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Designing and Maintaining a Retirement Plan

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A number of different factors drive an employer's decision to offer a tax-qualified retirement plan. Once the decision to offer a plan has been made, the employer then has some important choices to make about plan design. Many options are available with respect to plan eligibility, benefits, vesting and payment timing, and methodology, among other things. In addition, federal law imposes significant obligations on the people charged with operating a retirement plan. The employer, and the individuals acting as plan fiduciaries, must be prepared to invest the necessary time, money and expertise to operate the plan properly, must understand their legal responsibilities, and must hire vendors to provide technology, expertise, and other support as needed.

The average US defined contribution plan account balance was roughly $85,000 as of the end of 2012, an all-time high—and painfully inadequate as a source of retirement income.[1] Encouragingly, however, although employees rank health care ahead of retirement plans when prioritizing employee benefits, retirement plans have seen a jump in their perceived importance, with 63 percent of workers identifying the retirement plan as an important factor in accepting

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a job, and nearly half indicating that the retirement plan was a compelling reason not to terminate employment.[2] Whether motivated by paternalism, recruitment and retention needs, or retirement savings goals of owners and executives, there are good reasons for employers to invest the time and money necessary to build a robust retirement program.

That said, employers should look before they leap, and should keep a cautious eye on the terrain even once their plans are well-established. Significant legal obligations accompany the establishment and operation of a retirement plan, and the wide variety of design options available means that an employer must take the time to consider its alternatives when it sets up the plan, and periodically thereafter, if it wants to use the plan to best advantage.

GETTING STARTED

Should You Maintain a Retirement Plan at All?

Retirement readiness is of increasing concern, and offering retirement benefits can be a valuable recruitment and retention tool, but attempting to maintain a retirement plan without paying proper attention can be much worse than not offering one at all. After all, no one wants to depend for retirement savings on a plan with poor investment options, or on a pension fund that might run out of money. For individuals tasked with managing the plan, the stakes are even higher. Section 409 of the Employee Retirement Income Security Act of 1974, as amended (ERISA), holds plan fiduciaries personally liable for losses associated with imprudent plan investing, improper plan administration, and other violations of ERISA's fiduciary duties.[3] An employer that is not prepared to commit the time and resources needed to make prudent financial choices and facilitate accurate plan administration should not offer a retirement plan.

What Do You Hope to Accomplish by Offering a Retirement Plan?

An employer may have a variety of reasons for offering a retirement plan. Those goals, and the employer's other priorities, will shape the decision to offer a plan and the eventual plan design. Even once the plan is operational, the employer will want to revisit its goals periodically, and evaluate the success (or lack thereof) of the plan in its current incarnation at meeting those goals. If the goals have changed, or the plan is not meeting those goals, the employer may need to make changes to the plan design.

Recruitment and Retention

If recruitment and retention are important motivations, the employer needs to consider first of all whether its current or desired workforce will value retirement benefits, and consider as well how best to market the plan as a valuable employee benefit. On a related note, the employer needs to analyze what level of benefits it will have to offer to inspire employee appreciation for the plan, and whether it can afford to meet that threshold. If other benefits or compensation will be lower as the result of establishing a plan or increasing benefits under an existing retirement plan, the employer will need to take into account employees' likely reaction to the trade-off.

Retirement Savings for Company Leadership

If members of the company leadership want to maximize their current tax deferral and future retirement savings, a qualified retirement plan is a prime candidate to accomplish that goal. However, when Congress designed the provisions governing tax-favored employee retirement savings vehicles, it granted amounts contributed to those plans favorable tax treatment *if* the plan extended its benefits to the rank-and-file in rough proportion to the manner in which it made benefits available to company owners and executives.

Accordingly, the company needs to bear in mind that the extent to which the plan provides retirement benefits to rank-and-file employees will affect the extent to which company leadership can obtain maximum benefit from the plan. Ensuring the requisite parity for the rank-and-file may require some level of company contributions, and may also require investment in participant outreach and education. Those costs need to be factored into the analysis of whether a retirement plan will be advantageous for company leadership.

Employee Retirement Readiness

Offering a plan provides valuable assistance to employees who might not otherwise be willing or able to save for retirement. If the employer provides automatic benefits (as in the case of most defined benefit plans and some defined contribution plans), participants are guaranteed some level of retirement savings once they satisfy the plan's vesting requirements. If the plan requires or permits contributions by employees, the availability of payroll deduction, matching contributions (if any), and the reassurance of knowing the employer is keeping an eye on the plan can encourage employees to save when they otherwise would not, and restrictions on withdrawals and distributions foster a savings mentality and limit the risk of casual spending. However, the mere presence of a plan may not be sufficient to build the necessary level of retirement savings, particularly if the plan requires contributions by employees. The employer will need to consider the utility of making a plan available in light of its particular workforce demographics and employee culture.

Are You Prepared for the Responsibilities Associated with Sponsoring a Retirement Plan?

Setting up a plan often is not that difficult. Many vendors offer plan documents that the Internal Revenue Service (IRS) has preapproved as satisfying the legal rules for plan documents, and can quickly (sometimes too quickly) walk the employer through the process of selecting among the various optional features and establishing an investment and administrative platform. Before signing on the dotted line, however, the employer's benefits personnel should consider:

- Do I understand the plan document and service agreement?
- Do I know how much the company will need to contribute to the plan, and how much it will cost to operate the plan?
- Do I know what administrative services are not provided by the plan vendor, and where the company can obtain them if they cannot be provided in-house? Conversely, do I understand the responsibilities of company personnel in connection with administering the plan?
- Do I know how much employees can expect to receive from the plan and when?
- Will the plan be professionally managed, or will participants select their own investments? Does the company have the in-house expertise to manage the plan's assets or select the plan's investment option menu? If not, is the company prepared to commit the resources to hire employees and/or vendors with the requisite skills?

So, You Want a Retirement Plan. What Type of Plan Do You Want?

Currently, the most popular type of plan is the "401(k) plan," designed to allow employees to contribute on a pre-tax basis in accordance with Section 401(k) of the Internal Revenue Code of 1986, as amended. There are many other options, however. Smaller employers can consider individual retirement account (IRA)-based options, and formal retirement plans of a variety of types are available to all sizes of employers. Most employers prefer a "defined contribution" model, under which the employer's only obligation is to contribute whatever amounts were promised for the year, but some employers still offer "defined benefit" plans, which promise participants a specified level of benefits and thus place the investment risk on the employer. The IRS maintains a website to assist potential plan sponsors with exploring their options.[4]

SEPs and SIMPLEs

In the first place, a smaller employer[5] should consider whether a full-fledged plan is the best option. IRA-based options such as Simplified Employee Pensions (SEPs) and Savings Incentive Match Plans for Employees (SIMPLEs) typically require less employer involvement and little or no administrative infrastructure other than selection of the IRA vendor. However, they also are subject to lower contribution limits, and SIMPLEs in particular tend to be much less flexible.[6] The discussion in the remainder of this article focuses on full-fledged plans rather than SEPs and SIMPLEs.

