

## InFRE® Retirement Plan Administrator Series

# Fundamentals of Compliance & Ethics

## Part 1

Presented by  
Mary Willett  
Willett Consulting

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## Workshop Overview

A basic understanding of what is required to ensure the retirement plan is in compliance with federal tax laws and the ethics that should be adhered to is necessary for all parties responsible for the program and, in particular, those who have a fiduciary role.

This workshop covers various compliance topics, provides an overview of the fiduciary role and discusses ethical principles that should govern plan administrators, board or committee members and other fiduciaries.

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## Course Topics

- Introduction to Governmental Regulation
- Fiduciary Role and Responsibilities
- Compliance in Form
- Compliance in Operation
- IRS Corrective Programs
- Reporting
- The Role of Independent Professionals in Plan Operation
- Ethics for Retirement Administrators

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## Today's Webinar Agenda

- Text Book Chapters
  1. Introduction to Governmental Regulation
  2. Fiduciary Role and Responsibilities

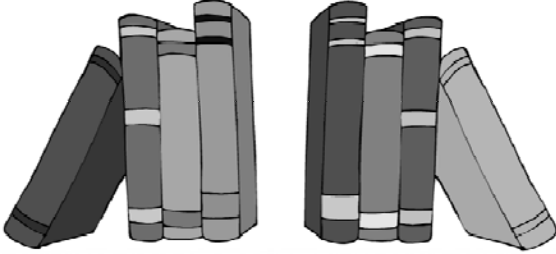


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# Chapter 1

## Introduction to Governmental Regulation



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### Why is Compliance Important?

- Rules are imposed to ensure retirement plans meet their intended goals
- IRS code and regulations are designed to
  - Protect plan assets
  - Preserve tax advantages
  - Ensure fair treatment of participants and beneficiaries

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## Spotlight on Retirement



- Today's environment has increased importance of retirement programs
- Policy makers (federal & state levels) are focusing on issues impacting employer plans
- Increased legislative and regulatory attention can make plan sponsors job more difficult

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## Why Regulations?

### ***To protect benefits for participants and beneficiaries***

- Fiduciary standards protect against fraud, dishonesty, mismanagement
- Courts decide breach of fiduciary duties based on laws and rules set in regulations

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## Why Regulations?

### ***To manage tax revenues by defining***

- When and how benefits will be taxed
  - Early withdrawal penalties
  - Required minimum distribution rules
- Type and amount of contributions that can be made to the retirement plan
  - IRS provides updates to annual benefit and contribution limits

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## ERISA – 1<sup>st</sup> Major Regulatory Action

- State and local government employers are exempt from ERISA
- Often state laws are adopted that are similar to protections afforded in ERISA
- Public sector employers may consider ERISA requirements as fiduciary best practices

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## More Recent Legislative Actions

- Small Business Job Protection Act of 1996
  - Significantly changed Sec. 401(k) and 457 plans
- Economic Growth and Tax Relief Reconciliation Act of 2001
  - Liberalized many retirement plan rules
- Pension Protection Act of 2006
  - Simplified defined benefit plan rules and added additional fiduciary rules and safe harbors for DC plans

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## Legislative Process



- Legislation signed by the President is codified into law
- Regulations may be mandated in laws, or necessary for interpretation
- Guidance may also be provided in other forms
  - Rulings, procedures, notices, announcements, advisory publications

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## Communicating Laws

- Federal tax laws are referred to as Internal Revenue Code
- Explanations/interpretations of federal laws are established in regulations
  - IRS is responsible for guidance pertaining to federal tax laws
  - DOL is responsible for guidance pertaining to ERISA

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## Treasury Regulations

- Issued in proposed, temporary or final form
  - Public offered an opportunity to comment on proposed regulations at public hearings or in writing
  - Purpose of temporary regulations is to offer immediate guidance for a short period of time, before proposed / final regulations are issued
  - Final regulations provide permanent guidance until amended or replaced

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## Revenue Rulings

- Provides IRS **statement of position** with respect to particular tax issue
- Provides official interpretations of related statutes and regulations
- Clarifies and standardizes how the law applies to specific sets of facts

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## Revenue Procedures

- Provides an official **statement of procedure** impacting rights or duties of taxpayers / general public
- Pertains to related statutes and regulations and provides general instructional information

**If a statement of position and statement of practice is needed, both a revenue ruling and revenue procedure will be issued**

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## Private Letter Rulings

- Requested by a single taxpayer (or employer)
- Only applicable to specific question or situation
- Other taxpayers cannot rely on the position taken in the ruling
- Often considered guidance on how the IRS **may** respond in similar situations, but no guarantees

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## Two Additional IRS Documents

*When published in the Internal Revenue Bulletin, Notices and Announcements are considered authority and may be relied on to the same extent as revenue rulings and revenue procedures*

