WINSTEAD

Life with Conflict of Interest Starting to be Implemented and Retirement Plan Update

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Fee Changes and Disclosures Post Conflict of Interest Regulations Initial Partial Effective Date

The effects of the U.S. Department of Labor's (DoL) conflict of interest or fiduciary regulation and related prohibited transaction exemptions (the COI Package) on plans have started. This means that many retirement plan fiduciaries have received or will soon receive new agreements from retirement plan investment advisors (service providers) and should have also received related new fee disclosures required by ERISA. In response to the COI Package mutual funds have created a new class of mutual fund investments with revenue sharing fees removed called "clean shares". It is important for the plan fiduciaries to review these new agreements and fee disclosures, and then to appropriately determine what is best for the plan participants. Depending on the size of your retirement plan, there may be more than one way your plan's service providers can comply with the COI Package. Plan fiduciaries may consider approaching their retirement plan record keepers and related service providers about alternative approaches to any proposal the plan fiduciaries receive.

Fee disclosures have been required for indirect compensation under ERISA for a number of years. While the COI Package may have led vendors to develop new clean shares which reportedly eliminate built-in compensation, a new fee disclosure is still required because there is likely a change from the prior disclosure. Plan fiduciaries should still see new compensation disclosures. Plan fiduciaries who received new agreements that do not include a new fee disclosure should request an updated fee disclosure of direct and indirect compensation to comply with the ERISA fee disclosure requirements under ERISA section 408(b)(2).

Plan fiduciaries should document their review of any updated agreements and fee disclosures to document their compliance with applicable fiduciary obligations under ERISA and to be prepared to show that such items were reviewed in the event their number is drawn for a DoL audit. Plan fiduciaries will want to document the results of efforts to investigate or negotiate for different agreements.

As the new compensation arrangements available from different vendors settle in under the COI Package, plan sponsors may want to consider surveying what is available in the market for their plan in terms of services and fees. After the landscape settles in the next 12 to 18 months or so, a new request for updated proposals may uncover new alternatives for plan fiduciaries and plan sponsors to consider for complying with the COI Package.

The COI Package we currently have is not likely to be the final word on the law in this area. The DoL requested comments on the COI Package on June 29, so it is likely that even though it seemed that we were close to the finish line on these changes, we may only be at an interim plateau in the development of this area of the law and more changes may still be coming. The deadlines for comments on whether the applicability date of January 1, 2018 should be delayed further is Friday, July 21, 2017. The deadline for comments on the 17 other items the DoL requested additional information on related to the COI Package is August 7, 2017.

In a new twist, the DoL gave a hint of what it may be thinking in withdrawing a portion of the briefs it had filed in two cases opposing the challenges to the COI Package. In both of the cases, the DoL withdrew its previous arguments supporting the anti-arbitration provision in the Best Interest Contract Exemption ("BICE"). The anti-arbitration provision in the BICE precluded fiduciary advisors (brokers, retirement advisors and others acting as fiduciaries by advising a person considering requesting a distribution or rolling over a distribution to an individual retirement account) from putting a provision in their service agreements requiring all disputes to be handled in binding arbitration, rather than in court. The DoL's withdrawal of its defense of the no-arbitration clause requirement in BICE, this may be signaling that the DoL is considering changing the BICE to permit arbitration clauses. The no-arbitration clause eliminated a device used by many financial advisors to avoid class action litigation and keep plaintiffs out of court by requiring them to pursue disputes only in arbitration and not in court.

When the courts proceed on the litigation, they will have only an argument that the no-arbitration clause requirement should not be enforced without an opposing argument. This demonstrates a new way the government's winds of change are on the move. We will need to wait and see what this no support of a piece of the BICE means when we see what ultimately survives in the COI Package and when that will become fully effective.

Lump Sum Distribution Study

MetLife commissioned a study by Harris Polls, entitled, "Paycheck or Pot of Gold Study" and the results of the study contain interesting findings on what retirees (and certain recipients of lump sum settlements) do with their lump sum distributions. The study was done via an online survey of 1,069 adults in the U.S. who were age 50 to 75 and received retirement plan distributions in either a lump sum or annuity, or who were 18 to 75 years old and received a lawsuit settlement of $25,000 or more and could have received it in a lump sum or annuity. The average defined benefit pension lump sum in the surveyed group was $192,357 and the average lump sum from a defined contribution plan was $239,792. The average monthly annuity from an employer's defined benefit pension plan was $2,661.

