THE 401(k) HANDBOOK

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For the record, meticulous retention of plan documents is crucial

by Arris Reddick Murphy

The Employee Retirement Income Security Act (ERISA) requires that every employer maintain sufficient records for each employee to be able to determine the benefits due to the employees now or in the future. The plan sponsor has responsibility for retaining retirement plan records even when a third-party administrator (TPA) is hired to provide recordkeeping and administrative services.

Records may be requested at any time to respond to queries related to daily operations, investments, plan features, or plan errors and corresponding corrections, as well as for audit purposes. In light of this, a primary responsibility for plan sponsors is giving appropriate attention to establishing and implementing the plan's record retention requirements.

See *Murphy*, p. 6

Plan self-correction opportunities improved in new IRS EPCRS procedure

by Todd B. Castleton

Practitioners and plan administrators are celebrating the arrival of several helpful revisions in a newly updated Internal Revenue Service (IRS) Employee Plans Compliance Resolution System (EPCRS) Revenue Procedure 2019-19.

The updated procedure for correcting mistakes in qualified retirement plans makes several minor revisions, updates, and clarifications to EPCRS but also significantly expands self-correction opportunities in two key areas through the Self-Correction Program (SCP).

First, the new procedure expands the set of plan mistakes that can be corrected by plan amendment through SCP, which does not require an IRS filing, a user fee, or IRS approval to complete. Second, it provides practical solutions for correcting certain plan loan failures. These advancements are discussed below.

Overview of EPCRS

The IRS EPCRS revenue procedure gives an opportunity for sponsors and administrators of tax-qualified retirement plans to correct plan mistakes. EPCRS identifies two broad categories of mistakes: documentation failures and operational failures.

See *Castleton*, p. 4

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In This Update

The following sections of *The 401(k) Plan Handbook* have been updated in the July Supplement:

Made editorial changes throughout to update discussion of fiduciary duties in 401(k) plan investment management (Vol. I, ¶410–413)

Updated parts of Index (Vol. II, Pages 15–16)

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New mandatory electronic VCP submissions add to IRS online filings

by Roxanne Nydegger

In 2008, the Internal Revenue Service (IRS) established a voluntary program aimed at retirement plan sponsors and administrators to encourage correction and resolution of plan document or operational failures as soon as they are discovered. The Employee Plans Compliance Resolution System (EPCRS) stresses the importance of established administrative practices and procedures to avoid federal tax code failures that may arise from a lack of such practices and procedures. (See related column on Page 1 about IRS Revenue Procedure (Rev. Proc.) 2019-19, released in April, which introduced further updates to EPCRS.)

EPCRS consists of three programs: the Self-Correction Program (SCP), Voluntary Correction Program (VCP), and Audit Closing Agreement Program (Audit CAP). Each of the correction principles and methodologies in EPCRS applies to all three programs. When EPCRS launched more than a decade ago, VCP applications were submitted using certified mail and fax machines, the standard IRS communication method at the time.

Much-welcomed reprieve

EPCRS has been a much-welcomed reprieve for plan sponsors and administrators. Compliance statements (an agreement between the plan sponsor and the IRS that the proposed correction of plan failures is acceptable) have been granted to plans for over a decade in exchange for conforming amendments, corrective contributions and distributions, lost earnings calculations, and revisions to administrative practices and procedures.

The EPCRS program is no stranger to updates over the years; several have resulted in an expansion of correction methodologies, additional SCP opportunities, and user fee adjustments.

The IRS introduced the previous EPCRS transformation in September 2018, through Rev. Proc. 2018-52, which became effective on April 1. The biggest change from that round of revisions is to the VCP submission procedures—which are now required to be electronic. The IRS will no longer accept VCP submissions through the mail in hard-copy form; instead, plan sponsors must use the http://www.pay.gov website for VCP submissions.

