⟨RETHINK⟩ *Everything*

Lessons Learned: How to Better Manage Your Employee Benefit Plan in 2015

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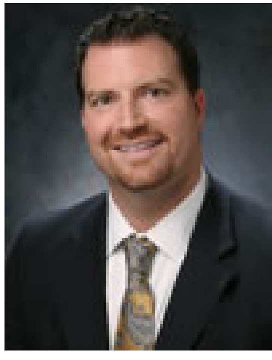

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Agenda

- Lessons Learned
  - Plan errors
  - How changes may impact plan administration
  - DOL hot topics & tips for a smoother audit
  - Could a Nonqualified plan provide solutions for management benefits

Lessons Learned: Plan Errors

- Most common errors identified during the past audit season involve
  - Eligibility
  - Definition of Compensation
  - Auto Enrollment
  - Vesting
- The errors typically result from operations not being in accordance with the Plan document.

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Lessons Learned: Plan Errors

- Eligibility
  - The Plan document will describe the requirements needed in order to participate in the Plan.
  - Typical requirements
    - Age
    - Service
    - Class
  - Most common errors
    - A class of employees is not offered participation to the Plan, however this class is not excluded by the Plan document. Ex. Interns, temporary/part-time employees, union employees
    - An ineligible class of employees is offered participation and participating in the Plan.

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Lessons Learned: Plan Errors

- Eligibility Corrections
  - Incorrectly *included* employees
    - Salary deferrals are distributed to employees (without penalty).
    - Employer contributions are transferred to forfeitures.
  - Incorrectly *excluded* employees/class
    - *Missed deferral opportunity* is calculated by applying the Actual Deferral Percentage (ADP) of either the Non Highly Compensated Employees (NHCEs) or Highly Compensated Employees (HCEs) (depending on the missed employee's classification) for the year to the appropriate compensation for the excluded period.
    - In a safe-harbor plan, the missed deferral opportunity is equal to the greater of 3% of compensation or the maximum deferral percentage which is matched at least 100%.
  - The missed deferral opportunity is then used to calculate the missed matching contribution, if applicable.
    - The corrective contribution is 50% of the missed deferral opportunity plus 100% of the missed match.

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Lessons Learned: Plan Errors

- Eligibility Corrections
  - Employee contributions are deposited as a Qualified Non Elective Contribution (QNEC). Matching contributions can be deposited as a Match or QNEC.
  - If a non-elective contribution was made for the year of improper exclusion, there are two possible methods of correction.
    - Employer makes an additional contribution to the excluded employee equal to the percentage of compensation allocated to similarly situated employees i.e. If all employees received 5% of pay, then the missed employee would receive 5% of pay.
    - Employer does not make an additional contribution but adds excluded employee(s) and reallocates contribution. This effectively lowers contribution rate to all previously included employees.

Note: All corrections must include lost earnings and be carried back for as many years as the employer has records.

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Lessons Learned: Plan Errors

- Eligibility Error: What to do going forward?
  - Determine if error has continued into subsequent plan year. If so correction in subsequent year needs to occur
  - Determine employer's intent
    - Modify process to match document
    - Amend document to match practice
  - Modify documents and employee communications to reflect correct practice and plan provisions.

Lessons Learned: Plan Errors

- Definition of Compensation
  - The Plan document will outline the compensation that is eligible for the Plan.
  - This is the compensation that should be included or excluded in order to calculate participant deferrals and employer contributions.
  - Most Plan documents start with a general definition – withholding wages or W-2 compensation and then provide options for the Plan administrator to make specific inclusions and exclusions to:
    - Include contributions made to a tax deferred plan (cafeteria plan).
    - Exclude overtime, bonus, stock compensation, fringe benefits etc.
    - It is possible for certain inclusion/exclusions to be part of the general definition.

