

1 **An Overview of Changes in the 401(k) World – What You Need to Know**

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2 **Retirement Plans Before ERISA**

The first employer sponsored pension plans were established in the late 19th century in the railroad industry

Congress first gave pension and profit-sharing plans preferential income tax treatment in the 1920s

The Revenue Acts of 1938 and 1942 outlined specific requirements for “tax-qualified” status

During the Second World War, pensions were exempt from wartime wage controls, which led to more creative total compensation structuring

In the late 1940’s, pensions were subjected to collective bargaining¹

The introduction of higher marginal tax rates and the expansion of the income tax to more households made pensions more valuable

3 **The Emergence of ERISA**

As the number and size of pension plans grew in the 1950s and 1960s, so did the instances of the misuse of pension plan balances

In 1958, Congress passed The Welfare and Pension Plans Disclosure Act, which required public disclosure of plan finances²

When Studebaker terminated its underfunded pension plan in 1963 leaving thousands of people without promised pensions, Congress started considering legislation to secure private sector pensions

In the early 1970s, both the House and Senate labor committees drafted bills to regulate the private pension system

The Employee Retirement Income Security Act of 1974 (ERISA) was signed into law by President Gerald Ford on September 2, 1974³

4 **ERISA – The Basics**

The plan fiduciary’s responsibilities include:

- Acting solely in the interest of the participants and their beneficiaries⁴
- Acting for the exclusive purpose of providing benefits to workers⁵ participating in the plan and their beneficiaries

- Paying only reasonable plan expenses⁶
- "Carrying out duties with the care, skill, prudence and diligence of a prudent man acting in a like capacity and familiar with such matters would use"⁴ – Prudent Expert v. Prudent Man Rule⁷
- Following the plan documents⁸
- Diversifying plan investments⁹

5 **The 401(k) Surprise**

The Tax Reform Act of 1978 added paragraph (k)¹⁰ to § 401 in order to make cash-deferred profit-sharing plans less discriminating, but included

26 USC § 401(k)(2)(A)

- "under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash;"

Ted Benna of Johnson Cos., a consulting company, designs a benefit plan that encompasses salary deferrals and not just bonuses in 1980

Initially, contributions were limited to \$45,475 and contributions were not subject to payroll or FICA taxes¹¹

2012 Federal Reserve data reflects over 650,000 plans with over 88 million participants holding over \$4 trillion dollars in assets¹²

6 **From Then to Now – Prominent Developments**

The Pension Protection Act of 2006

ERISA covered defined contribution plans were given guidelines regarding:

- Auto enrollment of participants¹³
- Negative election¹⁴
- Auto escalation of participant deferrals¹⁵
- Qualified Default Investment Alternative (QDIA)¹⁶
- Portability¹⁷
- Participant investment advice¹⁸

7 **A Game Changer – The LaRue Case**

LaRue v. DeWolff, Boberg & Associates

- On February 20, 2008 the US Supreme Court authorized suits for individual DC plan participants for fiduciary breaches that "impair" the value of their account
- This rejected a prior Supreme Court ruling from 1985 that permitted claims only on behalf of a plan through a class action suit
- The Court's decision was based on the fact that most tax-qualified corporate retirement plans are now defined contribution instead of defined benefit
- This ruling significantly increased the liability exposure of a plan's trustee
- Significant amounts of litigation have stemmed from this ruling

8 **The Roth 401(k) Option**

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) authorized the establishment of the Roth 401(K) plan option¹⁸ beginning January 1, 2006 – the IRS finalized the rules December 30, 2005.

Provisions are different from those of the Roth IRA:

- Contributions are fully vested at all times
- Balances may be used to determine available loan amounts
- Same distribution rules as pre-tax contributions apply
- Recharacterization is not allowed
- As of January 1, 2013, the entire vested balance is conversion eligible¹⁹
- Roth Qualified Automatic Contribution Arrangement (QACA) is possible
- Roth 401(k)s are subject to RMD rules unlike the Roth IRA
- Roth 401(k) balances rolled to a Roth IRA have a new qualification clock for tax exempt distributions if a qualified Roth IRA has not been established (most participants and brokers do not know this fact and it has caused a lot of difficulties!)

