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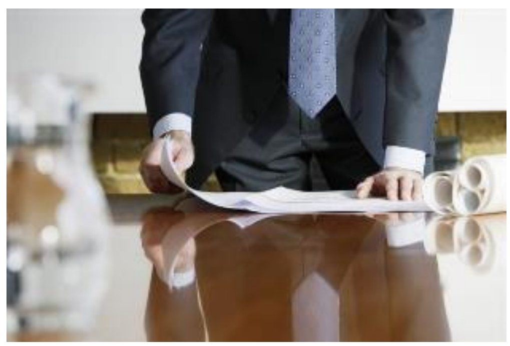
DOL Focuses Audits on Failure to Make Timely Payments to Participants

The DOL is now specifically investigating retirement plans to determine whether plan sponsors have timely begun paying vested benefits to retirement-eligible participants. Issues are not limited to retirement plans and have been found in ERISA severance plans as well. Plan sponsors can avoid criticism by following robust operational policies and procedures.

Background

A number of plan qualification provisions require that retirement benefits be paid to participants and former participants by a particular date. For example, Code Section 401(a)(9) obligates every qualified plan to provide required minimum distributions (RMDs) as soon as a participant reaches his or her required beginning date (generally April 1 following the end of the year in which the participant attains age 70½ or has a termination of employment, if later). Failure to distribute an RMD may result in plan disqualification by the IRS and/or the imposition of a 50% excise tax on the participant or beneficiary. But the DOL also has an interest in such failures.

DOL has broad authority to investigate or audit an employee benefit plan's compliance with ERISA. Audits are performed by the DOL's Employee Benefits Security Administration (EBSA). DOL audits often focus on violations of ERISA's fiduciary obligations and participants' benefit rights and responsibilities.



Fiduciaries have important responsibilities and are subject to certain standards of conduct because they act on behalf of the participants in the plan. These responsibilities include, among other things:

- Acting solely in the interest of plan participants and their beneficiaries, with the exclusive purpose of providing benefits to them and defraying reasonable expenses of administering the plan
- Carrying out their duties with skill, prudence, and diligence
- Following the plan documents (unless inconsistent with ERISA)

Participants can sue the plan and its fiduciaries to enforce or clarify the participants' rights under ERISA and the plan in the following situations:

- To appeal a denied claim for benefits after exhausting the plan's claims review process
- To recover benefits due
- To clarify the participant's right to future benefits
- To obtain plan documents previously requested in writing but not received
- To address a breach of a plan fiduciary's duties
- To stop continuing any act or practice that violates the terms of the plan or ERISA

DOL Targeted Investigations

The DOL has stepped up its investigation of large plans with unpaid pension benefits. The investigations appear to be the result of participants' inquiries after receiving a notice of Potential Private Retirement Benefits from the Social Security Administration following a claim for social security benefits. The results of the investigations suggest that more targeted investigations will not be far behind. One DOL official reported that the undiscounted value of the unpaid pension benefits they discovered was more than half a billion dollars for five or six big plans they audited, and that the largest plan they reviewed so far had over $120 million in back payments owed to participants over the age of 70½.

The DOL investigations have focused on plan procedures to locate missing participants, inform retirement-eligible participants that a benefit is payable, and make required minimum distributions. The DOL found that some retirement plan sponsors do not have procedures in place to ensure the timely payment of retirement benefits to participants and other plans have procedures, but they have not been followed. Additionally, DOL has found errors in plan records where dates of birth are clearly incorrect (e.g., numerous individuals carried with the same "dummy" birth date who all appear to be over 100 years old).

Failure to Timely Pay Plan Benefits Not Limited to Retirement Plans

In addition to performing targeted audits involving retirement plans, DOL's review of payment practices also extends to other plans. In a recent complaint against an ERISA severance plan, DOL found that the plan administrator had paid inappropriate expenses out of plan assets and had also failed to locate missing participants and make distributions to them — to the tune of at least 10,192 participants with benefits due totaling over $13,600,000.

