Parker Brown Macaulay & Sheerin

What's New

April 2017

DOL Delays Applicability Dates of Final Fiduciary Rule and Related PTEs

On April 4, 2017—after reviewing approximately 193,00 public comments received during the comment period ended March 17, 2017 on its March 2, 2017 proposal to delay for 60 days (from April 10, 2017 to June 9, 2017) the applicability date of its April 8, 2016 **final fiduciary rule** and **related Prohibited Transaction Class Exemptions** (PTEs)—the U.S. Department of Labor (DOL) published a **final rule** which:

- Delays for 60 days—from April 10, 2017 to June 9, 2017, as proposed—the applicability date of all provisions of its **final fiduciary rule**, defining who is a "fiduciary" under ERISA and the Internal Revenue Code as a result of giving investment advice to a plan (including an IRA) or its participants or beneficiaries.

- Also delays for 60 days—from April 10, 2017 to June 9, 2017, as proposed—the applicability dates of the Best Interest Contract Exemption (also known as the BIC Exemption or PTE 2016-01) and the Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (also known as the Principal Transactions Exemption or PTE 2016-02) and, in a variation on the proposal, during a transition period from June 9, 2017 through January 1, 2018, requires that fiduciaries relying on these PTEs for covered transactions adhere only to the PTEs' "impartial conduct standards" (i.e., providing advice in retirement investors' best interest, charging no more than reasonable compensation, and avoiding misleading statements). The remaining conditions of the PTEs—including representations of fiduciary compliance, contracts, warranties about firms' policies and procedures, etc.—will apply on January 1, 2018, unless revised or withdrawn.

- Delays—from April 10, 2017 to January 1, 2018—the applicability date of previous amendments to PTE 84-24 (Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters), except that fiduciaries relying on this PTE for covered transactions will be required to adhere to its impartial conduct standards on June 9, 2017.

- Delays for 60 days—from April 10, 2017 to June 9, 2017—the applicability dates of previous amendments to the following PTEs:

  - PTE 86-128 (Securities Transactions Involving Employee Benefit Plans and Broker-Dealers);
  - PTE 83-1 (Class Exemption for Certain Transactions Involving Mortgage Pool Investment Trusts);
  - PTE 80-83 (Class Exemption for Certain Transactions Involving Purchase of Securities Where Issuer May Use Proceeds to Reduce or Retire Indebtedness to Parties in Interest);
  - PTE 77-4 (Class Exemption for Certain Transactions Between Investment Companies and Employee Benefit Plans); and
  - PTE 75-1 (Exemptions from Prohibitions Regarding Certain Classes of Transaction Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks).

These delays follow a February 3, 2017 **Presidential Memorandum**, which also required the DOL to more generally examine the **final fiduciary rule** and the **related PTEs** and to consider revising or rescinding them if it determined that they may adversely affect the ability of Americans to gain access to retirement information and financial advice. Between now and April 17, 2017, the DOL will continue to receive and review additional public comments on these general questions, and between now and January 1, 2018, the DOL will perform the examination required by the **Presidential Memorandum**. After the DOL

completes its examination, some or all of the **final fiduciary rule** and the **related PTEs** may be revised or rescinded, including the provisions scheduled to become applicable on June 9, 2017. The DOL has stated that the above-described delays of the applicability dates should not be viewed as prejudicing the outcome of its mandated examination of the **final fiduciary rule** and the **related PTEs**.

DOL Issues Final Regulations on Disability Benefit Claim and Appeal Procedures

On December 19, 2016, the DOL published **final regulations** revising the ERISA-required claim and appeal procedures for employee pension and welfare benefit plans that provide disability benefits. The final rules apply to plans that make their own disability determinations, but not to plans that follow disability determinations made by third parties, such as the Social Security Administration or LTD insurers. Although most of the final rules apply to disability benefit claims filed on or after January 1, 2018, under a special transition rule, a few rules–imposing certain disclosure requirements for initial denial letters and appeal denial letters–apply to disability benefit claims filed from January 18, 2017 to December 31, 2017. If your plan is subject to these new rules, you may need to update your initial and appeal denial letters to satisfy the special transition rule, and, by January 1, 2018, you will need to update all descriptions of your plan's disability benefit claim and appeal procedures (whether appearing in your plan documents, SPDs, and/or standalone claim and appeal procedures) and to further update your initial and appeal denial letters (to satisfy all of the other requirements that will go into effect on January 1, 2018).

For a chart summarizing the DOL's **final regulations**, click here.