New process

While the contents of a VCP submission have not changed, the submission follows a new process:

- Applicant creates a pay.gov account.
- If the plan sponsor authorizes an attorney to sign and file the VCP on its behalf, a cover letter with a signed penalty-of-perjury declaration must accompany the submission.
- The Form 8950, *Application for Voluntary Correction Program Submission*, will now be completed directly on the pay.gov website.
- All VCP submission documents (model forms, failure explanations, correction computations, plan documents, etc.) must be converted into one PDF file and uploaded to pay.gov. If the file exceeds 15 megabytes in size, the excess must be faxed to a dedicated IRS VCP fax number.
- After the plan sponsor files a VCP submission, the system automatically generates a payment confirmation. The "pay.gov Tracking ID" on the receipt serves as the IRS control number for the submission. The IRS no longer issues a separate acknowledgment letter confirming receipt of the submission.

See *Nydegger*, p. 8

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Confusion clouds two more IRS adjustments to individually designed plan determination letters

Starting September 1, the Internal Revenue Service (IRS) will accept determination letter applications for a few more categories of individually designed plans, it announced in Revenue Procedure (Rev. Proc.) 2019-20, released May 1.

Once the change is effective, determination letter requests can be made for "merged plans," which have had other plans incorporated into them as a result of business transactions, as well as some types of defined benefit (DB) hybrid plans—namely, cash balance or pension equity plans.

The new IRS procedure also addresses penalties for plan document failures found as part of the expanded determination letter review program. But attorneys at several employee benefits law firms had questions about the coming adjustments.

Background

As reported, the procedures for seeking IRS determination letters were adjusted in January 2017 after the IRS eliminated the 5-year remedial amendment cycle in a bid to streamline administration. An individually designed plan now could request a determination letter, the IRS indicated, only in the following three situations:

- An initial application;
- Plan termination; *or*
- Some special circumstances the IRS said it would define later.

Changes to the staggered cycle system for individually designed plans were described in IRS Rev. Proc. 2016-37 issued in late June 2016. Many in the retirement plan community have seen the changes as encouraging standardized and simpler preapproved plans.

In the changes to come this September, determination letter applications for merged plans will be accepted on an ongoing basis, provided that:

1. The plan merger was completed by the end of the first full plan year following the business transaction; *and*
2. The application is submitted by the end of the first full plan year after the plan merger.

In the case of DB hybrid plans, applications must be filed between September 1, 2019, and August 31, 2020.

Result of practitioner comments

In 2018, the IRS sought comments about the need for expanding the revised determination letter program and how it should be implemented. In response to what it heard, the IRS has now expanded the program to cover the two areas mentioned. Key aspects of the new revenue procedure, including the deadlines and eligibility rules, are summarized here.

Merged plans

On September 1, the IRS will accept determination letter applications from merged plans, which are defined as a single individually designed plan resulting from the consolidation of two or more plans maintained by unrelated entities due to a corporate merger, acquisition, or other similar transaction between unrelated entities.

At first glance, the merged plan review procedure appears relatively straightforward, said law firm Proskauer LLC in a May 3 client bulletin. "However, the guidance gives rise to a number of important issues," it said, such as:

- Whether sponsors are required to submit merged plans for review;
- Dealing with merging preapproved plans into individually designed plans;
- Handling plan document failures from acquired plans;
- Whether pre-2017 plan merger transactions are eligible for review; *and*
- Compliance when a company undergoes multiple plan mergers in a short time. ❖

Tussey v. ABB closes with $55 million settlement; complex case changed views of fees, fiduciary duty

The original "excessive fees" case—first filed in 2006—finally concluded on March 28 with a $55 million settlement for the plaintiffs, one of the largest ever awarded in 401(k) fee litigation.

Tussey v. ABB, after winding through earlier settlement awards to the plaintiffs, two appellate hearings in the 8th Circuit, and double rejections by the U.S. Supreme Court, ultimately will be remembered both as a case about plan sponsors' fiduciary duties and one that defined how to quantify participant losses from related breaches.

As a result, the retirement plan industry has moved in a unified way to press for reductions in service provider fees, opt for lower-cost share classes, and insist upon greater transparency for recordkeeping and asset management costs.

Breakdown of settlement award

Of the total settlement award, $20.8 million, or nearly 40 percent, will go toward attorneys' fees and litigation costs. The lawsuit was brought by plaintiffs' counsel Schlichter Bogard & Denton of St. Louis, which went on in subsequent years and many similar court filings to make this type of Employee Retirement Income Security Act (ERISA) litigation against employer plans its signature work.

