Investment Outlook and the Human Side to Investing in a 401(k) Plan

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Agenda

- 2016 Investment Outlook
- Emotional Intelligence and 401(k) participation

2016 Investment Outlook

S&P 500 Index and Volatility

S&P 500 Drawdowns Since 1980:
Greater than 5%: 43 times
Greater than 10%: 13 times
Greater than 15%: 7 times

S&P 500 Price

2500
2000
1500
1000
500
0

2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016

Financial Crisis (-55.2%)

U.S. Downgrade (-18.6%)

Recent Global Slowdown (-12.0%)

Flash Crash (-15.6%)

VIX Level Past 10 Years:
Peak: 80.9
Average: 20.4
Latest: 14.0

VIX Level

90
80
70
60
50
40
30
20
10
0

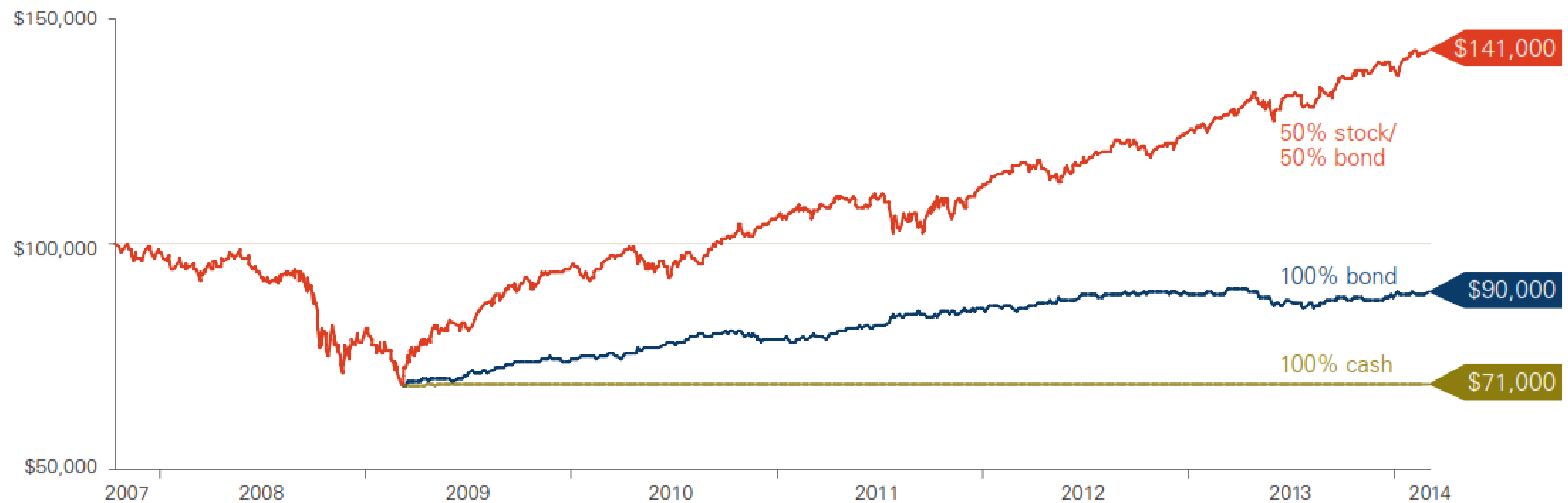
2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016

Source: Bloomberg

[1] S&P 500 is divided by 10 for scaling purposes.

Stick with your plan even when the market gets scary.

An investor who moved the portfolio to cash/bonds at the market bottom in 2009 didn't recover as well as the investor who stayed the course.



Source: FactSet, The Vanguard Group, Inc. Data as of 12/31/14.

U.S. Presidential risk is assumed, but worldwide politics are more pressing

From Brussels to Beijing, hazards lurk behind the headlines. Stay diversified, and don't try to time the markets when geopolitical risks flare-up. - BlackRock

EVENTS TO WATCH IN 2016

UNITED STATES
Election:
White House and Senate in Play

CHINA
Policy Response

SOUTH CHINA SEA
Tensions Escalate

UNITED KINGDOM
Brexit?
EU Referendum by the end of 2017

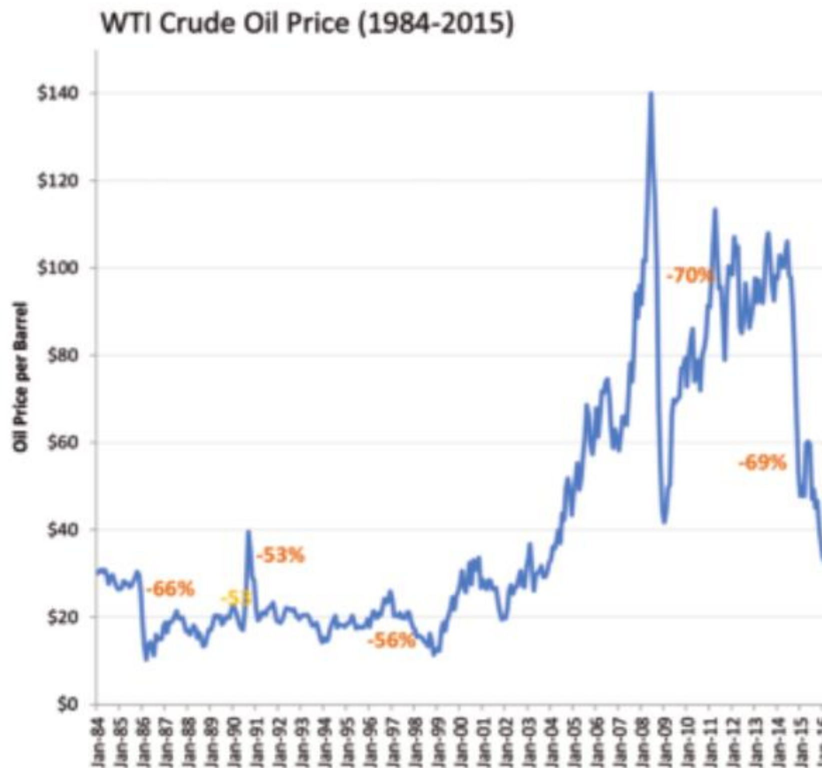
EUROZONE
Refugee Crisis

EURO PERIPHERALS
Portugal Election Signals End to Austerity?

SYRIA
Conflict Expands

Source: BlackRock. 3/31/16.

Stocks tend to rise after significant oil price declines



Time Span	Oil Price Drop	S&P 500 Index Total Return 1 Year After Price Decline
Oct. 85 - Mar. 86	-66%	37.66%
Sept. 90 - Feb. 91	-53%	15.99%
Dec. 96 - Nov. 98	-56%	20.90%
Jun. 08 - Jan. 09	-70%	33.14%
Jun. 14 – Feb.16	-69%	?

S&P 500 Index Average Gain After Crude Oil Price Drop of More Than 50%:

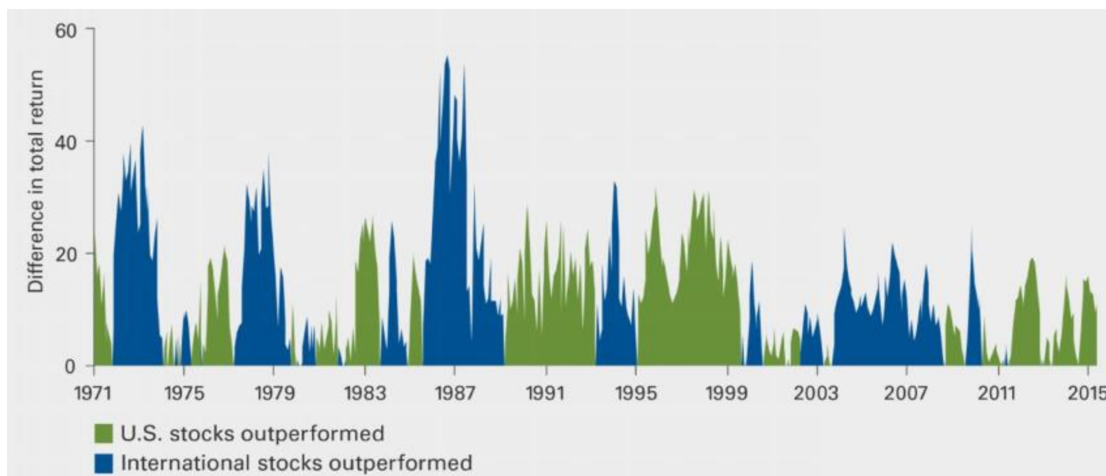
26.92%

WTI (West Texas Intermediate) is a grade of crude oil used as a benchmark for oil prices.

Source: Federal Reserve Bank of St. Louis, Bloomberg, Hartford Funds. 2/29/16.

Global stocks don't follow each other – local currency exposure is important

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Highest Return	S&P	EM	EM	EM	EM	EM	EM	EM	S&P	EM	EM	S&P	EM	S&P	S&P	EM
	ACWI	S&P	EAFE	EAFE	EAFE	EAFE	EAFE	ACWI	EAFE	ACWI	S&P	ACWI	EAFE	EAFE	ACWI	S&P
	EAFE	ACWI	ACWI	ACWI	ACWI	ACWI	ACWI	EAFE	ACWI	EAFE	ACWI	EAFE	ACWI	ACWI	EM	ACWI
Lowest Return	EM	EAFE	S&P	S&P	S&P	S&P	S&P	S&P	EM	S&P	EAFE	EM	S&P	EM	EAFE	EAFE



Hedging:

- Is an expense
- Has underperformed unhedged portfolios by 1.1% since 1990
- Currency exposure contributes to foreign diversification

We believe:

- If investing in a single foreign market, hedging may make sense
- If investing in broadly diversified portfolios with multiple countries and currencies, hedging can be costly, complex, and sometimes undesirable.

Domestic stocks have risen >200% since 2009 & have room to grow further with fair price valuations

S&P 500 Price Index

Characteristic	Mar. 2000		Oct. 2007		Mar. 2016
Index level	1,527	→	1,565	→	2,060
P/E ratio (fwd.)	27.2x	→	15.7x	→	16.6x
Dividend yield	1.1%	→	1.8%	→	2.3%
10-yr. Treasury	6.2%	→	4.7%	→	1.8%

2,200
2,000
1,800
1,600
1,400
1,200
1,000
800
600

Dec. 31, 1996
P/E (fwd.) = 16.0x
741

+106%

Mar. 24, 2000
P/E (fwd.) = 27.2x
1,527

-49%

Oct. 9, 2002
P/E (fwd.) = 14.1x
777

+101%

Oct. 9, 2007
P/E (fwd.) = 15.7x
1,565

-57%

Mar. 9, 2009
P/E (fwd.) = 10.3x
677

+204%

Mar. 31, 2016
P/E (fwd.) = 16.6x
2,060

'97 '98 '99 '00 '01 '02 '03 '04 '05 '06 '07 '08 '09 '10 '11 '12 '13 '14 '15 '16

Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management. As of 3/31/2016.