DOL Issues an Interpretive Bulletin Clarifying Fiduciary Standards on Proxy Voting and Investment Policies

On December 29, 2016, the DOL issued **Interpretive Bulletin (IB) 2016-1,** effective as of that date, clarifying how ERISA's fiduciary standards apply to voting proxies on securities held in employee benefit plan portfolios, maintaining and complying with investment policy statements (including proxy voting policies), and exercising other shareholder rights. IB 2016-1 withdrew IB 2008-2 (which had replaced IB 94-2), and restored the language of IB 94-2, with certain modifications.

IRS Issues Proposed 401(k) Regulations that OK Using Forfeitures as QNEC/QMAC/Safe Harbor Contributions

On January 18, 2017, the IRS published **proposed regulations** --which may be relied upon immediately-- allowing employers to use 401(k) plan forfeitures to fund QNECs and QMACs that will be used as safe harbor contributions or that will correct ADP/ACP test failures.

Current rules require that amounts used to fund QNECs/QMACs be nonforfeitable and subject to distribution restrictions when first contributed to the plan, which many have interpreted as prohibiting the use of forfeitures to fund QNECs/QMACs because forfeitures arise from contributions that were forfeitable when first contributed. Under the proposed rules, amounts used to fund QNECs/QMACs must be nonforfeitable and subject to distribution restrictions "when they are allocated to participants' accounts", thereby allowing employers to use forfeitures to fund these contributions.

IRS Gives 403(b) Plan Sponsors Until March 31, 2020 to Fix Plan Document Defects

On January 13, 2017, the IRS issued **Revenue Procedure 2017-18**, which gives a 403(b) plan sponsor until March 31, 2020 to correct any 403(b) plan document defects, by either adopting a pre-approved (volume submitter or prototype) plan restatement or amending/restating its individually-designed plan, to bring the plan document into compliance with the 2007 final 403(b) regulations and subsequent IRS guidance. Plan amendments/restatements adopted by the March 31, 2020 "remedial amendment" deadline may be effective retroactive to the later of January 1, 2010 or the plan's initial effective date.

For any 403(b) plan that existed before January 1, 2010, the March 31, 2020 remedial amendment deadline applies only if the plan sponsor had amended its plan document (retroactive to January 1, 2009) to comply with the 2007 final regulations and subsequent IRS guidance by the December 31, 2009 amendment deadline.

Note that the March 31, 2020 deadline applies only to "remedial" amendments–that is, amendments necessary to make the plan document comply with the 2007 final regulations and subsequent IRS guidance–but not, for example, to "discretionary" amendments (such as amendments that change the plan's design), which should be adopted no later than their effective date. On February 24, 2017, the IRS posted informal guidance on its website about the remedial **amendment period for 403(b) plans**.

IRS Issues Required Amendments List (RAL) and Operational Compliance List (OC List) for Qualified Plans

Effective January 1, 2017, pursuant to **Revenue Procedure 2016-37**, the IRS eliminated the 5-year remedial amendment/determination letter (D/L) cycle for individually-designed 401(a) qualified plans (except for "Cycle A" plans, which were allowed to submit their last 5-year cyclical D/L requests by January 31, 2017), and limited D/L requests to initial plan qualification, qualification upon plan termination, and "certain other" (as yet unspecified) circumstances. In **Revenue Procedure 2016-37**, the IRS promised that every year, it would publish a **Required Amendments List (RAL)** and an **Operational Compliance List** (the **OC List)** to help plan sponsors keep their plan documents and operations in compliance with changes in plan qualification requirements.

- **RAL**. On December 13, 2016, in **Notice 2016-80**, the IRS published its first RAL–the **2016 RAL** –listing only one change in formal qualification requirements and setting December 31, 2018 as the deadline for adopting any required plan amendments. (The one change related to Code §436 restrictions on accelerated distributions from collectively-bargained single-employer defined benefit plans in employer bankruptcy, and so has very limited impact.) The IRS is expected to issue the **2017 RAL**, listing changes in plan qualification requirements becoming effective in 2017 and requiring remedial plan amendments by December 31, 2019, between October 1 and December 31, 2017.

- **OC List**. On February 27, 2017, the IRS published its first **OC List**. The **OC List** will be available only on the IRS's webpage. The IRS intends to update the **OC List** periodically, to reflect new legislation and IRS guidance, but the **OC List** will not reflect every new item of guidance, nor will it include annual, monthly or other routine periodic changes (such as cost-of-living increases, spot segment rates and applicable mortality tables, all of which can be found on the IRS's Recent Published Guidance webpage).