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Lessons Learned: Plan Errors

- Definition of Compensation
  - Most common errors
    - When a type of compensation, ex. bonus, is excluded for purposes of calculating participant deferrals and employer contributions in practice, but the document does not allow for the exclusion.
    - When a type of compensation, ex. an allowance, is included for purposes of calculating participant deferrals and employer contributions in practice, but the document has excluded this type of compensation from being eligible.

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Lessons Learned: Plan Errors

- Definition of Compensation Corrections
  - Compensation can vary for each contribution type.
  - Compensation incorrectly ***excluded*** for salary deferral is corrected through the missed deferral opportunity calculation of 50%. Matching contribution deposit may also be required.
  - Compensation incorrectly ***included*** for salary deferral results in a distribution to the participant of the ineligible salary deferral. Matching adjustment deposit may also be required.

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Lessons Learned: Plan Errors

- Definition of Compensation Corrections
  - Compensation incorrectly ***excluded*** for matching contribution calculations is corrected by recalculating the amount with the correct compensation and an additional contribution from the employer.
  - Compensation incorrectly ***included*** for matching contribution calculations is corrected by recalculating the amounts with the correct compensation and transferring the excess to the forfeiture account.
  - Incorrect computation period calculations are corrected by using the correct compensation and deferral period with shortages resulting in an additional contribution and excesses transferred to forfeitures.

Note: All corrections must include lost earnings and be carried back for as many years as the employer has records.

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Lessons Learned: Plan Errors

- Definition of Compensation Error: What to do going forward?
  - Determine if error has continued into subsequent plan year. If so correction in subsequent year also needs to occur.
  - Determine employer's intent
    - Modify process to match document
    - Amend document to match practice
  - Modify documents and employee communications to reflect correct practice and plan provisions.
  - Make sure payroll codes reflect proper inclusions and exclusions.

Lessons Learned: Plan Errors

- Auto enrollment
  - This is a fairly new concept for 401(k) plan and is a great way to improve participation in your plan.
  - Typical provisions
    - Only new employees from an effective date.
    - New and existing employees with no election on file from an effective date.
    - Inclusion of an step up on an effective date or participant anniversary.
  - Most common errors
    - Not addressing existing employees with no election on file, when the document includes them.
    - Not administering the step-up in line with the Plan provisions.
    - Not enrolling participants timely.

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Lessons Learned: Plan Errors

- Auto Enrollment Corrections
  - Auto enrollment correction methods are still evolving with minimal specific guidance. However, many of the correction principals exist.
    - Plan administrators are given a certain level of administrative leeway when it comes to timing of enrollment; consistency is key.

Note: All corrections must include lost earnings and be carried back for as many years as the employer has records.

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Lessons Learned: Plan Errors

- Auto Enrollment Corrections
  - Participants that are not timely enrolled must receive a corrective contribution equal to 50% of the missed deferral associated with the auto enrollment provisions and 100% of the missed matching contribution.
    - This is applicable for both employees that are enrolled late or excluded from the auto enrollment process.
    - Employee contributions are deposited as a QNEC. Matching contributions can be deposited as a Match or QNEC.
    - Corrective contribution must be made even it the participant subsequently makes a 0% election.
  - Missed step ups are corrected by making a QNEC of 50% of the missed step up and 100% of the corresponding missed match which can be made as a QNEC.

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Lessons Learned: Plan Errors

- Auto enrollment Error: What to do going forward?
  - Determine if error has continued into subsequent plan year. If so correction in subsequent year also needs to occur.
  - Determine employer's intent
    - Modify process to match document
    - Amend document to match practice
  - Modify documents and employee communications to reflect correct practice and plan provisions.

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Lessons Learned: Plan Errors

- Vesting Calculations
  - The Plan document will outline vesting provisions
  - Typical provisions
    - Method – hourly versus elapsed time.
    - Number of hours required to satisfy a year of service.
    - 100% vesting for death, disability and attaining normal retirement age while active.
  - Most common errors
    - Using the incorrect method to calculate the years of service earned by a participant.
    - Not using actual hours worked, but an assumption, to calculate the years of service earned by a participants.

