DRSUpdate

Retirement solutions for the digital age

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Using Plan Assets To Pay Expenses

SITUATION: Our company currently picks up all the costs of operating our 401(k) plan. We are looking at using plan assets to pay for some of our plan's expenses.

QUESTION: Which plan expenses can be paid from the assets of a retirement plan?

ANSWER: Only certain plan expenses can be paid using the plan's assets. The U.S. Department of Labor (DOL) applies strict standards in determining the types of expenses employers can pass on to the plan. You need to be very clear on what is permissible and what is not so that you do not inadvertently violate the pension law.

DISCUSSION: Basically, plan assets can be used only for two purposes: to pay benefits to participants and beneficiaries and to pay the *reasonable* expenses of administering the plan. The administrative expenses of a 401(k) plan that *are* payable from plan assets include amounts paid for:

- Plan recordkeeping
- Routine nondiscrimination testing
- Trustee fees
- Preparation and distribution of benefit statements
- Plan accounting
- Safekeeping of plan assets
- Annual compliance auditing
- Preparation of Form 5500 and other legally required reports
- Claims processing
- Legal fees for determining if a domestic relations order is qualified (disclose in the summary plan description)
- Participant communications
- Third-party administrative expenses

A variety of expenses related to plan investment services, including management fees (investment advisory or account maintenance fees) and sales charges, also may be paid from plan assets.

What expenses *must* the employer/sponsor pay? Referred to as "settlor" expenses, they include amounts related to the establishment, design, and termination of a plan, such as legal or consulting services. Because settlor functions are essentially business-related activities, the employer is responsible for paying the associated expenses.

If a plan says that the employer will pay the plan's administrative expenses, the plan can be amended to provide for the plan to pay those expenses on a prospective basis. You should talk with your plan advisor about potentially amending your plan before you make any changes in your expense payment policies.

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Managing the Use of Plan Loans

A plan loan feature can be a useful tool for helping to increase plan participation and contribution rates. Nevertheless, plan loans may impede employees' efforts toward achieving their long-term retirement goals and complicate plan administration. Following is a general discussion of some of the issues surrounding plan loans and suggestions for addressing them.

Understanding the Rules

Two sets of rules must be complied with when a plan maintains a participant loan program — those under the pension law (ERISA) and the tax rules set forth in the Internal Revenue Code. Generally, ERISA rules provide that loans will be exempt from treatment as prohibited transactions if, under the plan, loans are available to all participants on a "reasonably equivalent basis," are not made available to "highly compensated employees" in amounts greater than to other participants, are adequately secured, are extended at a reasonable rate of interest, and comply with the plan's terms.

The Internal Revenue Code contains parallel prohibited transaction provisions. The income tax rules also provide that, generally, a loan from a qualified plan will not be treated as a taxable distribution if it must be repaid within five years (except for certain home loans) and doesn't exceed the lesser of: (1) $50,000 or (2) the greater of (a) half the present value of the employee's nonforfeitable accrued benefit under the plan or (b) $10,000. (The limits are somewhat different where an employee has more than one loan.) The tax law also requires that a loan be amortized in substantially level payments, at least quarterly, over its term. An exception applies while an employee is on unpaid leave for up to one year (or possibly longer for those in the uniformed services).

Responsibilities

When a plan allows loans, plan sponsors should make sure they have appropriate procedures in place to keep track of each loan. In a broad sense, loan administration involves determining the right of the employee to take a loan, ensuring that the employee makes loan payments on a timely basis, and promptly identifying loan defaults. The IRS recommends that sponsors retain the following information for each plan loan:

- Evidence of the loan application, review, and approval process
- An executed plan loan note
- If the loan is for buying or constructing a primary residence, documentation verifying that the loan proceeds were used for that purpose
- Evidence of loan repayments
- Evidence of collection activities for defaulted loans, if any

Curbing Enthusiasm

To reduce the overuse of plan loans, sponsors may want to begin by educating participants about these potential disadvantages of taking loans from their retirement plan:

- Loan repayments are made with after-tax money
- Income taxes are paid again on distributions
- It may be difficult to save for retirement and pay back a loan at the same time
- Generally, loans must be paid back when the employee leaves
- If the loan is not repaid, the outstanding balance is treated as a taxable withdrawal subject to income tax and a possible 10% tax penalty

Additionally, sponsors may want to consider amending their plans to provide for some or all of the following:

- Limiting the number of loans participants can have outstanding at one time
- Implementing a waiting period between loans
- Not permitting borrowing from employer contributions
- Not allowing employees to refinance loans
- Restricting the loans to specified purposes only
- Making loans available only to active employees and not to terminated participants or plan beneficiaries

Other options include increasing the loan origination fee or processing charges. If fees incurred by the plan to set up and administer loans are reasonable and permitted under the plan document terms, they may be charged to the participant's account.