Defined Benefit and Defined Contribution Plans

The retirement plan universe divides into two types of plans: defined benefit plans and defined contribution plans. Defined contribution plans place investment risk on the employee. If the plan's investments fare poorly, the employee will have less money for retirement. Defined benefit plans place the investment risk on the employer. The employer must contribute enough money so that, when contributions are coupled with investment returns, the plan can pay the promised benefits. Although there are many plan design rules that are different for the two types of plans, the placement of the investment risk is the key differentiator.

Some plans attempt to combine features of both types, but these plans ultimately still fall into one category or the other. For example, a "hybrid" defined benefit plan (typically a plan with a "cash balance" or "pension equity" formula) expresses a participant's benefit in terms of a fixed amount, perhaps adjusted for notional earnings, similar to a defined contribution plan account balance. However, at the end of the day, these plans are subject to defined benefit plan funding rules, placing the ultimate investment risk on the employer. In contrast, a "target benefit" money purchase pension plan uses a contribution formula designed to enable an employee to receive a specified level of benefits, but the employee's actual benefits will be limited to the account balance, placing the ultimate investment risk on the employee.[7]

Both defined benefit plans and defined contribution plans have their advantages and disadvantages.

Defined Contribution Plans

Defined contribution plans offer employees control of their retirement savings, particularly if the plan permits employees to make contributions and select their own investments. They are more portable (an advantage for today's mobile workforce) and easier for employees to understand.

These plans also give the employer the advantage of a fixed financial obligation. The employer must make the contributions (if any) that it has promised for a given year, but it is not obligated to ensure that employees have any particular level of retirement income. In addition, an employer generally can reduce or eliminate contributions to a defined contribution plan for future periods,[8] although the IRS has increasingly required "safe harbor" 401(k) and 403(b) plans to adopt most amendments prior to the start of the plan year.

However, defined contribution plans have a darker side. In exchange for the control and flexibility available under a participant-managed defined contribution plan, participants assume responsibility for savings and investment decisions they may lack the inclination or knowledge to make. Almost all employers have at least some employees who are ill-suited to making their own financial decisions, and a participant-managed defined contribution plan may not offer these individuals enough of a safety net. If plan benefits depend on voluntary contributions from employees, participants who do not set aside sufficient funds will not have sufficient retirement assets when the time comes. Even if the participants save enough (on their own or with the aid of employer contributions), poor or just unlucky investment choices can decimate the participants' retirement savings at the worst possible time.

Selecting quality investment options can help, but funds in the most carefully selected investment array will go through periods of investment losses. Furthermore, a high-quality investment array cannot protect a participant who invests in higher-risk, more volatile investments despite being close to his or her retirement date against the consequences of a decline in those investments at the wrong time. The employer can mitigate the risk of poor participant management by opting to have some or all of the plan's assets professionally managed, but this is increasingly uncommon. Assigning responsibility for investment management to the plan fiduciary increases the fiduciary's risk of liability. This in turn increases the risk to the company, which may be a fiduciary itself or responsible for indemnifying fiduciaries and vendors serving in that role. In addition, many participants want investment control, and may be disenchanted by the plan if they have no say in its investments.

Defined Benefit Plans

From the employer's perspective, the fundamental disadvantage of defined benefit plans is the funding obligation. The employer is responsible for putting in enough money to enable the plan to pay benefits and cover its operating expenses. Defined benefit plan contribution obligations tend to increase when the economy is doing poorly, since low interest rates and poor investment returns increase the gap between anticipated benefit obligations and anticipated available assets. This means that companies' costs tend to go up when they can least afford it.

In recent years, a variety of funding risk management and derisking techniques have gained in popularity, and new plan designs have evolved that better enable employers to predict their costs and fund accordingly. However, the financial obligations associated with defined benefit plans remain considerable. Furthermore, once an employer has established a defined benefit plan, the plan typically cannot be terminated unless the employer has funded all promised benefits and purchased annuity contracts for payment of those benefits from a reputable insurance company. Even reducing or freezing benefit accruals requires advance notice.[9]

Defined benefit plans also are more expensive to administer than a typical defined contribution plan. A defined benefit plan needs an actuarial valuation each year, and also requires actuarial support to calculate benefit payments as they come due. Defined benefit plans also must pay insurance premiums to the Pension Benefit Guaranty Corporation (PBGC), a federal agency that guarantees payment of plan benefits in the event of plan and employer insolvency (up to certain limits), and must report certain events to the PBGC.

Conversely, however, defined benefit plans may be a less expensive way to provide a specified level of benefits. Because the employer only has to put in enough money to fund benefits, strong investment returns can reduce the contribution obligation. Defined benefit plans may also offer superior tax deferral opportunities. For 2014, Section 415 of the Code caps annual contributions to a defined contribution plan at $52,000 ($57,500 for individuals 50 or over, if the plan offers "catch-up" contributions under Code Section 414(v) and the individual takes advantage of that opportunity). For 2014, in contrast, the maximum annual benefit payable from a defined benefit plan is $210,000.[10] For this reason, defined benefit designs are of increasing interest to high-revenue professional practices, such as medical groups and law firms.

From a participant's perspective, defined benefit plans likewise have both positive and negative features. Principally, defined benefit plans protect employees against adverse investment results. They also are more likely to offer cost-effective lifetime payment options that prevent employees from outliving their savings, mitigating longevity risk. However, many defined benefit plans are better-designed for a long-term workforce, and are ill-suited to today's culture in which individuals often change jobs (voluntarily or involuntarily) every few years. Traditional defined benefit plan formulas tend to calculate benefits in a way that favors long service, with the annual increase in a benefit higher in later years of service than in earlier ones. Many plans prohibit distributions until the age of 55 or even later, and may also limit payment to monthly pension payments rather than lump sums, preventing participants from consolidating their retirement savings. Although designs allowing earlier payment and rollover-eligible lump sums have increased in prominence, those features undercut the traditional advantages of defined benefit plans as hedges against longevity risk and the risk of imprudent early expenditure of assets meant for retirement.

You've Chosen Your Plan Type. What Features Should Your Plan Offer?

All plans are required to address certain key issues, and employers have the flexibility to offer a variety of optional features. Plan documents preapproved by the IRS will include the required features, and typically offer the employer some level of discretion with respect to various optional features, although different documents offer different levels of flexibility. If the employer wants a type of plan not available in preapproved form, or cannot locate a preapproved document with design features it considers important, it can pay for a customized document and submit the document for an IRS determination that it contains all required features and that the optional features have been drafted in a manner acceptable to the IRS.

Whether the employer uses a preapproved or customized document, however, it needs to make at least some design decisions.

Eligibility

Section 410(a) of the Code and Section 202 of ERISA prohibit a plan from requiring an employee to complete more than one year of service (two, in the case of fully vested employer contributions),[11] and also prohibit exclusion of employees 21 or older on the grounds of age. Within these parameters, however, employers have numerous options.