9 **Required Disclosure Notices**

Costs for qualified corporate retirement plans have been a focus of studies and the research has found that many plans may have higher plan and participant expenses than is necessary

On October 20, 2010, enhanced disclosure notice regulations were published²⁰ by the Department of Labor:

- 404a-5 disclosures will hopefully help participants invest more efficiently

The DOL published final regulations for plan service provider disclosures on February 3, 2012²¹:

- 408(b)(2) disclosures will hopefully help trustees make better decisions on service providers

10  **Plan Authorized Investment Advice Is Here**

In the Pension Protection Act of 2006, Congress amended ERISA and the IRC to provide prohibited transaction exemption to allow fiduciaries to be compensated for investment advice under “eligible investment advice arrangements”

Final regulations were published on October 11, 2011 and became effective on December 27, 2011²²

Participant advice does not have to be provided or allowed by the plan, but if it is it must conform to an approved model²³ :

- The investment advisor must be a fiduciary
- Fee leveling must be used
- The advice may be given by an individual using accepted financial principles or delivered through an accepted computer model

11  **Same-Sex Marriage Benefits Confirmed**

On June 16, 2013, the Supreme Court ruled in *United States v. Windsor* that section 3 of the Defense of Marriage Act (DOMA) is unconstitutional

On August 29, the IRS issued regulations²³ related to the ruling and the DOL provided guidance²⁴ on September 18

Some 401(k) plan benefits that have been impacted due to the DOMA ruling are:

- Death Benefits
- Qualified Joint and Survivor and Qualified Pre-Retirement Survivor Annuities
- Spousal Consent for beneficiary Changes
- Qualified Domestic Relations Orders (QDROs)
- Hardship Distributions

12  **Other Important Court Cases**

Hellman v. Cataldo – rejecting long standing precedent, an Eighth Circuit district court allowed an ERISA jury trial to proceed

Santomenno et al. v. John Hancock Life Insurance Co. et al – case was dismissed as John Hancock was not deemed a fiduciary for any of the alleged actions – the plans’ trustees selected John Hancock’s platform

Beesly v. International Paper – one of the original excessive fee cases filed on September 11, 2006 was settled for \$30 million, a significantly different outcome than in *Hecker v. Deere* (2009) in which neither lack of “revenue sharing” disclosure nor inclusion of excessive fee funds in a plan menu were ruled to expose fiduciaries to a fiduciary breach

Leimkuehler v. American United Life Insurance Co. – Building on *Hecker v. Deere*, a vendor that reserved the right to change a menu’s funds did not commit a fiduciary

breach by not changing to a lower cost share class – the responsibility is the trustee's

13  **Looking to the Future**

President Obama's budget proposal would have capped qualified account balances at a level that would fund an annual defined benefit limit

The Treasury Department and the Department of Labor have been exploring structures that mandate corporate plans and investments since 2011

California proposes its "State-Run" Auto-IRA program for all non-governmental employers with 5 or more employees – 3% required withholding

14  **References**

1. Inland Steel Co. v. National Labor Relations Board, 170 F.2d 247 (7th Cir. 1948). cert. denied, 336 U.S. 960 (1949).
2. P.L. 85-836, 72 Stat. 997 (Aug. 29, 1958).
3. Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 5 USC, 18 USC, 26 USC, 29 USC, and 42 USC).
4. 29 USC § 1104 (a)(1).
5. 29 USC § 1104 (a)(1)(A)(i).
6. 29 USC § 1104 (a)(1)(A)(ii).
7. 29 USC § 1104 (a)(1)(B).
8. 29 USC § 1104 (a)(1)(C).
9. 29 USC § 1104 (a)(1)(D).
10. Prior to 1978, there was a subsection (k) to Section 401, but it was simply a cross reference to the qualified trust rules in IRC § 501(a). The cross reference was redesignated as subsection (l).

15  **References**

11. 44 Fed. Reg. 55544 (daily ed. November 10, 1981).
12. US Department of Labor. Private Pension Plan Bulletin – Abstract of 2010 Form 5500 Annual Reports.
13. 26 USC § 401(k)(13)(C)(i).
14. 26 USC § 401(k)(13)(C)(ii).
15. 26 USC § 401(k)(13)(C)(iii).
16. 71 Fed. Reg. 56806 (Sept. 27, 2006).
17. 26 USC § 408(g)(3) and 408(b)(14).
18. 26 USC § 402A
19. 26 USC § 402A(c)(4)(E)
20. 29 CFR § 2550.404a-5, Ref. 29 CFR § 2550.404c-1

21. 29 CFR § 2550.408b-2
22. 76 Fed. Reg. 66136 (daily ed. October 25, 2011)

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16  **References**

23. Rev. Rule 2013-17
24. Tech. Rel. 2013-04