MULTNOMAHGROUP

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2017 Regulatory Update

The events framing this 2017 Regulatory Update began on Nov. 8, 2016, with what some may argue was a surprise victory for President Donald J. Trump. Following his inauguration in January 2017, President Trump began setting forth his agenda, which included tax reform as one of his top priorities. He also quickly began making cabinet appointments, including his first appointment for the head of the Department of Labor (DOL), which ultimately failed. After making a second, more successful appointment to the Secretary of Labor, Mr. Alexander Acosta, the DOL proceeded with a busy agenda, including its work on the Fiduciary Advice Regulation (also known as the "fiduciary rule").

While many of our past Regulatory Updates have been packed with highlights and accomplishments from the regulators, this Regulatory Update proves to be different. The government agencies have a shorter list of accomplishments from the past year, but the federal courts have filled the gap, as they have been busy making waves in ERISA litigation, including a ruling in a critical United States Supreme Court case for church plans.

This Regulatory Update seeks to provide a high-level overview of the initiatives from the Trump administration, DOL, and Internal Revenue Service (IRS), as well as cover significant litigation throughout the year. For additional information or to discuss the way in which these changes impact your plan(s) specifically, contact a Multnomah Group consultant.

Tax Reform

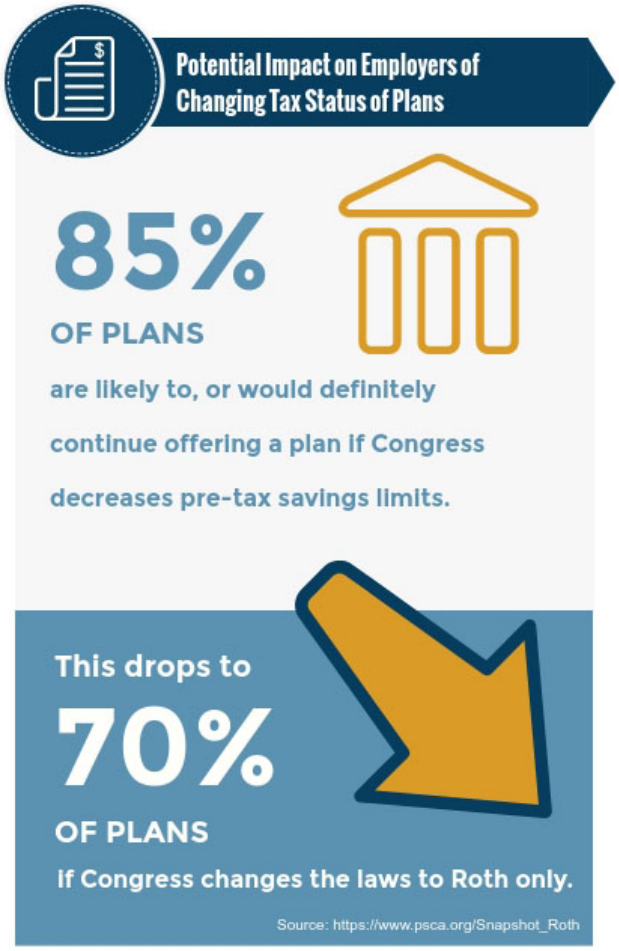
One of President Trump's primary objectives for his first year in office is comprehensive tax reform. In April 2017, the White House released an initial tax plan that suggested removal of all individual deductions except for mortgage interest and charitable donations. Later, the Trump administration clarified that it would also keep the deduction for tax deferred retirement contribution; however, there continues to be inconsistent messaging from the White House and details of the White House proposal are scarce.[1] Based on previous Republican proposals, a plan for comprehensive tax reform is likely to focus on reducing marginal tax rates, reducing the number of tax brackets, and limiting deductions and tax credits.

Background. Any time tax reform is discussed, retirement plans are a part of the discussion because of how the government scores proposals, using a 10-year time frame. While traditional retirement plan contributions serve to defer the taxes until retirement, in most cases, those taxes are deferred past the 10-year budget scoring window. As a result, the budget score shows retirement plan contributions as a large tax expenditure, with the U.S. Treasury reporting it at more than $100 billion annually. The largest tax expenditures are for health insurance and mortgage interest. In contrast to retirement contributions, these expenditures permanently reduce government receipts rather than defer them to the future.