  The current **OC List** includes changes in operational qualification requirements effective in 2016 and 2017. The changes effective in 2017 include:

  (1) Proposed regulations on QNECs and QMACs in defined contribution plans,
  (2) Extension of temporary nondiscrimination relief for closed defined benefit plans,
  (3) Final regulations on partial annuity distribution options for defined benefit plans,

(4) Final regulations on cash balance/hybrid plans, and
(5) Application of benefit restrictions for certain defined benefit plans.

The changes effective in 2016 include:

(1) Relief for plans that make loans and hardship distribution to victims of Hurricane Matthew or the Louisiana Storms,
(2) Mid-year changes to safe harbor 401(k) plans,
(3) Proposed regulations on nondiscrimination testing under Code §401(a)(4),
(4) Proposed regulations on normal retirement age for governmental pension plans,
(5) Extension of temporary nondiscrimination relief for closed defined benefit plans, and
(6) Restrictions on distributions in bankruptcy for collectively-bargained single-employer defined benefit plans.

Plan sponsors should review their plans' operations against the applicable requirements effective in 2016 and 2017 and make any operational adjustments necessary to fully comply with them.

IRS Proposes New Mortality Tables for Determining DB Plans' Minimum Funding Requirements for 2018 Plan Year and Beyond

On December 29, 2016, the IRS issued **proposed regulations** under Internal Revenue Code §430 prescribing mortality tables for determining defined benefit pension plans' minimum funding requirements for plan years beginning on or after January 1, 2018. The IRS is scheduled to hold a public hearing on the proposed rules on April 13, 2017; the public comment period closed on March 29, 2017.

These latest rules, like their predecessors (proposed in 2007 and finalized in 2008), do not include the Code §417(e)(3)(B) "applicable mortality table" that plans must use to determine the amount of lump sum (or other accelerated) distributions. After the IRS finalizes these new proposed regulations, it will issue separate guidance specifying the applicable §417(e)(3)(B) mortality table for determining lump sum values. In November 2007, shortly after the IRS issued its 2007 proposed regulations under Code §430, the IRS issued Revenue Ruling 2007-67, which provided that the applicable §417(e)(3)(B) mortality table for 2008 would be based on a fixed blend of 50% of the static male combined mortality rates and 50% of the static female combined mortality rates from the 2007 proposed regulations under Code §430.

The applicable §417(e)(3)(B) mortality table for a given year applies to distributions with annuity starting dates that occur during stability periods that begin during that calendar year. Revenue Ruling 2007-67 further provided that the applicable §417(e)(3)(B) mortality table for each year after 2008 would be published in future IRS guidance (which has taken the form of Notices) and, except as provided in that future guidance, would be determined from the Code §430(h)(3)(A) "generally applicable mortality tables" on the same basis as the applicable §417(e)(3)(B) mortality table for 2008.

IRS Notice 2008-85 prescribed the applicable §417(e)(3)(B) mortality tables for distributions with annuity starting dates that occurred during stability periods beginning during calendar years 2009 through 2013; Notice 2013-49, for calendar years 2014 and 2015; Notice 2015-53, for calendar year 2016; and Notice 2016-50, for calendar year 2017. Revenue Ruling 2007-67 also provided that, if a defined benefit pension plan document includes a general reference to the "applicable §417(e)(3)(B) mortality table", the IRS would treat that reference as meaning not only the applicable §417(e)(3)(B) mortality table for 2008 set forth in Revenue Ruling 2007-67, but also each subsequent year's applicable mortality table, and the plan would not have to be amended to reflect future changes in that mortality table. By contrast, a plan provision that specifically refers to an annual applicable §417(e)(3)(B) mortality table would have to be amended to reflect subsequent applicable mortality tables, and such plan amendments would have to satisfy the anti-cutback requirements of Code §411(d)(6).

If the IRS were to issue final regulations under Code §430 as well as an updated Notice prescribing the applicable §417(e)(3)(B) mortality table for 2018 early enough in 2017 for such Notice to be included on the IRS's **2017 RAL** (which is expected to be issued on or after October 1, 2017 and before January 1, 2018), then plan sponsors of individually-designed

defined benefit pension plans that specifically refer to annual applicable §417(e)(3)(B) mortality tables presumably would have until December 31, 2019 to amend their plan documents to either add a specific reference to the 2018 mortality table or to remove all specific references to annual mortality tables and to substitute a general reference to the "applicable §417(e)(3)(B) mortality table".

IRS Issues Substantiation Guidelines to its Auditing Agents for Safe-Harbor Hardship Distributions from 401(k) and 403(b) Plans

On February 23, 2017, the IRS issued a **Memorandum** to its Employee Plans (EP) examinations employees setting forth substantiation guidelines they must follow during an audit to determine whether hardship distributions made from a 401(k) plan may be "deemed to be on account of an immediate and heavy financial need" under the safe harbor standards set forth in IRS Regulation §401(k)-1(d)(3)(iii)(B). (The **Memorandum** does not address substantiation of non-safe harbor hardship distributions under IRS Regulation §1.401(k)-1(d)(3)(iii)(A).)