For example, an employer may choose to be more generous, and allow employees to enter immediately, or after a period of service less than the maximum, for some or all contributions. Some plans allow employees to contribute from their own paychecks immediately, but require a period of service before the employees can be eligible for employer contributions.[12] Some plans impose different eligibility requirements on different groups of employees, or on specific types of employer contributions. An employer must remember, however, that the more variations its plan includes, the more complex the plan is to administer and the higher the risk of error, especially if employees may change from a group covered by one set of rules to a group covered by another.

The employer must also decide when an employee who has satisfied any relevant age and service requirements can begin to participate. Although a number of employers allow immediate entry once age and service requirements are satisfied, many employers prefer to consolidate new entrants to the plan, such as by allowing entry only on the first day of the month. The earlier of the first day of the plan year or six months from satisfaction of the eligibility rules is the maximum permissible waiting period once the age and service requirements are met.

Furthermore, an employer does not have to allow all employees to participate, even if they satisfy the age and service rules. Employers commonly exclude various classifications of employees. For example, an employer might offer a plan to individuals in one location but not in another, offer separate plans to salaried and hourly workers, or maintain a separate plan for union employees.[13] It is important to note, however, that an employee's service with the employer (and entities aggregated with the employer under Section 414 of the Code)[14] counts towards satisfaction of service requirements, even if he or she is working in an ineligible classification. If a plan covers Division A and requires a year of service, an employee who works a year in Division B would be eligible if he or she switched to Division A thereafter.

In addition, eligibility classifications must satisfy the Code's prohibitions on discrimination in favor of highly compensated employees.[15] Section 410(b) of the Code allows a plan to demonstrate that participation is available to a nondiscriminatory group using various methods,[16] but the employer should bear in mind that the workforces of all entities related to it under Section 414 of the Code must be taken into account. For example, a parent company with a subsidiary related to it under Section 414 of the Code would have to take that subsidiary's workforce into account, and the subsidiary likewise would need to consider the parent's workforce.[17] For this reason, maintenance of multiple plans within a group can be disadvantageous. Since maintenance of multiple plans also increases administrative costs and effort, employers generally should seek to consolidate retirement benefits as much as possible. Even if different benefit structures for different groups are necessary for business reasons, a single plan often is sufficient. Many preapproved plan documents can now accommodate multiple benefit designs under a single umbrella, and a customized document certainly can do so.

Even if an employer's eligibility classifications are nondiscriminatory, the employer must bear in mind that eligibility classifications cannot be used as an end run around the rules regulating age and service conditions. Thus, the IRS generally does not permit exclusionary classifications based on "temporary" or "part-time" employment status, unless individuals in those classifications are permitted to participate if they satisfy Section 410(a) of the Code.[18]

Benefit Structure

The Options

Like an employer's eligibility classifications, a plan's benefit or contribution formula, must satisfy rules designed to ensure approximate parity of benefits (in proportion to compensation) when rank-and-file employees are compared to highly compensated employees. Many employers choose to offer a single benefit or contribution design, though some employers offer different designs to different groups of employees, or even to particular employees.[19] There is a fair amount of flexibility, so long as nondiscrimination tests are satisfied. However, the more different benefit or contribution structures a plan contains, the more complicated it is to administer. Accordingly, employers should consider carefully before opting for different plan designs for different employee groups.

If the plan is a defined benefit plan, the employer can permit or require employees to contribute on an after-tax basis, but such plans are uncommon in the private sector. Likewise, some defined contribution plans permit after-tax employee contributions, but most do not. In contrast, employers commonly opt to include a 401(k) or 403(b) elective deferral feature in a defined contribution plan.[20] Under a 401(k) or 403(b) arrangement, an employee can elect to have amounts withheld from his or her paycheck and contributed to the plan, up to an annual statutory limit ($17,500 in 2014, with employees turning 50 or older during the year allowed to make an additional $5,500 in "catch-up contributions" if the plan so permits, and enhanced amounts permissible for some 403(b) plan participants). Traditionally, these amounts were disregarded for purposes of calculating the employee's taxable income for the year of the contribution, but if the plan permits, an employee has the option of designating some or all of these elective deferrals as "Roth" contributions. Roth contributions are taxed when contributed, but can be withdrawn tax-free once the employee has attained age 59½, died, or become disabled, so long as at least five taxable years have elapsed since the initial Roth contribution was made to the plan (or a prior employer's plan, if Roth amounts were directly rolled over from that plan to the new plan).

If the employer maintains a 401(k) or 403(b) elective deferral plan and/or permits after-tax contributions to a defined contribution plan, the employer may opt to "match" some or all of a participant's deferrals. A defined contribution plan sponsor may also make nonelective contributions, which are employer contributions that do not require employees to contribute, often called "profit-sharing contributions." A defined contribution plan may specify the manner in which the employer will calculate some or all contributions each year, or may leave the contribution amount to the employer's discretion.

In addition to deciding on the amount of contributions or benefits, the employer needs to specify what employees must do to earn a contribution or benefit for the year. Many employers do not impose any requirements on receipt of a matching contribution other than contribution of elective deferrals (or after-tax employee contributions, in some cases), but some require employees to be employed on a specified date (typically the last day of a plan year, or the last day of a plan quarter) and/or to have completed a specified number (no more than 1,000) of hours of service. Requirements of this type are more common for nonelective contributions. Defined benefit plans often require completion of a specified number of hours of service in a year in order for a benefit to accrue.[21]

Compensation

Most plans use employee compensation in their benefit calculations. For example, a defined benefit plan might calculate the employee's benefit as a specified percentage of compensation times years of service. Many defined contribution plans calculate contributions as a percentage of compensation. Even if the plan uses a benefit formula that does not base benefits on compensation, the employer will still need to look to a participant's compensation for purposes of nondiscrimination testing and certain limits on plan contributions and benefits. When selecting a definition of compensation, the employer should consider whether the definition satisfies legal requirements, and whether it is readily administrable by the employer's payroll personnel.

With respect to the first consideration, the IRS has identified four definitions that will automatically satisfy Section 415 of the Code. A plan using one of those definitions, or using one of those definitions with certain variations authorized by regulations under Section 414(s) of the Code, automatically qualifies as having a nondiscriminatory definition of compensation for purposes of the nondiscrimination testing rules applicable to plan benefits or contributions. Using one of the preapproved definitions avoids the need to test the definition of compensation to demonstrate that it is nondiscriminatory under Section 414(s) before tests on benefits or contributions can be run.

However, the employer may find a customized definition easier to administer, or may feel that the preapproved definitions do not meet its needs for other reasons. Customizing the definition allows the employer to specify the treatment of the particular types of compensation it pays in familiar terminology, and offers the flexibility to address specific situations (such as the handling of trailing compensation to terminated employees) in more detail than the IRS's regulatory definitions allow. Since the IRS has identified erroneous application of plan definitions of compensation as among the most common plan errors,[22] clarity is important, as is regular review of payroll practices.

Testing

Defined benefit plans, defined contribution plan employer nonelective contributions, availability of each matching contribution formula (if more than one), and certain other plan features must satisfy the requirements of Section 401(a)(4) of the Code. The regulations under Section 401(a)(4) allow employers to select from several designs that automatically pass this test, but an employer can also opt for a different design and run a more elaborate test to demonstrate that a benefit or contribution formula, or availability of a feature, falls within acceptable parameters.