Giving participants the ability to take out a loan can reassure employees that they have access to their account assets if they need them. Taking some of the steps outlined here may prove helpful in discouraging employees from taking unnecessary plan loans.

Answering Your Fidelity Bonding Requirements Questions

As a retirement plan sponsor, you should be aware that every person who handles the property or funds of the plan must be bonded. A field assistance bulletin (FAB) issued by the U.S. Department of Labor provides guidance on fidelity bonding requirements. Understanding these requirements fully will help protect your plan and your business.

The bulletin includes the following information about applying the fidelity bonding requirements.

What is the purpose of a fidelity bond? The purpose of a fidelity bond is to protect your organization's retirement plan from risk or loss due to acts of fraud or dishonesty by individuals handling the plan's assets. These acts include theft, embezzlement, and forgery.

Who must be bonded? Generally, plan fiduciaries and any other person who handles plan funds or other property (a "plan official") must be bonded. For example, officers and employees of the plan or plan sponsor who handle the receipt, safekeeping, and disbursement of plan funds are subject to bonding. Service providers and fiduciaries don't need to be bonded if they don't handle plan funds or property. Several specific exemptions also are included in the pension law.

What is meant by "handling" plan funds? Generally, "handling" plan funds refers to activities that pose a risk that the funds or property could be lost in the event of fraud or dishonesty, such as:

- Physical contact with cash or checks
- Power to transfer funds or property from the plan to oneself or a third party
- Authority to direct disbursement
- Authority to sign checks or other negotiable instruments
- Supervisory or decision-making responsibility over activities that require bonding

How much coverage must the bond provide? Each plan official must be bonded in an amount equal to at least 10% of the amount of funds he or she handled in the previous year, with a minimum bond requirement of $1,000. Generally, the maximum bond amount that can be required for any one plan official is $500,000 per plan. However, the maximum required bond amount is $1,000,000 for plan officials of plans that hold employer securities.

Is a fidelity bond the same as fiduciary liability insurance? A fidelity bond is not the same as fiduciary liability insurance. Fiduciary liability insurance is additional coverage that generally protects the plan against claims for losses sustained because of a plan fiduciary's breach of duty.

Can any bonding or insurance company issue an ERISA fidelity bond? No, fidelity bonds must be placed with a surety or reinsurer that is named on the Department of the Treasury's Listing of Approved Sureties, Department Circular 570 (https://www.fiscal.treasury.gov/fsreports/ref/suretyBnd/c570.htm).

Are any plans exempt from the bonding requirements? Plans that are completely unfunded or not subject to Title I of ERISA are exempt from the bonding requirements. An unfunded plan is one that pays benefits only from the general assets of the organization.

Can a bond insure more than one plan? If your organization sponsors more than one retirement plan, you can purchase one bond to cover all of your plans. However, the bond's amount must be sufficient to allow for a recovery by each plan in an amount at least equal to the amount that would have been required for each plan under separate bonds.

Can the bond have a deductible? No. The bond must provide coverage from the first dollar of loss up to the maximum amount required.

If the amount of funds handled by the plan increases after the bond is purchased, must the bond be updated during the plan year? No. The bond amount must be fixed annually (or estimated at the beginning of the plan's year pending receipt of necessary information) for each covered person based on the highest amount of funds handled by that person in the preceding plan year. So the bonding amount can change from year to year, but not during the year. If the plan doesn't have a complete preceding reporting year, the amounts covered must be estimated.

