PLAN SPONSOR
Digest

Issue 1, 2021

Your Challenge, Our Solutions™

A checklist for plan sponsors

Plan sponsors should periodically review their plan's provisions and features to ensure the plan continues to operate at maximum effectiveness.

Once a retirement savings plan has been approved and is in place, it's tempting to sit back and adopt an "I'm done," hands-off attitude. However, to ensure that a plan will continue to operate effectively, employers should periodically review plan provisions and features. Here are some points to check.

- **How the plan is presented.** The more convinced employees are of the wisdom of saving for retirement, the greater the level of employee participation. The greater the participation, the more the plan can benefit all employees—including highly compensated ones. Regular meetings, newsletters, and handouts are effective means of communicating plan advantages. Check to make sure printed materials are up to date and easy to understand, and distribute them frequently.
- **Plan investments.** Employers that sponsor participant-directed plans can limit potential legal liability for losses caused by employees' investment decisions if plan investment choices meet certain requirements under Section 404(c). Very generally, where 404(c) protection is sought, a plan should offer at least three "core" investment choices, allow employees to switch investments at least once each quarter, and provide participants with adequate disclosure of specified investment information.
- **Administration.** Participants and beneficiaries must be given a copy of the Summary Plan Description (SPD) within 120 days after a plan is adopted or within 90 days after becoming eligible to participate in the plan or receive benefits. Review the SPD to make sure it accurately describes the provisions of your plan. If changes have been made to the plan document—which is likely, given the recent tax law changes—then all participants must receive a notification of these changes within 210 days after the end of the plan year in which the changes were adopted. Generally, all participants must receive a copy of the SPD every five years.
- **Summary annual reports (SARs).** Summary annual reports must be distributed to participants within nine months after the close of the plan year. If a plan receives an extension to file its annual report (Form 5500) with the IRS, then the SAR must be distributed within two months after the end of the extension.
- **Plan rollovers.** Qualified plans must allow a participant to elect direct rollover of any eligible distribution to an IRA or another employer-sponsored retirement plan. Your plan should have procedures in place to handle direct rollovers.

Continued on page 2

Continued from page 1

- **Bonding.** Generally, plan fiduciaries and others who handle the assets of a plan must be bonded. The bond must be equal to at least 10% of the funds handled by the bonded individual, but cannot be for less than $1,000 and need not be for more than $500,000.
- **Loans to participants.** Loans that are not properly administered may be treated as constructive distributions resulting in taxable income to the recipients. Review loans to make sure that loan balances do not exceed the maximum limitations. Unless used to finance the purchase of a principal residence, all loans must be repaid within five years. A plan may impose more stringent conditions on loans than the law requires.
- **Plan forms.** All forms should meet current requirements. Forms that may need updating include beneficiary designation forms, benefit election forms, and the notice of distribution options.

Check fiduciary liability coverage

Qualified retirement plan sponsors should review their fiduciary liability coverage to make sure they have adequate protection.

Employers that sponsor 401(k) and other defined contribution retirement plans should review their fiduciary liability policies to make sure they provide adequate protection. Here's some information you may find helpful when you check your coverage.

Fidelity bonding is not fiduciary liability insurance

Retirement plan fiduciaries face personal liability exposure that will not be protected by a fidelity bond. The pension law (ERISA) generally requires that every fiduciary of an employee benefit plan and any other person who handles plan money be covered by a fidelity bond. The fidelity bond protects the retirement plan against misappropriation of funds by individuals handling the plan's assets. However, the fidelity bond does not protect against claims for losses sustained because of a breach of fiduciary duty.

Fiduciary liability insurance protection

Fiduciary liability insurance provides protection for trustees and other plan fiduciaries in the event of a breach of fiduciary duty. These policies typically cover settlements or judgments. Wrongful acts that may be covered by fiduciary liability insurance include:

- Negligent investment practices
- Failure to diversify investments
- Failure to file required reports
- Conflicts of interest
- Errors in computing eligibility
- Inadequate instructions to beneficiaries that cause a loss of benefits

The benefit plan itself can purchase fiduciary liability insurance. However, the policy must allow the insurer to seek recourse against the fiduciary if it is determined that the fiduciary breached his or her duty to the plan.

Commonly, the employer purchases the insurance as part of the overall compensation package of company executives who assume responsibility over the company's benefit plan.

Check coverage carefully

Fiduciary liability insurance coverage varies widely from policy to policy, so it's important to check what is covered in your policy and determine if you need additional coverage.

Occurrence or claims-made policies. Most policies are claims-made policies that only cover claims made and reported during the policy period. Look to obtain an occurrence-basis policy that covers all acts that occurred during the policy period, no matter when claims are made.

Aggregation of wrongful acts. If "wrongful act" is defined vaguely in a policy, insist upon a clear,

Continued on page 4

Continued from page 3

objective definition. A wrongful act is generally defined as a breach of duty under ERISA, another federal law, or state law. And, if multiple wrongful acts may be treated as part of an interrelated series of wrongful acts, negotiate the elimination of this provision. Otherwise, this aggregation provision may allow the insurer to allocate a new claim as part of a prior claim, which may limit what is paid on the claim (in the event that the policy's annual limit is unavailable to pay the claim).

Nonrecourse riders. If the policy is purchased with plan assets, the policy must allow the insurer to recover any paid losses from the fiduciary whose breach caused the loss. To protect themselves, individual fiduciaries can purchase nonrecourse riders. Under a nonrecourse rider, the insurer waives its subrogation rights against the fiduciaries in cases that do not involve fraud, willful neglect, or criminal wrongdoing.

Defense costs. To help ensure adequate defense coverage, fiduciaries may want to purchase a separate defense policy, since many policies count any costs of defending an action against the overall policy limit. Also, a policy may require you to accept defense counsel appointed by the insurer. Purchasing a separate defense policy will allow you to name your own defense counsel.

Punitive damages or fines. Since most policies will not pay punitive damages, you may want to negotiate coverage of punitive damages. Even if a policy covers the 20% penalty tax on fiduciary violations, it may not cover the 15% initial excise tax on prohibited transactions.

60 South Sixth Street | Minneapolis, MN 55402

20-20-04121_20181-CC (12/20)