

Retirement Times

NEWS AND UPDATES FOR RETIREMENT PLAN SPONSORS AND FIDUCIARIES

WHAT HAPPENS WHEN YOU DEPOSIT EMPLOYEE DEFERRALS LATE?

In our research, late deposit of contributions is a frequent error made by plan sponsors and is a key priority of the Department of Labor (DOL). In our experience, during every plan audit conducted by the DOL, the investigator looks to see if contributions have been deposited in a timely manner.

A number of years ago, the DOL revised the instructions to Form 5500 requiring plan auditors to review and confirm that contributions are made in a timely manner. For this reason, it is unlikely that late deposit of contributions will go undetected in the case of plans subject to the audit requirement.

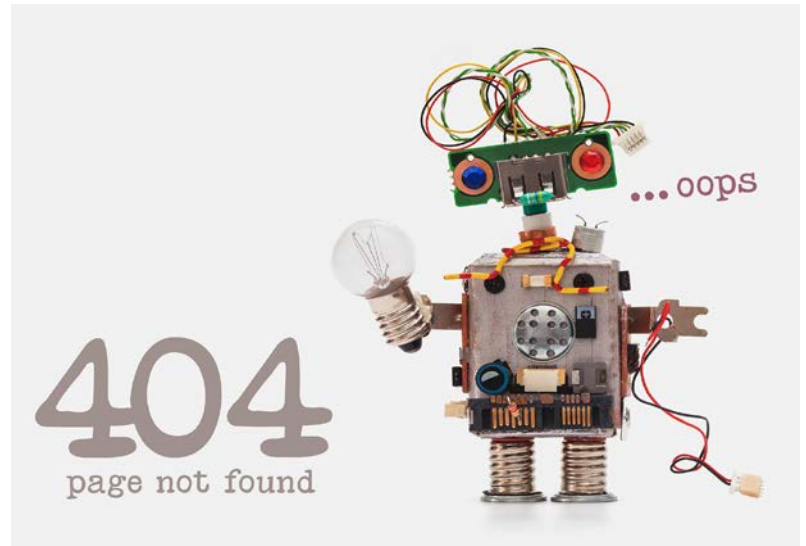
The essence of the requirement to deposit deferrals quickly is that once these amounts are withheld from employee paychecks, they become plan assets and therefore must be held in trust. It is a prohibited transaction for a

sponsor to continue to hold these amounts after they have become plan assets.

Deadlines for Depositing Contributions

ERISA requires plan sponsors to deposit these amounts in the plan trust as of the earliest date they can “reasonably be segregated” from the sponsor’s general assets. Although this timeframe is somewhat subjective, there is an outer limit which is the 15th day of the following month.

This period is sometimes interpreted as a safe harbor, in the sense that the rule has been complied with so long as the deposits are made by the 15th day of the following month. However, the DOL has made clear on many occasions that this is not the case. There is rarely a situation where a sponsor can wait this long to make deposits.



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In determining whether contributions have been made in a timely fashion, investigators look at how long it usually takes the sponsor to make deposits as the standard. For example, if contributions are generally deposited within two to three days after being withheld from employee paychecks, two to three days is seen as the standard. If a deposit for another pay period is delayed for a month, it would be considered late.

Small plans (less than 100 participants), although not subject to plan audit requirement, must still comply with the timeframe for depositing deferrals. However, the ERISA regulations allow a seven-day safe harbor period for small plans. As such, deposits made by small plans will be deemed timely if made within seven business days following the date withheld from employee paychecks.

What Steps are Required When Deposits are Late?

When it is detected that deferrals have not been deposited in a timely manner, the sponsor must follow four steps of action:¹

1. Deposit these amounts as quickly as possible;
2. Calculate and deposit the lost earnings on these contributions to compensate participants for loss of investment opportunity due to the delay;

3. Report the late contributions on Form 5500 for the year in question; and
4. Pay the excise tax on the prohibited transaction.

There are two approaches to correcting late contributions – filing under the DOL’s Voluntary Fiduciary Compliance Program (VFCP) or self-correction. Most sponsors elect self-correction, rather than undertake the expense and effort involved in completing a filing under the VFCP.

When a sponsor elects self-correction, lost earnings can be calculated using the interest rate imposed by the Internal Revenue Service on the underpayment of taxes, essentially the same rate as the DOL’s online calculator. However, the plan’s actual investment return must be used if this is greater. The interest on underpayment of taxes can be in the range of 4-to-6 percent.

The excise tax on the prohibited transaction must be paid. The return used to pay this tax is Form 5330. Although this form is six pages in length, it is relatively simple to complete. The tax is 15 percent. This tax is assessed only on the lost earnings and not the late contributions themselves, so the amount of the tax is generally not significant - often less than \$100.

If a sponsor elects to do a filing under the VFCP, it must still complete the first three steps above. The main disadvantage of this approach is that

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the application is time-consuming and cumbersome. It must describe in detail why deposits were not made within the required timeframe and the method of correction, and they will have to do so under penalty of perjury.