As Congress looks to reform the tax code and potentially reduce taxes, they must grapple with how the scoring will impact the federal deficit and the long-term impact on the federal debt. This is where retirement plans come into play. One way to offset the reduction in tax rates is to limit large deductions, such as retirement plan contributions. This could be done in one of two ways, to varying degrees of extremity.

Two options. First, some or all employee deferrals could be mandated to be Roth contributions. Roth contributions are not tax-deductible when they are made and the tax benefit is achieved down the road in retirement when withdrawals are made tax-free. Because the benefit will typically occur past the 10-year budget window, this approach looks attractive to budget planners focused on the 10-year budget score. In this scenario, employer contributions would likely continue to be tax-deductible in the year they were made with income taxes due upon withdrawal in retirement to encourage ongoing employer contributions.

Second, the deductions could be limited to lower tax bracket rates. Because the current tax system uses graduated rates and retirement plan contributions to reduce marginal income, the greatest tax benefits go to those in the highest income brackets. High-income earners receive a greater tax benefit from contributing to their retirement plan than low-income workers because they are in a tax bracket with a higher marginal rate. Because of this, one option would be to limit the deduction to a lower marginal benefit. If that was done, everyone would receive the same lower level of tax benefit for saving into their retirement account. This approach is likely to raise less in tax revenue than a full or partial Roth mandate but is still an option that could be considered.



Retirement industry perspectives. Many in the retirement industry are concerned about any changes to the tax code that would make saving for retirement more challenging for individuals. Right now, it appears that there is a lot of discussion about the "Roth-ification" of retirement plans, as it helps with the current deficit. The concern among many is that without the immediate incentive of a tax deduction, employees will save even less for their retirement, forcing everyone to fall further behind in terms of retirement security.

Ultimately, comprehensive tax reform is not easy to accomplish, even with a Congress and executive branch controlled by the same party. It remains to be seen what, if anything, will be proposed, and how it would impact retirement plans. If tax reform moves ahead it is worth monitoring the impact it will have on retirement policy, if any.

Department of Labor Fiduciary Advice Regulation

Arguably, one of the DOL's most known achievements under the Obama administration – known for creating investor protection – was the Fiduciary Advice Regulation[2] (also known as the fiduciary rule). Originally proposed in 2010 during the Obama Administration, withdrawn under criticism and then reproposed in 2015, the final fiduciary rule became effective June 2016 so that even a November 2016 election won by a President not supportive of the fiduciary rule would not deter the implementation of the rule the following spring (at least not without a fight). November 2016 came, Donald Trump won, and the fight against the fiduciary rule was on.

What's the fiduciary rule? The fiduciary rule expands the definition of investment advice such that many additional financial professionals are considered a fiduciary under ERISA Section 3(21)(A)(ii). One of the new ways in which these professionals are now fiduciaries is in the context of individual retirement accounts (IRAs). In addition, many additional activities by financial professionals with respect to qualified retirement plans (and their participants) also

> ***The fiduciary rule expands the definition of investment advice such that many additional financial professionals are considered a fiduciary under ERISA Section 3(21)(A)(ii).***

became investment advice under the fiduciary rule. Further, the fiduciary rule amends several existing prohibited transaction exemptions (PTEs) and adds a PTE known as the Best Interest Contract Exemption (BICE).

What's the impact on plan sponsors? For most plan sponsors, the fiduciary rule impacts the financial services industry – financial professionals, recordkeepers, brokers, among others – but there is a very low impact on plan sponsors. The fiduciary rule emphasizes the plan sponsor's responsibility to prudently select and monitor service providers and to ensure they are not providing biased educational materials or communications to participants.