Pretax and Roth elective deferrals must pass the Actual Deferral Percentage (ADP) test set forth in Section 401(k) of the Code. Employee after-tax contributions to defined contribution plans and matching contributions made on account of elective deferrals or after-tax contributions must pass the similar Actual Contribution Percentage (ACP) test under Section 401(m) of the Code. A plan can satisfy these tests automatically if the employer commits to a "safe harbor" design providing specified levels of employer contributions, and otherwise must run these tests each year.

Top Heavy Plans

If an employer's plan, combined in some cases with other retirement plans sponsored by that employer and its affiliates, has more than 60 percent of benefits (in the case of a defined benefit plan) or account balances (in the case of a defined contribution plan) allocated to certain owners and highly paid officers, the plan is considered "top heavy." In that case, the employer is required to provide a certain minimum level of benefits. Smaller employers and professional firms tend to be the most at-risk of top-heavy status.

Disability

An employer can provide for continued contributions to a defined contribution plan, or continued accruals under a defined benefit plan, for disabled employees. An employer should be aware, however, that IRC Section 415 may limit its ability to stop making these disability accruals or contributions available.

Vesting

Plan benefits are "vested" when an employee can leave the employer without forfeiting the entitlement to eventual receipt of those benefits. Section 411 of the Code and Section 203 of ERISA set forth minimum vesting standards. Naturally, contributions made by employees must be fully vested when made. For employer contributions, defined contribution plans cannot require employees to complete more than three years of service to be fully vested, or six years of service if participants vest at least 20 percent per year starting after two years of service. Defined benefit plans cannot require employees to complete more than five years of service to be fully vested, or seven years of service if participants vest at least 20 percent per year starting after three years of service. Hybrid defined benefit plans such as cash balance plans and pension equity plans must adhere to the defined contribution plan rules, as must top heavy plans. Years of service are calculated as a specified number of hours (no more than 1,000) in either the plan year or the 12-month period measured from the employee's employment date or anniversary thereof, unless the employer opts to use the "elapsed time" method. The elapsed time method avoids the need to track hours, but has its own complexities, especially for rehired employees.

A plan must also provide for full vesting if a participant reaches normal retirement age while still employed. Normal retirement age cannot be after the later of the participant's attainment of age 65 or the fifth anniversary of the participant's commencement of plan participation, though an employer may establish an earlier age.[23] Many plans also provide for full vesting upon disability and/or death while employed, and some employers provide for additional vesting triggers. Termination of the plan requires full vesting (to the extent benefits are funded, in the case of a defined benefit plan), and participants affected by permanent cessation of contributions to a defined contribution plan (other than a money purchase pension plan) or a partial termination also are entitled to full vesting.

Before selecting a vesting schedule, the employer should give serious thought to whether it wants to impose a vesting requirement at all. Historically, vesting schedules were intended to offer an inducement to employees to stay with an employer for the long term, as well as to allow employers to redirect money originally contributed on behalf of nonvested former employees to still-active employees or towards payment of plan expenses. However, the maximum permissible vesting schedules have shortened over the past few decades, reducing the potential benefit of a vesting schedule. If the employer contributions are modest, the value of a vesting schedule is further reduced. Since vesting schedules require monitoring of service for active employees and reinstatement of returning employees' forfeited balances and past service if the requisite conditions are met, having a vesting schedule means additional administrative effort and risk of error. The employer will need to decide whether the benefits of delaying employees' vesting are worth these costs. If the employer concludes that a vesting schedule will be worthwhile, it must then select a schedule within the permissible parameters.

Distributions

Under Section 401(a)(14) of the Code, a plan must make distributions available no later than 60 days after the end of the plan year in which occurs the participant's normal retirement age (or 65, if earlier), the tenth anniversary of the participant's commencement of participation in the plan, or the participant's termination of employment, whichever comes latest. Even if a participant does not request payment, Section 401(a)(9) of the Code requires the plan to begin distributions no later than April 1st after the year in which the participant turns 70½ (or, if later and if the participant is not a more-than-five-percent owner of the employer, the year in which the participant's employment terminates).

Defined benefit plans often require a terminated participant to wait until reaching early or normal retirement age to commence payment, and generally are not permitted to allow in-service payments prior to age 62. In contrast, some defined benefit plans and most defined contribution plans allow payment whenever a participant terminates employment, regardless of age. Many defined contribution plans also permit in-service withdrawals of some or all contributions under certain conditions, although money purchase pension plans generally cannot offer in-service distributions for any reason prior to age 62. For those plans that do allow in-service payment, the most common circumstances are the participant's attainment of age 59½ (the earliest permissible date for elective deferrals and certain types of employer contributions) and in cases of financial hardships described in Section 1.401(k)-1(d)(3) of the Treasury Regulations. Many defined contribution plans also permit participants to take loans against their account balances, up to limits established by Section 72(p) of the Code. Although loans and in-service distribution options are popular, and may encourage participants to save since they can access funds when necessary, both features also increase the risk of premature use of money intended for retirement, often with detrimental tax consequences.

Once payments are available, the plan needs to know how to make payment. Most defined contribution plans offer payment in the form of a lump sum, and some also allow payment in the form of installments or life annuity contracts, particularly for terminated participants. In contrast, under Section 401(a)(11) and Section 417 of the Code, defined benefit plans and some defined contribution plans are required to offer payment in the form of a single life annuity for an unmarried participant, and a qualified joint and survivor annuity for a married participant.[24]

A qualified joint and survivor annuity offers payment for the participant's lifetime, with benefits continuing to the surviving spouse in a specified percentage. The survivor percentage must be at least 50 percent of the amount payable to the participant, with an option for a 75 percent survivor percentage; if the plan's presumptive survivor percentage is 75 percent or more, the participant must have an option for a 50 percent spousal survivor percentage. If a participant's monthly payment is reduced as a result of the cost of the survivor benefit, the participant must have the right to waive the qualified joint and survivor annuity and opt for a single life annuity instead, if the participant's spouse consents. Many plans also offer additional elective distribution options, subject to spousal consent if the distribution option does not provide the spouse at least a 50 percent survivor benefit. A defined contribution plan that is not required to use the annuity rules can be designed to do so, or can offer annuities as an optional payment form. In the latter case, the participant must have spousal consent to select a life annuity that does not offer the spouse at least the requisite 50 percent survivor benefit, but does not need spousal consent for a nonannuity distribution.

In any event, however, most plans require automatic cash-out payments to participants whose benefits do not exceed a specified amount. A plan can select a cash-out threshold of up to $5,000, excluding amounts attributable to rollover contributions, but must automatically roll payments in excess of $1,000 to an IRA, unless the participant elects otherwise.[25]

If the plan is using the annuity rules, the participant's spouse must have the right to a 50 percent survivor annuity, if the participant dies before commencing payment.[26] If a defined contribution plan does not use the annuity rules, the participant's spouse must be entitled to 100 percent of the participant's vested account balance if the participant dies before commencing payment. In both cases, the plan can allow a nonspousal beneficiary if the spouse consents, though many defined benefit plans offer pre-retirement death benefits only to spouses.