However, there are three distinct advantages to filing under the VFCP. First, generally the DOL will not recommend a plan for audit where the late contributions are revealed through a VFCP filing.

The second is that the online calculator may be used to calculate lost earnings regardless of the plan's actual investment return. As mentioned above, the rate for the online calculator is in the range of 4-to-6 percent, far below typical investment returns in recent years.

The third advantage is excise tax relief. This relief is available if three conditions are met:¹

1. Late deposits were made to the plan within 180 calendar days of the date these amounts were withheld from employee paycheck;
2. The applicant has not filed under VFCP in the three years prior to the submission date; and
3. If the amount of the excise tax exceeds \$100.00, a notice of the filing is provided to plan participants affected by the delinquent deposits within 60 days of the date of the submission.

Summary

Don't get into a bind with the DOL by depositing employee deferrals late. If deferrals are late, be sure to follow the action steps to rectify the situation.

¹"401(k) Plan Fix-It Guide - You Haven't Timely Deposited Employee Elective Deferrals." 401k Plan Fix It Guide You Have Not Timely Deposited Employee Elective Deferrals | Internal Revenue Service, www.irs.gov/retirement-plans/401k-plan-fix-it-guide-you-have-not-timely-deposited-employee-elective-deferrals.

IS IT TIME FOR A PLAN REFRESH?

The duty to provide participants with sufficient information to make consistently informed retirement investment decisions is a basic fiduciary responsibility under ERISA Section 404(a). However, there could be some plan committees who feel their participants are not consistently making prudent decisions.

According to a recent JP Morgan survey,¹ nearly 75 percent of participants say they are not confident with selecting investments. It is no surprise they found that 80 percent of participants surveyed have portfolios that do not match their stated risk tolerance. Also, according to an Investment Company Institute (ICI) research report,² only six percent of participants changed their asset allocation in 2016. This percentage has been similar since

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2007 including during the 2008 market crash. No rebalancing after violent market movement? This does not look like “consistently informed investment decisions” as per ERISA.

Plan refresh is a process by which participants are notified that all existing assets and future contributions will be invested in the plan’s target date fund (TDF) (Qualified Default Investment Alternative (QDIA)) based on each participant’s date of birth, unless the participant notifies the plan otherwise. This is the same process as for other QDIA default actions.

The primary motivation for a plan refresh should be to improve participant investing. Assuming an appropriate TDF is offered as QDIA, why not affirm to participants that this is typically where they should invest, as opposed to giving them an array of mutual funds and anticipating that they will choose prudently? Surveys show that employees look to their employers for messaging which they assume to be in their interest.³ For many employers it seems this messaging may not be working and often results in participant confusion and imprudent investment selection, thereby diluting retirement readiness. A plan refresh could help solve this problem and also can have significant fiduciary liability mitigation benefits.

Benefits of investment refresh:

For participants this can help: 1) improve asset allocation*; 2) solve for use of any imprudent

investments that may be in menu; 3) solve for legacy assets (prior default no longer appropriate); 4) solve for employees who asked HR what may be a suitable investment option; 5) solve for inertia; and 6) solve for rebalancing investments.

We find that refresh is frequently used at the point of a recordkeeper change or menu reconstruction. Assuming that doing a refresh makes sense and yields the type of results you want to see, why wait for a recordkeeper change?

Unfortunately, there is a pervasive misperception that participants may push back, as was anticipated when auto enrollment was first introduced. Let’s look at the data:

1. According to JP Morgan Plan Participant Research in 2016, one in two participants would rather push the easy button
2. 75 percent of participants are not confident they know how to best allocate contributions
3. 82 percent of participants support employers conducting a re-enrollment

Often, many re-enrolled participants stick with the default investment long term. With good communication, pushback can be often non-existent, as with original auto enrollment.

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Another misperception is that participants will opt out. Vanguard noted that the percentage of participants who fully opt out of refresh remains low. In fact, after one year, QDIA was held by 92 percent of participants and captured 81 percent of plan assets. A small group, 7 percent of participants, held what Vanguard described as “extreme” positions, a group that it said was comprised predominantly of participants who fully opted out of the target date default fund and constructed their own portfolios. This is exactly how refresh is supposed to work.⁴

We’ve covered the symptoms, diagnosis, prognosis, prescription and implementation. Can you recall a business decision that appears so clearly beneficial for plans, their participants and fiduciaries? If a situation were presented and you were faced with making a decision that impacted the productivity or profitability of your ... would you not consider taking action?

**Asset allocation does not protect against loss of principal due to market fluctuations. It is a method used to help manage investment risk.*

¹J.P. Morgan Plan Participant Research 2016. <https://am.jpmorgan.com/gi/getdoc/1383355101755>

²ICI report. https://www.ici.org/pdf/ppr_16_rec_survey_q4.pdf

³NYU Law Review. “The Behavior of Defined Contribution Plan Participants.” 2002. www.nyulawreview.org

⁴Vanguard. Reenrollment: One year later. 2017. <https://institutional.vanguard.com/iam/pdf/REEROLL.pdf?cbfFor ceDomain=false>

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