Int'l stocks have grown since 2009 but not as much. Foreign investments have more growth potential long-term

MSCI EAFE Price Index

Characteristic	Mar. 2000	Oct. 2007	Mar. 2016
Index level	1,136	→ 1,212	→ 940
P/E ratio (fwd.)	27.7x	→ 14.8x	→ 14.5x
Dividend yield	1.4%	→ 2.7%	→ 3.4%
10-yr. German Bunds	5.3%	→ 4.6%	→ 0.2%

MSCI EAFE weights	Mar. 2016
Europe	45.5%
Japan	22.5%
United Kingdom	19.3%
Other	12.7%

Dec. 31, 1996 P/E (fwd.) = 19.5x 670

+70%

Mar. 29, 2000 P/E (fwd.) = 27.7x 1,136

-56%

Mar. 12, 2003 P/E (fwd.) = 13.2x 503

+141%

Jul. 16, 2007 P/E (fwd.) = 14.8x 1,212

-57%

Mar. 9, 2009 P/E (fwd.) = 10.2x 518

+81%

Mar. 31, 2016 P/E (fwd.) = 14.5x 940

1,600 1,400 1,200 1,000 800 600 400

'97 '98 '99 '00 '01 '02 '03 '04 '05 '06 '07 '08 '09 '10 '11 '12 '13 '14 '15 '16

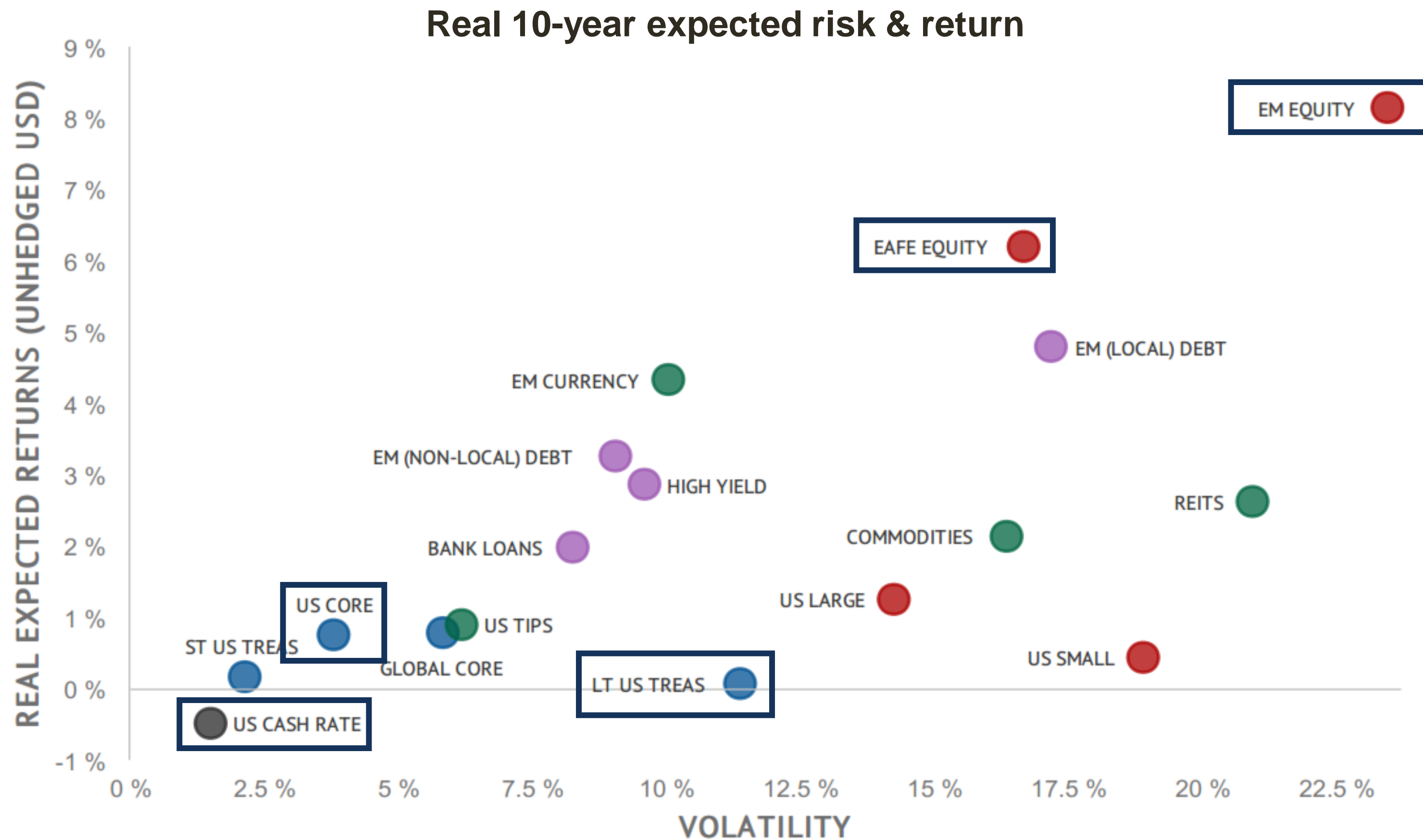
Source: FactSet, MSCI, J.P. Morgan Asset Management. As of 3/31/2016.

Diversification is even more important in volatile markets

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Highest Return	Emerging Markets 29.18	Emerging Markets 36.48	Global Bond 10.89	Emerging Markets 74.5	Small Cap Growth 29.09	Intermediate Bond 7.84	Mid Cap Value 18.48	Small Cap Growth 43.30	Mid Cap Value 14.75	Large Cap Growth 5.67	Highest Return
	Small Cap Value 23.48	Large Cap Growth 11.81	Short-Term Bond 6.66	Mid Cap Growth 46.29	Mid Cap Growth 26.38	Global Bond 6.35	Emerging Markets 18.23	Mid Cap Growth 35.74	Large Cap Value 13.45	Global Bond 0.63	
	International Equity 23.47	Mid Cap Growth 11.43	Intermediate Bond 5.24	Large Cap Growth 37.21	Mid Cap Value 24.75	Large Cap Growth 2.64	Small Cap Value 18.05	Small Cap Value 34.52	Large Cap Growth 13.05	Short-Term Bond 0.56	
	Large Cap Value 22.25	Global Bond 10.95	Small Cap Value -28.92	Small Cap Growth 34.47	Small Cap Value 24.50	Short-Tern Bond 1.55	Large Cap Value 17.50	Large Cap Growth 33.48	Mid Cap Growth 11.90	Intermediate Bond 0.55	
	Mid Cap Value 20.22	International Equity 8.62	Large Cap Value -36.85	Mid Cap Value 34.21	Emerging Markets 18.88	Large Cap Value 0.39	International Equity 17.32	Mid Cap Value 33.46	Intermediate Bond 5.97	Mid Cap Growth -0.20	
	Small Cap Growth 13.35	Short-Term Bond 7.1	Large Cap Growth -38.44	International Equity 27.75	Large Cap Growth 16.71	Mid Cap Value -1.38	Mid Cap Growth 15.80	Large Cap Value 32.53	Global Bond 5.75	International Equity -0.81	
	Mid Cap Growth 10.66	Small Cap Growth 7.05	Mid Cap Value -38.44	Small Cap Value 20.58	Large Cap Value 15.51	Mid Cap Growth -1.65	Large Cap Growth 15.26	International Equity 22.78	Small Cap Growth 5.60	Small Cap Growth -1.38	
	Large Cap Growth 9.07	Intermediate Bond 6.97	Small Cap Growth -38.54	Large Cap Value 19.69	International Equity 7.75	Small Cap Growth -2.91	Small Cap Growth 14.59	Short-Term Bond 0.36	Small Cap Value 4.22	Large Cap Value -3.83	
	Global Bond 6.12	Large Cap Value -0.17	Mid Cap Growth -44.33	Intermediate Bond 5.93	Intermediate Bond 6.54	Small Cap Value -5.50	Intermediate Bond 4.26	Global Bond -2.01	Short-Term Bond 0.63	Mid Cap Value -4.78	
	Intermediate Bond 4.33	Mid Cap Value -1.42	International Equity -45.09	Global Bond 2.55	Global Bond 5.21	International Equity -12.14	Global Bond 1.65	Intermediate Bond -2.02	Emerging Markets -2.19	Small Cap Value -7.47	
Lowest Return	Short-Term Bond 4.12	Small Cap Value -9.78	Emerging Markets -54.48	Short-Term Bond 1.41	Short-Term Bond 1.06	Emerging Markets -18.42	Short-Term Bond 0.43	Emerging Markets -2.60	International Equity -4.90	Emerging Markets -14.92	Lowest Return

