Learning from Recent Litigation and Enforcement Actions

Discussion and Worksheet for Retirement Advisors
Learning from Recent Litigation and Enforcement Actions

No employer wants to be the subject of the new retirement plan lawsuit or regulatory enforcement effort that everyone is reading about in the news. Litigation and audits are costly and create a huge distraction for any business. One way to reduce your chances of becoming the subject of a lawsuit or audit initiative is to monitor litigation and enforcement trends and learn from other plan sponsors’ mistakes. The rulings in lawsuits and enforcement actions can have a big impact on the way you administer your plan. Consider for example the ruling in U.S. v. Windsor that changed the federal definition of spouse.

This article provides a summary of four retirement plan topics that were the subject of recent lawsuits or regulatory enforcement initiatives and illustrates how you can apply the lessons learned to your plan.

Apply the Correct Definition of Marriage

In 2013, the U.S. Supreme Court ruled that it was unconstitutional for federal law to define “marriage” as a legal union between a man and a woman, or “spouse” as a person of the opposite sex.1 After this ruling in U.S. v. Windsor, same-sex marriages that are legal under state law must be recognized for federal law purposes, including retirement plan laws under the Employee Retirement Income Security Act (ERISA) and the tax code. Same-sex spouses now have the same rights and benefits under a retirement plan as opposite sex spouses. These include certain benefits under the plan such as spouse beneficiary distribution options and distribution consent rights.

As is common with a ruling of this magnitude, additional Internal Revenue Service (IRS) and Department of Labor (DOL) guidance was needed to help plan sponsors understand how to implement the law change. For example, both the IRS and DOL have released guidance to clarify that the “state-of-celebration” rule applies for federal tax law purposes.2 The state-of-celebration rule means that a same-sex marriage must be recognized if the spouses were legally married in a state or other jurisdiction that recognizes the marriage — regardless of whether the couple currently lives in a state that recognizes the marriage. The IRS also issued guidance to address how the new law should be applied to periods before the Windsor ruling and before issuance of the IRS guidance.3 The IRS clarified that you will need to amend your plan if the plan document contains language inconsistent with the Windsor ruling or related IRS guidance.4 The deadline to adopt an amendment is the later of the general amendment deadline as stated in IRS Revenue Procedure 2007-44 or December 31, 2014. Special rules have also been issued to address amendments for safe harbor 401(k) plans.4

Suggested action: Significant retirement plan lawsuits can lead to changes to plan documents and plan operations. Consult with your plan document provider to determine whether an amendment is required.

Carefully Monitor Plan Fees

There has been a dramatic increase in recent years in lawsuits alleging that plan sponsors have breached their fiduciary duty by paying excessive fees from plan assets. In some cases the focus has been on investment expenses, with plan participants alleging that the plan sponsor breached its fiduciary duty by offering more expensive retail share classes when less expensive institutional shares were available, or that only less expensive passively managed assets should have been offered as compared to actively managed investments. In another case, plan participants alleged that the fiduciaries failed to monitor recordkeeping fees, resulting in excessive fees being paid by the plan, and failed to benchmark costs.

The DOL has also increased its focus on the plan sponsor’s fiduciary responsibility to ensure that only reasonable fees are paid by the plan. The DOL’s ERISA 408(b)(2) service provider fee disclosure requirements became effective in 2012. These new regulations put a spotlight on the plan fiduciary’s responsibility to understand and benchmark costs related to each retirement plan service component. Plan fiduciaries must also analyze the impact of any revenue sharing arrangements that may exist among service providers to the plan. The objective of the DOL rules is to avoid excessive fees that may decrease the value of the participants’ accounts. Compliance with these requirements is likely to be a significant DOL audit and enforcement focus over the next few years.

Suggested action: Develop a prudent process for monitoring plan fees that includes collecting the required service provider and investment fee information and keeping records to document your compliance with these requirements. Your financial advisor is a great resource to help you (1) design a due diligence process for analyzing fees, and (2) analyze and benchmark service provider and investment and service provider fees.

Secure an Adequate Fidelity Bond

The IRS conducts periodic focused exams to assess compliance levels for selected groups of retirement plans. These exams, referred to as LESE examinations (Learn, Educate, Self-Correct, Enforce), can be helpful to plan sponsors because they can identify common problems in retirement plans. You can use the LESE project results to assess your compliance with the particular issue and proactively correct problems before they are discovered under an audit.

