JOURNAL of PENSION BENEFITS

ISSUES IN ADMINISTRATION, DESIGN, FUNDING, AND COMPLIANCE
Volume 28 • Number 4 • Summer 2021

Plan Distributions

Plan Distribution Disclosures and Enhanced Communications

Retirement plan administrators should not only ensure that they are meeting required plan distribution disclosure obligations, but also consider how to permissibly enhance communications to address a participant or beneficiary's last step in the employer-provided retirement plan cycle—the plan distribution.

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Plan administrators of Employee Retirement Income Security Act of 1974 (ERISA)-governed, tax-qualified retirement plans are required to provide plan participants with various types of disclosures to inform them of their rights and benefits in the plan. It is not uncommon to provide enhanced communications on a myriad of topics in addition to those that are required by ERISA or the Internal Revenue Code (Code). Often, enhanced communication campaigns are provided to address a particular issue being experienced by the plan (*e.g.*, low participation rates) or in the marketplace (*e.g.*, lack of financial literacy). In

recent years, investment education has been a focus for plan fiduciaries to assist plan participants with their retirement savings efforts and understanding of financial concepts. As guidance has evolved, plan fiduciaries have been cautious to ensure that investment education information and materials do not include advice or recommendations with respect to specific investments or distribution options. Efforts also have been made to provide enhanced communications regarding auto-enrollment and auto-escalation provisions in defined contribution plans to increase retirement savings, a subject that the 2013 ERISA Advisory Council examined to provide best practice recommendations for such participant communications and plan designs.

Yet, an important part of a participant's experience with a retirement plan involves not only participation and investment of their benefit during their working years, but also the distribution of that benefit. Plan administrators should not advise a participant or a beneficiary regarding when to take a plan distribution (beyond required distributions), or the form of distribution to take, but they should ensure that there are appropriate administrative practices in place to provide plan participants (and beneficiaries) with timely disclosures and notifications regarding plan distribution issues in accordance with applicable law. Furthermore, there are enhanced communications that could be provided as part of educational efforts.

Required Disclosures and Communications Programs

As distribution options become more complex, a well-designed communications program can aid plan sponsors and fiduciaries in their decisions to offer those more complex distribution options to their plan participants and allay their concerns in doing so. Thus, the plan fiduciaries should periodically review their procedures for complying with the required participant distribution disclosures and communications for their tax-qualified, ERISA-governed retirement plans to ensure that they are meeting their obligations. In addition, they should evaluate whether there are enhanced materials that could be provided for the benefit of the plan participants and beneficiaries, as well as determine appropriate levels of communications for special events. Below are some examples to consider.

Summary Plan Description

A primary document required under ERISA that would explain plan benefits, rights, and features, including distributions, is the summary plan description (SPD). An overview of the various types of plan distributions available under the particular plan and their terms would be set forth in the retirement plan's SPD, which must be communicated in an understandable manner. The SPD should be reviewed periodically to make desired updates. At least every five years, if plan amendments have been made, then the plan administrator must furnish an updated SPD that includes all the plan amendments made within the five-year period. [ERISA § 104(b); Labor Reg. § 2520.104b-2(b)(1)]

Plan Amendments and Summaries of Material Modification

Amendments to plan distribution provisions must be timely communicated in a summary of material modification (SMM). While an SMM generally is not due until 210 days after the close of the plan year when a retirement plan amendment is adopted [ERISA § 104(b)], communications of plan amendments impacting material plan terms are best communicated as soon as possible (and in some cases, advanced notice of certain amendments is required for applicable pension plans under ERISA Section 204(h) and Code Section 4980F). For example, when plan sponsors could adopt coronavirus-related distributions and loan provisions in 2020 under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), actual plan amendments for such provisions were not yet due, but communications regarding the availability of these options were necessary for participants. Money purchase plan sponsors also were provided an opportunity under the Consolidated Appropriations Act of 2021 (CAA), which amends the CARES Act, to extend favorable tax treatment to qualified individuals for in-service coronavirus-related distributions made from money purchase pension plans during the period from March 27, 2020, through December 30, 2020, which would also necessitate special communications to participants. In these types of scenarios, communications regarding these options and their terms should be proactively provided to participants as soon as possible in order for plan participants to understand the availability of these provisions and their terms.

