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BENEFITS & COMPENSATION UPDATE

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In This Issue:

IRS Expands Self-Correction Program under EPCRS

On April 19, the IRS issued its 2019 update to its correction programs for qualified retirement plan errors under its Employee Plans Compliance Resolutions System ("EPCRS"). The key change is that the IRS has expanded the kinds of errors eligible for self-correction. Certain plan document and operational failures may now be corrected through self-correction without applying to the IRS for approval of the proposed correction under the voluntary correction program ("VCP") and paying the filing fee.

Plan Document Failures

A plan document qualification failure (e.g., the failure to timely adopt a required amendment) may now be self-corrected by retroactively amending the plan to fix the defect if the plan has a favorable IRS determination letter and the amendment is adopted within the 2-year period following the year in which the error occurred.

Operational Failures

Self-correction is also now available to correct operational failures through a retroactive plan amendment that conforms the plan terms to its operations if (1) the plan amendment would result in an increase of a participant's benefit, right or feature, (2) the increase is available to all eligible employees, and (3) the increase is permitted under the tax code and satisfies EPCRS's general correction principles.

Plan Loan Failures

- *Delayed Reporting of Loan Defaults*: A participant's failure to timely repay a plan loan is a deemed taxable distribution and the plan is required to issue a Form 1099-R to the participant in the year of the default. If the plan mistakenly does not report the deemed distribution in the year of the default, it may now be self-corrected by reporting it in the subsequent year.

- *Relief from Taxable Distributions for Loan Defaults*: When a participant misses loan payments and defaults on a loan, the default will not be a deemed taxable distribution if the loan is repaid in a single sum and/or reamortized over a new repayment period (which cannot extend beyond the five-year period from the original loan date).

Self-correction is not available for plan loans that violate the dollar limit, maximum loan term or level amortization requirements. For such failures, VCP remains the only method for correction.

Your Plan

The expansion of the self-correction program enables plan sponsors to take necessary actions to self-correct many plan errors and avoid plan qualification issues without the burden and cost of filing a VCP application. In light of the significant adverse tax consequences that may arise should plan qualification issues occur, it is important that you speak to your benefits advisor about any plan errors and the availability of these newly expanded correction procedures for your plan.

DOL to Review ESG Investing and Proxy Voting by ERISA Plans

A recent Executive Order signed by President Trump on April 10, 2019 may signal that increased scrutiny of environmental, social and governance (or "ESG") investing by ERISA plans may be forthcoming. The purpose of the Executive Order on Promoting Energy Infrastructure is to promote investment in transportation infrastructure for U.S. coal, oil and natural gas supplies.

While the Executive Order does not immediately impact ERISA plans, it directs the DOL to (1) review available plan data for trends with regard to plan investments in the energy sector and current DOL guidance on fiduciary responsibilities for proxy voting and (2) advise whether any changes should be made. The Executive Order appears to indicate that the Trump Administration is concerned that environmentally-conscious investment decisions, including those made by ERISA plans, may be discouraging new investments in the country's fossil fuel industry.

Background on ESG Investing

ESG investing is the consideration of an investment's environmental, social and/or governance impact when making investment decisions. Historically, DOL guidance construed ERISA's fiduciary obligations to act prudently and solely in the interest of participants and beneficiaries as severely restricting ESG investing because of the risk that it subordinates the interests of participants and beneficiaries in their retirement income to unrelated objectives. The DOL's view was that considering ESG factors in making investment decisions should be rare and, when considered, should be documented in a manner that demonstrates how the decision complies with ERISA's high fiduciary standard.

Changes under the Obama Administration

In 2015, the DOL issued Interpretive Bulletin 2015-01, which expressed the concern that prior DOL guidance had unduly discouraged fiduciaries from engaging in ESG investing and clarified that the DOL's position is not that ESG investing is always (or almost always) inconsistent with ERISA's fiduciary duties. First, the Interpretive Bulletin recognized that, in some instances, ESG issues may directly affect the performance of an investment option by presenting material business risks and/or missed business opportunities. In these instances, it took the position that ESG factors are proper economic considerations that should be considered by a prudent fiduciary when evaluating the risk and return profiles of competing investment choices. Second, the Interpretive Bulletin provided that, when selecting among competing choices that are economically equivalent, it is not incompatible with ERISA's fiduciary duties to favor one choice over another based on the merits of any collateral ESG benefits that the choice provides.

The DOL also issued Interpretive Bulletin 2016-01, which explained that fiduciaries' duty of prudence includes the exercise of shareholder rights and the voting of proxies for plan securities. Because ESG issues may have an impact on shareholder value and other financial and non-financial measures of corporate performance, the Interpretive Bulletin further explained that fiduciaries may appropriately vote proxies and exercise other shareholder rights based on ESG issues if there is a reasonable expectation that the issue will enhance the value of the plan's investment after taking into account the costs involved.

Changes under the Trump Administration

Last year, the DOL issued Field Assistance Bulletin 2018-01, under which the DOL narrowed its interpretation of when ESG factors count as economic considerations and warned that fiduciaries must not too readily treat ESG factors as economically relevant to an investment decision. In particular, a fiduciary's evaluation of an investment should be focused on economic considerations that have a material effect on the return and risk of an investment, determined based on what "qualified investment professionals would treat as economic considerations under generally accepted investment theories." The view that, by promoting ESG factors, an investment arguably promotes positive general market trends or industry growth does not sufficiently count as economic in nature. The Field Assistance Bulletin also warned that it is inappropriate for a fiduciary, including appointed investment managers, to incur significant expenses when voting proxies and undertaking other shareholder engagement activities on ESG issues (i.e., mailing campaigns on shareholder resolutions, calling special shareholder meetings, or initiating or actively sponsoring proxy fights), unless the issue creates significant operational risks and costs to business and is clearly connected to long-term value creation for shareholders.

