What Not To Do

(And If You Did, How to Correct It)

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What is ERISA?

Two laws:

- ERISA
  - Codified in 29 U.S.C. § § 1001 through 1461
- Internal Revenue Code (the "Code")

"Seven essential parts"

1. Standards for employee participation in private retirement plans that encourage earlier participation by workers, and longer periods over which benefits can be earned
2. Standards for the "vesting" of retirement benefits, ensuring no punishing forfeiture standards or inadequate pension fund resources
3. Fiduciary rules for those who control the funds
4. Mandatory disclosure of information concerning the operations of the employer's retirement plan
5. Code revisions to provide tax incentives
6. Federally sponsored, privately financed Pension Benefit Guaranty Corporation
7. Portability of pension benefits by allowing workers to transfer some of their pension benefits to other plans or to their individual retirement accounts

ERISA Compliance Watchdogs

Plaintiff's Bar

- Plan participants
- Plaintiff's attorneys

Department of Treasury

- Internal Revenue Service (IRS)

Department of Labor

- Employee Benefits Security Administration (EBSA)

Plaintiff's Bar

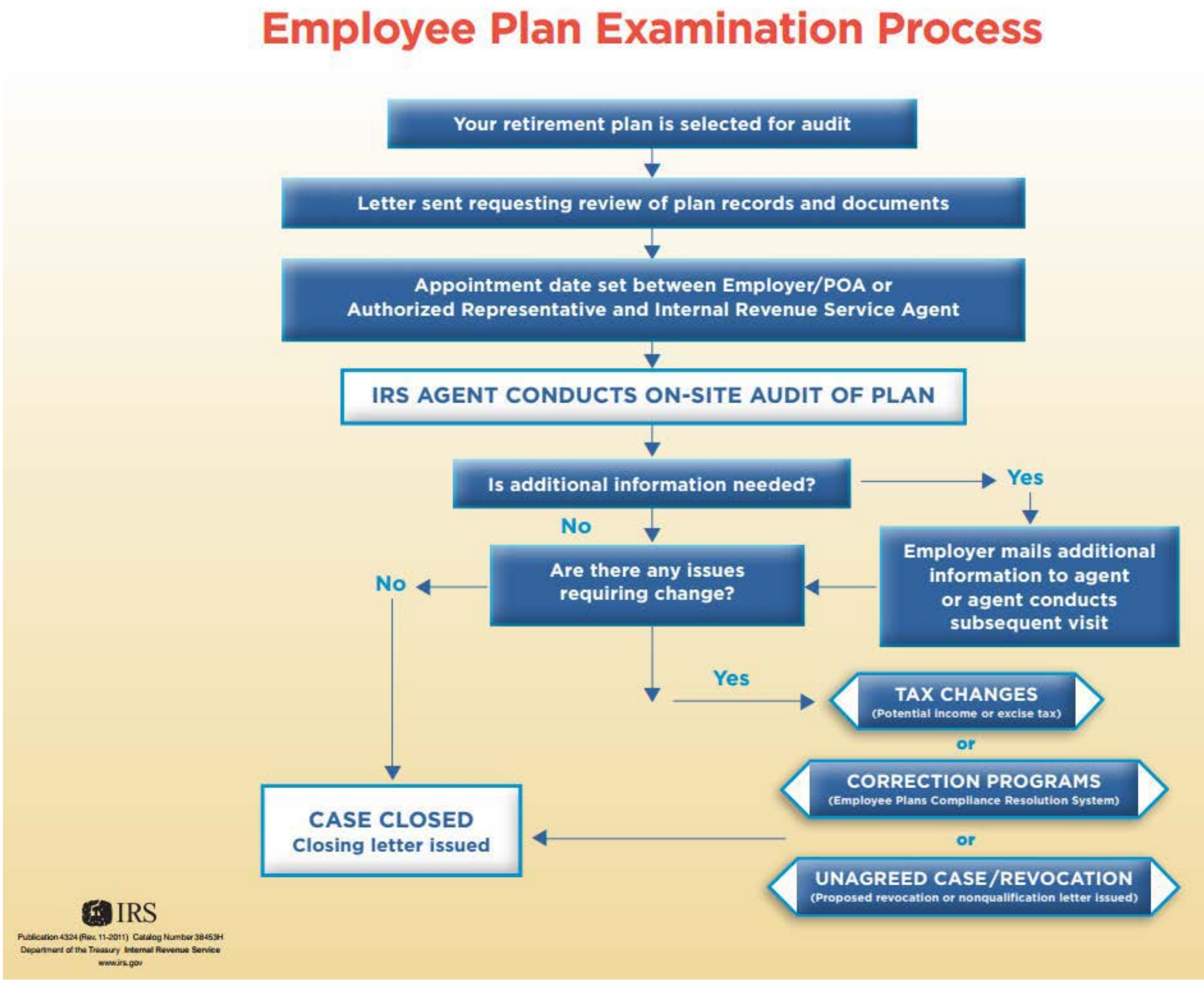
What attracts their attention?