Offering a range of payment forms gives participants flexibility, but adds to the cost and complexity of the plan. Annuity options, in particular, require detailed disclosures. Furthermore, the associated spousal consent requirements present compliance risks due to the increased possibilities for erroneous failure to obtain consent, as well as the potential fraudulent signatures and after-the-fact spousal objections that generate costs even when resolved in favor of the plan. Annuity options are also seldom used when a lump sum option is available, especially in the defined contribution plan context, meaning that a plan sponsor may take on additional burdens to make annuities available without providing a meaningful additional benefit to plan participants. A participant who wants an annuity or an installment payment option can roll a lump sum into an IRA and establish his or her own payment schedule.

Conversely, however, as concern about longevity risk grows, there has been correspondingly increased interest in defined contribution investment products that permit participants to elect lifetime income payments. Those products are still developing, and a number of issues remain unsettled despite some preliminary guidance from the IRS.[27] This is an area that is likely to see continued growth, but one that plan sponsors and fiduciaries should approach with caution.[28] For example, annuity and other lifetime income products generally involve additional costs, and may limit flexibility and portability. Spousal consent rules may not be clear. The product provider's creditworthiness and the performance of the investment product may decline, presenting fiduciary risk. If a lifetime income product is under consideration, the plan fiduciaries should review the specific product details carefully with counsel and their investment advisers, and be sure that their ongoing oversight and participant disclosure practices are adequate.

Employer Stock

Normally, plan investments are the domain of the plan's fiduciaries once the plan is operational, and not a matter for the employer in its capacity as plan sponsor. Employer stock, however, can be an exception to this rule. An employer can choose to designate a defined contribution plan as an employee stock ownership plan (ESOP), which is specifically designed to invest primarily in employer securities and which is eligible for certain tax breaks not available to other plans. An employer also can specify that a non-ESOP defined contribution plan must or may invest (or permit participants to invest) in employer stock. Under current case law, plan provisions mandating investment in employer stock offer protection to plan fiduciaries in the event of a decline in the value of employer stock, as discussed below. That said, an employer should consider carefully before deciding to offer employer stock, and should explore alternatives (such as employee stock purchase plans or stock options) not governed by ERISA. Plans with employer stock have generated significant litigation in recent years, even for companies whose stock experienced only temporary declines and in some cases even for companies whose stock increased after participants had opted or been required to sell it.[29]

OPERATING YOUR PLAN

Section 404 of ERISA requires the fiduciaries responsible for a plan to conduct their duties in accordance with the plan documents and ERISA, for the exclusive benefit of plan participants and beneficiaries, and with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of a like enterprise and with like aims. A breach of this obligation carries personal liability under Section 409 of ERISA, and hence appropriate fiduciary insurance coverage is essential.

Section 402 of ERISA requires a plan to have at least one "named fiduciary" charged with operating the plan in accordance with this standard. ERISA also requires a "plan administrator" (the employer, unless someone else has been designated) to perform certain tasks, file an annual report (Form 5500) with the government and prepare and circulate certain participant communications. Accordingly, operating a benefit plan requires investment expertise, administrative attention to detail, appropriate administrative resources, and familiarity with the legal requirements governing employee benefit plan operations.

Plan Fiduciaries

The plan administrator may be the only named fiduciary, or the plan may designate additional named fiduciaries for certain functions. Under Section 3(21) of ERISA, a "fiduciary" is anyone with discretionary authority or control over the administration of the plan, anyone with control over plan assets, and anyone who regularly offers investment advice for a fee with respect to the plan's assets. Under Section 405 of ERISA, if there is more than one fiduciary, each fiduciary is responsible for the tasks assigned to it and will not be liable for the actions or omissions of the other fiduciaries, so long as the first fiduciary did not aid or enable the other fiduciary in committing or concealing a breach of fiduciary duty.

The plan administrator or other named fiduciary may hire additional fiduciaries, although fiduciary duties regarding investments cannot be delegated to anyone other than a named fiduciary, an investment manager qualified under Section 3(38) of ERISA, or the plan trustee.[30] In addition, the plan administrator usually retains one or more individuals or vendors to perform day-to-day tasks that do not require fiduciary authority or discretion. In either case, delegation is permissible, but the delegating fiduciary must act prudently when delegating.

Selecting Plan Personnel and Vendors

A plan requires human effort to operate. Some of the necessary support typically comes from the employer's staff. Third-party vendors may agree to assume certain responsibilities, but the employer, an employee of the employer, or a committee of the employer's employees typically acts as plan administrator and named fiduciary, and in that capacity is responsible for the selection of third-party vendors and the oversight of services by in-house staff.

When selecting a plan service provider, a fiduciary must be sure the provider is competent, and that any compensation paid to the provider from the plan is reasonable.[31] The latter has been a source of increasing concern, and regulations intended to provide fiduciaries (and participants in participant-directed defined contribution plans) with more information about plan costs and services went into effect in 2012.[32] A plan's fiduciaries must know which vendors are subject to the disclosure rules and be sure all required information is provided, because significant liability can attach to a violation.[33] When they have the information, the fiduciaries should confirm that the disclosures align with their expectations, and revisit the plan's contracts periodically to be sure that the services promised remain appropriate for the plan and are being provided with acceptable quality for a reasonable price. As the plan's asset base increases, the plan typically can qualify for better prices and more extensive services.

Selecting the Named Fiduciary and Plan Administrator

By default, the employer will be the named fiduciary and plan administrator, unless the employer names someone else. Although it is common for the employer to retain both these roles, and many off-the-shelf documents effectively mandate this structure, the employer must understand the implications of holding these positions itself versus naming someone else.

The "plan administrator" is personally responsible for discharging the duties assigned to it. Failing to perform some of those duties, such as a failure to file the annual report (Form 5500) or to provide plan documents requested by a participant within 30 days, carries potentially significant financial penalties. Having the employer serve as plan administrator prevents individual employees from incurring these personal liabilities, but an employer wishing to appoint an alternative plan administrator can ameliorate that concern with appropriate insurance and indemnity coverage.

If the employer is named or acts as a plan fiduciary (including, but not limited to, situations in which the employer is the named plan administrator), the individual members of the employer's governing body typically are also fiduciaries, since they select the employees and vendors who carry out plan functions and hence are in the fiduciary chain of command.[34] Under Section 409 of ERISA, the individual members therefore have personal liability for the proper discharge of fiduciary duties. In this situation, the board should require periodic reporting on plan operations and investments, even if it has delegated the bulk of the day-to-day duties and investment discretion to others. If it does not do so, it may be in breach of its fiduciary duty to exercise appropriate oversight.