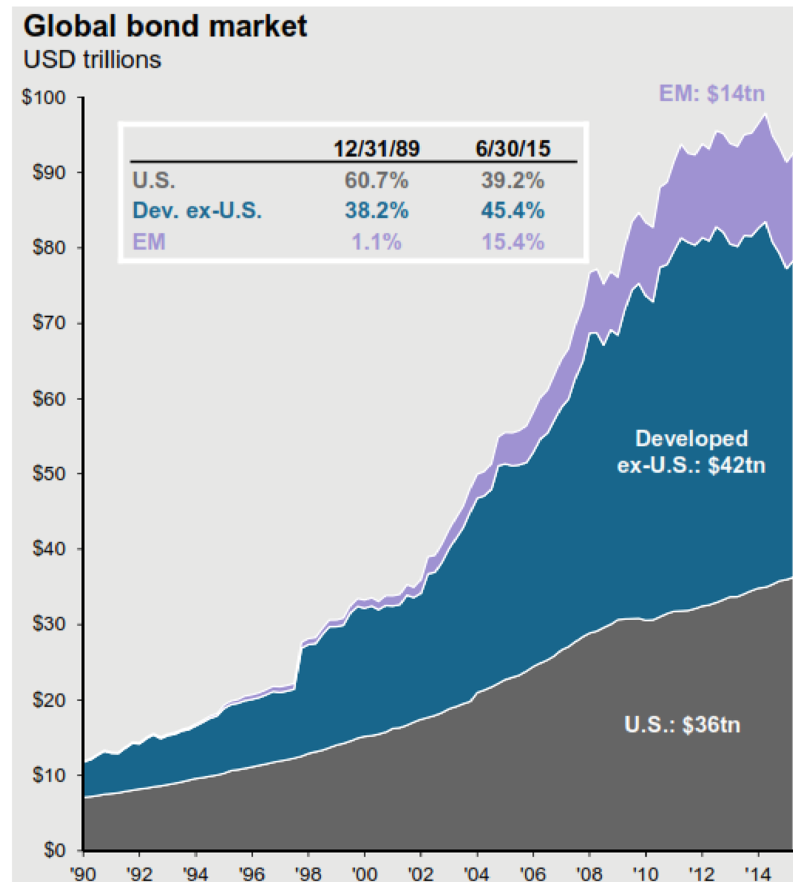
Asset classes are represented by the following indexes: Large Cap Growth: Russell 1000 GR; Large Cap Value: Russell 1000 VAL, Mid Cap Growth: Russell MC GR; Mid Cap Value: Russell MC VAL; Small Growth Equity: Russell 2000 GR; Small Cap Value: Russell 2000 VAL; International Equity: MSCI EAFE; Emerging Markets: MSCI EM; Intermediate Bond: Barcap Aggregate; Short-Term Bond: Barcap 1-3 Year Gov't/Credit; Global Bond: Citi World Gov't Bond.

Emerging Markets appear most attractive long-term, but position portfolios based on risk, return.



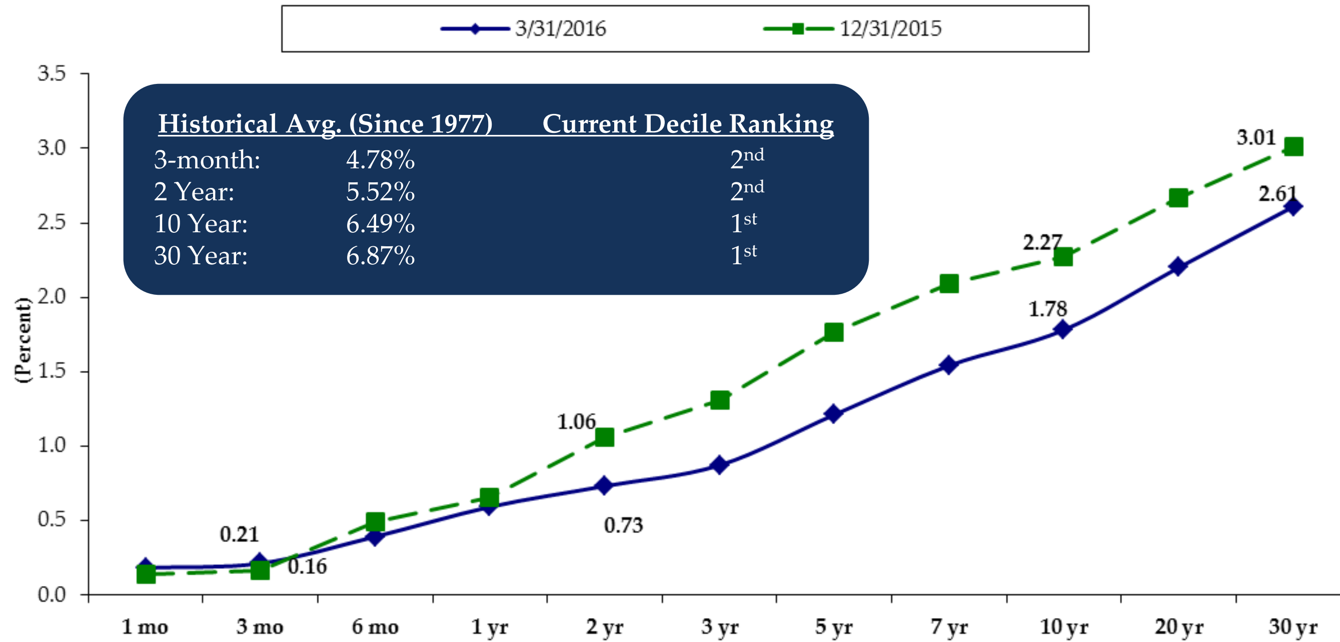
Source: Research Affiliates, MSCI Inc., Bloomberg, Barclays. 3/31/16.

Choosing the right bonds is ever-important; be sure to look outside the U.S., too.

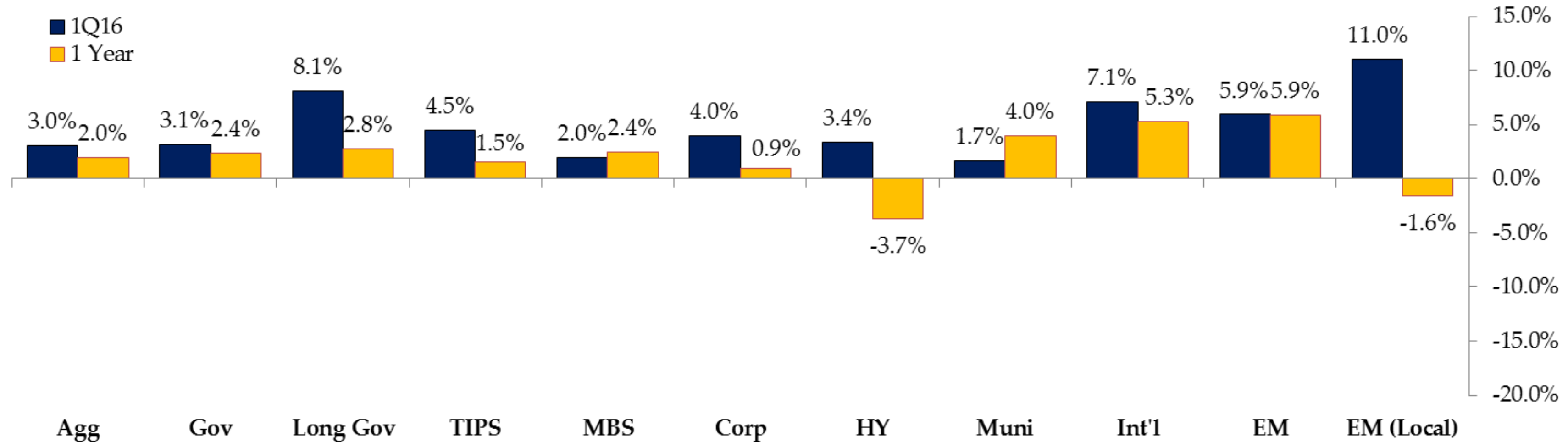


Source: J.P. Morgan Asset Management, BIS. 3/31/16.

Treasury Yield Curve & Bond Market



Fixed Income Performance (Sector)



Q2 2016 Outlook

Expect global growth to stabilize as 2016 progresses with Chinese stabilization and domestic inflation growth.

U.S. recession risks remain low, but late-cycle signals have risen	Global macro environment stabilizing	Pace of Fed tightening will likely be gradual
Volatility will likely continue Review asset allocation and diversification positioning	Global economy continues to stabilize Equities should outperform bonds worldwide U.S. is sturdy; Europe improves slowly but steadily; China is risky but still strong	Inflation may surpass low expectations Higher inflation can be healthy in the right amounts

Source: Fidelity. 3/31/16.

Emotional Intelligence and 401(k) participation

Human Side to Investing in a 401(k) Plan

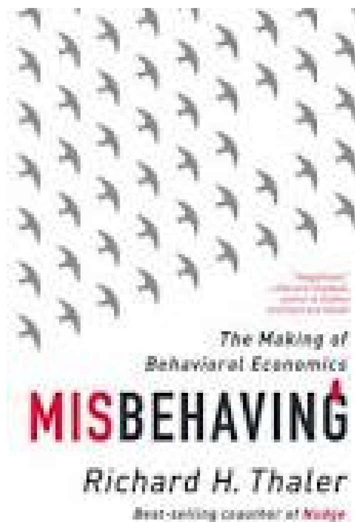
Emotional intelligence (EI) or **emotional quotient** (EQ) is the capacity of individuals to recognize their own, and other people's **emotions**, to discriminate between different feelings and label them appropriately, and to use **emotional** information to guide thinking and behavior.

Human Side to Investing in a 401(k) Plan

"US Stocks Post Worst Annual Loss Since 2008"

"2015 was the hardest year to make money in 78 years!"

Human Side to Investing in a 401(k) Plan



"…losses have about twice the emotional impact of an equivalent gain."

Human Side to Investing in a 401(k) Plan

- Continue to save
- Time matters
- Don't lose sight of your long term objectives and risk tolerances
- Don't try to time the market
- Diversification matters

Human Side to Investing in a 401(k) Plan

Managing and protecting your retirement savings is important.

It is perfectly normal to be concerned, but you should not panic.

Don't let your emotional intelligence get the best of you!

Thank You!

PRESENTATION

Fiduciary Duty and the Voluntary Compliance Program

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FIDUCIARY RESPONSIBILITY, VOLUNTARY COMPLIANCE AND COMMON MISTAKES IN QUALIFIED RETIREMENT PLANS

Bill Robinson

Baker, Donelson, Bearman, Caldwell & Berkowitz, PC

May 12, 2016

Special thanks to my colleague, Paul O'Rourke, for his outstanding work on the preparation of this outline.

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I. FIDUCIARY RESPONSIBILITY

A retirement plan which satisfies the federal tax law requirements of Internal Revenue Code ("Code") sections 401(a) and related Code sections, including 401(k), is favored with a number of federal income tax advantages. The Internal Revenue Service ("IRS") has enforcement authority over the Code's tax-qualification requirements which apply to a qualified retirement plan such as a 401(k) plan. While most of this outline is relevant to all qualified retirement plans, the most common type is a 401(k) plan. Therefore, hereafter I will refer to 401(k) plans when discussing qualified plans.

Regardless of whether a 401(k) plan satisfies the Code rules for tax-qualified status, it is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), as an "employee benefit plan". In general, the U.S. Department of Labor ("DOL") has ERISA regulatory authority over the fiduciary responsibility, civil enforcement, reporting and disclosure, and certain other aspects of a 401(k) plan, through its Employee Benefits Security Administration ("EBSA") division.