Three named class representatives in the two ABB 401(k) plans in the case will be awarded $25,000, and the remainder will be paid out to plan participants in the class period from December 29, 2000, through December 31, 2007.

The settlement also requires ABB to conduct a search for recordkeeping services, rebate any revenue-sharing fees back to plan participants, and employ the "loyal selection" of 401(k) investments going forward, according to a court document. Several similar nonmonetary remedies addressing plan fee and fund bidding reform were ordered over the years as the suit appeared and reappeared in federal courts.

In the late March settlement documents, both parties in the suit asked the court to schedule a final fairness hearing, then an order granting final approval of the agreement.

Background of the case

Among other things, the lawsuit claimed that ABB had failed to monitor excessive recordkeeping fees and that plan fiduciaries had engaged in self-dealing when they replaced Vanguard's Wellington Fund target-date series with Fidelity's Freedom Funds. The plaintiffs alleged that Fidelity, the ABB plan recordkeeper, gave ABB a break on pricing for plan services after the link to Fidelity funds was established.

In 2012, the plaintiffs won a $36.9 million judgment, which was then appealed in two actions filed with the 8th U.S. Circuit Court of Appeals in St. Louis. The case also was twice remanded to a federal district court for additional proceedings. ❖

Castleton (continued from p. 1)

Document failures occur when the plan document contains, or fails to contain, any provision that disqualifies the plan on its face. An operational failure arises from the failure to follow plan provisions. (Other types of failures include demographic failures and employer eligibility failures, which are less important when discussing the new EPCRS changes because they remain ineligible for correction through SCP.)

EPCRS prescribes several broad correction principles for correcting plan mistakes and also sets forth many specific methods for correcting a variety of specific plan document and operational failures. EPCRS also prescribes three different programs for making plan corrections.

SCP, as its name suggests, allows plan sponsors and administrators to correct plan mistakes on their own without applying to the IRS to approve the correction. If a particular failure is eligible for SCP and the sponsor or administrator follows the principles and methods set forth in EPCRS, then the IRS will not treat the plan as disqualified because of the failure.

Under the EPCRS Voluntary Correction Program (VCP), plan mistakes are corrected by making an application to the IRS, paying a user fee, and receiving IRS acceptance of the proposed correction. (See related column on Page 2 about April changes that now require VCP submissions to be electronic.)

The Audit Closing Agreement Program (Audit CAP) program under EPCRS is used when plan mistakes are discovered upon audit by the IRS and have not been corrected by SCP or the VCP. Generally, the methods used to correct mistakes under Audit CAP are accompanied

See *Castleton,* p. 5

Castleton (continued from p. 4)

by fines, penalties, and excise taxes that may exceed VCP user fees or the costs of SCP. The incentive is for sponsors and administrators to correct plan mistakes on their own, before being discovered by the IRS.

Insignificant operational failures are eligible for SCP anytime, including while the plan is under audit. Correction of significant operational failures must be completed, or substantially completed, before a plan is under audit or, if earlier, before the end of the second plan year following the plan year in which the failure occurred. Also, to be eligible for SCP, a plan must have received a favorable determination letter and have established practices and procedures that are designed to promote and facilitate overall compliance in form and operation with plan qualification requirements.

Self-correction through plan amendment

The new EPCRS provides expanded opportunities to correct plan mistakes through SCP by plan amendment. Under the prior EPCRS, no plan document failure could be corrected through SCP. All plan document failure corrections had to be sent to the IRS for approval under the VCP, although the IRS had previously prescribed a streamlined process for correcting certain document failures and paying a reduced user fee.

However, this reduced user fee for streamlined applications was eliminated in 2018 when the IRS announced a new user fee structure in Revenue Procedure 2018-4 (see January 2018 story). In addition, only a limited list of specified operational failures could be corrected through SCP. Revenue Procedure (Rev. Proc.) 2019-19 makes correction of certain plan document failures possible through SCP and also allows self-correction of a broad category of operational failures discussed below.