If the board is not prepared to accept that level of responsibility, the plan document should avoid identifying the employer as a fiduciary. If the plan document names the employer as a fiduciary, or fails to name an alternative to the employer as a fiduciary, the employer (and its governing body) will have residual fiduciary liability even if the employer adopts a resolution, enters into a contract, or otherwise seeks to designate an alternative fiduciary, because the board remains in the chain of command. Providing in the plan document for a specified officer to name the members of the plan fiduciary committees and avoiding the assignment of any fiduciary duties to the employer places the responsibility to oversee the appointed fiduciaries with the officer.[35]

If a defined contribution plan holds investments in employer stock, ensuring that board members, senior officers and other individuals likely to have inside information regarding the employer's business are *not* plan fiduciaries can help prevent potential conflicts between ERISA's requirement that fiduciaries act prudently in the participants' exclusive interest, on the one hand, and insider trading rules, on the other hand.[36] On a related note, since courts have also, when they deem the circumstances to warrant, permitted claims based on incorporation of inaccurate SEC filings into plan communications, even nonfiduciary corporate officers should understand the ERISA implications of any securities filings so incorporated.[37] Plan fiduciaries should be cautious about incorporating securities filings into ERISA documents and should identify any such documents accompanying or cited by ERISA communications as distinct from the ERISA communication.

Ministerial Service Providers

Nonfiduciary ministerial duties are split between the employer's own staff and one or more vendors, but the division of responsibility varies widely among different plans.

Participant-Directed Defined Contribution Plan Recordkeepers

A participant-directed defined contribution plan requires access to an investment trading platform and a way for participants to give instructions to the plan. Most participant-directed plans use a professional plan recordkeeper, which will arrange for professional custody of assets, process investment, contribution and distribution elections, and offer compliance support with respect to non-discrimination testing, government reporting, and participant disclosure. Recordkeepers usually offer plan documents preapproved by the IRS, and may provide some level of consulting services with respect to plan design, plan operation, and participant education.

Selecting the right 401(k) plan recordkeeper can be a key to the success of the retirement plan, particularly when the employer does not have an involved and sophisticated in-house benefits staff. In all cases, the plan administrator must monitor the quality of the recordkeeper's overall performance, accuracy of administration, and the quality of the support provided to in-house staff and plan participants. The recordkeeper will generally be the face of the plan from the participants' perspective, so friendly and knowledgeable representatives should be a priority.

Especially in the case of a large plan, drafting a service agreement that encompasses quality control benchmarks and periodically auditing the recordkeeper's performance regarding Web site access, call center service, contribution processing, vesting monitoring, and so forth can help to ensure the expected quality of service. Even if a formal arrangement is not established, the plan administrator should set aside time periodically to consider the recordkeeper's performance and confirm that it remains satisfactory.

Other Vendors

Defined benefit plans and professionally invested defined contribution plans are more likely to be administered at least partially in-house. However, these plans typically receive some outside assistance as well. Benefits consultants may assist with testing or plan communications, for example, and a defined benefit plan will typically rely on actuaries to calculate benefits, or to review calculations produced by the plan.

Trustee

Under Section 403 of ERISA, a plan's assets must be held in trust, protected from the creditors of the employer.[38] A trustee can be given the authority to control plan investments (a "discretionary trustee"), or can be a "directed trustee" retained to act as directed by the plan's named fiduciary and to follow the investment elections of participants in a participant-directed plan).[39] A trustee generally must be an individual, or an institution with trust powers.

Investment Fiduciaries

A plan may retain one or more investment consultants or advisers, who offer investment recommendations but leave the final decision to the plan's trustee or named fiduciary. A plan may also or instead retain one or more investment managers or discretionary trustees to make investment decisions and oversee the plan's assets on a discretionary basis. The named fiduciary responsible for appointment of the investment professionals must, however, monitor their performance, and take action if they fail to meet appropriate standards.

Counsel

In accordance with the advice typically emblazoned on the front cover or near the signature line of mass-marketed plan documents, an employer should consult with counsel before setting up a retirement plan, and periodically during the life of the plan. An attorney with employee benefits experience can review the plan document with the employer to be sure the employer understands the implications of its design decisions (and to confirm the accuracy of a document conversion, if the employer is switching to a new plan document vendor),[40] review the summary plan description to be sure it meets legal requirements and accurately reflects the plan document, train the employer's staff who will serve as plan fiduciaries to understand their responsibilities and carry them out in accordance with best practices, review the service contracts for plan vendors, advise regarding resolution of the occasional problems or errors that are the inevitable corollary of operating a retirement plan, and offer other assistance as needed.

Counsel can also assist the plan fiduciaries in setting up a process that will facilitate prudent oversight of plan administration and investment, assist with the review of benefit claims, advise regarding defensive features such as contractual statutes of limitations and arbitration clauses, and meet with the fiduciaries regularly to help keep the fiduciary process functioning properly and ensure that fiduciaries are up to date on legal developments. It is, however, important for the fiduciaries to understand that their communications with counsel may not be privileged when it comes to matters involving the plan, since case law recognizes an exception to attorney-client privilege in a number of situations involving employee benefit plans.[41]

Keeping the Plan Operating

General Best Practices

Fiduciaries should meet at appropriate intervals to review plan investments, the performance of vendors, and various other aspects of plan administration (including participant communications and required filings). Since the most appropriate schedule for periodic reviews will vary depending on the size and complexity of the plan, the sophistication of in-house benefits staff, the level of support available from vendors, and other factors, counsel can help the plan fiduciaries set the most appropriate timeline for their activities. Many plans follow a quarterly schedule for fiduciary committee meetings, with one or more individuals tasked to notify the committee if circumstances require an interim meeting. For example, a committee may direct its investment adviser to monitor market developments and call an interim meeting when necessary, or may hold a special meeting to deal with a claim.

Special Issues Presented by Employer Stock

Section 404(a)(2) of ERISA exempts employer stock from the requirement that a plan's assets be diversified unless it is clearly prudent not to do so, although not from the general requirement that the plan be prudently administered. Courts therefore have held that investment in employer stock does not require the usual level of fiduciary scrutiny when a defined contribution plan document *requires* that such an investment be made. However, they differ in the details of the way they apply this "presumption of prudence" and the circumstances in which they consider fiduciary action to be necessary for the plan's protection notwithstanding an employer's mandate that the plan invest (or permit investment) in employer stock.[42]

If the plan requires or permits investment in employer stock, special precautions are advisable. Steps should be taken to avoid conflicts between fiduciary obligations and insider trading rules. The fiduciaries should understand the evolving state of the law with respect to their obligations to oversee the employer stock investment, and if applicable also need to know how the presence of a plan document provision requiring investment in employer stock (or in the case of a participant-directed plan, requiring that employer stock be an available investment option) affects their obligations. Given the special risks associated with investment in a single stock, particularly when that stock's issuer also provides the employee's paycheck, fiduciaries would be well-advised to offer participant investment education and clear risk-disclosure documents.

As a corollary, fiduciaries need to bear in mind that if the employer stock is publicly traded, Section 401(a)(35) of the Code requires that participants be able to divest the stock (and that they have a sufficiently broad selection of alternatives), except in the case of ESOPs with no elective deferral or matching contribution components.[43] Participants must be informed of this right. More limited diversification rights apply in other situations involving plan ownership of employer stock, and fiduciaries must be sure those rules are properly administered, if applicable. If the plan is participant-directed, fiduciaries must maintain and communicate a confidentiality policy protecting participant employer stock investment and voting decisions in order to claim protection against liability for participant investment decisions.[44]

CONCLUSION

Establishing and operating a retirement plan is not for the faint of heart, but it can be well worth the effort. Taking the time and hiring the expertise necessary to make the right decisions in the first place is likely to pay dividends over the life of the plan, but periodic review of both plan design and plan administration is essential for the plan to accomplish the desired goals of providing retirement benefits to employees without unexpected liabilities for the plan sponsor and fiduciaries.