However, there are several secondary impacts on plan sponsors. For example, as a result of the fiduciary rule, plan sponsors and participants are subject to many new forms, disclosures, and contracts. This means plan sponsors should be prepared to review and understand novel forms and disclosures. Second, because of the fiduciary rule, there has been a great deal of changing products and innovation, which means plan sponsors need to be prepared to review and monitor the new materials and products.

Wait, did this fiduciary rule ever actually start? Yes, and no. Yes, the fiduciary rule became applicable on June 9, 2017, meaning that there is a much broader definition for determining who is a fiduciary under ERISA. However, some of the more stringent contract provisions, class action litigation provisions, etc., which were set to commence on Jan. 1, 2018, are likely to be pushed back 18 months to July 2019. For plan sponsors, continue to look for updates from your Multnomah Group consultant related to the changing status of the fiduciary rule, but for now, the more "watered-down" version of the fiduciary rule is in effect.

ERISA Litigation Update

Stock drop cases are so last season[3], while excessive fee cases continue to be fashionable in retirement plan litigation. The bad news is there is a new target for excessive fee litigation: colleges and universities (described below), while the traditional excessive fee cases against 401(k) plans continue to keep coming. Several ERISA cases have been filed throughout the past year, but there are a few key cases plan sponsors may want to review – some of which offer good news.

White v. Chevron: For once, plan sponsors got a WIN in excessive fee litigation when a judge in the Northern District of California dismissed the plaintiff's lawsuit not once, but twice.[4] One of the claims in this case was that the defendants should have used a money market fund rather than a stable value fund. However, the judge held that simply looking at performance numbers in hindsight wasn't enough evidence that the fiduciaries breached their duty; rather, there had to be evidence that fiduciaries lacked a prudent process or failed to consider relevant information. Additionally, the plaintiffs claimed the recordkeeping fees were imprudently high. The court found that the plaintiffs lacked evidence for the claim and that inclusion of relative data (based on assumptions) from the Form 5500 was insufficient.[5]

Barrett v. Pioneer Natural Resources USA, Inc. Pioneer is not necessarily a significant case because of its claims, but rather because of the attorney filing the complaint.[6] This case was brought by Franklin D. Azar & Associates, which is a personal injury firm specializing in motor vehicle accidents and product defects. The case symbolizes the entrance of a smaller plaintiff's firm into the arena of ERISA litigation, which may suggest a greater proliferation of these cases and/or the ability to "copycat" the cases that were traditionally filed by a single St. Louis-based law firm against only jumbo-sized plans.

Sulyma v. Intel. This case serves as another WIN for plan sponsors and provides a critical lesson for plan sponsors regarding the need to provide required participant notices. Here, the plaintiffs argued that the target date funds offered in the plan were too exotic and that such funds were underperforming.[7] However, the defendant plan sponsor argued there was a three-year statute of limitations because the plaintiffs had actual knowledge by having access to the summary plan description as well as the fund fact sheets (which the plaintiffs were directed to read). Ultimately, the judge dismissed the case as time-barred.[8] For plan sponsors, this means that it is critical to provide required participant notices, as they may serve as your best shield in litigation.

***Tibble v. Edison* Comes to a Close.** A decade since the case began, *Tibble v. Edison* comes to a close, resulting in a victory for the plaintiffs and offering lessons for plan sponsors. As the only case of its kind to go all the way to the Supreme Court, the case ended in a California district court in August.[9] From the ruling, plan sponsors can learn:

- **Meet Regularly:** Fiduciaries and/or the Committee should meet at regular intervals and be prepared during such meetings to review the investments and take action thereafter, if needed. The holding suggests that meeting once per year to review the investments and/or share class and then make changes would be insufficient.

- **Share Class Selection:** Fiduciaries to the plan should know the share classes available and be proactive about making a share class selection and/or changing share class when a new share class becomes available.

- **Document Decisions for Investment Selection:** Fiduciaries should document the fund selected (and associated share class) and over time continue to document the rationale for retaining funds and respective share class during the monitoring process.