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## Notices



- Public pronouncement that may contain guidance involving substantive interpretations of the IRC
- May be used to relate what regulations will say when not expected to be published in the immediate future

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## Announcements

- Public pronouncement that has only immediate or short-term value
- May summarize law or regulations without making substantive interpretations
- May be used to relate what regulations will say when expected to be published in the immediate future
- May announce existence of an election or approaching deadline

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## Accessing Documents

- For IRS official documents go to [www.irs.gov](http://www.irs.gov)
- For DOL guidance go to [www.dol.gov/ebsa](http://www.dol.gov/ebsa)
- Other on-line resources include:
  - Commerce Clearing House
  - Bureau of National Affairs

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## Role of Government Agencies



Under federal tax laws and ERISA,  
there are a number of government  
agencies that have authority to  
administer and enforce plan rules

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## Internal Revenue Service (IRS)

- Implements and enforces federal tax laws and regulations
- Enforces ERISA provisions applicable to the IRC, including
  - Exclusive benefit rule
  - Maximum deduction rules
  - Participation and coverage rules
  - Vesting and funding requirements
  - Contribution and benefit limits

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## Department of Labor (DOL)

- Employee Benefits Security Administration of the DOL enforces ERISA
  - Formerly known as Pension and Welfare Benefits Administration (PWBA)
- Applicable to private sector employers
- For public sector plans, state laws must be closely monitored to see if there is additional oversight and enforcement on state and local government plans

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## Other Government Agencies

- Pension Benefit Guaranty Corporation protects and insures participant benefits in private sector defined benefit plans
- Department of Justice (DOJ) investigates and prosecutes criminal actions against fiduciaries/others responsible for ERISA plans
  - State's attorney general, district attorney or other law enforcement officials generally responsible for governmental plans

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## Exclusive Benefit Rule

- IRC and ERISA require plans to be operated responsibly and for the exclusive benefit of participants and beneficiaries
- Specific rules and standards imposed on person or institution legally responsible and authorized to act on behalf of the plan
- Institutions / individuals are considered fiduciaries and subject to specific rules and standards

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## Chapter 2

# Fiduciary Role and Responsibilities



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## Fiduciary is a legal term



## Fiduciaries can be held legally accountable

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## Identifying Fiduciaries

- ERISA definition is anyone who
  - Exercises discretionary authority or control over the management of the plan and/or plan assets
  - Renders, or has the responsibility or authority to offer investment advice for a fee or other compensation, direct or indirect for any of the plan assets
  - Has discretionary authority or responsibility in the administration of the plan

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## Identifying Fiduciaries

- Fiduciary may be designated by name or function
- Responsibilities may be delegated to others, but does not remove fiduciary responsibility
- Individuals giving advice or making recommendations may also have a fiduciary role

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## Functional Analysis

- Fiduciaries include anyone who
  - Participates in decisions regarding plan type, features and investments
  - Is on a committee or board member responsible for the plan and/or its investments.
  - Has responsibility to chose or evaluate service providers
  - Has authority to bind the employer through contracts
  - Establishes policies and procedures for the plan or has the ability to make exceptions

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## Who is not a fiduciary?

- Someone who performs administrative functions but does not have authority for discretionary decisions
- Generally not considered fiduciary activities:
  - Applying established rules
  - Preparing communication material
  - Receiving contributions and applying them to accounts
  - Calculating benefits

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## Fiduciary Duties

1. Act solely in the interest of plan participants and beneficiaries
    - Duty of loyalty
    - May not engage in “self-dealing,” acts that serve personal or business interests
- The decision to hire an advisor must be made in the best interest of the plan and participants, not because the advisor (or firm) has a long-standing relationship with the board or committee

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## Fiduciary Duties

2. Maintain the plan and its assets for exclusive purpose of providing benefits
    - Exclusive benefit rule; primary plan purpose is to provide retirement benefits for participants and beneficiaries
- Expenses paid from plan assets must be for the benefit of participants and beneficiaries

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## Fiduciary Duties

3. Act with care, skill, prudence and diligence as a prudent person would in similar circumstances
    - Prudent person rule
    - Investment decisions are often elevated to prudent “expert” rule
- When selecting and monitoring investments, it may be necessary to hire expert services to advise decision makers

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## Fiduciary Duties

4. Diversify plan’s assets to minimize risk unless it is clearly prudent to do otherwise
- Provide suitable, diversified investment choices, and adequate investment education, to enable participants to make decisions that will minimize their investment risk

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## Fiduciary Duties

5. Act in accordance with the plan documents and governing instruments

- Fiduciaries must make sure that the plan document and trust agreements are amended to comply with any changes in federal/state laws and applicable regulations

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## Fiduciary Best Practices

- Governing structure
- Documentation
- Investment selection and monitoring
- Outsourcing decisions
- Plan costs
- Participant communication and education
- Fiduciary education

