Retirement PLAN news

Winter 2017

Review Plan-related **Insurance Protection**

It's not unusual to see litigation against retirement plans in the news. Sponsors of 401(k) and other defined contribution retirement plans should evaluate their fidelity bonds and fiduciary liability policies to make sure they have adequate protection.

Pension law (ERISA) generally requires that every fiduciary of an employee benefit plan and any other person who "handles funds or other property" of the plan be covered by a fidelity bond unless exempted under the law. This requirement protects a retirement plan against losses due to fraud or dishonesty (e.g., larceny, theft, embezzlement, or forgery). In contrast, fiduciary liability insurance — which is not required by ERISA — more broadly protects the plan (and typically the fiduciaries) against claims for losses resulting from the act or omission of a fiduciary.

Who Requires Fidelity Bonding?

A person "handles" funds or other property of a plan whenever his or her duties or activities might cause a loss of plan funds due to fraud or dishonesty. The general criteria for determining "handling" include:

- Physical contact with cash, checks, or similar property
- Ability to transfer funds from the plan
- Ability to negotiate plan property
- Authority to direct disbursements
- Authority to sign checks
- Supervisory responsibility for activities that require bonding

"Funds or other property" generally refers to all funds or property that the plan uses or may use to pay benefits to participants and or beneficiaries, including investments such as land and buildings, mortgages, and stock in closely held corporations.

Service providers may have to be bonded if they have access to plan funds or other property or have decision-making authority that can give rise to a risk of loss through fraud or dishonesty.

Parties to Fidelity Bonds

Usually, the insurer provides the bond and the plan is named as the insured party. The parties covered by the bond are those handling funds or other property of the plan. If a plan official causes a covered loss to the plan due to fraud or dishonesty, the plan can make a claim on the bond.

Bonding Coverage Requirements

Fidelity bonds must be purchased from a surety or reinsurer named on the Department of the Treasury's Listing of Approved Sureties. Each person generally must be

(Continued on page 2)

PENSION INVESTORS CORPORATION

A COMPANY THAT CREATES AND SERVICES EMPLOYEE BENEFIT PROGRAMS

220 E. Central Parkway #3040
Altamonte Springs, FL 32701
407-875-3332
(fax) 407-875-0189

Review Plan-related **Insurance Protection** (continued)

bonded in an amount equal to at least 10% of the plan assets handled during the plan's previous year. The minimum required bond amount is $1,000, and there is a maximum requirement, generally, of $500,000. For officials of plans that hold employer securities, the maximum required bond amount is $1,000,000. Fiduciaries should review the adequacy of bonding amounts at the beginning of each plan year as plan asset totals change. Since the purpose of fidelity bonding is to protect the plan, plan assets may be used to pay for the bond.

Fiduciary Liability Insurance

Because plan liability may arise out of not only acts of fraud or dishonesty but also out of breaches of the many complex fiduciary duties involved in administering a plan, many plans maintain fiduciary liability insurance. These policies protect the plan and typically any fiduciaries against losses resulting from acts or omissions — particularly, for failures to observe the many complex statutes, regulations, court rulings, and other guidance that define a fiduciary's obligations to the plan.

Other Aspects of Fiduciary Liability Coverage

Fiduciary liability insurance typically protects a wide range of plan fiduciaries, including administrators, trustees, committees, and the plan sponsor. Coverage of fiduciaries often includes past, present, and future trustees and all plan and trust fund employees who are fiduciaries.

Fiduciary liability insurance may also provide protection for situations when a fiduciary knew of a breach by a co-fiduciary and failed to remedy the breach. A plan may also maintain fiduciary liability insurance to protect itself from losses caused by a fiduciary's involvement in a prohibited transaction, but it may not contain a provision relieving a fiduciary of liability in that situation.

When selecting the amount of fiduciary liability insurance protection for the plan, a fiduciary must purchase the most suitable coverage at a cost of plan assets no greater than necessary. To meet ERISA's requirements, the insurance company should have a satisfactory rating from a reputable rating agency.

The plan can purchase fiduciary liability insurance for its fiduciaries or itself if the policy allows recourse by the insurer against the fiduciary where the loss was caused by a breach of a fiduciary obligation by the fiduciary. Alternatively, a fiduciary can purchase insurance (or an employer can purchase insurance for the fiduciary) to cover his or her liability from a breach of fiduciary duties. Where the employer purchases such a policy, there is no need for the policy to provide for recourse against the fiduciary.

2017 Cost-of-Living **Changes**

The IRS has released 2017 cost-of-living adjustments (COLAs) for various retirement plan limitations, with some limitations increasing and others remaining at their 2016 levels. Changes include the following:

- Annual additions limit for defined contribution plans increased from $53,000 to $54,000
- Maximum annual benefit limit under a defined benefit plan increased from $210,000 to $215,000
- Annual compensation limit used to determine qualified plan benefits or contributions increased from $265,000 to $270,000
- Compensation limit used in determining whether officers are key employees for top-heavy plan purposes increased from $170,000 to $175,000

The following limitations remain unchanged:

- Elective deferrals to 401(k), 403(b), and most 457 plans: $18,000
- Catch-up contributions to 401(k), 403(b), and most 457 plans: $6,000
- SIMPLE plan deferrals: $12,500
- SIMPLE plan catch-up contributions: $3,000
- Dollar limit used in the definition of highly compensated employee: $120,000
- Individual retirement account (IRA) contributions: $5,500
- IRA catch-up contributions: $1,000

Managing the Use of **Plan Loans**

A plan loan feature can be a useful tool for helping to increase plan participation and contribution rates. Nevertheless, plan loans may impede employees' efforts toward achieving their long-term retirement goals and complicate plan administration. Following is a general discussion of some of the issues surrounding plan loans and suggestions for addressing them.