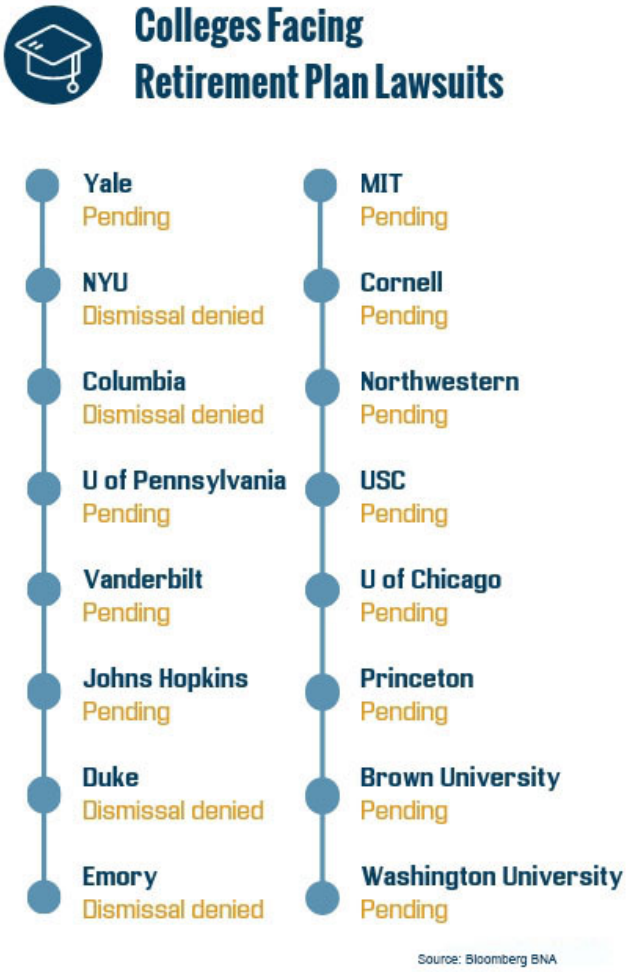
While the final damage calculation is still underway, the judge found for plaintiffs and against the defendant electric company, ending many years of litigation and attorney's fees.

> ***Tibble reminds plan sponsors of best practices for investment-related responsibilities:***
>
> ✓ ***Meet Regularly***
>
> ✓ ***Document Decisions***
>
> ✓ ***Prudently Select Investments and Associated Share Classes***
>
> ✓ ***Monitor Investments and Share Classes***
>
> ✓ ***Replace Investments and Share Classes, when necessary, and in a Timely Fashion***

The Case Against Colleges and Universities. Historically, 403(b) plans have generally stayed out of the crosshairs of excessive fee litigation. August 2016 saw a change that took aim at a new target: America's finest colleges and universities. From August 2016 to present, 16 lawsuits have been filed against colleges and universities alleging a myriad of claims as they attack plan fiduciaries for offering multiple recordkeepers, which resulted in higher fees for participants; too many total investment options and duplicative investment options which created confusion for participants; revenue sharing arrangements that led to excessive fees to service providers or as "kickbacks" to the plan sponsor; and utilization of funds that contained multiple expenses and multiple layers of expenses.

Some of the universities have already had their first day in court with an opportunity to argue their motions to dismiss. While some claims were dismissed, the cases overall have survived, with several claims remaining against each university. Be on the lookout for updates, as we continue to monitor to understand if these colleges and universities will take the same path as the 401(k) cases of the past 10 years, which ultimately led to many settlements or, alternatively, if

these colleges and universities will chart a new course and proceed further down the litigation route.



U.S. Supreme Court Rules on church plans. On June 5, 2017, the U.S. Supreme Court, in a unanimous opinion authored by Justice Kagan in *Advocate Health Care Network v. Stapleton*, held that employee benefit plans established or maintained by church-affiliated entities are exempt from ERISA, even when they are not originally established by a church.[10] The employees claimed that their employers' plans did not fall within ERISA's church-plan exemption because, although subparagraph (C)(i), a 1980 amendment to ERISA, allowed "principal-purpose organizations," such as the defendant, to "maintain" exempt benefit plans, ERISA still required that such plans must have been originally "established" by a church.