1. Self-correction of plan document failures by amendment

Previously, if a plan discovered it had failed to adopt a plan amendment that was required by a change in the qualification requirements (an "interim amendment"), SCP was not an option, and a VCP application was required to make the correction. Now, under Rev. Proc. 2019-19, plan document failures that otherwise meet the requirements for SCP may be self-corrected without filing a VCP application.

But there are important limits to SCP. EPCRS provides that all plan document failures are significant, meaning that SCP is only available if the interim amendment is adopted no later than the end of the second plan year following the plan year in which the missed adoption deadline expired. If this deadline has passed, plans will need to apply for IRS approval through the VCP to rely on the relief EPCRS affords. Also, SCP is not available to correct the initial failure to adopt a plan document or the failure to timely adopt a written 403(b) plan. A plan must also meet the general SCP eligibility procedures by having a favorable determination letter and compliance practices and procedures in place.

2. Self-correction of operational failures by plan amendment

Under the prior EPCRS, adopting a plan amendment to conform the terms of the plan to its prior operation was allowed only in three limited circumstances:

1. A defined contribution plan could be corrected by amendment if it allocated contributions or forfeitures based on a participant's compensation that exceeded the compensation limit under Section 401(a)(17) of the Internal Revenue Code.
2. A defined contribution plan that allowed hardship withdrawals or plan loans from a plan whose terms did not allow for them could be amended to conform the plan to the practice.
3. If a plan allowed an employee to participate before meeting the plan's age and service requirements or before the plan's specified entry date, the plan could be amended to allow for this early participation.

If a plan adopted any of these amendments through SCP, it was required to disclose these amendments in its next determination letter application—that is, until the IRS significantly curtailed the determination letter process for most individually designed plans (see related story on Page 3).

Under the new EPCRS, a broad category of operational failures may now be eligible for SCP through adoption of a retroactive plan amendment to conform the terms of the plan to its prior operation. Correction of both significant and insignificant operational failure can be made by plan amendment if three conditions are met:

1. The plan amendment must increase a benefit, right, or feature;
2. The increase in the benefit, right, or feature must be available to all eligible employees; *and*
3. Providing the increase in the benefit, right, or feature must be permitted under the federal tax code and satisfy the EPCRS general correction principles.

See *Castleton*, p. 7

Murphy (continued from p. 1)

Let's take a look at a few scenarios when review of the plan's records will be necessary to resolve any disputes.

Background

In the retirement plans community, a "plan record" is a general term used to cover the plan's accounting, administrative, benefit determination, compliance, corrective, educational, financial, governing, investment, and reporting documents. It is prudent to look broadly at what constitutes a plan record to ensure that information that could be requested is not inadvertently destroyed.

The time span required for maintaining documents and data seems equally long, whether it comes to records that are needed to determine a participant's benefit or, in some cases, to prove that a former employee is not entitled to a benefit. In both cases, it basically seems that the records must be maintained indefinitely.

Reporting documents

A common inquiry for plan administrators involves the potential benefit letter sent from the Social Security Administration that informs an individual that he or she may have a benefit under a particular plan. The letter, sent when an individual files a claim for Social Security benefits, lists the name of the plan that previously reported this individual to the Internal Revenue Service (IRS) on Form 8955-SSA as an employee who separated from employment with a deferred benefit under the plan or on Form 1099 as an employee who took a plan distribution.

Receipt of the letter results in a call or letter to the listed plan's sponsor in which the amount of benefit due is provided in response, if known. If not, research into historical records is required before the administrator of the plan can report whether the benefit has been paid out, leaving no further benefit due, or whether a benefit is still owed the inquiring former employee.

Corrective documents

Another common occurrence is discovering a plan error, making it necessary to review plan records from the applicable period. Most recordkeepers house a limited amount (for example, 2 years) of data for plan clients and their participants online for ease of access to this information. However, when a few years pass before the error is discovered, the process for and ease of getting access to historical plan records become good indicators of the strength of the plan's internal controls—and, more commonly, the TPA's controls.

