Pension Potholes – Plan Document Compliance

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This article on plan document compliance is the second in our series of articles related to “Pension Potholes” that can crop up over time without proper maintenance. Our first article focused on potholes associated with plan distributions after normal retirement age. This article focuses on three potholes associated with plan document compliance. Plan documents govern the administration of all qualified retirement plans including pension plans. They specify the provisions for accruing benefits, the timing for paying those benefits, and the available payment forms (e.g. joint and survivor, certain annuities). Plan documents include the formal legal document and the Summary Plan Description (SPD) that explains the plan to Participants. Plan amendments are made periodically to plan documents to keep the plan up to date without having to restate the whole document.

Pothole #1 – Plan Amendments and Administration

Background: Occasionally plan sponsors decide to make changes to benefits. The most common benefit changes in the past decade have been closing the plans to new entrants, decreasing levels of benefits provided, or completely freezing benefit accruals for all participants. Plan fiduciaries are responsible for ensuring that these company decisions are implemented correctly and match the provisions documented in the plan amendments.

The Pothole: Sometimes the proper timing and documentation for plan design
changes are not made correctly. The company decides to make a change, it gets approved by the board, HR implements the change, participants are told but the plan document is not properly amended. In the case of benefit reductions certain participant notifications also have to accompany the amendment in order for the amendment to properly take effect.

Flawed plan design change amendments can result in an amendment being deemed invalid thus negating the intended plan change altogether. If this happens, the sponsor could be on the hook to participants for the larger benefits that existed before the amendment. The process of making participants whole can be time consuming as well as expensive. A lawyer friend of ours tells the story of a sponsor who froze their plan but did a poor job of executing the amendment – years of additional accruals had to be provided to participants when the error was discovered. If a discrepancy between the plan document and how the plan is actually administered exists it could pose serious problems to sponsors when the issues come to light (which they often do at the most inopportune time).

_Avoiding the Pothole:_ For plan design change amendments sponsors need to ensure proper documentation, including signatures, dates and participant notifications. They need to ensure that the attorney drafting the plan change coordinates with the parties involved in making the design change so they can properly implement the amendment. Sponsors should also consider periodically conducting a review of plan provisions and plan administration to assure that they are aligned. This can be achieved by having a third-party (consultant, ERISA attorney, etc.) review the plan provisions and compare against the plan's administrative procedures.

**Pothole #2 – Incorporating Regulatory Amendments**

*Background:* Almost annually new laws are passed that change how pension plans are administered. Often these changes are minor and may not have any real impact on the plan. Still, plan sponsors are required to amend their plan documents to keep up-to-date with the law. For example, the provisions regarding same-sex spouses from the _Windsor_ decision are, in general, required to be written into plan documents by the end of 2014.
The Pothole: Some plan sponsors do not actively work with ERISA counsel. They may rely on their auditor, consultant or actuary to keep their plan document up-to-date. These providers may not realize that their client is relying on them for keeping the plan document current. Turnover and obscure regulatory changes can lead to missed technical, required amendments. In other cases the plan sponsor may think that they can take care of these amendments as they prepare to submit a determination letter request once every five years. The problem is that these regulatory amendments often have required timelines for incorporating them into the plan that occur independent of the determination letter cycle timing.

Missed or improper regulatory amendments can cause significant headaches for plan sponsors. The big issue with this pothole is that the plan might not be in compliance with required law which could potentially disqualify the plan. These oversights can typically be resolved through the IRS correction procedures which can be costly and time consuming.

Avoiding the Pothole: Plan sponsors need to keep up to date on required amendments to their plans and ensure that they are adopting and implementing required amendments on time. If having ERISA counsel on a retained basis is not practical, sponsors need to make sure that their advisors are keeping them informed or that they are staying informed on their own. For required amendments, the IRS maintains a “Listing of Required Modifications and Information Package” on their website.

Pothole #3 – Summary Plan Descriptions & Summary of Material Modifications

Background: Under ERISA, qualified plans are required to provide a summary plan description (SPD) to plan participants (including beneficiaries receiving payments). SPDs contain information about the plan’s operations as well as the high level provisions of the plan (e.g. eligibility, benefit formula, early retirement, forms of payment available). Anytime the provisions of the plan change and that change affects information shown in the SPD, plan sponsors have to provide participants a Summary of Material Modifications (SMM). In general, SPDs have to be sent to participants within 90 days of becoming an eligible participant (including beneficiaries that begin to receive payments from the plan). After that, SMMs have
to be provided to affected participants each time the plan provisions change the information that is contained in the SPD. The SMM has to be distributed to participants 210 days after the end of the plan year that the amendment was adopted. Sponsors need to distribute updated SPDs every 5 years or every 10 years if the information in the SPD has not changed.

The Pothole: SPDs and SMMs are commonly overlooked as part of a plan’s administration. Even sponsors of frozen plans should be aware of the updates and distribution requirements that have to be communicated to plan participants. One commonly overlooked requirement with SPDs is the need to distribute updated SPDs every 5-10 years. Even a simple sponsor address change presumably would trigger the 5 year requirement.

If the plan has been changed and the SPD has not been updated then participants may rightfully believe their benefits have not changed. Obviously this is a huge problem if benefits have been reduced. If a participant sues, the courts may rule that the SPD overrides the plan document!

Avoiding the Pothole: Sponsors will want to take note of the last time that they sent out an updated SPD to plan participants. If it has been more than five year since a plan’s SPD was updated they will want to update the SPD and send it out to all participants as soon as possible. They will also want to make sure that they are distributing SMMs in a timely manner when they are needed. The distribution of SPDs and SMMs is a small part of a plan’s operations and can often be overlooked unless the sponsor has procedures in place to ensure the timely distribution and updates to these documents.

Summary

The plan document potholes discussed in this article are not only expensive to fix but can jeopardize the qualified status of a plan if they are neglected. They can also put a plan on shaky ground if participants ever sue. Fixing the damage from these potholes will almost always involve notifying the IRS and may require substantial time from the plan’s ERISA attorney and other providers to correct. Sponsors will want to make sure that they fix any discrepancies between the plan administration and the plan document, incorporate required regulatory amendments in a timely
manner, and send SPDs and SMMs as the need arises.

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