In some cases, similar statutory requirements are found in both the Code and ERISA. In these cases, ruling authority is generally granted to either the IRS or the DOL.

Every ERISA plan has one or more fiduciaries. ERISA requires a written plan document, which "shall provide for one or more named fiduciaries who jointly or severally shall have the authority to control and manage the operation and administration of the plan." If a written plan does not exist, or if the plan document does not specify the named fiduciary(ies), that violates ERISA, but it does not mean that there are no plan fiduciaries.

The following is a general discussion of matters relating to 401(k) plan fiduciaries.

A. Who is a Fiduciary?

Fiduciary status can exist by specific statutory language where a person:

- ♦ has "*discretionary* authority or *discretionary* control respecting management of the plan" (e.g., a "plan administrator" with authority to construe the plan);

    - o Example: A plan document commonly designates the company as the plan administrator, or whomever the company appoints. In the absence of express language or delegation of authority, the plan sponsor is the administrator, and the Board of Directors has the authority to act for a company, including the selection and retention of persons to administer the plan. The plan administrator will have discretionary authority or control regarding plan administration. In the absence of express language or delegation of authority in the plan document, the Board of Directors has the authority to act for a company, including the selection and retention of persons to administer the plan. In so doing, the Board would act as a fiduciary, with a responsibility to prudently designate and monitor the person(s)

who will serve as the plan administrator. In making and monitoring (or not monitoring) these appointments, the Board members (or other party with this discretionary authority) would have exposure to personal liability. The appointed or acting plan administrator would have discretionary authority regarding the administration of the plan, and thus would also be a plan fiduciary in this regard.

- has “discretionary control over plan assets” (e.g., the members of a plan investment committee which selects and monitors investment fund options for participant selections, or an investment manager who has discretion to invest plan assets); or

- gives investment advice for any direct or indirect compensation, with an understanding that the advice will be used as a primary basis for investment decisions (e.g., a paid investment adviser to the plan).

Fiduciary status can also exist based upon:

- The inherent nature of the function (e.g., a trustee).

- The reasonable expectation of participants. A person may act in both fiduciary and non-fiduciary capacities. A person is generally a fiduciary only to the extent that they are exercising a fiduciary power. If a person acts in both fiduciary and non-fiduciary capacities and a participant can't determine in which capacity the person has acted, a federal court may presume that the action was taken as a fiduciary, which would result in fiduciary responsibility to the participant. A person serving in multiple capacities should be clear about the capacity in which they are acting.

- Conduct. A person can assume fiduciary functions or authority and thus fiduciary status, even if not properly appointed. Title alone does not determine fiduciary status.

A person may serve in multiple fiduciary capacities.

B. What is the Fiduciary Standard of Care under ERISA?

The ERISA fiduciary standard of care is among the “highest known to law” and requires:

- Administration in accordance with plan terms, to the extent the plan terms are consistent with ERISA.

  - If the plan terms are inconsistent with ERISA, a fiduciary generally must act in accordance with ERISA rather than follow the plan.

  - However, a fiduciary is not required to violate other applicable laws, such as a violation of securities law by engaging in illegal insider trading.

- Prudent administration:

  - Acting as a "prudent expert" with the care, skill and diligence that a prudent person acting in a like capacity and familiar with such matters would use under the circumstances (the "prudent expert" standard). Where the fiduciary lacks the

necessary expertise, education or expert help may be needed. It is still the plan fiduciary who must make the decision based upon any such expert assistance. A fiduciary should not accept data at face value, even from an expert. Questions should be asked where needed for understanding. The fiduciary should then arrive at a reasoned conclusion and document the process. “A pure heart and an empty head are not enough.” Thus, for the DOL (just like for the IRS), "I didn't know any better" is not an excuse.

- Prudence is a guarantee of an adequate process to reach a reasoned decision, not a guarantee of a result.

- Concurrent documentation of a prudent process is important. It may be difficult or impossible later for a fiduciary to show that the necessary level of skill and an adequate process was used in reaching the decision.

♦ Acting for the exclusive benefit of participants and beneficiaries - the duty of loyalty. Sometimes called the "exclusive benefit rule”.

- Duty not to engage in self-dealing nor act for the benefit of parties other than the plan participants. An incidental benefit to others is generally not prohibited.

- Duty not to misrepresent when information is conveyed.

- Duty to correct if information previously conveyed was or becomes incorrect. However, a statement which is true when made is not in itself a basis for a claim of fiduciary breach if that statement later turns out to be inaccurate.

- Duty to disclose:

  - Duty to respond, generally within 30 days, to requests for documents under which the plan is established or maintained. Civil penalties of up to $110 per day may be imposed for failures, at the discretion of a court. Intentional failures may be a criminal act.
  - Even if not asked, a duty to disclose may exist when acting in a fiduciary capacity if a proposal is being "seriously considered" and if failing to disclose the proposal might cause harm to participants.
  - If a participant makes a general request for benefit information, or perhaps if the participant doesn't ask the right question, the fiduciary may have an obligation to provide all material information, even if that information has been previously communicated, such as in a summary plan description.

♦ Assuring "reasonable" costs of administration.

- Expenses paid with plan assets are often scrutinized and sometimes litigated.

- This does not require the fiduciary to obtain the lowest fee possible.

- ♦ Construing and interpreting the plan. Retirement plans are typically long, complex documents, sometimes requiring interpretation. A fiduciary's interpretation of plan language is subject to a deferential, abuse of discretion standard of review by a court, as long as the plan document delegates interpretive authority to the fiduciary. Document all decisions on plan construction.

C. May a Fiduciary Delegate Authority and Responsibility?

- ♦ Fiduciary and non-fiduciary authority and responsibility can be delegated by a fiduciary, to the extent authorized by the operative documents (i.e., is within their authority).

- ♦ Delegation of authority is itself is a fiduciary act and carries an ongoing duty to monitor the delegation. If the appointed fiduciary lacks the expertise needed, expert assistance should be provided or assured, as well as a reporting procedure for monitoring purposes.

D. What Can Happen if a Fiduciary Breaches or Does Not Follow the Plan or ERISA?

- ♦ Generally, a failure to follow the terms of a plan, or to follow the plan if it is inconsistent with ERISA, is a breach of fiduciary responsibility, resulting in personal liability for resulting losses to the plan, and perhaps civil penalties.

- ♦ In some cases, intentional disregard of the rules is a criminal act.

- ♦ If the terms of a plan are not followed, the plan can lose its tax-qualified status. The IRS rarely carries through on plan disqualification because the innocent participants will suffer. The employer is almost always willing to correct an error despite the cost. We now have the IRS Employee Plans Compliance Resolution System ("EPCRS"). (See Part III of this outline.)

- ♦ The DOL also has a Voluntary Fiduciary Compliance Program (VFCP) under which the DOL may similarly approve certain types of correction for ERISA purposes. This does not prevent further action by participants.

- ♦ A plan can maintain fiduciary liability insurance coverage, and/or the fiduciary or employer can purchase fiduciary liability insurance. In addition, the employer can, and generally does, provide indemnification of employee fiduciaries on some basis.

- ♦ In some circumstances, liability can be limited, such as for participant-directed investments, provided regulatory requirements are satisfied. This does not, however, relieve the responsible fiduciaries from potential liability for the prudent selection and monitoring of the investment options which are offered to participants.

E. Investments

A fiduciary must diversify plan investments in order to minimize the risk of large losses, unless it is clearly prudent not to diversify, and allow adequate diversification of participant-directed investments from among a prudently selected and monitored investment menu.

- Prudent selection of investment options for participants is a fiduciary act.
- Investments and investment options for participants should be monitored and replaced, if appropriate.
- Participant investment options should allow adequate diversification.
- Fees associated with investment options should be reasonable.
- Be careful about being too accepting of investment advice from advisers.
- Use appropriate share classes for investment options.
- Providing investment education (general investment concepts, or asset allocation models based on generally accepted investment theories) will not generally make you a fiduciary.

F. Prohibited Transactions

A plan fiduciary must avoid “prohibited transactions.” This involves complex rules which ban certain types of dealings between a plan and related parties who or which are "disqualified persons" (as defined in the Code) or "parties in interest" (as defined in ERISA).

Excise taxes and civil penalties may result from a prohibited transaction, in addition to personal liability to the plan for resulting losses.

G. Liability For Acts of Others

In some circumstances, a fiduciary may be liable for the acts of another fiduciary on a "co-fiduciary liability" basis, even where the fiduciary has no part in the other fiduciary's status as such. For example, if a fiduciary *knowingly participates* in another fiduciary’s breach of responsibility, *conceals* the breach, or *does not act to correct* it, that fiduciary is liable as well.

H. Fee Disclosures

Under DOL Regulations, covered service providers are required to disclose fees received both directly and indirectly and the source of any indirect compensation. This allows the responsible plan fiduciary to assess the reasonableness of total compensation paid, identify potential conflicts of interest, and satisfy reporting and disclosure requirements.

I. Reporting and Disclosure

ERISA includes a number of reporting and disclosure requirements. In general, a plan fiduciary (usually the plan administrator) is responsible for compliance with these rules.

Noncompliance with ERISA's reporting and disclosure requirements may have a number of consequences, including:

- ♦ Civil penalties.
- ♦ In some cases, willful noncompliance is a criminal act.
- ♦ Noncompliance is generally a breach of fiduciary responsibility, exposing the responsible fiduciary to suit by the participants or the DOL, with personal liability for resulting plan losses. Both legal and equitable claims are possible.

II. COMMON ERRORS IN 401(k) PLANS

A. Incorrect Compensation

There are several common errors to look out for:

- ♦ using the wrong compensation amount, as defined in the plan and/or the statute.
- ♦ missing special compensation items, like taxable fringe benefits and bonuses.
- ♦ missing special checks issued outside of the regular payroll system.

Payroll and plan administration personnel need to understand, report and use exactly the amount included in compensation for different purposes.

- ♦ A plan can have several different definitions of compensation to be used for different purposes.
- ♦ Plan compensation is often different from gross or taxable pay.

The correct compensation amount must be correctly applied.

B. Elective Contributions Are Not Deposited on a Timely Basis

- ♦ DOL regulations require a trust deposit as soon as employee deferral contributions can reasonably be segregated from the employer's general assets.
- ♦ The absolute deadline for deposit under any circumstances is the 15th business day of the month following the payroll date. This delayed date is not a safe harbor.
- ♦ For small plans (under 100 participants), 7 business days after the payroll date is safe.

