A Fiduciary Responsibility Checklist for Sponsors of Defined- Contribution and Deferred-Compensation Retirement Plans

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Over the past five to 10 years, many employer-sponsored retirement plans – both private and public – have shifted some responsibility, risk and costs to employees through defined contribution and deferred compensation plans (DC plans). This transition from traditional defined-benefit pension plans (DB plans) is an indicator of our changing economic environment. The U.S. government has even discussed shifting Social Security benefits to individual accounts, similar to DC plans. Although the proposal for personal accounts has not passed, ever-increasing future liabilities, coupled with difficult budgeting situations, make this transition a possibility for Social Security, as well as many other pension plans.

Understanding the parallel between Social Security and DB plans is important, since some pension plans are in the same predicament. Increasing costs of benefits, investment market volatility and other factors continue to drive up costs of DB pension plans; however, plan sponsors must continue to pay the promised benefit to retirees. As a result, local governments might have to contribute higher amounts into the plan, even with concerns over budget constraints.

Utilizing DC plans to better define future costs is one solution that plan sponsors are considering. DC plans such as the 401(k), 457(b) and 401(a) have a guarantee of contribution rate, or “match,” rather than a guaranteed benefit.

**Defined Contribution**

A defined contribution plan does exactly what it says – it defines the contribution rate or amount contributed by the employer and/or the employee as a percentage of salary. Contributions are made to an employee’s individual account, rather than a single pooled account. A defined contribution (or 401(a) plan for public plans) has vesting requirements, which reward employees for tenure through regular and continuous contributions. Distributions from the account are not taxed until the employee withdraws funds during retirement.

**Deferred Compensation**

In a deferred compensation plan, employees actually defer their compensation until retirement, ideally when they are in a lower-income tax bracket. Employees elect a percentage of their salary (and may contribute up to $17,000 in 2012). Employees over the age of 50 may contribute an additional $5,500 as a catch-up contribution. Lastly, employees within three years of normal retirement age (as defined by the plan) who have not exhausted their annual maximum contribution in prior years may also make additional catch-up contributions.

Deferred compensation offers significant tax deferral for the employee. In 2010, legislation was passed for 457(b) accounts to offer a Roth provision. Roth account contributions are made with after-tax dollars. The benefit of this type of account is for employees who plan to have a higher income during retirement.

DC plans are appealing to employers from a potential cost-control perspective, and employees may benefit from more flexibility and personal control of the selection of investment funds. DC plans may offer many investment choices, allowing more ways for employees to plan for their individual retirement. Employees may invest according to their age and risk tolerance. Although employees make investment choices and bear the market risk in a DC plan, employers still play an important role as fiduciary.
Fiduciary Responsibility

Now that we know the difference between the types of DC plans, what does being a fiduciary of these plans really mean?

A fiduciary is typically defined as a person acting on behalf of another with regard to financial decisions and responsibility. Fiduciaries are typically power of attorneys, financial advisers or trustees. A fiduciary can also be a company or an employer in an influential capacity that provides financial guidance and assists with important decision making. If your local government offers a 401(a) or 457(b) plan, is it the fiduciary? Is your third-party administrator a fiduciary? Are you a fiduciary in your position with your local government?

When it comes to providing DC benefits, the answer may be more complicated than you think. According to the IRS, a plan fiduciary is defined as “anyone who exercises discretionary authority or discretionary control over management or administration of the plan, exercises any authority or control over management or disposition of plan assets, or gives investment advice for a fee or other compensation with respect to assets of the plan.” So the answer may be yes to all of the questions above. If this is true, what are your fiduciary responsibilities?

Employee Retirement Income Security Act of 1974

Although public retirement plans are not required to follow the Employee Retirement Income Security Act of 1974 (ERISA), the law acts as a benchmark for local-government plan sponsors and plan administrators. ERISA directly relates to fiduciary responsibility. It not only sets standards but acts as a resource for employers while providing protection for employees. The IRS gives many fiduciary responsibilities to plan sponsors, such as approval of early retirement withdrawals. It is important to know how local government retirement plans differ from private plans. Unlike an IRA or 401(k), early withdrawals from a 401(a) and 457(b) cannot be taken for first-home purchase or higher-education expenses.