ERISA specifically exempts church plans established and maintained "by a church or by a convention or association of churches which is exempt from tax." But people questioned whether ERISA's church plan exemption applies to plans maintained by tax qualifying, church-affiliated organizations or just church-established plans. The Supreme Court decision in the *Advocate Health Care* case ends the dispute by finding that religiously-affiliated nonprofits' plans are exempt from ERISA even if they were not originally established by a church. The Supreme Court, however, did not opine on what constitutes a "Principal-Purpose" organization, as that question was left open for another case.

For churches and their affiliates, this legal victory essentially means things return to the status quo of the past 30 years, but it is important that church plan sponsors do not mistake "exempt from ERISA" with "absolved of fiduciary responsibility." Church plan sponsors would be wise to review state fiduciary and trust laws and consult with a qualified ERISA attorney before taking any action as a result of this holding.

State Initiatives

As discussed in last year's Regulatory Update, since 2012, many states have introduced legislation (some of which has been passed) to either set up or study options for state-sponsored retirement savings programs for workers at private sector or nonprofit employers that do not offer retirement savings programs. Why? Because studies show that more than 20 million private sector workers in the United States earning between $30,000 and $100,000 do not have access to a retirement plan at work[11] and workers are more likely to save for retirement in a workplace plan than on their own.[12]

> ***"…workers are more likely to save for retirement in a workplace plan than on their own."***

As a result, states have stepped in to offer an alternative program. A few of the states leading the way include Oregon, Washington, Illinois, and California, whereby Oregon launched its program during the summer 2017. Note that under the Obama administration, the DOL issued guidance that would support these state-run programs, making it clear that such programs were not subject to ERISA.[13] Although that guidance has subsequently been pulled back under the Trump administration, states such as Oregon have moved ahead despite the lack of DOL guidance.

At present, there are not any foreseeable consequences to our existing plan sponsors offering an employer-sponsored plan, as the state plan is a complement for those other

employers that are unable to offer an employer-sponsored plan.

Regulations Impacting Defined Benefit Plans

Proposed defined benefit mortality table change regulation. In December 2016, the IRS proposed regulations that would update the mortality tables used by most defined benefit plans to determine minimum funding requirements and minimums for lump sum distributions.[14] The regulations would also relax requirements for plan sponsors to use substitute mortality tables. As of the date of publication, no final rule has been released.

Model amendments (& related regulations) to add bifurcated distribution options to defined benefit plans. In September 2016, the IRS and the Department of Treasury released final regulations allowing for bifurcated distributions for defined benefit plans.[15] This allows benefits to be paid partly as an annuity and partly as a single sum or other accelerated form. Additional regulations clarifying portions of the new rules were released in November 2016 and have not yet been finalized.[16] Recently the IRS also released model amendments that include language for plan sponsors to use if offering such options.[17]

On the Horizon in the Retirement Plan Marketplace

Changes to determination letters. As discussed in last year's Regulatory Update, the IRS has modified procedures governing determination letters for individually designed plans. The IRS will now issue determination letters for individually designed plans only upon initial plan adoption and termination, and it has eliminated the five-year cyclical determination letter and remedial amendment program.[18] For 403(b) plans, the IRS does not anticipate opening a determination letter program for individually designed 403(b) plans. However, over the summer, the IRS did start rolling out their approval for prototype and volume submitter 403(b) plans[19] by issuing an updated list of 403(b) pre-approved retirement plans that have received an IRS-favorable opinion or advisory letter, meaning that the IRS has determined that the plan document satisfies the requirements of Internal Revenue Code Section 403(b). For more information, check with your vendor and/or experienced ERISA counsel to determine how the plan document changes apply to your plan.