Cost of Non-Compliance

On top of dealing with the disruption of an audit, plan sponsors that are found not to be in compliance with applicable requirements can be subject to penalties. Failure to establish procedures and to follow the procedures may be a breach of fiduciary duty under ERISA. According to the DOL, fiduciaries who fail to maintain, and follow, procedures for ensuring payment of retirement benefits to participants (including lost participants) may have personal liability for any tax consequences to those participants. In addition, ERISA requires an employer to "maintain records with respect to each of its employees sufficient to determine the benefits due or which may become due to such employees" and the DOL can assess a $10 per participant penalty for failure to do so. In extreme cases, for example, where the plan fiduciary intentionally fails to distribute plan benefits, criminal actions may be taken.

In addition, as mentioned earlier, there may be other costs involved in these plan failures. There is the potential for IRS sanctions (up to and including disqualification) that could have tax implications for both the participants and the plan sponsor. And, where plan failures result in negative tax implications for the participant, participants can take legal action against the plan administrator or employer. See, for example, *Davidson v. Henkel*, where a class action settlement agreement of over $3 million resulted from a failure to withhold FICA taxes under the special timing rule — an action that was deemed required under the terms of a nonqualified deferred compensation plan. See our February 29, 2016 *For Your Information* for more on the Henkel case.

Other Reasons for Cleaning Up Data

Clearly, cleaning up plan records, making required distributions, and filing with the IRS under the voluntary correction procedure, if appropriate, is preferable to making these corrections under a stressful situation such as a DOL audit. But there are other reasons for tight distribution procedures.

Plan Terminations and Spin-offs. Regulations under Section 411 of the Code provide a lost participant's benefit under a defined benefit plan may be forfeited as long as the plan reinstates the benefit if a claim is made at a later date (a "conditional forfeiture"). This theoretically enables plan sponsors to exclude the participant and benefit from the PBGC variable-rate premium calculations and the plan's valuation liability on an ongoing basis.

> **Comment.** Plan sponsors will want to assure that plan documentation and procedural rules are in place to support the use of this option. This includes procedures for making a search and documenting the attempts made under the procedures as well as data retention provisions that will support access to suitable data for benefit calculations when needed at a later date.

However, the conditional forfeiture mechanism for missing participants is not available in a standard plan termination, even if the conditional forfeiture took place before the plan termination. In this case, the plan sponsor must either pay the PBGC the value of the benefit or purchase an annuity for the missing participant. Similarly, in a plan spin-off, where each plan must receive assets equal to the assets that would be allocated to the participant in that plan if a plan termination occurred immediately before the spin-off, the allocation of assets upon the plan spin-off should include the benefits for missing participants. This may leave the plan sponsor short of funding at termination and may muddy the waters for spin-off calculations.

Data cleanup can mitigate these problems and increase the effectiveness of selective derisking campaigns for ongoing plans (such as lump sum windows or annuity purchases).

Benefit Overpayments. Another cost of inaction is the lost opportunity to retrieve overpayments. The longer the plan sponsor waits to take action, the more difficult it can be to fashion a correction. In the recent *Montanile* case, the Supreme Court ruled an overpayment from a medical plan was not recoverable because the participant already spent the settlement funds by the time the plan pursued recovery. More commonly for pension plans, direct deposit of pension checks is now routine for most participants, and by the time the plan administrator is informed of a death, several unnecessary pension checks may have been deposited to the participant's account.

Volume 39 | Issue 31 | March 15, 2016

In Closing

To assure meeting their fiduciary responsibilities to plan participants, plan sponsors should perform an internal review to ensure the adequacy of participant records; make sure that effective procedures are in place to ensure the timely payment of benefits to retirement-eligible participants and to locate missing participants with vested benefits; and ensure that they are following those procedures. If issues are found, corrective action should be taken as soon as possible.

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