- For larger plans, consider the date when payroll taxes are submitted to the IRS.

Failure to make a timely deposit is considered a prohibited transaction.

C. Failure to Properly Calculate or Timely Make Matching Contributions

Matching contributions are usually calculated as a percentage of a participant's contribution. For example, 50% of the participant's deferral amount up to 6% of pay.

- Miscalculation of the correct match is an error, e.g., if incorrect compensation is used.
- Failure to use the correct match frequency as provided in the plan is an error.

To change or eliminate safe harbor matching contributions, employees must receive at least 30 days advance notice.

- An opportunity to change elections before the effective date of the change must be provided.
- Nondiscrimination testing is required for the year of change.

D. Errors in Eligibility

This type of error can apply in many ways:

- Including an ineligible employee;
- Including an eligible employee too early (service & entry dates);
- Excluding an eligible employee;
- Eligibility for a contribution (retirement, service, entry date, etc.);
- Covering entities or divisions which are not covered by the plan.

E. Failure to Distribute a Required Safe Harbor Notice Every Year

A "safe harbor" 401(k) plan can avoid certain discrimination testing requirements. The safe harbor requires advance notice to participants, 30 to 90 days before each year. If proper and timely notice is not given, then the required testing must be completed.

F. Failure to Make Timely "Required Minimum Distributions"

- Payments must start by each person's "required beginning date" ("RBD").
- Normally, the RBD for a participant who is not a 5% owner is April 1 of the year which begins after the participant both reaches age 70 ½ and terminates employment. For a 5% owner, the RBD is April 1 of the year after the year in which the individual reaches age 70 1/2, whether or not they are still employed.

- ♦ A participant is not allowed to delay distribution beyond the RBD.

- ♦ RBD rules also apply after a participant's death. In general, distributions to a non-spouse beneficiary must begin by the end of the following year or, if not started by then, the entire benefit must be paid within 5 years. In some circumstances, a beneficiary who is a spouse can further delay the commencement of payments.

The consequences of not making a required minimum distribution include:

- ♦ Possible plan disqualification.

- ♦ Penalty tax payable by the participant equal to 50% of the amount not timely distributed, in addition to normal income taxes.

G. Failure to Timely or Properly Implement Employee Deferral Elections

A failure to timely or properly implement a participant's deferral election is an error. Correction generally requires the employer to make a fully vested contribution equal to 50% of the "missed deferral opportunity", adjusted for lost earnings.

- ♦ For an erroneously excluded employee (where the person never made a contribution election), the missed deferral opportunity is generally based on the average of the deferral percentages ("ADP") for other HCE or non-HCE employees, as applicable.

- ♦ For a failure to timely implement an employee's election, the missed deferral is based on the employee's election.

Matching contributions associated with the missed deferrals, and lost earnings on those matching contributions, would also be required. These matching contributions no longer need to be fully vested.

H. Loan Issues

Loans must be written and enforceable, adequately secured, reasonable rate of interest, level payments of principal and interest, generally limited to a 5 year terms, within statutory limits on amount, and otherwise in accordance with the law, the plan and any loan policy. In some cases, an improper loan can cause the plan to be disqualified.

Participant loans may be outstanding when a participant's employment ends. The loan can be treated as repaid based on a reduction in the account balance or can remain outstanding, depending upon the language of the plan and the promissory note.

- ♦ If loan payments have been made through payroll deduction, new arrangements will be needed to avoid a default under a continuing loan. If timely repayments do not continue, the loan will be in default no later than the end of the following quarter. For loans in default, the entire amount outstanding is deemed distributed to the participant and must be so reported.

Loan problems can arise when the payroll frequency changes for a participant, if payments are not adjusted to the new payroll frequency. For example, if the employee changes jobs and goes from a bi-weekly payroll to a monthly payroll, then unadjusted loan payments by payroll deduction will be too slow. If not corrected by the end of the following quarter, then for tax purposes the loan is in default and is generally required to be reported as a taxable distribution.

Loans to "parties in interest" other than as a participant are generally prohibited.

I. Vesting Issues

A "complete discontinuation" of employer contributions to a plan can result in a "partial termination" of the plan, requiring full vesting of the accounts of all "affected employees".

A reduction in force may result in a "partial termination" of a plan due to a decrease in the number of participants.

Failure to determine vesting service correctly may result in payment of an incorrect amount to a participant, resulting in either an obligation to try to collect an overpayment or restoration of an account to correct an underpayment.

Holding forfeitures in an unapplied suspense account over a period of years, or using forfeitures other than as allowed by the plan document, are each an error which can be very complicated to correct.

J. Fiduciary Issues

As indicated above in Part I, when a person carries out a fiduciary function they must do so as a "prudent expert".

- The law doesn't require the fiduciary to be an expert in every area.
- Where the expertise doesn't exist to act as a prudent expert, such as deciding whether to continue to offer an investment fund, expert advice may be needed. At least appropriate periodic monitoring and documenting a prudent process is important. The frequency depends, e.g., on the volatility of the investment and key changes relating to the fund, such as a change in managers or assets.
- It may be difficult or impossible later for the fiduciary to show that the level of skill of an expert was used in the decision.
- Records developed after the fact are subject to greater scrutiny.

The IRS lists a failure to carry the required ERISA fidelity bond as one of the most common errors in small plans. The bond for fiduciaries is generally 10% of the plan assets, with a minimum of $1,000 and a maximum of $500,000. Exceptions apply.

III. IRS AND DEPARTMENT OF LABOR CORRECTION PROCEDURES

A. Tax-Qualified Plan Status and the IRS

A retirement plan which is intended to be tax-qualified, such as a 401(k) plan, is subject to a variety of requirements in the Code which must be satisfied in order to preserve the tax-qualified status of the plan. As a practical matter, however, operational failures that violate the Code requirements are likely to occur. Retaining a plan's tax-qualified status is important to both the employer and the plan participants.

Although in practice the Internal Revenue Service ("IRS") rarely disqualifies a plan, it has the authority to do so. More typically, if the IRS discovers an operational or form defect it will assess a penalty in lieu of plan disqualification, provided a full correction of the error is also made. It is not uncommon, however, for the IRS agent who discovers an operational or form defect to point out to the employer that the IRS has the authority to disqualify the plan and, therefore, any penalty is negotiated on that basis. Because the IRS has established procedures for voluntary disclosure and correction of administrative or document errors, the penalty for correction of an error that is discovered by the IRS may be quite significant, and could theoretically be as much as all of the tax revenue which would be realized by the Treasury Department if the vested benefits under the plan were all taxed, the employer deductions for affected years were modified, and the trust which holds plan assets was taxable.

B. ERISA Compliance and the Department of Labor

In addition to the adverse income tax consequences that can result from Code requirements which have not been satisfied, ERISA imposes its own requirements for 401(k) plans which are also mandatory in application. Both the DOL and plan participants have standing under the civil enforcement provisions of ERISA to pursue legal and equitable claims for failure to comply with ERISA by the employer or other fiduciary, such as failing to follow the terms of a plan or for plan losses resulting from breaches of fiduciary responsibility. The DOL is as active as the IRS in auditing plans to determine whether they are complying with ERISA's requirements.

C. IRS and DOL Correction Procedures

In order to encourage compliance and voluntary disclosure and/or correction of errors, both the IRS and the DOL have established and are administering correction programs. These programs may have a number of benefits.

- ♦ The total cost of correction can be minimized.
- ♦ The tax-qualified status of the plan can be restored.
- ♦ Further regulatory and/or participant action can be avoided.

IV. THE IRS VOLUNTARY CORRECTION PROGRAM

A. In General

The IRS program for the correction of errors in the form or operation of a qualified retirement plan (or a 403(b) plan or Individual Retirement Account) can be used to avoid or limit the potentially dramatic income tax, excise tax, penalty and interest consequences of such a plan losing its tax-qualified status.

- ♦ The Employee Plans Compliance Resolution System ("EPCRS") is an umbrella system which contains three programs: the Self Correction Program ("SCP"); the Voluntary Correction Program ("VCP"); and the Audit Closing Agreement Program ("Audit CAP").
- ♦ Under SCP, insignificant errors can be fully corrected, often without IRS involvement.
- ♦ Under VCP, errors can be disclosed in an application to the IRS if done before the employer receives notice of an audit or investigation. The application must propose a corrective action to put the participants and the plan in the position they would have held in the absence of the error and the employer must pay a fee determined using an IRS schedule.
- ♦ Under Audit CAP, errors discovered by the IRS during a plan audit must be corrected to the satisfaction of the IRS and a substantial penalty is usually assessed against the employer.

B. Eligibility

- ♦ Certain acts or failures to act are not eligible for VCP, such as any "abusive tax-avoidance transaction" (these will be resolved outside of the VCP).
- ♦ If the plan is under IRS examination, insignificant operational errors can still be self-corrected (see below), but document errors and significant errors can then only be corrected under the more expensive Audit CAP.

C. IRS Fees For VCP Applications

The IRS fee for processing a VCP application is generally based upon the number of participants in the plan. They range from $750 to $25,000.

For late amendments required by legislative or regulatory changes, an alternate fee can be as low as $375.

The number of errors does not affect the application fee, but may affect whether the errors are significant and thus whether the errors can be self-corrected without a fee or IRS involvement (see below).

D. No IRS Fees For Self-Correcting Recent Significant Operational Errors or Insignificant Operational Errors

- "Insignificant" operational errors can be self-corrected, even if discovered by the IRS. Whether an error is significant or insignificant is to be determined on a fact and circumstance basis, taking into account all relevant factors. Employer should maintain records describing the failure and the steps taken to correct it, in case any questions come up later.

- "Significant" operational errors can be self-corrected if two full calendar years have not elapsed after the year in which the error occurred, provided that notice of an IRS audit or investigation has not been received. Again, whether an error is "significant" is based on the facts and circumstances.

- Self-correction generally requires that compliance procedures were in place and routinely followed but an error still occurred.

E. Full Correction Required

- A full correction of any error is required, for all affected persons and for all affected years.

- Standard correction methods are published by the IRS for particular types of errors, though an employer may propose an alternate correction method.

- Under the VCP, the correction must be documented in an application. The employer must also explain why the failure occurred and what safeguards have been put in place to prevent a similar failure from occurring again.

F. Formal IRS Approval

If a VCP-proposed correction is approved by the IRS, and if the approved correction is made within the time allowed by the IRS, a "Compliance Statement" will be issued by the IRS, preventing the IRS from disqualifying the plan for the disclosed and corrected errors. Errors which are self-corrected do not involve a VCP application, and no Compliance Statement will be issued. Therefore, it is important for an employer that self-corrects an error to keep good records of the error and the correction.