IRS Limits for 2016, 2017 and 2018 Tax Years

Annual Compensation Limit – The maximum compensation which may be used to calculate benefits and contributions under a qualified retirement plan for the 2018 Plan Year. **$275,000**

Annual Defined Contribution Limit - Generally includes employer contributions, employee contributions, and forfeitures allocated to a participant's account under a defined contribution plan. **$55,000**

Highly Compensated Employee Threshold - An individual is considered highly compensated for IRS non-discrimination testing if the employee owned more 5% of the company in the current or prior year or if in the prior year the employee's compensation was more than the HCE threshold for that year. For example, to be considered an HCE in 2018, a participant must have made more than $120,000.00 in 2017. To be considered an HCE for 2019, a participant will have to make more than **$120,000** in 2018.

Annual Limits:	2016	2017	2018
Annual Compensation Limit [401(a)(17)/404(l)] :	$265,000	$270,000	**$275,000**
Annual Contribution Limit [415(c)(1)(A)] :	$53,000	$54,000	**$55,000**
HCE Threshold [414(q)(1)(B)] :	$120,000	$120,000	**$120,000**
Annual Deferral Limit [402(g)(1)] :	$18,000	$18,000	**$18,500**
Catch-Up Contributions [414(v)(2)(B)(i)] :	$6,000	$6,000	**$6,000**

Annual Deferral Limit – The maximum any one participant may defer for the 2018 Plan Year. **$18,500**

Catch-Up Deferral Limit – For participants turning age 50 or older during the Plan Year, the maximum additional "catch-up" deferrals allowed for the 2018 Plan Year. **$6,000**

Income Subject to Social Security - The maximum amount of earnings subject to social security taxes in 2018. **$128,700**

If you have not already done so, please update this information with your payroll department. If you have any questions regarding these limits or how they affect your plan, please feel free to contact our Helpdesk at 303-485-9000 or helpdesk@drs401k.com for assistance.

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DRS Compliance Calendar for Defined Contribution Plans*

January 15, 2018 – DRS closed for Martin Luther King Jr. Holiday

January 31, 2018 – Mailing deadline for participant copies of 2017 1099-R's

January 31, 2018 – DRS Year-End Information Packet and Census Data Due

February 19, 2018 – DRS closed for President's Day Holiday

February 28, 2018 – Filing deadline for 2017 1099-R's and 1096

March 15, 2018 – Deadline to correct excess deferral and match for 2017 plan year testing failures without IRS penalties

March 30, 2018 – DRS closed for Good Friday Holiday

April 1, 2018 – Required minimum distribution (RMD) begin date for participants attaining age 70 1/2 or retiring after age 70 1/2 in 2018

April, 13 2018 – Deadline to process corrective distributions for excess deferrals

May 28, 2018 – DRS closed for Memorial Day Holiday

June 30th, 2018 – Deadline to process corrective distributions for failed ADP/ACP test from EACA plans without incurring 10% excise tax

July 4, 2018 – DRS closed for Independence Day Holiday

July 31, 2018 – Initial 2017 Form 5500 and 8955-SSA filing deadline or deadline for filing extension (5558)

July 31, 2018 – Deadline to file Form 5330 to report prohibited transactions and excess 401(k) contributions for 2017

July 31, 2018 – Deadline to distribute Summary of Material Modification (SMM) for plans with amendments effective in 2018

September 3, 2018 – DRS closed for Labor Day Holiday

September 30, 2018 – Distribute Summary Annual Report (SAR) for plans that did not extend their 5500 filing deadline

October 15, 2018 – Final filing deadline for 2017 Form 5500 if extension was filed prior to July 31, 2018

November 22, 2018 – DRS closed for Thanksgiving Holiday

December 1, 2018 – Deadline to distribute Safe-Harbor Notice, Qualified Default Investment Alternative Notice and Annual Automatic Contribution Arrangement Notice

December 15, 2018 – Extended deadline for distribution of SAR to participants

December 25, 2018 – DRS closed for Christmas Holiday

December 31, 2018 – Final deadline to correct failed ADP/ACP test via distributions or qualified nonelective contributions

December 31, 2018 – Required minimum distributions due under IRC Section 401(a)(9)

January 1, 2019 – DRS closed for New Year's Holiday

*assumes 12/31 Plan Year End

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To submit your year-end census data:
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For audit support, tax forms, and testing inquiries:
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For quotes for new retirement plan services:
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