In a recent LESE exam project, the IRS examined Form 5500 returns of approximately 50 defined contribution plans that had assets valued between $100,000 and $250,000. One of the two most common issues found was failure to have an adequate fidelity bond. ERISA 412 and related regulations require fiduciaries and other individuals who handle plan assets to be bonded. The purpose of the bond is to protect plans from risk of loss due to fraud or dishonesty. A plan official must be bonded for at least 10 percent of the plan assets, with a minimum bond amount of $1,000 and a maximum bond amount of $500,000 ($1 million if the plan holds company stock).

Suggested action: Periodically review the amount and scope of your fidelity bond to make certain you have adequate coverage for all fiduciaries and other individuals who handle plan assets.

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5 Tibble v. Edison International, 711 F.3d 1061 (9th Cir. 2013)
6 Taylor v. United Technology Corp, 2009 WL 4255159 (2d Circuit 2009)
7 Tussey v. ABB, Inc., 2014 WL 1044831 (8th Cir. 2014)
Make Timely Deposits

In the same LESE examination that identified a lack of fidelity bonds, the IRS found that almost one-third of the 401(k) plans examined had compliance errors resulting from the plan’s failure to timely deposit employee elective deferrals into the trust.

ERISA mandates that deposits be made as soon as administratively feasible after being deducted from an employee’s wages, but in no event later than the 15th day of the following month. There is a safe harbor period for small plans (fewer than 100 participants). For small plans, deposits are deemed timely if made within seven business days.

For plans that have made late deposits, the DOL has designed a corrections program, including an online calculator to determine the amount of any corrective contributions.9

Suggested action: Review your process and the timeline for depositing employee elective deferrals to ensure you are making deposits “as soon as administratively feasible.”

Summary

Keeping a pulse on retirement plan lawsuits and enforcement actions can lead you to plan practices that you may want to adjust within your own plan. Invest the time to discuss recent lawsuits and enforcement initiatives with your plan advisor. Use this information to reflect on your plan practices and proactively correct problems to reduce the chances of your plan becoming the subject the latest enforcement initiatives.

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The following checklist is designed to help you review your plan operations and oversight with respect to four topics that have been the subject of recent lawsuits or regulatory enforcement efforts. Once you have completed the tasks on this checklist, retain this review worksheet with your plan records to document the steps of your compliance efforts.

This Trends Review worksheet is designed as a tool to assist you in monitoring and documenting compliance with certain ERISA fiduciary and operational compliance responsibilities that have been the subject of recent retirement plan litigation and enforcement actions. It is not intended to cover the broad range of responsibilities that apply to plan fiduciaries, nor is it intended as a substitute for competent ERISA counsel.

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<tr>
<th>Litigation/Enforcement Topic</th>
<th>Suggested Actions</th>
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| **Apply the Correct Definition of Marriage** | • Check with your document provider to determine whether a plan amendment is necessary  
  • Confirm you are applying the correct definition of marriage when determining marital status for plan participants  
  • Communicate marital status to Third Party Administrators (TPAs)/recordkeepers as needed (e.g., age 70½ required minimum distribution calculations, nondiscrimination testing) |
| **Monitor Plan Fees**  
  • Service Providers  
  • Investments | • Identify fiduciaries responsible for selecting service providers and investments  
  • Define the process that will be followed to select service providers  
  • Define the investment selection process – determine whether to adopt an investment policy statement (IPS)  
  • Collect required information and disclosures regarding each service provider and investment option  
  • Analyze impact of revenue sharing, if applicable  
  • Benchmark fees  
  • Document all critical decisions |
| **Secure a Fidelity Bond** | • Identify all plan fiduciaries and other individuals who handle plan assets  
  • Confirm that your bond amount is adequate ($1,000 minimum bond up to $500,000 maximum; $1,000,000 maximum if the plan holds company stock)  
  • Explore whether fiduciary insurance covering plan fiduciaries would be beneficial |
| **Make Timely Deposits** | • Review payroll deduction procedures internally and with payroll processer (if applicable)  
  • If a small plan (fewer than 100 participants), confirm deposits are within the small plan safe harbor (7 business days)  
  • For larger plans, determine the “administratively feasible” time frame  
  • Identify payroll deposits that exceeded the permissible time frame  
  • Consult with legal counsel or a corrections expert (e.g., third party administrator) regarding any necessary corrections for late deposits |

For more information
Contact Virtus at 1-800-243-4361.