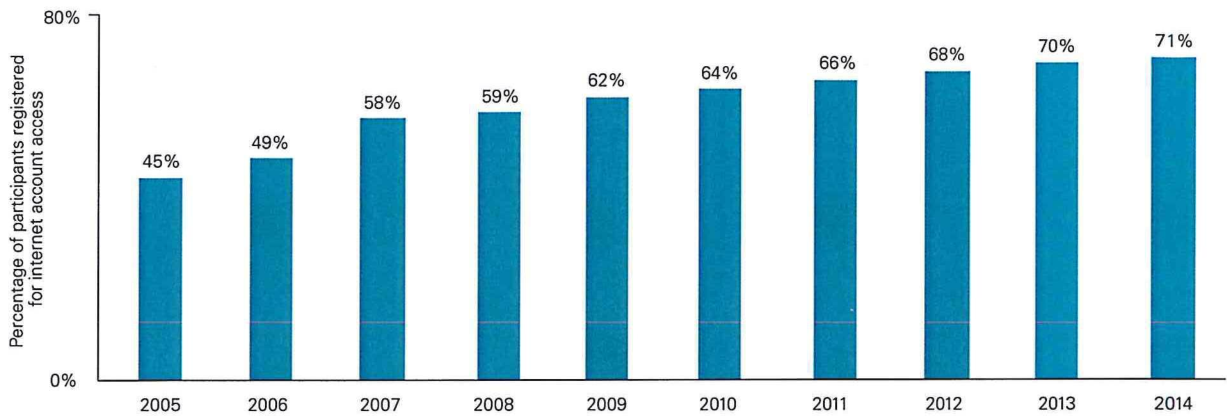
Percentage of participants contacting Vanguard via . . .

	2005	2014	Change
Voice, telephone associate, or internet	53%	63%	19%
Telephone associate	30	19	(37)
Voice-response unit	10	11	10
Mobile		8	
Internet	37	56	51
Participants registered for internet access	45	71	58

Source: Vanguard, 2015.