NOTES

1. *See* Deloitte, the International Foundation of Employee Benefit Plans (IFEBP) and the International Society of Certified Employee Benefit Specialists (ISCEBS), *Annual 401(k) Benchmarking Survey (2012 edition)* (last visited January 24, 2014) <*http://www.deloitte.com/view/en_US/us/Services/consulting/human-capital/c9bd901987c5e310VgnVCM1000003256f70aRCRD.htm*>.

2. Steve Nyce, *Attraction and Retention: What Employees Value Most*. Towers Watson Insider (March 2012) (citing Towers Watson 2011 Retirement Attitudes Survey) (last visited January 24, 2014) <*http://www.towerswatson.com/en-US/Insights/Newsletters/Americas/insider/2012/Attraction-and-Retention-What-Employees-Value-Most-March-2012*>.

3. Retirement plans offered only to a select group of management and highly compensated employees (often referred to as "top hat plans") are exempt from ERISA's fiduciary obligations and most of ERISA's other requirements. Governmental plans, church plans, some 403(b) plans, and certain other arrangements also qualify for exemptions from some or all of ERISA's requirements. This article focuses on broad-based plans subject to ERISA.

4. Internal Revenue Service, *Help With Choosing a Retirement Plan* <*http://www.irs.gov/Retirement-Plans/Help-with-Choosing-a-Retirement-Plan*> (last visited January 24, 2014).

5. Section 408(p)(2)(C) of the Code restricts SIMPLEs to employers with no more than 100 employees (taking into account all entities related under Section 414 of the Code) receiving at least $5,000 in compensation during the year, and Section 408(p)(2)(D) of the Code prevents employers from sponsoring SIMPLEs if they also

maintain other plans. SEPs are not size-restricted, but a larger employer generally will find the lack of flexibility and lower limits associated with a SEP reason enough to justify the added complexity of maintaining a full-fledged plan.

6. Section 408(p) of the Code requires a SIMPLE to satisfy one of two employer contribution designs, and generally prohibits amendment or termination of the contribution structure during the year. Both SEPs and SIMPLEs generally must cover all employees of the employer's group, with only a few permitted exceptions.

7. The Pension Protection Act of 2006 authorized a "DB/401(k)" plan for smaller employers (no more than 500 employees), but these arrangements are uncommon. Likewise, Section 414(k) defined contribution accounts within a defined benefit plan are unusual.

8. Some plans can even reduce or eliminate contributions for past periods to the extent participants have not yet completed all the requirements to receive contributions. For example, if a plan requires participants to be employed on the last day of the plan year to receive a contribution, the employer could amend the plan at any point prior to that last day to reduce or eliminate the contribution. In contrast, if a plan provides for a contribution of a specified percentage of compensation for any participant employed during the year, the employer could amend the plan to disregard all future compensation, but would have to make the contribution on compensation paid prior to the approval of the amendment.

9. ERISA §204(h); Code §4980F. 45 days is the normal advance notice requirement. Failure to provide a compliant notice results in an excise tax, and in egregious circumstances can invalidate the amendment reducing or freezing benefits.

10. *COLA Increases for Dollar Limitations on Benefits and Contributions http://www.irs.gov/Retirement-Plans/COLA-Increases-for-Dollar-Limitations-on-Benefits-and-Contributions* (last visited January 24, 2014). An individual's compensation will also limit the maximum permissible contribution or benefit.

11. An employer cannot require more than 1,000 hours of service in a specified 12-month period for a year of service. The hours can be measured by actual hours worked, or using certain assumptions set by regulations. The initial 12 months is measured from the employee's date of hire, and an employer can opt to measure subsequent 12-month periods from the anniversary of the date of hire, or to switch to the plan year (starting with the plan year beginning after the individual's date of hire). An employer that does not want to track hours can instead measure service on an "elapsed time" basis, so that an employee completes a year of service if employed for 12 months, counting periods of absence of less than a year. The elapsed time calculation rules can be complicated, particularly for employees who leave and are subsequently rehired. An employer must be sure it understands the way the calculation is required to work and that it tracks all covered service.

12. If the employer's plan is top heavy under Section 416 of the Code, the employer will not be able to use this option without making at least the minimum "top heavy" contribution.

13. Employers often draft their plans to exclude an individual not classified as an employee on the employer's payroll. Although this can be an important protection if the employer is later determined to be the common law employer of an individual paid through a third-party agency or as an independent contractor, this classification will not change the individual's classification for nondiscrimination testing or general tax purposes. Accordingly, proper classification of workers is important even when a plan contains this safeguard.

14. Generally, parents and subsidiaries with at least 80 percent common ownership are aggregated, as are businesses with the same five or fewer individuals, estates, or trusts as owners if certain requirements are met. Businesses owned by close relatives may have to be aggregated, depending on the circumstances. In addition, service or management oriented businesses with little or no common ownership but certain types of common operations or other entanglements may need to be combined. *See* Code Sections 414(b), (c) and (m).

15. As defined in Code Section 414(q) (employees with prior year compensation above specified threshold, or more than 5 percent ownership of the employer).

16. Defined benefit plans must also satisfy Section 401(a)(26) of the Code, which generally requires a plan to be available to the lesser of 50 employees or 40 percent of the employer's workforce.

17. Certain employees (most notably collective bargaining employees) can be disregarded for purposes of this nondiscrimination testing under Section 410(b) of the Code, making it easier to maintain a separate plan for these individuals or to exclude them from retirement plan participation entirely.

18. *See Employee Plans Determinations Quality Assurance Bulletin, Part-Time Employees Revisited*, FY 200 No. 3 February 14, 2006 *http://www.irs.gov/pub/irs-tege/qab_021406.pdf* (last visited January 17, 2014). Note that an employer can apply a year of service requirement (two years, with respect to participation in fully vested employer contributions) to a "temporary," "part-time," or similar classification even if other employees can participate sooner.

19. As with Section 410(b) of the Code, certain employees can be disregarded. Collectively bargained employees automatically pass nondiscrimination testing, with the exception of the ADP test under Section 401(k) of the Code, and thus can have their benefits negotiated separately.

20. Section 501(c)(3) organizations and public schools can utilize a Section 403(b) arrangement in lieu of a 401(k) plan. Governmental organizations can offer pretax and Roth deferrals under a Section 457(b) arrangement.

21. Generally, an hours-of-service requirement cannot require more than 1,000 hours of service, but a defined benefit plan can require a higher number for full benefit accrual if proportional accruals are available for employees with less than the full-accrual number.