Note: All corrections must include lost earnings and be carried back for as many years as the employer has records.

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Lessons Learned: Plan Errors

- Vesting Calculation Corrections
  - Proper calculation of year-of-service
    - Hours method – 1,000 hours during plan year, using actual hours worked.
    - Elapsed time method – completion of 12 months from anniversary date regardless of hours worked.
  - Employers must review all data elements, it is not the TPA's responsibility.
  - Distributions in excess of a participant's vested interest are not eligible for rollover out of the Plan and should be returned to the plan's forfeiture account. If not by the participant, then by the employer.
  - Distributions less than a participant's vested interest can be corrected through funds in forfeitures or from employer contributions.

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Lessons Learned: Plan Errors

- Vesting Calculation Error: What to do going forward?
  - Determine if error has continued into subsequent plan year. If so correction in subsequent year also needs to occur.
  - Determine employer's intent
    - Modify process to match document
    - Amend document to match practice
  - Modify documents and employee communications to reflect correct practice and plan provisions.
  - Adjust review checklists.

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Lessons Learned: Vendor Change

- What to consider when changing Plan vendors – Custodian/Recordkeeper
  - In most cases a change in Plan custodian means a new restated Plan document.
    - Ensure there is a review by the Plan sponsor of the newly restated Plan document compared to the previous document to ensure the only changes are those intended by Plan management.
    - Inquire with the new Plan document providers if there was any provision in your old Plan documents that can not be maintained with the new Plan documents.
    - If there are provision changes with the restated Plan document, be sure to review the administration in place to ensure the new provisions are being carried out in practice.
    - New Plan provisions cannot remove a benefit from a participant – example - new vesting schedule requiring more years of service to reach 100% vesting.

Lessons Learned: Vendor Change

- What to consider when changing Plan vendors – Custodian/Recordkeeper
  - Asset reconciliation
    - Did the new custodian receive all funds held by the previous custodian?
      - In addition to reconciling Plan assets at the top level, also be sure to check the records at the participant level are reconciled.
    - Were the investments mapped to the proper funds?
    - If the funds were to be allocated to target funds based on retirement age, was this done properly?
    - Participant loan records should be transferred in addition to the assets being transferred.

Lessons Learned: Vendor Change

- What to consider when changing Plan vendors – Custodian/Recordkeeper
  - Plan audit considerations
    - Consider if there are any new processes or controls in place as a result of the change in custodian/recordkeeper.
    - The auditors will need audit packages, including certifications if available, from both custodians/recordkeepers during the year, not just the new custodian/recordkeeper, regardless of the length of time the assets were with the first custodian/recordkeeper.
    - Request the audit package from the previous custodian/recordkeeper as early as possible, along with any supporting data needed to provide to the auditors.
    - What is the process to obtain the audit package from the new vendor?
    - What is the process to submit changes for the Form 5500?

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Lessons Learned: Vendor Change

- What to consider when changing Plan vendors – Payroll Provider
  - Proper set up for all earnings codes
    - Ensure all types of compensation are set up in the new payroll system to be included or excluded in accordance with the Plan document.
    - Most organizations use the transfer to a new payroll provider to revisit the categories of compensation paid to employees.
      - When creating a new earnings type consider the intent for this to be included or excluded, then consult the Plan document to ensure the document provides for the intent.
    - If the Plan document in not in line with management's intent reach out to your third party administrator to inquire about amending the document.

Lessons Learned: Vendor Change

- What to consider when changing Plan vendors – Payroll Provider
  - Proper set up for all employer contribution calculations
    - Ensure the proper set up of the various earnings types in accordance with the Plan document.
    - Verify the computation period for the employer contribution is proper.
      - Pay period, monthly, quarterly, annually etc.
    - If additional requirements are needed to receive the employer contribution ensure these are considered in the calculation performed by the payroll system.
      - Last day rule, hours requirement.
      - Consider waivers to additional requirements – death, disability, attaining retirement age.