Figure 114. **Internet access trend**

Vanguard defined contribution plans

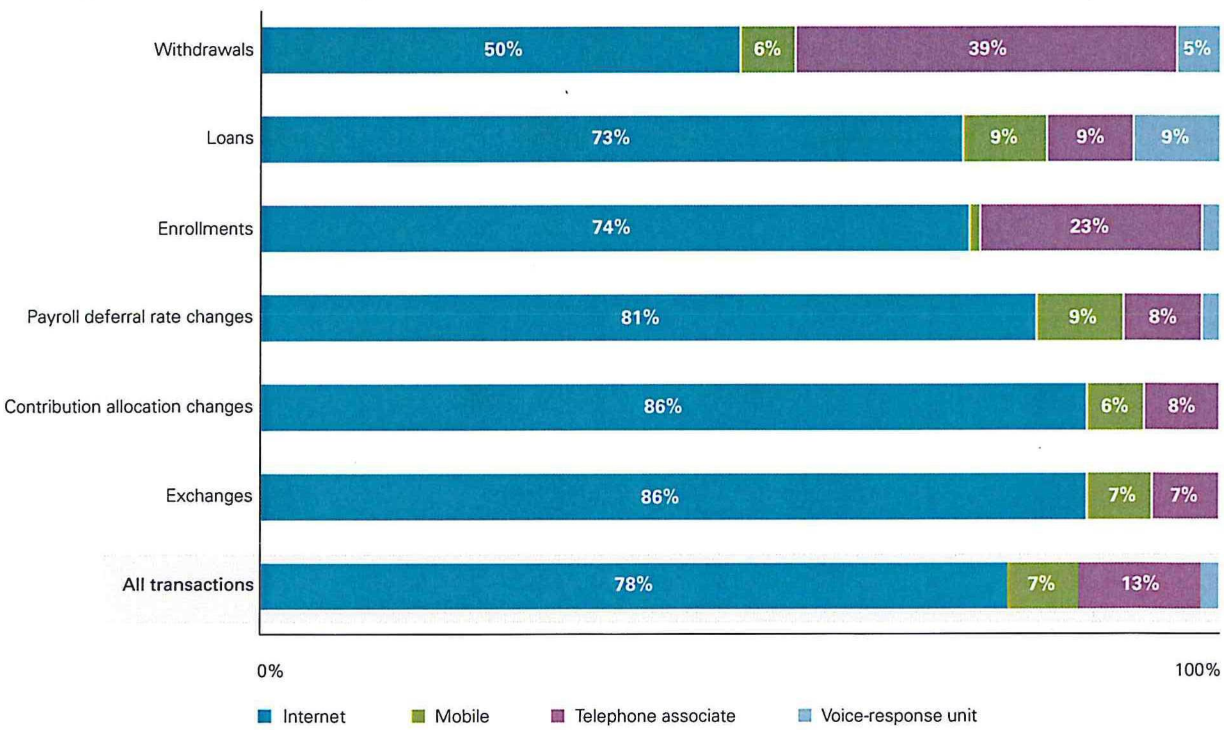


Source: Vanguard, 2015.

Figure 115. **Participant channel utilization, 2014**

Vanguard defined contribution plans

Percentage of transactions processed by channel



Source: Vanguard, 2015.

Methodology

The Vanguard data included in this report is drawn from several sources.

All defined contribution clients. This universe consists of about 1,900 qualified plans, 1,500 clients, and more than 3.6 million participants for which Vanguard directly provides recordkeeping services. About 9 in 10 of these plans have a 401(k) or 403(b) employee contributory feature; the other 1 in 10 is an employer contributory DC plan, such as a profit-sharing or money purchase plan, in which investments are directed by participants. Unless otherwise noted, all references to "Vanguard" are to this universe, and all data is as of December 31, 2014.

Vanguard participation and deferral rates. Data on participation and deferral rates is drawn from a subset of Vanguard recordkeeping clients for whom we perform nondiscrimination testing. For the 2014 analysis, the subset is composed of plans that complete their testing by March and represents approximately half of the clients for whom we perform testing.

For the 2014 analysis presented in this edition of *How America Saves*, this subset includes approximately 400 plans and 800,000 participants and eligible nonparticipants. Almost all of these plans are 401(k) or paired 401(k)/profit-sharing plans. Income data used in participation and deferral rate analyses also comes from this subset of plans.

When compliance testing has been completed for all plans, the analysis is performed again and the data is restated for prior years. The restated data for 2013 now includes 900 plans and 1.8 million participants and eligible nonparticipants. Plans that complete their testing by March generally have lower participation rates and generally include plans with concerns related to passing testing. Hence, the restated numbers generally show an improvement over the numbers initially reported.

Household income data. Household income data for asset allocation, account balance, and loan demographics is from an external source overlaid onto Vanguard participant data. This external household income data covers approximately 80% of the Vanguard participant universe and is the most recent data available.

Vanguard Retirement Plan Access to *How America Saves*

Launched in 2011, Vanguard Retirement Plan Access™ (VRPA) is a comprehensive service for retirement plans with up to $20-plus million in assets. Ascensus, Inc.—a nationally recognized recordkeeping firm—provides the administration of these plans on Vanguard's behalf. Through Vanguard Retirement Plan Access we served an additional 2,700 plan sponsors with more than 125,000 participants as of year-end 2014.

Industry benchmark data supplements to *How America Saves*

Industry benchmark data supplements to *How America Saves* are available for the following sectors:

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- Construction
- Engineering
- Finance
- Information
- Insurance
- Legal services
- Manufacturing
- Mining, oil, and gas extraction
- Retail
- Small business
- Technology
- Transportation and warehousing
- Union plans
- Utility
- Wholesale trade

If the sector you are interested in is not available at this time, please contact your sales executive or relationship manager.

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Quantifying the impact of chasing fund performance

Vanguard research note | July 2014

- Given many investors' goal of maximizing return, it's not surprising that some investors select funds based primarily on the funds' recent performance record. But is that a prudent strategy?
- This research note simulates a performance-chasing strategy among U.S. equity mutual funds for the ten years ended December 31, 2013; we then compare the results with a buy-and-hold strategy over the same period. Our analysis shows clearly that buy-and-hold has been the superior approach.
- For investors using active management, it's critical to understand that short-term performance should not be the sole reason to enter or exit a mutual fund. To improve their chances of succeeding with active funds, investors must be willing and able to avoid the "thrill of the chase."