Revisions to Form 5500. Last year, the DOL, in conjunction with the IRS and Pension Benefit Guaranty Corporation (PBGC), announced what is part of a long-term strategic project to "modernize and improve" the Form 5500. The DOL proposed the changes to the Form 5500, conducted a comment period, and ended the extended comment period in December 2016. At the time of this Regulatory Update, no final rule has been announced, though the proposed rule originally had a compliance date of 2020 for all proposed revisions.[20]

Lifetime income. Studies report[21] plan sponsors have traditionally been reluctant to make annuities available as default options in retirement plans given the lack of protection from the DOL around fiduciary liability. In December 2016, the DOL provided guidance in the form of a letter to TIAA[22], which provided the assurance some plan sponsors may have been seeking. The letter stated that lifetime income products may serve as a default investment option in the retirement plan so long as certain requirements are met. For plan sponsors, this new guidance means there is greater fiduciary protection in using lifetime income products that was not available before – keeping in mind that each case is still facts and circumstances dependent.

Auto portability. While you may be familiar with the term small sum distribution, you may not be familiar with the term auto portability, though the two address similar issues in a very different way. While small sum distributions remove terminated participants with a small balance, auto portability is the concept of the routine, standardized and automated movement of an inactive participant's retirement account from a former employer's retirement plan to their active account in a new employer's plan.[23] This concept, developed by the Retirement Clearinghouse has not yet been introduced as a regulation nor as legislation, but it has been gaining traction over the summer and it's a topic to watch in the coming months.

Oregon mandatory withholding. Over the summer, Oregon's legislature adopted a new statewide payroll tax as a part of its major transportation bill. This bill, which becomes effective Oct. 6, 2017, applies to periodic payments starting July 1, 2018. Essentially, every employer (or payor) of periodic payments from an employer deferred compensation plan will be required to withhold and remit 0.1% of each gross periodic payment. For additional information, be sure to reach out to your tax professional or attorney to discuss how this provision may apply to your plan.

Off the Horizon in the Retirement Plan Marketplace

Guide to the 408(b)(2) disclosures. Consistent with the DOL's theme of less regulation under the Trump administration, the DOL amended its regulatory agenda in the Federal Register on Aug. 24, 2017.[24] The amendment included removal of the previously-proposed (but never final) rule to require service providers to include a guide along with the 408(b)(2) disclosures. While the DOL's withdrawal does not mean the DOL may never revisit this subject matter for rule making, it is off the agenda for now. For plan sponsors this means 408(b)(2) disclosures will continue to come to plan sponsors in their current fashion with no additional disclosures, guides or changes in the near future.

Conclusion

While the regulators may be taking a less aggressive approach, plaintiffs' attorneys are stepping up to fill that gap. To mitigate your risk as a retirement plan sponsor, we look forward to working with you to understand the issues presented in this Regulatory Update as well as best practices with respect to fiduciary governance, investment consulting, employee engagement and more. To discuss any of the matters covered in this Regulatory Update or other issues related to your plan, please contact your Multnomah Group consultant.

Footnotes:

[1] *See generally,* White House Office of the Press Secretary, Joint Statement of Tax Reform, available at: https://www.whitehouse.gov/the-press-office/2017/07/27/joint-statement-tax-reform.

[2] *See generally*, Employee Benefits Security Administration, Conflicts of Interest Rule, available at: https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2.

[3] Since the Supreme Court decision in *Fifth Third Bancorp v. Dudenhoeffer* in 2014, plan sponsors have consistently defeated stock drop cases.

[4] *See generally*, *White v. Chevron*, Order Granting Motion to Dismiss, N.D. Cal. (2017), available at: https://www.bloomberglaw.com/public/desktop/document/White_v_Chevron_Corp_No_16CV0793PJH_2016_BL_281396_ND_Cal_Aug_29_?1504724498.

[5] Cases filed against *Intel* (described herein) and *CVS Health Corp.* have also been successful in defending against participant lawsuits that challenged the investment options included in the retirement plan during 2017.

[6] *See generally, Barrett v. Pioneer Natural Resources*, Complaint, N.D. Co. (2017), available at: http://www.planadviser.com/uploadedFiles/BarrettvPioneerNaturalResourcesComplaint.pdf.

[7] *See, Sulyma v. Intel*, Complaint, N.D. Cal. (2015), available at: http://staging.plansponsor.com/uploadedFiles/Plan_Sponsor/news/Rules,_Regs/SulymavIntelcomplaint.pdf.