It is important to remember that changing a TPA involves moving plan records from one recordkeeper to another. During the transition, both teams must ensure that all relevant, stored records are accounted for by the prior and new administrators. It is also advisable to make sure that the transferred records are uploaded appropriately and retrievable by date, transaction, and employee. When required, the records should be printable as a readable paper document. In some instances, it may be necessary to piece together the records with information from more than one recordkeeper, as when a distribution check sent to a former employee at an incorrect address is returned uncashed and a federal agency auditor is looking at plan records.

The delayed discovery of an error will likely bring into play a prior version of the plan, before the most recent amendments or restatements. This means that maintaining prior versions of the plan, summary plan description (SPD), summary of material modifications (SMM), and related participant communications is essential to establishing the applicable terms at a particular point in time for plan-defense purposes. When the provisions of the plan have been modified, documentation of the dates and authorization for such changes may come under review.

Investment documents

Another possible scenario that may require a review of historical plan records comes when participants file a lawsuit against the plan and plan sponsor, claiming that the expenses paid for designated plan investments are excessive. Here, the plan sponsor will need to produce and review the records related to investment, as well as investment provider fees and expenses. In addition, the case review may require a look at the plan's investment committee meeting minutes to assess whether the investment menu review and decision-making were done in a prudent manner.

It is expected that the meeting minutes will disclose whether a consultant was engaged in the process, what benchmarking and investment comparisons were performed, and whether a particular investment is in line with the plan's overall investment goals. Recent case rulings in this realm have considered whether the plan fiduciary inquired about lower-cost investment alternatives, especially when the amount invested warrants an available threshold reduction. This fee reduction occurs when plan assets grow to the point in which the plan may qualify for preferential treatment and lower fees from service providers, a point that plan fiduciaries must monitor for potential savings for the plan and its participants.

See *Murphy*, p. 8

Castleton (continued from p. 5)

It is not clear under EPCRS exactly what would qualify as an increase in a benefit, right, or feature. IRS officials have reportedly indicated, although only informally, that the concept is likely broader than a benefit, right, or feature as defined under Treasury Regulation Section 1.401(a)(4)-4 for nondiscrimination testing purposes under Code Section 401(a)(4).

Additional guidance may be needed for clarity on what amounts to a benefit, right, or feature for EPCRS SCP purposes, but at a minimum, the amendment would have to provide something to the participants that was not set forth in the plan. For example, a retroactive plan amendment under SCP would not be allowed to correct an operation failure in which the plan failed to provide a benefit that was promised under the terms of the plan.

Self-correction of plan loan failures

The new EPCRS makes SCP available for correcting a plan loan default if done within that loan's original statutory maximum loan period (5 years or possibly greater for home purchase loans) using methods that were previously only available through the VCP or Audit CAP. Procedures for treating loans as distributions are set forth in Treasury Regulation Section 1.72(p)-1. Under those provisions, a loan is deemed distributed when an installment payment is missed and defaults if missed payments are not paid within any cure period specified in the plan document or, if earlier, the last day of the calendar quarter following the quarter in which an installment payment is missed. A defaulted loan may be offset against the participant's account balance. Upon default, the plan should report the taxable distribution for the unpaid loan balance on IRS Form 1099-R.

Now, a plan loan default may be corrected under SCP by having the participant make up the missed payments with a lump-sum payment, re-amortizing the outstanding loan balance over a period not to exceed the loan's original maximum loan period, or any combination of the two. Previously, these options were only available under the VCP or Audit CAP. However, the new EPCRS points out that a plan wishing to participate in the U.S. Department of Labor's (DOL) Voluntary Fiduciary Correction Program (VFCP) will still need to go through the IRS's VCP and obtain a compliance statement to meet the requirements for VFCP.

The new EPCRS also prescribes additional specific situations for correcting common plan loan failures. First, if a plan subject to the qualified joint and survivor annuity rules makes a plan loan to a participant without obtaining the participant's spouse's consent, a plan may self-correct by simply notifying the participant and spouse and obtaining the spouse's consent retroactively. If the plan is unable to obtain the spouse's retroactive consent, then correction must occur through the VCP or Audit CAP.