The lure of performance-chasing

The refrain *"Don't just sit there, do something!"* has become part of daily life. The phrase exhorts us to take action to bring about a change. For investors experiencing below-average mutual fund returns, this advice may seem reasonable. The resulting action plan for such investors frequently involves moving assets from one fund to another fund with a stronger performance track record over the past few years. In short, these investors end up chasing performance.

Research has shown that performance-chasing is not restricted to specific groups or subsegments of investors; rather, both retail and institutional clients have shown an inclination to chase performance (Goyal and Wahal, 2008; Bennyhoff and Kinniry, 2013). Given the intuitiveness and popularity of this behavior, we decided to take a closer look at its underlying assumptions and historical performance.

In theory, performance-chasing succeeds if past performance can predict future performance. In financial terms, performance-chasing may provide a benefit if there is persistent (that is, repeated and prolonged) relative outperformance from year to year. By performance-chasing, investors implicitly or explicitly assume that performance persistence is fairly strong. In contrast, investors who follow a buy-and-hold strategy are assuming that performance persistence is fairly weak and that excess returns are not likely to be gained by chasing performance. This research note compares performance-chasing with buy-and-hold by comparing the returns and risk-adjusted performance of each strategy to determine if taking action based on past performance is worthwhile.

Study sample and ground rules

For our primary analysis we chose the universe of active U.S. equity mutual funds available in any of the nine equity style boxes in Morningstar's database during the ten years ended December 31, 2013. After filtering the database to include only funds in existence for a minimum of three calendar years at some point during the analysis period, we arrived at a study sample of 3,568 funds.

To compare performance-chasing with buy-and-hold, it's essential to define the trading/investment rules governing each strategy through time. We settled on a set of rules (see the box on "Trading/investment rules," on page 2) as a reasonable representation of actual investor behavior related to each strategy. Using these rules as part of a quantitative historical simulation for the period 2004–2013, we examined the performance of each possible path an investor could have taken within the trading-rule guidelines. We performed the analysis separately in each of the nine equity style boxes to control for size or style influences that might affect the results. Our simulation produced a total of more than 40 million return paths.

Trading/investment rules for this analysis

Performance-chasing

Initial investment: At the start of the analysis period, we invested in any fund in existence for the full three-year period from 2004 through 2006 that had an above-median three-year annualized return.

Sell rule: Using three-year rolling periods of returns, we moved forward one calendar year at a time. Funds that achieved below-median three-year annualized returns at any time were sold, as were funds that were discontinued.

Reinvestment rule: After any sale, we immediately reinvested in each fund that achieved an average annualized return within the top-20 performing funds in the style box over the prior three-year rolling period.

Buy-and-hold

Initial investment: Invest in any fund.

Sell rule: Sell only if a fund is discontinued.

Reinvestment rule: Reinvest in the median-performing equity mutual fund within the relevant style box.