- Participants
  - Bar may actually advertise to seek out plaintiffs for a "class"
- Large declines in stock value
- Sales immediately following distributions at lower values
- Bad facts
  - Bad behavior

Trends

- Prudence
  - Particularly in regard to failure to divest
- Exclusive Benefit
- Prohibited Transactions
- Duty to Follow Plan Documents

IRS: Audit


Employee Plan Examination Process
Your retirement plan is selected for audit
Letter sent requesting review of plan records and documents
Appointment date set between Employer/POA or Authorized Representative and Internal Revenue Service Agent
IRS AGENT CONDUCTS ON-SITE AUDIT OF PLAN
Is additional information needed?
Yes
Employer mails additional information to agent or agent conducts subsequent visit
No
Are there any issues requiring change?
No
Yes
TAX CHANGES
(Potential income or excise tax)
or
CORRECTION PROGRAMS
(Employee Plans Compliance Resolution System)
or
UNAGREED CASE/REVOCATION
(Proposed revocation or nonqualification letter issued)
CASE CLOSED
Closing letter issued
IRS
Publication 4324 (Rev. 11-2011) Catalog Number 38453H
Department of the Treasury Internal Revenue Service
www.irs.gov

IRS: Voluntary Corrections

Employee Plans Compliance Resolution System (EPCRS)

- Self-Correction Program (SCP)
- Voluntary Correction Program (VCP)
- Audit Closing Agreement Program (CAP)
- Correction must be reasonable and appropriate
- "Put the plan into the position it would have been in had no failure occurred"
- **NOT** Available if the plan is under audit

DOL: Audit

Random selection

- A certain number of plans filing a Form 5500 are selected each year for audit

Concerns over information included in the Form 5500

- Identification of late contributions
- Lack of Fidelity Bond
- Improper completion of Schedule C identifying compensation paid to providers

Participant complaints

- Office of Participant Education – a DOL office allowing for complaints of possible ERISA violations

Referral from the IRS or SEC

DOL: Voluntary Corrections

Delinquent Filer Voluntary Correction Program (DFVCP)

- Self-correction of Form 5500 violations
- Steps
  - Submit corrected 5500s
  - Pay fee

Voluntary Fiduciary Correction Program (VFCP)

- Self-correction of fiduciary violations
- Steps
  - Identification of all violations
  - Determination as to whether VFCP applies
  - Follow the VFCP process for correction
  - Calculate and restore any losses or profits with interest
  - Distribute any supplemental benefits to participants
  - File an application with the appropriate EBSA regional office
    - Include documentation showing evidence of corrective action taken
    - Include required plan documents

Traps for the Unwary: ESOP Lifecycle

Pre-Transaction

- Party relationships
- Appropriateness of providers
- Due diligence

Implementation

- Plan design
- Communication
- New employees

On-Going Administration

- Repurchase liability/loan amortization
- Distributions
- Diversification

Termination

- Timeline
- Distributions
- Missing participants

Pre-Transaction: Party Relationships

- No self dealing
- No conflict of interest transactions
- Specific prohibited transactions with a “party in interest” as defined in ERISA – **ESOP loans**
  - Sale, exchange, or leasing of any property
  - Lending of money or extension of credit
  - Furnishing of goods, services, or other facilities
  - Transfer or use of any assets of the plan
  - Acquisition of any employer property or securities unless certain conditions are met

Pre-Transaction: Appropriateness of Providers

Fiduciary, not expert, responsible for decision-making

Fiduciary must:

- Understand the qualifications of experts
  - Code Section 401(a)(28)(C) requires that valuations to be performed by an "independent appraiser," as such term is defined for purposes of Code Section 170(a)(1)
- Be aware of and appropriately address conflicts of interest
  - "ERISA does not prevent persons with 'conflicting loyalties' – such as a financial interest adverse to that of the ESOP beneficiaries – from serving as a trustee or named fiduciary of the plan"
- Ensure that reliance on expert is **reasonably justified under the circumstances**

Pre-Transaction: Due Diligence

Process is the key to demonstrating prudence

- Maintain written record of process
- Carefully select expert advisers
- Understand expert's advice before following the advice
  - Reasonable inquiries into the expert's recommendations
  - Blind reliance on counsel or other experts is no defense