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## Governing Structure

- Typically based on plan type, size of employer, public versus private sector
  - State statutes and local ordinances provide basic structure for public sector plans
  - ERISA governs private sector plans
- Members of decision making and advisor boards or committees are fiduciaries

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## Plan Governance

- Fiduciaries may be appointed or elected
- There may be multiple committees or staff with responsibilities for the plan
- Staff assigned to the plan may have a fiduciary role
- Public fiduciary meetings should be held as appropriate

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## Investment Committee or Board

- In DB plans: directs and/or oversees the investment of the trust assets
- In DC plans: selects and monitors the plan's investment menu
- Members must comply with fiduciary standards
- Role and responsibilities should be defined in investment policy statement

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## Documentation

- Documentation is needed to demonstrate fiduciary responsibilities have been met
  - Board and committee meetings minutes
  - Rationale for actions and conclusions
  - Policies – including investment policy statement
  - Operational procedures

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## Investment Selection and Monitoring

- One of the most important fiduciary functions
- DB plans: responsible for investing trust assets
- DC plans: responsible for selecting investment options to be made available to participants
- Regardless of plan type, an investment policy statement should be adopted

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## Investment Policy Statement (IPS)

- Sets overall objectives and investment strategies for the plan
- Guides all actions and decisions regarding investments
- If plan investment decisions are outsourced, contractor's IPS should be required and incorporated into the plan's overall policy statement

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## IPS Purpose

- Clarity and direction to plan fiduciaries and professionals
- Consistent evaluation process for selecting and monitoring investments and investment managers
- Continuity when fiduciaries leave employer
- Documentation of processes for managing the plan's investments

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## Outsourcing Decisions

- Service providers often share fiduciary role
- Contracting decisions must be based on the best interest of participants and beneficiaries
  - Selected through competitive bidding process
  - Reviewed and scored by independent panel
  - Justifications for contract award documented
- Monitoring contractors is an on-going process

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## Plan Costs

- Costs must be reasonable and appropriate
- All direct and indirect costs must be identified
- Fiduciaries must be aware of and understand costs



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## Plan Costs

- Employees and participants should be provided full disclosure of their fees and costs
  - Before deciding to participate
  - On participant statements
  - Anytime there are changes
- Clarity of costs is critical to ensure participants are able to make informed investment decisions

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## Communication & Education

***To ensure informed and educated decisions can be made about benefits***

- DB plan
  - Beneficiary elections
  - Benefit value
  - Distribution choices
- DC plan
  - Investment choices
  - Fees and costs
  - Retirement income options

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## Fiduciary Education

- To ensure fiduciary role and responsibilities are understood
- Particularly important for new fiduciaries
- Ongoing training is also important to ensure new issues / monitoring efforts are identified
- “Not knowing” is not a justifiable position

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## Staying Informed

- Federal legislative and regulatory actions
  - Proposals need to be evaluated for impact to the plan and its participants
  - Feedback to policy makers may be warranted
  - Once enacted, plan may need to be amended to remain in compliance
- Monitoring state laws / local ordinances is also important

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## Staying Informed

- Court decisions set precedents that can change interpretations of laws and regulations
- Changes in the retirement and service industries could have an impact on current contractual arrangements, requiring amendments



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## Fiduciary Breach Consequences

- Legal actions
- Potential liability
- Employee distrust
- Public scrutiny



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## Fiduciary Liability

- State or local laws may indemnify individuals acting in an official capacity as a fiduciary
- Fiduciary liability insurance protects plans and trustees against lawsuits for an alleged breach of duty, errors or omissions
- Fidelity bond covers loss of assets due to fraud or dishonesty

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## Additional Protections

- Select board, committee members carefully and monitor their actions
- Outsource to experienced, reputable firms
- Monitor plan and contract compliance
- Conduct regular performance reviews
- Conduct annual audits

## Current Issues

- Structure and administration of retirement plans under intense scrutiny
  - Investment menus
  - Fees and costs
- Plan administrators must ensure fiduciaries have sufficient education and training to understand duties and responsibilities
- *Educated fiduciaries = well managed plan*

## Redefining “Fiduciary”

- DOL issued a proposed rule to redefine definition of fiduciary in 2012
  - Rule was pulled back because of certain concerns but is expected to be reissued
- Security & Exchange Commission (SEC) is also exploring the issue of redefining a fiduciary

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## Recap of Today

- Ch 1: Introduction to Governmental Regulation
- Ch 2: Fiduciary Role and Responsibilities



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## Future Webinars

### May

- Compliance in Form
- Compliance in Operation
- IRS Corrective Programs

### June

- Reporting
- The Role of Independent Professionals in Plan Operation
- Ethics for Retirement Administrators

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## Any Questions?



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