Advantages of the methodology

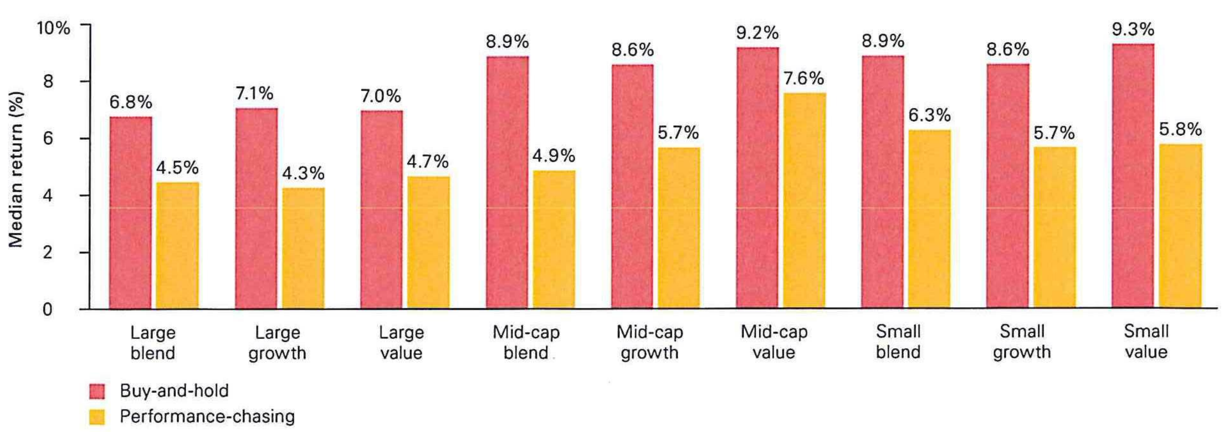
This process of cycling through the performance-chasing and buy-and-hold trading rules generated millions of potential return paths that could have been experienced by investors during the period 2004–2013. Using these return paths, we were able to calculate the median experience as well as the full distribution of potential outcomes for investors engaged in each type of strategy.

One rule in particular, the holding period over which performance is measured, has been the subject of extensive research in terms of performance persistence. We used a three-year rolling performance "look-back" for the performance-chasing strategy because of the time period's alignment with the approximate equity mutual fund holding period.[1]

The clear winner: Buy-and-hold

Once all possible return paths were created for both the performance-chasing and buy-and-hold strategies, we calculated various statistics such as annualized returns and Sharpe ratios for each path during the full ten-year period. **Figure 1** summarizes the basic return results, and **Figure 2** provides more details.[2]

Figure 1. Buy-and-hold was superior to a performance-chasing strategy across the board: 2004–2013

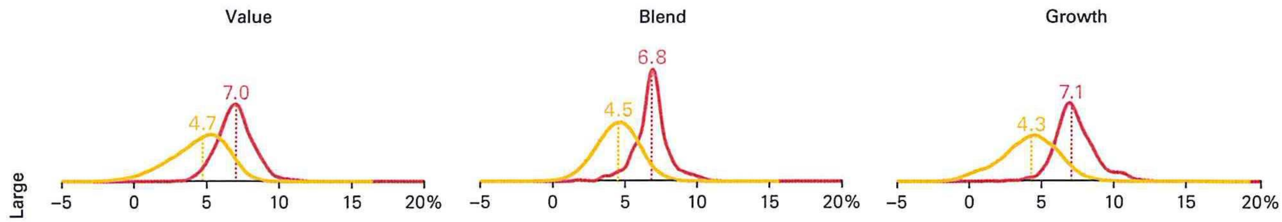


Source: Vanguard.

1 Using U.S. equity fund redemption data from the Investment Company Institute for the 15 years from 1999 though 2013, we estimated that the average mutual fund holding period just exceeded three years. Admittedly, redemption ratios are an imperfect measure of mutual fund holding periods, but given a lack of direct evidence on the holding periods of mutual fund investors, we believe this is a reasonable proxy.

2 Although the results are not displayed in this research note, we performed this analysis using a variety of trading rules and time periods and observed similar outcomes.

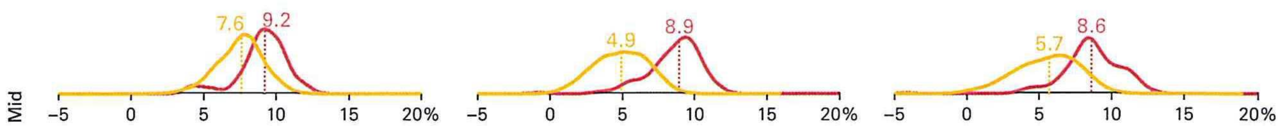
Figure 2. Detailed results of buy-and-hold versus performance-chasing strategies: 2004–2013



	Return	Sharpe
Buy-and-hold	7.0%	0.37
Performance-chasing	4.7%	0.25
Difference	2.3%	0.12