[8] *See, Sulyma v. Intel*, Order Granting Defendants' Motion for Summary Judgment, N.D. Cal. (2017), available at: http://www.planadviser.com/uploadedFiles/SulymavIntelOpinion.pdf.

[9] *See*, *Tibble v. Edison*, Findings of Fact and Conclusions of Law, N.D. Cal. (2017), available at: http://media.thinkadvisor.com/thinkadvisor/article/2017/08/17/567-findings-of-fact-and-conclusions-of-law-021365.pdf.

[10] *Advocate Health Care Network v. Stapleton*, 581 U.S. ___ (2017), available at: https://www.supremecourt.gov/opinions/16pdf/16-74_5i36.pdf.

[11] *See,* Retirement Policy Initiatives in the States: How You Might Be Impacted, ASPPA Presentation, available at: http://www.asppa-net.org/Portals/2/Comm_2016/WebcastOutlines_2016.08.23_ASPPA.pdf, citing: Unpublished Employee Benefit Research Institute estimates from March 2013 Current Population Survey.

[12] *See,* Retirement Policy Initiatives in the States: How You Might Be Impacted, ASPPA Presentation, available at: http://www.asppa-net.org/Portals/2/Comm_2016/WebcastOutlines_2016.08.23_ASPPA.pdf, stating: "Middle class workers are 15 times more likely to save for their families' retirement at work than on their own" and citing: Employee Benefit Research Institute (2010) estimates using 2008 panel of SIPP data (covered by an employer plan) and EBRI database estimate (not covered by an employer plan – IRA only).

[13] *See*, Savings Arrangements Established by States for Non-Governmental Employees, 29 CFR Part 2510, available at: https://www.dol.gov/sites/default/files/ebsa/temporary-postings/savings-arrangements-final-rule.pdf.

[14] *See,* Mortality Tables for Determining Present Value Under Defined Benefit Pension Plans, 81 FR 95911, available at: https://www.federalregister.gov/documents/2016/12/29/2016-30906/mortality-tables-for-determining-present-value-under-defined-benefit-pension-plans.

[15] *See,* Modifications to Minimum Present Value Requirements for Partial Annuity Distribution Options Under Defined Benefit Pension Plans, 26 CFR Part 1, available at: https://www.gpo.gov/fdsys/pkg/FR-2016-09-09/pdf/2016-21393.pdf.

[16] *See,* Update to Minimum Present Value Requirements for Defined Benefit Plan Distributions, 81 FR 85190, available at: https://www.federalregister.gov/documents/2016/11/25/2016-27907/update-to-minimum-present-value-requirements-for-defined-benefit-plan-distributions.

[17] *See,* Model Amendments to Add Bifurcated Distribution Options to Defined Benefit Plans, IRS Notice 2017-44, available at: https://www.irs.gov/pub/irs-drop/n-17-44.pdf.

[18] *See,* IRS Revenue Procedure 2016-37, available at: https://www.irs.gov/irb/2016-29_IRB/ar10.html.

[19] IRS Prototype and Volume Submitter Plans, available at: https://www.irs.gov/pub/irs-tege/preapproved_403b_plans_list.pdf.

[20] Revision of the Form 5500 Series and Implementing Related Regulations Under the Employee Retirement Income Security Act of 1974 (ERISA), available at: https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201704&RIN=1210-AB63.

[21] *See,* GAO, 401(k) Plans, DOL Could Take Steps to Improve Retirement Income options for Plan Participants (August 2015), available at: http://www.gao.gov/assets/680/678924.pdf.

[22] *See,* DOL Letter to TIAA, available at: https://www.dol.gov/sites/default/files/ebsa/employers-and-advisers/guidance/information-letters/information-letter-122216.pdf.

[23] Retirement Clearinghouse, Auto Portability, available at: https://www.rch1.com/auto-portability.

[24] 48 CFR Ch. 29, Semiannual Agenda of Regulations, available at: https://www.gpo.gov/fdsys/pkg/FR-2017-08-24/pdf/2017-17060.pdf.

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