V. THE DOL VOLUNTARY FIDUCIARY COMPLIANCE PROGRAM

A. The Role of the U. S. Department of Labor in Compliance

- Among its other requirements, ERISA includes rules regarding fiduciary responsibility in the administration of a plan, including a requirement that the plan fiduciaries follow the terms of the plan unless those plan provisions are contrary to the requirements of ERISA.

- ♦ An operational error will result from a failure to follow the terms of a plan. A failure to follow the terms of the plan, where those terms are not inconsistent with ERISA, is a violation of ERISA.

B. The IRS EPCRS and DOL Correction Procedures are Separate

- ♦ Where violations of ERISA occur, the DOL offers the Voluntary Fiduciary Compliance Program (VFCP). VFCP is a voluntary enforcement and correction program which may be available to obtain formal regulatory approval for correction of an ERISA violation.

- ♦ As is the case for the IRS EPCRS, there is no legal requirement that an employer submit an operational error and correction method to the DOL under the VFCP. However, a VFCP program submission, if approved, provides protection against further DOL action against the employer and the responsible plan fiduciaries, at least for errors which are disclosed and corrected.

- ♦ VFCP is generally not available if the plan or the applicant has received notice that it is "under investigation" by EBSA, the IRS, any governmental agency conducting a criminal investigation, any state attorney general, or any state insurance commissioner.

- ♦ Full correction for all persons and all years is generally required.

- ♦ Generally, no application or processing fee is required, although an employer may submit an application if the error is related to delinquent deposit of employee deferrals or other violations to avoid having to make other filings related to the associated prohibited transaction rules.

- ♦ If the employer satisfies the VFCP requirements, EBSA will send the employer a "no-action letter" stating that EBSA will not initiate a civil investigation regarding any transaction disclosed, corrected and described in the no-action letter, nor will EBSA assess a penalty other than for any Form 5500 filing violations under ERISA.

- ♦ A no-action letter from EBSA does not prevent other government agencies or any other persons (such as plan participants) from enforcing their rights.

C. The DOL Delinquent Filer Voluntary Compliance Program

- ♦ Neither the IRS EPCRS nor the DOL VFCP provide relief from penalties for reporting and disclosure violations.

- ♦ The Delinquent Filer Voluntary Compliance Program (DFVCP) encourages voluntary compliance with ERISA's reporting and disclosure requirements, such as the Form 5500 Annual Return requirements, and gives plan administrators a way to avoid higher civil penalty assessments by satisfying the program’s requirements and voluntarily paying a reduced penalty.

VI. CONCLUSION

Virtually every plan that is intended to be tax-qualified will violate the IRS or DOL rules at some point in time. Both the IRS and the DOL have active audit programs in place to discover operational and document errors in such plans. If the IRS or DOL discover a violation in an employer's plan, the cost to the employer will be significant, both in terms of the legal and other fees incurred in working through the audit issues and the correction of the violation, and in the penalties assessed by the agency because of the violation. Therefore, it is prudent for employers to attempt to discover any violations by increased vigilance and by hiring competent and aware advisors to assist in the administration of the plan. If a violation is discovered, the employer should take advantage of the IRS EPCRS program and/or the DOL VFCP program to correct the violation.

Best Practices in Qualified Retirement Plans

2016

Susanne L. Hauk, J.D.

Senior Vice President – Regional Director

Wealth Management

Retirement Plan Services

Personal Trust

Good Fiduciary Conduct

- Committee Organization
- Investment Process
- Administrative Oversight
- Plan Cost Review

Source: planadvisor microplan survey 2015

Retirement Plan Committee Best Practices

- Meet Regularly
- Ongoing education
- Review investments & IPS
- Review plan costs & services
- Document each meeting

Source: planadvisor microplan survey 2015

Potential Plan Sponsor Risk

- IRS Audit
- Participant Lawsuit
- Beneficiary Lawsuit
- Plan Compliance
- DOL Audit

Source: planadvisor microplan survey 2015

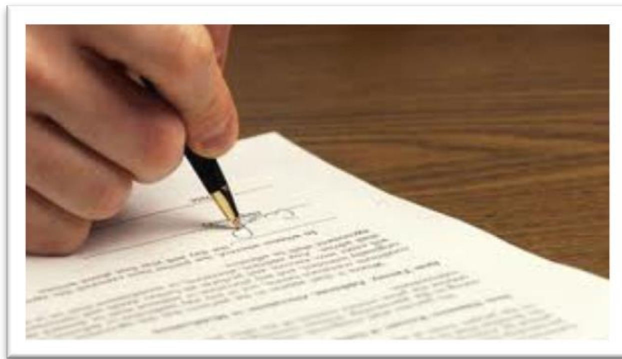
401k Lawsuit Examples

Source: planadvisor microplan survey 2015

Fidelity bond-required

- Fraud
  - Dishonesty
    - Forgery

Fiduciary insurance - optional



- Defense of lawsuit
  - Varies in coverage
    - Inexpensive

Source: planadvisor microplan survey 2015

What duties can be delegated to a fiduciary?

Can be Delegated

ERISA Compliance Monitoring

Participant Advice

Asset Custody

Investment Selection & Management

Record Keeping & Administration

Select & Monitor Plan Providers

Payroll, Terminations, Census, etc.

Cannot be Delegated

Source: planadvisor microplan survey 2015

Types of Plan Fiduciaries

Individual Trustee (no delegation of duties)

- **Monitor** and **select** investments
- Participant education
- Retains **full** fiduciary liability

3(21) Fiduciary

- Helps **monitor** plan investments
- Participant education
- Accepts some fiduciary liability

3(38) Fiduciary

- Monitor, selection, discretion of plan assets
- Participant advice
- Accepts full fiduciary liability

Discretionary Trustee

- Selection, monitoring, discretion, custody of plan assets
- Participant advice
- Accepts full fiduciary liability including plan compliance

Source: planadvisor microplan survey 2015

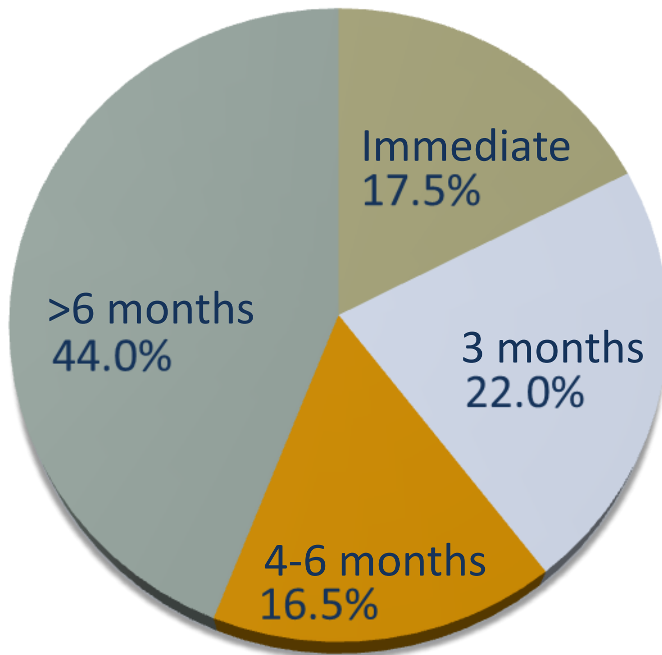
Reduce Liability

Best Practices

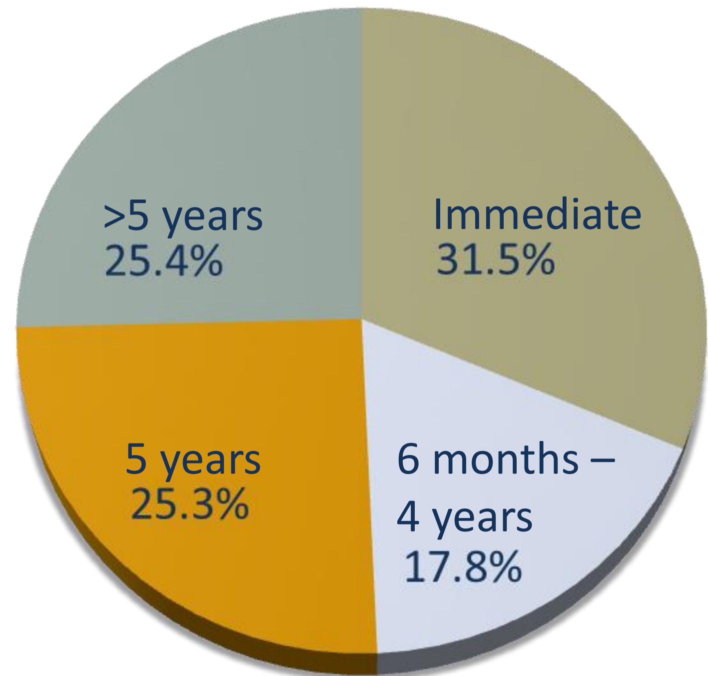
- Ask for fiduciary status of providers in writing
- Benchmark plan fees
- Get a competitor's analysis
- Establish & Follow IPS
- Meet at least annually with providers