Key Takeaways

- While there appears to be an increasing interest in ESG investing by ERISA plans, it also appears that the uncertainty created by shifting DOL guidance has discouraged plan fiduciaries from incorporating ESG principles into their analysis when making investment decisions.
- Plan fiduciaries should proceed with caution before utilizing ESG factors in their investment decisions. If ESG factors are used, the plan's investment advisor should advise plan fiduciaries that either the ESG issue would have a material effect on the return and risk of the investment or the investment option selected does not sacrifice investment returns or assume greater investment risks relative to economically equivalent alternatives.
- Plan fiduciaries should review the plan's practices with respect to exercising its shareholder rights, including its proxy voting decisions, and be sure to document the basis of the course of action taken.

IRS Issues Guidance Expanding Pension Plan De-risking Opportunities

In March, the IRS issued Notice 2019-18, which modifies the IRS's position on voluntary lump sum offers to retirees who are receiving annuities under defined benefit pension plans. The new guidance potentially provides more flexibility for those plan sponsors who are seeking to "de-risk" their pension liabilities.

Background

In recent years, plan sponsors have used various approaches to reduce the financial risks associated with defined benefit pension plans. One approach is for a plan that otherwise permits only annuity forms of payment to offer participants a one-time opportunity to elect an equivalent lump sum instead.

Prior to 2015, IRS guidance permitted these voluntary lump sum offers even to participants who had already started to receive their annuity payments. However, in 2015, the IRS issued Notice 2015-49 which generally prohibited lump sum buyouts once a retiree began receiving annuity payments. The IRS's position in the Notice was that such lump sum buyouts of annuity payments impermissibly modified the payment period in violation of IRS required minimum distribution rules. As a result, since 2015, lump sum buyouts have been limited to participants who have not begun receiving their benefit (subject to limited exceptions such as a plan termination).

IRS Notice 2019-18

The new guidance provides that the IRS will no longer take the position that a voluntary lump sum buyout of participants in pay status violates the IRS required minimum distribution rules until further guidance is issued. As a result of this guidance, at least for now, lump sum buyout offers to annuitants appear to be viable.

Additional Considerations

Although the new guidance clears one hurdle to plan sponsors wishing to offer lump sum buyouts, such offers are subject to other IRS tax qualification rules and fiduciary considerations, including the following:

- The selection of the retiree group eligible for the buyout may not provide a benefit, right or feature that discriminates in favor of highly-paid participants.
- Lump sum payments must comply with spousal notice and consent requirements.
- Lump sum buyouts are limited or prohibited for pension plans that are significantly underfunded under IRS rules.
- Participants must be provided adequate disclosure explaining the terms of the lump sum offer and the potential impact of electing a lump sum in lieu of annuity payments.

In addition to compliance issues, plan sponsors should consider any accounting consequences of offering lump sum payouts and evaluate alternative approaches to reducing pension-related risk, such as transferring their pension liabilities to an insurance company through the purchase of annuity contracts.

Before proceeding, plan sponsors should consult with their benefits advisor regarding the legal and other considerations applicable to offering participants a lump sum buyout.

IRS Determination Letter Program Expanded for Merged and Hybrid Plans

On May 1, the IRS announced that it was expanding its determination letter program for qualified retirement plans to cover merged and hybrid plans. Under the IRS determination letter program, retirement plan sponsors submit the plan document and related materials for the IRS to make a determination as to whether the plan satisfies the plan document requirements under the tax code's qualification rules.

All individually-designed qualified retirement plans were eligible for the IRS determination letter program on a 5-year cycle until 2017, when it was eliminated other than for individually-designed plans that are either newly-established or being terminated. Because practitioners and plan sponsors have expressed concerns regarding the loss of protection that the program provided to help ensure documentary compliance with the qualification rules, the expansion of the program to individually-designed merged and hybrid plans, while limited, is welcome news.

Merged Plans

Beginning in September 2019, the IRS determination letter program will be available for an individually-designed merged plan if:

- two or more qualified plans of unrelated entities were merged in connection with a corporate merger, acquisition or similar transaction;
- the plan merger is effective by the last day of the plan year immediately following the plan year in which the corporate transaction occurred; and
- the determination letter application is filed no later than the last day of the plan year immediately following the plan year in which the plan merger occurred.

Hybrid Plans

For one year beginning on September 1, 2019, the program will also be open to hybrid plans (e.g., cash balance plans) in order for the IRS to review and issue determination letters covering the requirements set forth in the final IRS hybrid plan regulations that were not covered by on-cycle determinations before the program was eliminated.

Limited Sanctions

The new announcement provides that there will be no IRS sanction for a plan document failure if, in the case of a merged plan, it is attributable to a provision effectuating the plan merger and, in the case of a hybrid plan, it relates to a failure to meet the requirements of the final hybrid plan regulations. For other plan document failures discovered in the course of its review, the IRS will apply a limited monetary sanction ($3,500 for large plans) so long as the defective provision was adopted timely and in good faith.

Key Takeaways

In light of the importance of an IRS determination letter, particularly the protection it provides in the case of an IRS audit, plan sponsors of eligible merged or hybrid plans should seriously consider filing under the new procedures. For those plans which are ineligible for the determination letter program, it may be beneficial to engage benefits counsel to do a periodic review of the plan for documentary compliance. In addition, benefits counsel should be consulted during corporate transactions in which a plan merger is contemplated.

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