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Lessons Learned: Vendor Change

- What to consider when changing Plan vendors – Payroll Provider
  - Plan audit considerations
    - Subsequent to the change double check the computations performed by the payroll system to ensure proper treatment in accordance with the Plan document.
    - Prior to finalizing a special payroll, for example a bonus payroll, review the deferral and employer contributions to ensure proper inclusion or exclusion of bonus compensation.
    - Consider if there are any new processes or controls in place as a result of the change in payroll providers.

Lessons Learned: Changes in Plan Personnel

- Impact of employee turnover on successful plan administration
  - Plans should be administered by employees that have the correct skillset and management level.
  - Employers must be committed to maintaining the plan properly or problems will be constant; upper management must dictate the company's commitment.
  - Turnover often creates a loss of institutional knowledge that negatively impacts the day-to-day operation of the plan as well as the annual plan audit.
  - Employees begin to get frustrated and often suspicious that the plan is not being run properly.

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Lessons Learned: Changes in Plan Personnel

- Impact of employee turnover on successful plan administration
  - Errors can result from lack of knowledge related to plan procedures and provisions.
  - Errors can result in costly corrective contributions and substantial regulatory exposure.
  - If turnover occurs
    - Someone in upper management must take ultimate responsibility.
    - Provide clear direction for new person.
    - To the extent possible, have the terminating employee document the contact information for Plan vendors, Plan processes, and storage location for files both electronic and physical files.

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Lessons Learned: Mergers and Acquisitions

- How mergers and acquisitions impact your plan
  - All parties are so involved with the transaction that the retirement plan integration is often overlooked.
  - Start early and have a well thought out game plan.
  - There should be a clear understanding of how historical information will flow to new plan.
  - The acquirer will also need to be able to get all of the necessary information from the former employer in the event the associated plan requires an annual plan audit.

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Lessons Learned: Mergers and Acquisitions

- How mergers and acquisitions impact your plan
  - Do not be too quick to terminate the only staff that has any real plan knowledge.
  - There should be someone in charge of the transition that understands retirement plans; many times transition teams at very large organizations do not.
  - Employee communications and benefit reductions.
  - Wrapping up and shutting down the old plan is always difficult for the acquirer.

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Lessons Learned: Layoffs

- How layoffs could impact your Plan
  - When a substantial base of the participants are laid off the result could be a partial plan termination.
  - A partial plan termination results in all affected participants (those laid off) becoming 100% vested in employer sourced funds, regardless of years of service.
  - Potential impact: The lack of evaluation of partial plan termination at the time the layoffs may result in several participants being underpaid and subject to correction.

Lessons Learned: Layoffs

- How layoffs could impact your Plan
  - A partial termination occurs when approximately 20% of eligible participants have been laid off.
  - The definition of “eligible participant” and “laid off” is more complicated than expected. In additional the calculation is very complex.
  - If you are nearing the 20% threshold, reach out to your third party administrator and ask for their assistance in determining if a partial plan termination occurred. ERISA counsel can also be a resource in determining whether or not a partial plan termination has occurred.

Lessons Learned: Layoffs

- How layoffs could impact your Plan
  - What to do going forward
    - Track the number of layoffs occurring, as this is a cumulative figure. This is likely already happening in your organization, however the person responsible for plan administration may not be included.
    - When the organization is getting ready to do a large layoff run the numbers and if you are near the 20% threshold reach out to the third party administrator prior to processing the layoffs.
    - The earlier a partial plan termination is identified the more likely distributions paid will be proper.