The ERISA regulation was enacted to provide a thorough definition of fiduciary responsibility. According to the U.S. Department of Labor, ERISA “requires plans to regularly provide participants with information about the plan including information about plan features and funding; sets minimum standards for participation, vesting, benefit accrual and funding; requires accountability of plan fiduciaries; and gives participants the right to sue for benefits and breaches of fiduciary duty.” ERISA states that plan trustees, plan administrators and members of a plan’s investment committee are all plan fiduciaries.

Understanding the advantages and disadvantages of each pension plan, being aware of ERISA, and knowing the IRS guidelines for contributions and distributions are a great start to understanding your fiduciary responsibility. Below is a list of a few important components of this responsibility:

Fiduciary Responsibility Checklist

☑ **Documentation:** Document everything. It is imperative to keep paper and electronic files of any retirement paperwork (election, enrollment, beneficiary forms, etc.), correspondence, meetings and conversations regarding all retirement plans between the employer, employee and plan sponsor. Documentation and proof of eligibility for hardship withdrawals from 401(a) and 457(b) accounts, according to IRS guidelines, is imperative. Plan sponsors must keep the participants’ eviction/foreclosure notice or proof of medical payments on file.

☑ **Create a pension and investment committee and an investment policy statement:** This committee will help communicate the goals of the local government and the participants with the plan administrator. Having this committee in place will allow an additional resource for employees, as well as a voice of the employees to any third-party administrators (i.e., the Florida League of Cities). The investment policy statement will help clearly define the expectations of the investment guidelines and managers.

☑ **Schedule regular meetings with your plan administrator for your participants:** Establish monthly, quarterly or at least annual one-on-one meetings between the participant and the plan administrator. Participants are given the opportunity to modify their investment objectives, evaluate market returns and discuss their retirement goals.
☑ **Summary plan document:** This should be provided to each employee when hired or when considering retirement. When any changes are made, a new summary plan document should be provided to each employee.

☑ **Understand distributions from 401(a) and 457(b) accounts:** Distributions from 401(a) and 457(b) plans are prohibited, except in the case of retirement, separation from service, or if the participant has an immediate and heavy financial hardship.

» 401(a) Hardship exceptions include expenses for medical payments not covered by insurance, and eviction or foreclosure. Hardship distributions from a 401(a) account will be subject to federal and state income taxation. A participant who is under age 59½ at the time of the distribution may be subject to a penalty tax of 10 percent of the distribution.

» 457(b) Hardship exceptions/unforeseeable emergencies include a sudden and unexpected illness or accident, loss of property due to casualty loss (e.g. due to a natural disaster), or other similar extraordinary and unforeseeable circumstances arising from events beyond the individual’s control. Distributions from a 457(b) account are subject to federal and state income taxation. Participants who are under age 59½ at the time of the distribution will not be subject to a penalty tax of 10 percent of the distribution.

Although more and more traditional defined benefit plans are transitioning to defined contribution and deferred compensation plans, plan sponsors still have fiduciary responsibility. Within a DC plan, participants have more personal control of their investments, but plan sponsors still must be responsible for providing the necessary plan information and documentation to participants, organize and assist participants with plan administrator regular meetings, and have an investment advisory committee to act as a liaison for the participant. This fiduciary checklist highlights just some of the responsibilities required as a plan sponsor, but there are many more to consider.

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**Find Out More**

For more information on this topic, see the following websites:

» Meeting Your Fiduciary Responsibilities, U.S. Department of Labor, Employee Benefits Security Administration:  
  www.dol.gov/ebsa/publications/fiduciaryresponsibility.html

» The Employee Retirement Income Security Act, U.S. Department of Labor, Employee Benefits Security Administration:  
  www.dol.gov/compliance/laws/comp-erisa.htm

» Benefits Practitioner/Plan Participant/Employee Plan Sponsor/Employer Definitions:  
  www.irs.gov/retirement/participant/article/0,,id=211142,00.html