22. *401(k) Compliance Check Questionnaire: a Review of the Interim Report, March 2012 <http://www.irs.gov/pub/irs-tege/401k_questionnaire_phoneforum_presentation.pdf* (last visited January 24, 2014).

23. In the case of a defined benefit plan or a defined contribution plan subject to Section 412 of the Code (*i.e.*, a money purchase pension plan), normal retirement age generally cannot precede age 62, but an employer may be able to support use of an earlier age.

24. A defined contribution plan is required to follow the annuity rules if it is a money purchase pension plan (and thus subject to Section 412 of the Code), or if the employer has opted to design the plan to offer annuity payments. Money purchase pension plans are increasingly rare, since the tax advantages they previously had over other defined contribution plans were eliminated by the Economic Growth & Tax Relief Reconciliation Act of 2001. Many of these plans were merged into 401(k) plans. A plan is required to preserve the annuity distribution rules for the merged money purchase plan benefits even if the rest of the plan is not

subject to those rules, but a plan with no money purchase pension plan benefits can cease to offer annuity options prospectively if the employer amends the plan to that effect.

25. *See* Code Section 401(a)(31)(B). A cash-out threshold of $1,000 or less avoids the need to make arrangements for an automatic rollover IRA, but a higher cash-out threshold can reduce plan costs and the administrative hassle of missing participants by facilitating removal of small balances.

26. Defined contribution plans typically either provide for a 100 percent spousal annuity, or for a 50 percent spousal annuity and the participant's free choice of beneficiary for the remainder of the account. Defined benefit plans often limit preretirement survivor benefits to the mandatory 50 percent (or the higher percentage offered by the plan's qualified joint and survivor annuity, if applicable), but some are more generous. Cash balance plans, in particular, often base the survivor benefit on the participant's entire benefit rather than on a 50 percent calculation. Some defined benefit plans require reduction of a participant's benefit if preretirement survivor protections were in force prior to the participant's commencement of payment, but most do not.

27. *See Lifetime Income Options: Recent Revenue Rulings and Proposed Regulations http://www.irs.gov/Retirement-Plans/Lifetime-Income-Options---Recent-Revenue-Rulings-and-Proposed-Regulations* (last visited January 24, 2014).

28. ***See*** Robert Steyer, "DC Plans Still Hesitant About Lifetime Income," *Pensions & Investments* (October 28, 2013) <*http://www.pionline.com/article/20131028/PRINT/310289976/dc-plans-still-hesitant-about-lifetime-income*> (last visited January 24, 2014).

29. *See, e.g., Tatum v. R.J. Reynolds Tobacco Co.*, 392 F.3d 636 (4th Cir. 2004).

30. *See* Section 405(c) of ERISA.

31. Individuals receiving full-time pay from the employer cannot receive compensation from the plan. *See* ERISA Section 408(c)(2).

32. *See* 29 C.F.R. 2550.408b-2(c); 2550.404(a)-5.

33. Failure to provide reported disclosures, or failing to report a service provider's known violation of the disclosure requirements, is a violation of the "prohibited transaction" rules, and imposes personal liability and potential excise taxes on the involved service provider and nonreporting fiduciary. *See* 29 C.F.R. 2550.408b-2;(c) Code Section 4975.

34. *See, e.g., Carr v. Int'l Game Tech.*, 770 F. Supp. 2d 1080 (D. Nev. 2011); *Tittle v. Enron Corp. (In re Enron Corp. Sec. Derivative & ERISA Litig.)*, 284 F. Supp. 2d 511 (S.D. 2003).

35. Case law continues to develop in this area, but this technique is now in use. *See* the cases cited *supra*, n.34, for the proposition that only board members with fiduciary authority are fiduciaries. Companies and their boards should bear in mind, however, that fiduciary authority must be entirely assigned to the desired fiduciaries, with no retention of authority by the company. *See Harris v. Amgen, Inc.*, 738 F.3d 1026 (9th Cir. 2013). In addition, fiduciary status is governed by facts, not documents, so companies must be sure their conduct aligns with the intended fiduciary hierarchy. Companies also should take into account the potential impact of the doctrine of *respondeat superior*, which some (though not all) courts have applied in the ERISA context. *See, e.g., Howell v. Motorola, Inc.,* 633 F.3d 552 (7th Cir. 2011) (recognizing the doctrine); *In re Bank of Am. Corp. Sec., Derivative, & ERISA Litigation*, 756

F. Supp. 2d 330 (S.D.N.Y. 2010) (noting circuit split and citing cases; finding factual premise not established in any event); *Tool v. Nat'l Emple. Benefit Servs.*, 957 F. Supp. 1114 (N.D. Cal. 1996) (rejecting applicability of doctrine).

36. The courts have yet to reach a definitive resolution to the potential conflict between ERISA's requirement that fiduciaries operate the plan in the best interests of participants and the restrictions imposed by insider trading rules. Courts have agreed that fiduciaries are not required to seek out information and then violate the law by trading on it. *See, e.g., Rinehart v. Akers*, 722 F.3d 137 (2d Cir. 2013) (noting, however, that this was not a case in which fiduciaries had inside information arising from their employment duties). In contrast, courts have also allowed claims to proceed on the grounds that other solutions to problems known via insider knowledge (suspension of additional purchases, disclosure of the information, etc.) potentially should have been explored (*see, e.g., Harris, supra*, n.35).

37. *See, e.g.*, *Dudenhoefer v. Fifth Third Bancorp*, 692 F.3d 410 (6th Cir. 2012), *cert. granted* on separate issue 187 L. Ed. 2d 623 (2013).

38. An insurer can hold plan assets in lieu of a trustee, if desired.

39. Even a directed trustee is considered to have fiduciary responsibilities, albeit very limited ones. *See* Field Assistance Bulletin 2004-03 (December 17, 2004).

40. The author's personal experience indicates that the document conversion process is a frequent source of errors and misunderstandings. Even if the new vendor has selected the proper options in the new document to align with the old document, he or she often does not identify differences in features not designed as choices. For example, an employer's new document may automatically allow in-service distributions at normal retirement age, while the old one did so only if a box was checked to activate this feature (or vice versa).

41. *See* L.E. DesMarteau, "Employee Benefits Exceptions to Attorney-Client Confidentiality (and the Exceptions to the Exceptions," *Benefits Law Journal* Vol. 23 No. 3 (Autumn 2010).

42. *See generally* Corey Rosen, "Recent Trends in Litigation Over Employer Stock in Defined Contribution Plans," *Pension & Benefits Reporter,* pp. 2280–2283 (September 24, 2013); Annemarie McGavin, "Recent Developments in Stock Drop Cases: *Moench* Presumption," *Tax Management Memorandum*, pp. 39-47 (2013). The US Supreme Court recently granted certiorari in *Fifth Third Bancorp v. Dudenhoeffer*, 187 L. Ed. 2d 623 (U.S. 2013).

43. Participants can be required to complete three years of service before the divestiture right activates, in the case of employer contributions. However, it is generally advisable from a liability perspective (and easier to administer) to permit participants to divest publicly traded employer stock at any time.

44. 29 C.F.R. §2550.404c-1(d)(2)(ii)(E)(4)(vii)-(viii).

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