As background, a 401(k) plan may distribute participants' elective deferrals on account of hardship only if the distribution is made on account of an immediate and heavy financial need of the participant and is necessary to satisfy the financial need. A distribution is "deemed" to be on account of an immediate and heavy financial need only if it is for one or more of the following:

(1) Expenses for medical care deductible under Code §213(d) for the participant or his or her spouse, children, dependents (as defined in Code §152) or primary beneficiary under the plan;
(2) Costs directly related to the purchase of the participant's primary residence;
(3) Payment of tuition, related educational fees, room and board expenses for up to the next 12 months of post-secondary education for the participant or his or her spouse, children, dependents (as so defined) or primary beneficiary under the plan;
(4) Payments necessary to prevent the eviction of the participant from his or her principal residence or foreclosure of the mortgage on that residence;
(5) Payments for burial or funeral expenses for the participant's deceased parents, spouse, children, dependents (as so defined) or primary beneficiary under the plan; or
(6) Expenses for the repair of damages to the participant's principal residence that would qualify for the casualty deduction under Code §165.

Substantiation that a distribution is for one or more of the above items is required to determine that a hardship distribution is "deemed" to be on account of an immediate and heavy financial need.

The IRS **Memorandum** provides the following administrative guidelines that EP examinations employees must follow when they are auditing 401(k) plans and trying to determine whether participants requesting hardship distributions have provided the substantiation required for the plan's sponsoring employer or a third-party administrator (TPA) to have determined whether the distribution is "deemed" to be on account of an immediate and heavy financial need:

> Step 1 directs EP examinations employees to determine whether the 401(k) plan's sponsoring employer or TPA, prior to making a distribution, obtained either source documents (e.g., estimates, contracts, bills and statements from third parties) or a summary of the information contained in the source documents.
>
> If a summary was used, the EP examinations employee must determine whether the employer or TPA provided required notifications to the participant before making the distribution (i.e., notification that the hardship distribution is taxable and additional taxes could apply, that the amount of the distribution cannot exceed the immediate and heavy financial need, that hardship distributions cannot be made from earnings on elective contributions, QNECs or QMACs, and that the participant agrees to preserve source documents and to make them available at any time, upon request, to the employer or TPA).

Step 2 further directs EP examinations employees to review the source documents or summaries that an employer or TPA has obtained to determine if they substantiate the hardship distribution, and also to review any required notifications that have been provided to participants, and if those notifications are incomplete or inconsistent, to request source documents from the employer or TPA.

If a summary of information is complete and consistent but shows participants who have received more than two hardship distributions in a plan year, the EP examinations employee may request source documents from the employer or TPA (including documentation of follow-up medical or funeral expenses or tuition on a quarterly school calendar). Also, if a TPA obtained a summary of source documents, the EP examinations employee must determine whether the TPA provided a report or other access to data to the plan's sponsoring employer, at least annually, describing the hardship distributions made during the plan year.

Finally, the **Memorandum** provides that if the EP examinations employee determines that all applicable requirements in Steps 1 and 2 have been satisfied, the 401(k) plan should be treated as satisfying the substantiation requirement for making hardship distributions "deemed" to be on account of an immediate and heavy financial need. The guidance in the **Memorandum** will be incorporated into the Internal Revenue Manual (IRM) by February 23, 2019. If your 401(k) plan uses the "deemed" immediate and heavy financial need standard and comes under IRS audit, be prepared for the EP auditing agent to request proof that these substantiation requirements have been met.

On March 7, 2017, the IRS issued another **Memorandum** to its EP examinations employees stating that, because 403(b) and 401(k) plan hardship distribution rules are the same, the February 23, 2017 **Memorandum** governing 401(k) plan hardship distribution substantiation should also be followed during examinations of 403(b) plans. The guidance in the March 7, 2017 403(b) plan **Memorandum** will be incorporated into the IRM by March 7, 2019.

The 401(k) and 403(b) plan **Memoranda** offer plan sponsors and TPAs a "best practices" roadmap for substantiating "deemed" immediate and heavy financial needs under their plans' hardship distribution features.

Parker, Brown, Macaulay & Sheerin, P.C. concentrates exclusively in employee benefits law. With more than seven decades of combined employee benefits experience, our lawyers find innovative, practical solutions to legal and business problems involving ERISA, employee benefits, executive compensation, and compliance with regulatory laws such as COBRA and HIPAA.

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