Understanding the Rules

Two sets of rules must be complied with when a plan maintains a participant loan program — those under the pension law (ERISA) and the tax rules set forth in the Internal Revenue Code. Generally, ERISA rules provide that loans will be exempt from treatment as prohibited transactions if, under the plan, loans are available to all participants on a "reasonably equivalent basis," are not made available to "highly compensated employees" in amounts greater than to other participants, are adequately secured, are extended at a reasonable rate of interest, and comply with the plan's terms.

The Internal Revenue Code contains parallel prohibited transaction provisions. The income tax rules also provide that, generally, a loan from a qualified plan will not be treated as a taxable distribution if it must be repaid within five years (except for certain home loans) and doesn't exceed the lesser of: (1) $50,000 or (2) the greater of (a) half the present value of the employee's nonforfeitable accrued benefit under the plan or (b) $10,000. (The limits are somewhat different where an employee has more than one loan.) The tax law also requires that a loan be amortized in substantially level payments, at least quarterly, over its term. An exception applies while an employee is on unpaid leave for up to one year (or possibly longer for those in the uniformed services).

Responsibilities

When a plan allows loans, plan sponsors should make sure they have appropriate procedures in place to keep track of each loan. In a broad sense, loan administration involves determining the right of the employee to take a loan, ensuring that the employee makes loan payments on a timely basis, and promptly identifying loan defaults. The IRS recommends that sponsors retain the following information for each plan loan:

- Evidence of the loan application, review, and approval process
- An executed plan loan note
- If the loan is for buying or constructing a primary residence, documentation verifying that the loan proceeds were used for that purpose
- Evidence of loan repayments
- Evidence of collection activities for defaulted loans, if any

Curbing Enthusiasm

To reduce the overuse of plan loans, sponsors may want to begin by educating participants about these potential disadvantages of taking loans from their retirement plan:

- Loan repayments are made with after-tax money
- Income taxes are paid again on distributions
- It may be difficult to save for retirement and pay back a loan at the same time
- Generally, loans must be paid back when the employee leaves
- If the loan is not repaid, the outstanding balance is treated as a taxable withdrawal subject to income tax and a possible 10% tax penalty

Additionally, sponsors may want to consider amending their plans to provide for some or all of the following:

- Limiting the number of loans participants can have outstanding at one time
- Implementing a waiting period between loans
- Not permitting borrowing from employer contributions
- Not allowing employees to refinance loans
- Restricting the loans to specified purposes only
- Making loans available only to active employees and not to terminated participants or plan beneficiaries

Other options include increasing the loan origination fee or processing charges. If fees incurred by the plan to set up and administer loans are reasonable and permitted under the plan document terms, they may be charged to the participant's account.

Giving participants the ability to take out a loan can reassure employees that they have access to their account assets if they need them. Taking some of the steps outlined here may prove helpful in discouraging employees from taking unnecessary plan loans.

PENSION
INVESTORS
CORPORATION
220 E. Central Parkway #3040
Altamonte Springs, FL 32701

PRSRT STD
US POSTAGE
PAID
ORLANDO, FL
PERMIT #1556

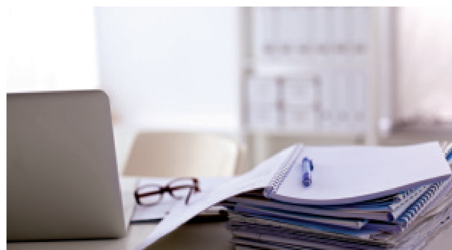
Recent **Developments**

Relief for Late Rollovers

The IRS has issued new guidance that will help some taxpayers avoid taxes and penalties on rollovers of distributions from employer-sponsored retirement plans that aren't completed within 60 days. The new guidance allows taxpayers who miss the deadline for any one of 11 specified reasons to correct the error by sending the IRS's model certification letter (or one substantially similar to it) to the receiving plan trustee. The taxpayer must complete the rollover "as soon as practicable" — usually within 30 days — after the reason for the delay ceased to apply.

IRS Makes Changes to EPCRS

The IRS has updated the Employee Plans Compliance Resolution System (EPCRS) to



account for changes in the determination letter application program and to incorporate certain other modifications outlined in previous IRS guidance. Among other updates, Revenue Procedure 2016-51 provides that determination letters may no longer be submitted with Voluntary Correction Program (VCP) submissions. Additionally, VCP user fees will be published in the annual Employee Plans revenue procedure that sets forth user fees, although the IRS reserves the right to impose a sanction higher than the VCP user fee for the correction of "egregious" failures.

Mutual Fund Ownership

An estimated 91 million individual investors owned mutual funds in mid-2015, based on data compiled by the Investment Company Institute in its *2016 Investment Company Fact Book*. At year-end, these investors held 89% of total mutual fund assets directly or through retirement plans. Mutual fund ownership by U.S. households in 2015 declined slightly from the prior year, from 43.3% to 43% (about 53.6 million households). The authors of the *Fact Book* noted that 91% of mutual fund investors are investing for retirement while 50% are saving for emergencies.

The general information provided in this publication is not intended to be nor should it be treated as tax, legal, investment, accounting, or other professional advice. Before making any decision or taking any action, you should consult a qualified professional advisor who has been provided with all pertinent facts relevant to your particular situation.

Copyright © 2016 by DST