Source: planadvisor microplan survey 2015

Participant Eligibility & Vesting



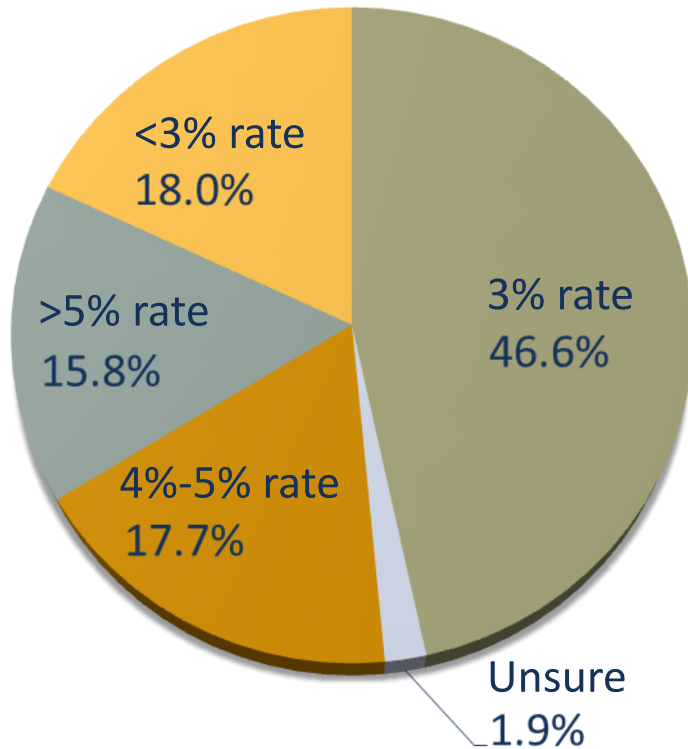
Eligibility

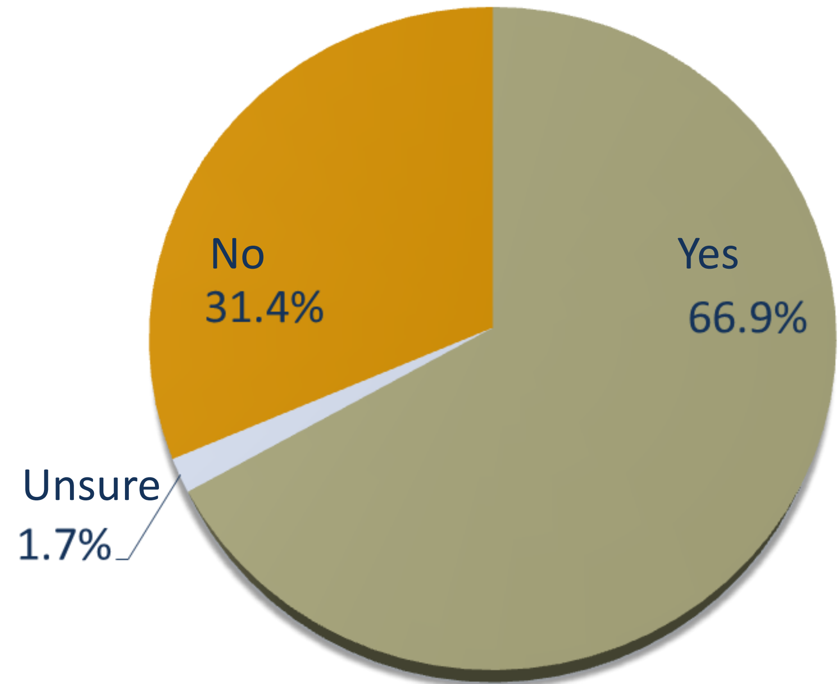


Vesting

Source: planadvisor microplan survey 2015

Auto-Enrollment Default Deferral Rate & Match Contribution Offer





Auto-Enrollment

Match Contribution Offer

Source: planadvisor microplan survey 2015

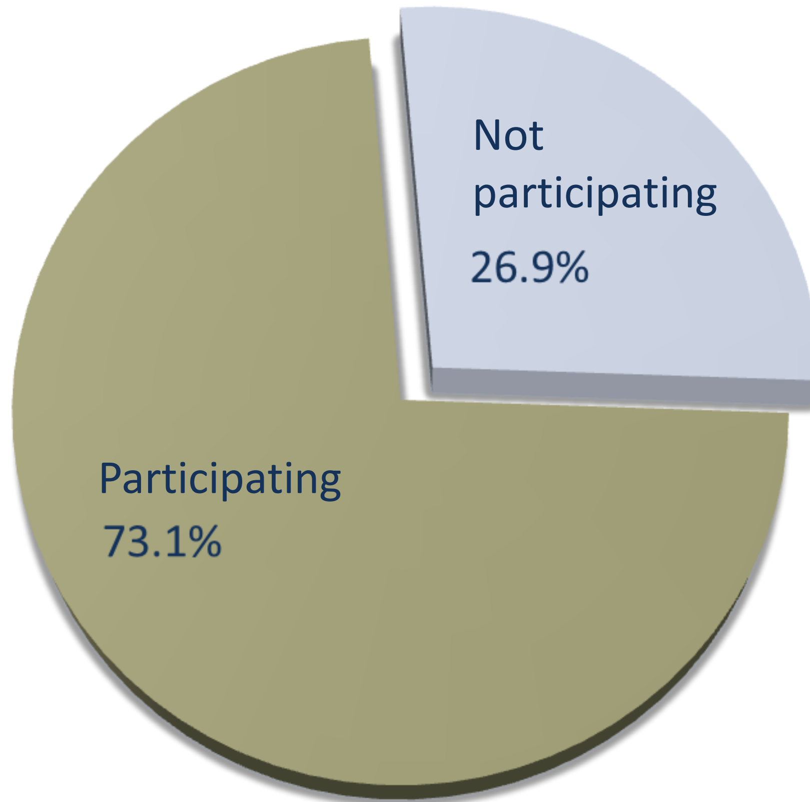
Approximate Maximum Match

Approximate Match Amount	
More than 100% of first 6% of salary	8.6%
100% of first 6% of salary	11.7%
51%-99% of first 6% of salary	25.3%
50% of first 6% of salary	19.5%
Less than 50% of first 6% of salary	26.6%
Other	8.4%

Approximate Match Amount

Source: planadvisor microplan survey 2015

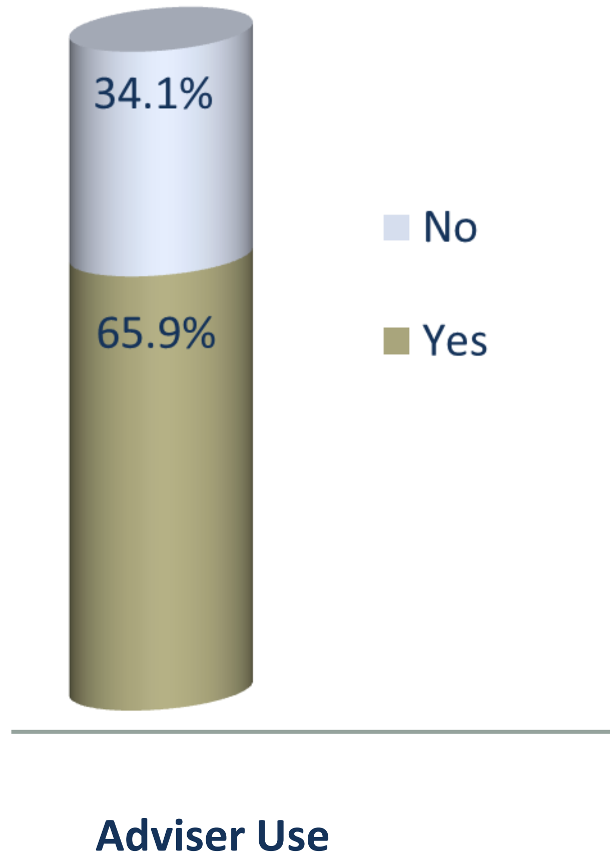
Results: Participation Rate & Account Balance Averages

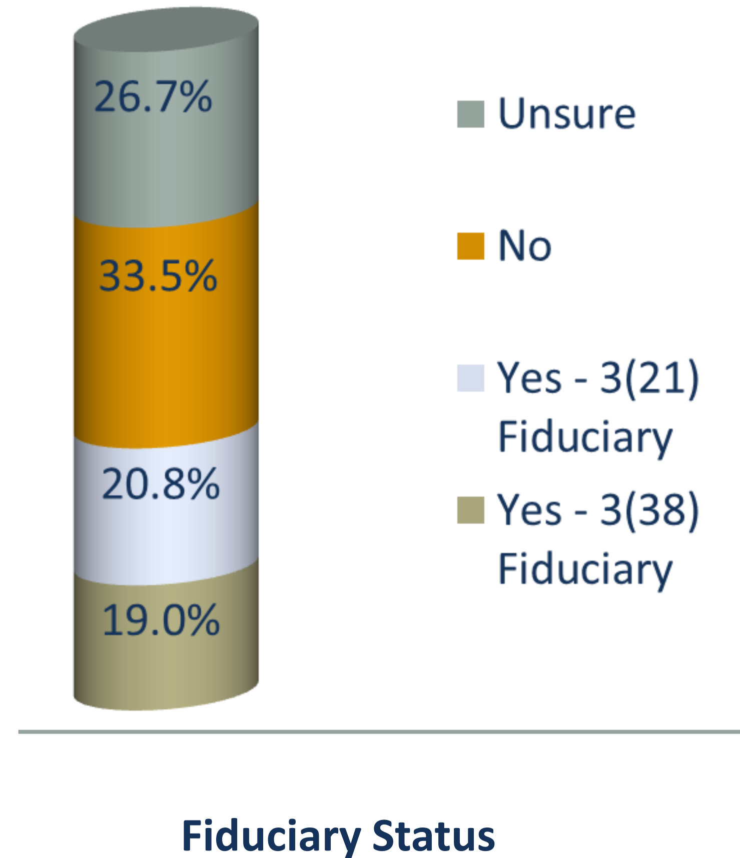


The average account balance is $69,868.