Fiduciaries do not need to have a "crystal ball"

- Even if a decision turns out "badly," liability can be avoided if the process was correct
- Even "good" results could theoretically create liability if the process was bad

Pre-Transaction: Due Diligence

Process agreements provide helpful insight into the Department of Labor (DOL) position regarding what is required to meet fiduciary obligations under ERISA when engaging in pre-transaction due diligence

- Process agreements have neither the force of law nor the ability to change any current laws or regulations

First introduced by the Department of Labor (DOL) in the 2014 settlement of *Perez v. GreatBanc Trust Co.*, the process agreements have been modified and expanded

- *Acosta v. First Bankers Tr. Servs., Inc.*,
- *Acosta v. BAT Masonry*
- *Acosta v. Mueller*
- *Acosta v. Cactus Feeders, Inc.*

Implementation: Plan Design

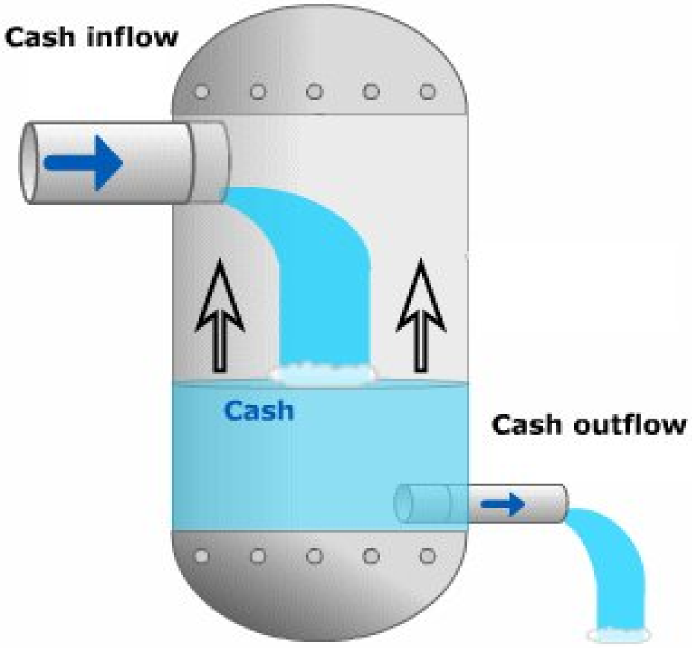
- Incorrect eligible compensation used
- Missed participants
- Incorrect vesting
  - o 1,000 hours required for YOS
  - o Vesting prior to participation missed
  - o Self-correction was sufficient approach

Implementation: New Employees

- Lack of employee communication
- Delay from hire date and first statement
- Poor transaction design
  - 100% owned S-corporation
  - 5-yr external note and 10-yr internal note
  - Low turnover with 5-year distribution delay

On-going Administration: Repurchase Liability

- Lack of planning
- Poor cash flow projections
- Short internal loan length
  - S-Corp becomes to 100% ESOP owned
  - 15-year internal loan
  - Double payments



On-going Administration: Distributions

- Lack of distribution strategy
- Delaying payouts until retirement age
- Immediate distributions upon retirement
  - An S-corporation is 70% owned by the ESOP
  - Annual s-distributions were being paid
  - Immediate distribution to former employees

On-going Administration: Diversification

- Incorrect calculations for eligibility
- Misunderstanding 10 years of participation
- Not offering the benefit
  - Mature ESOP with no employee education
  - No prior elections on file

- Survived ongoing administration . . .
- Survived regulator and other audits . . .
- What happens next?
- Plan is terminating!

How long does it take?

- Cash and other assets held in Trust; statement of assets
- File for termination of the Plan
- File 5500s; values to report
- Recordkeeping report and participant statements (how many?)

Plan Expenses?

- Estimate from all advisors - recordkeeper, attorney, auditor, trustee, etc.
- Who pays - Plan sponsor or participants?
- Expenses are for administration of Plan or settlor function?
- Is timing of paying expenses important?

Distributions

- Fixed investments to maintain principal and estimate interest/income
- Timing - when determination letter received or other ways?
- Errors such as overpayments
- Final checks and 1099s

Where are you?

- Trying to find participants - services to use
- Uncashed Checks
- Using PBGC service for Defined Contribution Plans
- Using other companies or banks to hold IRAs (cash or other assets)

Don't Forget!

Please fill out your evaluation for this session

You can find it in the Conference App or ask for a paper version

Questions ?

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