Lessons Learned: Hot Topics & Audit Tips

- Timing of Deposits
  - Large plans should target no longer than three days
  - Small plans should adhere to the no longer than seven days put forth by the DOL
  - Late deposits
    - Correct with earnings
    - Possible 5330 filing with the IRS
    - Consider Voluntary Fiduciary Correction filing

Lessons Learned: Hot Topics & Audit Tips

- ERISA Budgets
  - More plans have access to ERISA budgets or revenue sharing which allow Plan sponsors to use these funds to pay Plan expenses or allocate these funds to participants.
  - This activity may or may not be included in your Plan's trust activity. Inquire with your recordkeeper in advance. If the activity is maintained outside of the Plan's records obtain the activity for review.
  - Expenses paid from these funds will need to be reviewed to ensure they are allowable, invoices and/or service agreements should be available for review.
  - The allocation to participant accounts should be reviewed.

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Lessons Learned: Hot Topics & Audit Tips

- Audit Tips
  - The earlier you reach out to your auditor for a preliminary discussion the better.
    - Consider any changes that happened during the year, not only that directly impacted the Plan, but also changes at the Organization level that could impact the Plan.
  - Focus on providing populations to auditors to make testing selections timely.
  - Submit requests needed for the audit to the third party administrators once you receive the request from the auditor, particularly if you are no longer with the provider.
  - Have a plan for open items and follow up when the auditors leave your office on the last day of fieldwork.
  - Revisit and modify the plan for audit wrap up and completion as necessary.

Executive nonqualified excess plan

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The Retirement Gap

Your retirement savings gap could be between 40% - 60% of your need

% of Income Replaced at Retirement

120%
100%
80%
60%
40%
20%
0%

Income Replacement Goal

GAP

Qualified Retirement Benefits

Social Security Retirement Benefits

Less ◄ Current Income ► More

This information is from the Principal Financial Group® Replacement Ratio Calculator with source information from the Annual Statistical Supplements to the Social Security Bulletin (www.ssa.gov/SSA_Home.html). It is intended to demonstrate the potential impact of Social Security and 401(k) plan benefits at various income levels. For more information on your individual circumstances, please speak with your financial professional. ©2013 Principal Financial Services, Inc.

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Saving on a Pre-Tax vs. After-Tax Basis

The illustration is a hypothetical example showing the principle of compounding. This example assumes an initial investment of $10,000 with ongoing annual contributions of $10,000 growing at an annual 7% rate of return compounded annually over a 20 year period. The example does not include the impact of any fees and expenses that would be associated with an actual investment. It does include a lump sum distribution of the pre-tax amount with a 40% tax rate. Nonqualified deferred compensation plans do not incur tax penalties for withdrawals prior to age 59 1/2. This hypothetical illustration is not intended to represent any specific type of investment. Keep in mind there is no assurance the investment will grow at a steady rate of return and consumers need to consider their personal investment horizon and income tax bracket, both current and anticipated when making investment decisions as these may further impact the results of the comparison.

Comparing a Nonqualified Plan to 401(k) Plan

SIMILARITIES

- Pre-tax contributions
- Earnings accumulate tax-deferred
- Multiple investment options*
- Distribution options set by plan
- Elections continue unless modified*

DIFFERENCES

- Not subject to 401(k) plan deferral & compensation limits
- Greater distribution flexibility
- No tax penalty for distributions before age 59 ½
- No required minimum distributions at age 70 ½

* Subject to plan provisions.

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Managing Accounts & Distributions

20% College	20% Vacation Home	60% Retirement
August 2018	April 2020	Pay at separation
4 annual installments	Lump sum payment	7 annual installments

Asset Allocation Strategy/Timing	CONSERVATIVE/ SHORT-TERM	MODERATE/ MIDDLE-TERM	MORE AGGRESSIVE/ LONG-TERM

Income taxes payable in the year money is received.

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Primary uses of deferred compensation

1. "401(k) repair"
2. Save for retirement outside the limits of qualified plans
3. Determine the timing for the payment of taxes
4. Get control over the compensation of the most valuable employees
5. Provide an ownership experience, without diluting actual ownership
6. Provide insider transition options

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Questions?

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