Second, if a plan makes multiple loans to a participant in excess of the number of loans allowed by the terms of the plan, a plan may self-correct by adopting a retroactive amendment conforming the plan to its operation—as well as all statutory requirements—if the loans are available either to all participants or solely to one or more nonhighly compensated employees (NHCEs).

SCP is still not available to correct loan failures that exceed certain statutory requirements of Code Section 72(p)(2), including the maximum loan limit of $50,000 (or, in certain circumstances, a lesser amount), the maximum permissible loan period (5 years for nonhome purchase loans), or the level amortization requirements. These failures still must be corrected through the VCP or Audit CAP.

Reporting also was made easier in the new EPCRS. Under the prior EPCRS, if a plan loan failure required the plan to deem a loan and report the taxable distribution on Form 1099-R, and if the correction was made through SCP, the only option was to issue the 1099-R for the year of the failure, rather than the year of correction. This created potential problems for participants and may have required them to file amended tax returns for previously filed years to account for the additional income. Plans were allowed to correct loan failures as described above and not issue a 1099-R, or issue a 1099-R for the year of the correction, only if it participated in the VCP or Audit CAP and specifically requested that relief. Now, these options are available if a correction is done through SCP.

Conclusion

The new EPCRS includes significant enhancements to the correction procedure, consistent with its stated goal of encouraging self-compliance with the qualification rules. Sponsors and administrators wishing to take corrective actions should carefully review the new requirements to make sure the particular plan error is eligible for the correction, and that the chosen correction complies with the new requirements, as well as all other EPCRS correction principles and tax code requirements.

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Murphy (continued from p. 6)

Related fee information may be found in the plan's ERISA Section 408(b)(2) disclosure notice, and the committee minutes should reflect receipt and review of the notice by the committee. The notice will discuss investment provider fees and investment expenses, and outline fees that apply to certain plan features that a participant may use, such as processing fees for plan loans and qualified domestic relations order (QDRO) reviews. The minutes may include notes related to the use of technology to reduce administrative costs, for example, or the availability of lower fees for online applications. The minutes also may discuss any current services not being used or new service offerings being introduced.

More information relevant to lawsuit discovery and records retention also may be described in the plan's investment policy statement (IPS) and annual ERISA Section 404(c) compliance review. The IPS is a document designed to guide the plan's investment decisions and should be adhered to when making them. It's necessary to update it when the plan's investment goals change or, at a minimum, periodically.

Similarly, the Section 404(c) review will outline steps taken by the plan administrator to satisfy the requirements for ensuring that participants have sufficient information to make informed investment decisions.

Best practices

Here are a few best practices for structuring record-retention procedures:

- Prepare written record-retention requirements and distribute them to the internal and external teams involved in your plan administration. Update the requirements when any gaps are discovered.
- Create a paper file and online repository for plan documents, including any amendments, SPDs, and SMMs. Arrange the documents by effective date.
- Establish a file for annual plan accounting records for contributions, distributions, adjustments, fees, and expenses, along with annual audit results, reports, and financial statements.
- Confirm the ability to gain access to plan census information that includes participant demographic, employment, and balance information.
- Maintain the plan's current and previous procedural documents, likely prepared by the TPA providing services to the plan.
- Create online files of all participant communications, which will include required disclosures, required notices, and educational materials.
- Create a paper file and online repository for the plan committee's meeting minutes, along with any investment performance reports, consultant presentations, and related materials presented to the committee.

Final thoughts

While some plan sponsors and administrators attempt to rank which plan records are most important, suffice it to say that all records matter. It is critical that plan sponsors be able to produce requested documents during an IRS audit or U.S. Department of Labor (DOL) investigation and that retrieval of these plan records can be done in a timely matter because both agencies set a deadline for delivery.

Record retention and retrieval is an ongoing process, one that should be reviewed periodically to ensure strong controls.

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Nydegger (continued from p. 2)

Any new procedure can seem daunting and time-consuming until it becomes familiar. Yet, the efficiency that comes from a single uploading of documents, immediate generation of an IRS control number, and not having to bother with certified mailings will far outweigh any initial learning curve. Hopefully, plan sponsors will not make VCP submissions a habit, but when they are necessary, this new procedure will make the process nearly painless.

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