	Return	Sharpe
Buy-and-hold	6.8%	0.36
Performance-chasing	4.5%	0.25
Difference	2.3%	0.11

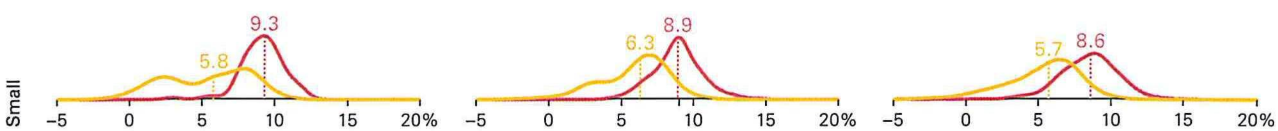
	Return	Sharpe
Buy-and-hold	7.1%	0.36
Performance-chasing	4.3%	0.24
Difference	2.9%	0.12



	Return	Sharpe
Buy-and-hold	9.2%	0.44
Performance-chasing	7.6%	0.38
Difference	1.5%	0.06

	Return	Sharpe
Buy-and-hold	8.9%	0.43
Performance-chasing	4.9%	0.27
Difference	4.0%	0.16

	Return	Sharpe
Buy-and-hold	8.6%	0.41
Performance-chasing	5.7%	0.30
Difference	2.9%	0.11



	Return	Sharpe
Buy-and-hold	9.3%	0.44
Performance-chasing	5.8%	0.29
Difference	3.5%	0.15

	Return	Sharpe
Buy-and-hold	8.9%	0.43
Performance-chasing	6.3%	0.32
Difference	2.6%	0.11

	Return	Sharpe
Buy-and-hold	8.6%	0.40
Performance-chasing	5.7%	0.29
Difference	2.9%	0.11

Notes: All returns and Sharpe ratios shown are median annualized; for "Difference," numbers may not compute because of rounding. Area under the curves represents frequency of returns realized under either strategy, similar in effect to a histogram. Dotted lines represent median return of the distribution. Investors prefer distributions with higher median returns and less dispersion, or volatility, around the median.

Sources: Vanguard calculations, using data from Morningstar, Inc.'s nine equity style boxes.

In all nine equity style boxes, the returns produced by the buy-and-hold strategy bested those of the performance-chasing strategy (see Figure 2). Even more striking, the buy-and-hold strategy Sharpe ratios (a measure of risk-adjusted performance) also exceeded the performance-chasing Sharpe ratios in all nine equity style boxes. Interpreting these results in relation to our earlier discussion of performance persistence, one can infer that the top-performing mutual funds over a measurement period of three years have demonstrated weak performance persistence in subsequent periods.

We excluded from the analysis the impact of any potential transaction costs or taxes incurred. If included, one could reasonably expect that the results of the active performance-chasing strategy would be even weaker in relation to the static buy-and-hold strategy. These results underscore that investing in mutual funds solely on the basis of their recent performance record is not likely to improve future returns.

Although it may be possible to tweak the performance-chasing rules and scour the historical data to find situations in which a buy-and-hold strategy has underperformed, our analysis supports the difficulty of succeeding with performance-chasing strategies in general. In Vanguard's view, buying actively managed mutual funds based on a combination of qualitative and quantitative factors and then maintaining a disciplined approach and long-term perspective despite fluctuations in manager performance has been a simpler and more effective approach for increasing returns than chasing active manager performance.

Conclusion

Investors are naturally drawn to top-performing actively managed funds. The result for many is a performance-chasing approach in which current funds are sold from the portfolio to make room for recent "winners." Vanguard research demonstrates that this behavior is misguided, as a buy-and-hold strategy has outperformed performance-chasing over the past decade in all nine Morningstar equity style boxes.

Our research furthermore reaffirms the importance of an oft-cited but frequently ignored legal disclaimer about investing: *Past performance is not necessarily indicative of future results.* This statement certainly appears to hold true among recent top-performing funds, and investors are well-advised to remind themselves regularly of it.

To improve the odds of their long-term investment success, investors should understand that some periods of below-average performance are inevitable. At such times, investors should remain disciplined in their investment approach and avoid the temptation to chase performance.

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