The study disclosed that many of the persons polled did not remember receiving the disclosures that those of us who deal regularly with retirement plans know are required, such as the disclosure of the relative values of the optional benefit forms available to a retiring participant from a defined benefit pension plan and only 45% of defined benefit pension participants remembered receiving a comparison of the benefit of an annuity form to a lump sum payment, or the notice of the tax impact of the choice between a distribution and a rollover.

The survey found that information about the risk of longevity (the risk you outlive your retirement money) and the risk of running out of money was lacking with only 31% of pension participants receiving such information and only 23% of defined contribution plan participants receiving longevity risk information.

Perhaps the most startling finding was that in 5.5 years on the average those who took the lump sum had depleted the lump sum after more than 10 years had passed since its receipt. Many lump sum recipients reported making major purchases or gifts in the first year following receipt of the lump sum, and 31% reported regretting such major spending. The report also stated that 65% of the persons who are now age 65 will live to the age of 85 years, and 25% of the persons who are now age 65 will live to the age of 95 years. If only 10% have funds remaining from their lump sum after 10 year following retirement, many individuals will outlive their retirement savings if the projections from this study are accurate and retirees continue to take lump sum distributions and continue the same spending trends.

Recognizing that the study was funded and reported by an annuity provider, it does provide an insight into reasons some may advocate for annuity options and more education for participants facing the retirement decision. The report provides interesting reading on retirement plans and for those considering a retirement decision.

De-risking Climate

With the stock market high and interest rates rising, many consultants are recommending pension plans engage in de-risking strategies. De-risking strategies involve removing longevity risk from the retirement plan by either cashing out the annuity payments for future benefit obligations via a lump sum or transferring the obligation to fund the annuity pension payments to an insurance company through the purchase of annuities. De-risking is usually done with pension plans, but can also be done with respect to self-insured long term disability benefits in pay status.

As plan sponsors consider such strategies for their pension plans, it is important to remember that de-risking can be done through annuity purchase or via lump sum cash-outs. While both move longevity risk out of the pension, if done properly, there are very different issues to be addressed and steps to be followed.

De-risking of long term disability plans by purchasing annuities or moving future claims to an insurance policy is another way employers with self-insured long term disability plans can move the risk off of their financial statements. Care must be exercised in selecting the strategies for a long term disability plan engaging in de-risking as well as a pension plan.

Self-Assessment Tools for State and Local Government Entities Provide Useful Reminders

The Internal Revenue Service recently issued three Self-Assessment tools for State and Local Governments or Public Employers addressing retirement plan issues, fringe benefits and Medicare coverage. State and local governments should review all three because they provide references to a number of compliance tools for handling 403(b), 457(b) and Social Security replacement plans (a type of plan only available to state and local governments and that was once available briefly to tax exempt employers).

The Medicare coverage tool is only applicable to state and local governments, but the fringe benefit tool or guide can be used by other employers because it references many common fringe benefits that have specific compliance requirements, such as reimbursing business expenses under an "accountable plan", personal use of employer owned vehicles, reimbursement of travel expenses, substantiation of expenses for certain "listed property", group term life insurance and tax withholding related to such insurance, employer provided meals and lodging, educational assistance provided to employees, achievement awards, membership fees paid by employers, reimbursement of employee moving expenses and gift certificates given to workers not being excluded from income if they are cash equivalents. The tools provide a quick reference to authorities on each of these various fringe benefits to help an employer ascertain its compliance issues. Each of these fringe benefits have their own set of rules which must be complied with to minimize the tax impact of the fringe benefit for the employees, to the extent possible. If handled improperly, the fringe benefits can become taxable and may become part of the compensation considered by your retirement plan's compensation definition resulting in potentially incorrect recognition of compensation for payroll tax purposes and for calculation of retirement plan benefits in compliance with the plan's provisions, opening the employer to potential risks for claims for benefits not appropriately credited to the employees participating in the plans.

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