Source: planadvisor microplan survey 2015

Adviser Use Among Plans & Adviser Fiduciary Status





Source: planadvisor microplan survey 2015

Common Adviser Services

Service	%
Fund performance review	89.9%
Plan investment selection guidance	87.3%
One-on-one participant education	74.2%
Evaluating provider fees	72.8%
Group participation education	70.8%
Provider selection	62.1%
Plan compliance	51.7%
Investment committee fund review	51.4%
Benchmarking plan design	50.8%
IPS creation & monitoring	46.1%

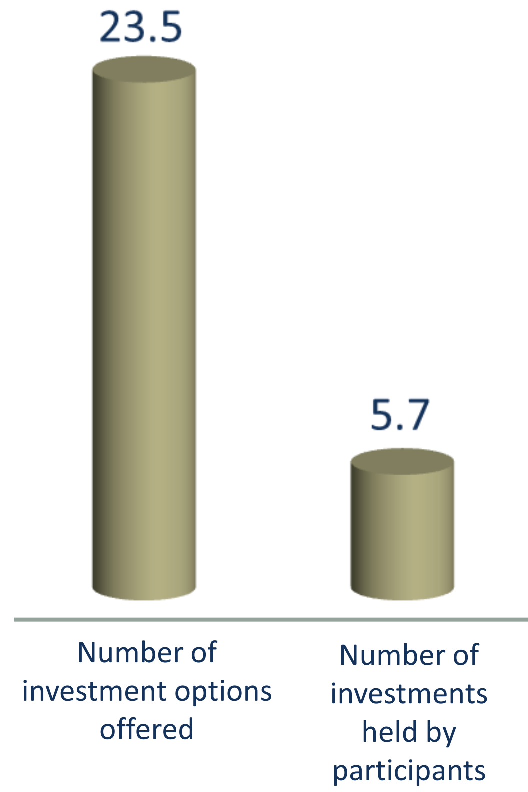
Source: planadvisor microplan survey 2015

Number of Investment Options Offered & Investment Advice Offered

45.1%
23.3%
11.1%
20.7%
4.8%
29.6%

On-site financial advisor
Phone-based financial advisor
Independent third party*
Provider's proprietary services
Through another source
No advice offered

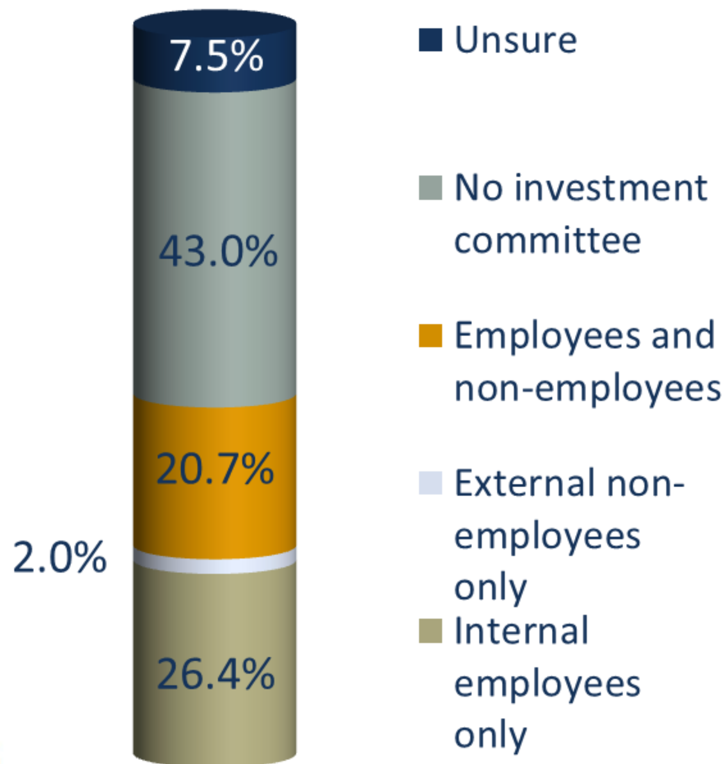
Advice

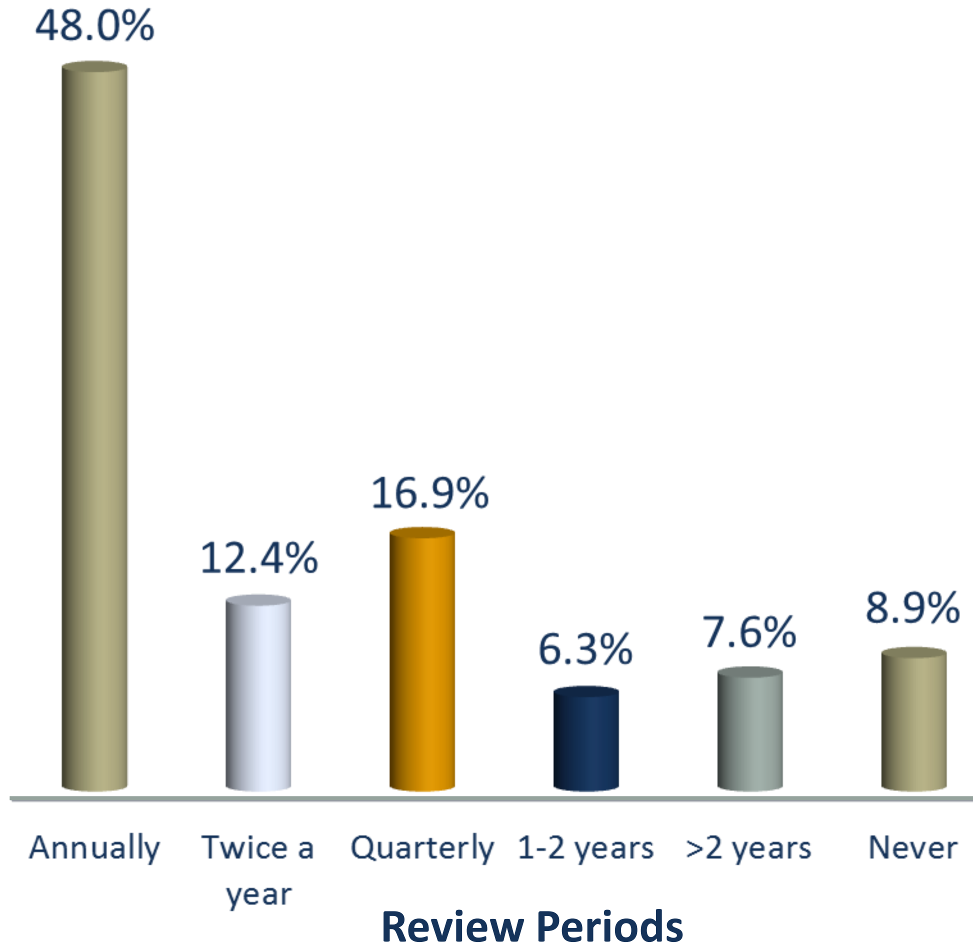


*E.g., Financial engines, Morningstar

Source: planadvisor microplan survey 2015

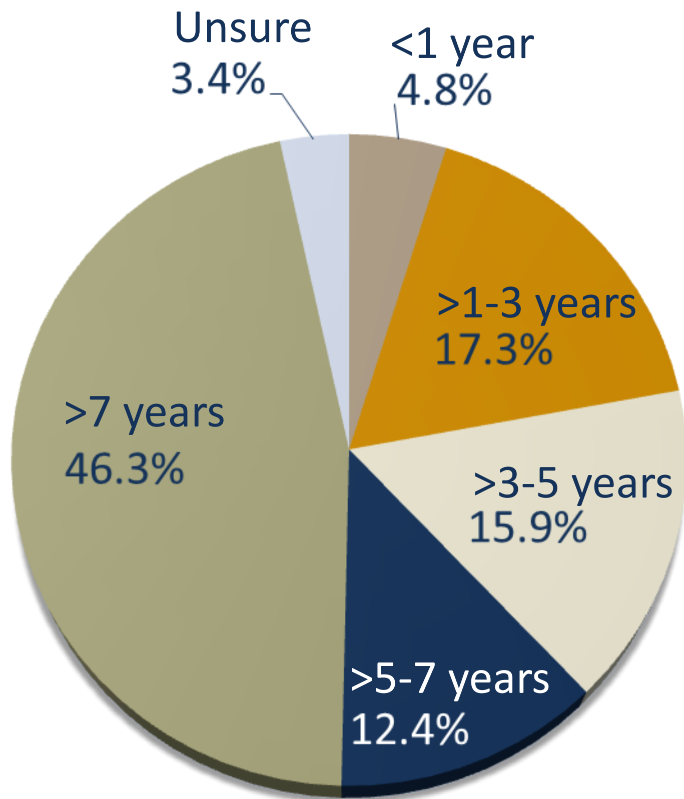
Investment Committee for the DC Plan &Formal Review of Investment Options



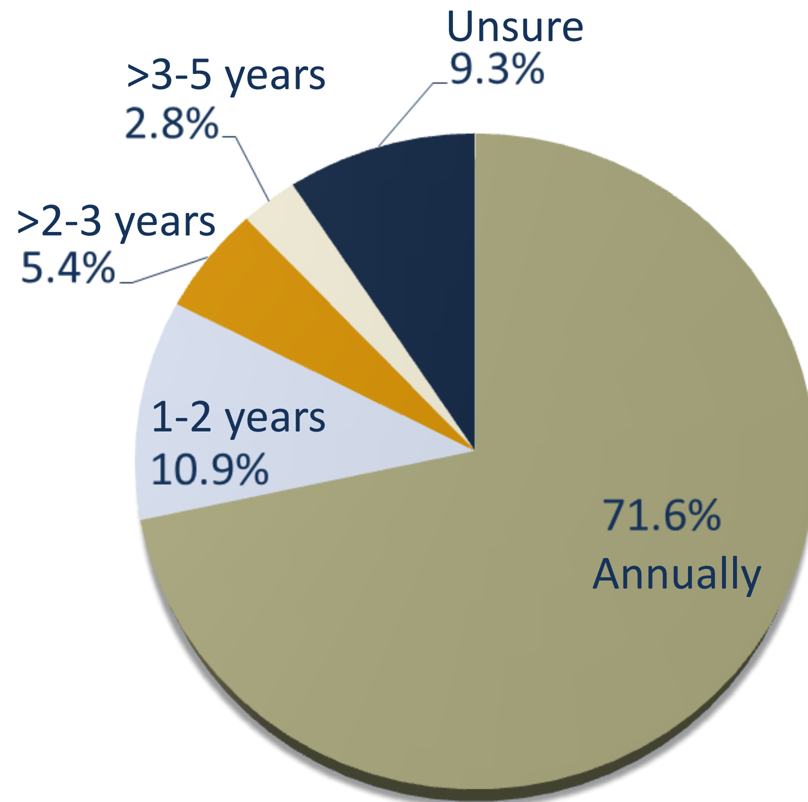


Source: planadvisor microplan survey 2015

Length of Relationship with Provider & Formal Review of Administrative Costs



Relationship Length



Cost Review

Source: planadvisor microplan survey 2015

Preparing for Retirement

- 11% of Employees feel prepared
- Social Security provides 33% of income
- Employees have to work beyond Normal Retirement Age

Financial Stress = Physical Stress

Physical Stress = Decreased Productivity

Source: planadvisor microplan survey 2015

Survey

- Satisfaction with company plan?
- Financially prepared for retirement?
- Need assistance?
- Interested in financial planning?
- Financial topics of interest?

Source: planadvisor microplan survey 2015

Educational Topics

- Financial planning workshop
- Debt elimination strategies
- Social security strategies
- Budgeting
- Investments 101
- Estate planning & asset protection
- Retirement calculator tutorial
- Preparing for retirement

Source: planadvisor microplan survey 2015

Fee documentation

Retirement Plan Fee Disclosure

(Handout)

Fee Benchmarking Report

(Handout)

Source: planadvisor microplan survey 2015