Operational Changes and Additional Materials

When the law changes, and either required or discretionary plan amendments are adopted, terms in the applicable withdrawal forms and communications, policies, notices, and disclosures also will need

to be updated in addition to amending the plan. There should be a process in place to coordinate efforts with applicable service providers to update and issue revised materials. Further, when special circumstances arise, communications might be designed in additional formats, such as in a "frequently asked questions" communications piece, email alerts, benefit plan intranet site announcements, or other format to present digestible facts regarding special changes.

QJSA Notices and Spousal Consents

For defined benefit pension plans and defined contribution plans offering qualified joint and survivor annuities (QJSAs), care should be taken to ensure that required QJSA notices are timely provided to a participant before the annuity starting date (in accordance with rules under the applicable plan). These notices should describe the alternative forms of distributions that are available under the plan, along with required relative value explanations for defined benefit plans, and spousal consent forms for waiver of any QJSA in accordance with applicable Code requirements. [Treas. Reg. § 1.417(a)(3)-1(c)] Disclosure practices (and spousal consents) regarding qualified pre-retirement survivor annuities should also be reviewed for compliance.

When 401(k) plans offer annuity forms of distribution, they are subject to the spousal annuity distribution requirements and spousal consent is required to waive the required form of QJSA distribution. Spousal consent also is required for beneficiary designations if a married participant chooses to name someone other than his or her spouse, even if the plan does not offer the annuity form of distribution. It is not uncommon for a plan to have failures to obtain spousal consent, which must be corrected under applicable Internal Revenue Service (IRS) procedures. Thus, plan administrators should ensure proper procedures are in place for distribution of these disclosures, spousal consents, and for maintenance of up-to-date beneficiary designations.

Consents for Distributions

Under Code Section 411(a)(11), a plan must obtain a participant's consent to a distribution of a vested benefit with a present value in excess of the cash-out limit ($5,000, although a plan can provide an automatic rollover to an individual retirement plan without participant consent where an amount in excess of $1,000 but no more than $5,000 is to be distributed) if the benefit is immediately distributable, and the participant must be informed of the material features of optional forms of benefit available under the plan and any rights to defer receipt of the distribution. The consent must not be made more than 180 days before the date that the distribution commences. [IRC §§ 401(a)(31), 402(f), and 417(a)(6)] No spousal consent is required for a distribution that is made pursuant to the cash-out rule for amounts equal to or less than $5,000.

Required Minimum Distributions

While Code Section 401(a)(9), as amended, provides that an employee must start receiving required minimum distributions from his or her retirement plan generally by April 1 following the calendar year in which an employee turns age 72 (or, if the plan provides for it for those who own 5 percent or less of the employer, the calendar year in which the employee retires, if later), there is no specific date when ongoing required minimum distributions must be received other than before the end of the successive calendar years. As explained in IRS Information Letter 2016-0072, the tax rules do not specify a date during the calendar year when a required minimum distribution payment must be made after the initial distribution, nor do they specify which party determines the date on which payment will be made. The retirement plan document may specify such terms or, if it does not, the procedures for payment of a requested required minimum distribution generally would be within the discretion of the plan administrator. There is no specific mandate regarding advanced communications for required minimum distributions, but clearly the plan's procedures should be communicated to participants and a process should be in place to monitor plan participants attaining the required beginning date so that they can be contacted regarding upcoming distributions, and any missing participant issues minimized.

In-Service Distributions and Loans

There are various forms of in-service transactions, including loans and distributions, requiring disclosures. For example, the basic terms of a plan loan and the related procedures must be in writing, including the loan amount, its term, and the repayment schedule. Loan policies and procedures should be periodically reviewed and updated and loan documentation should be maintained with plan records. Communications must be provided to participants regarding requirements for hardship applications and the necessary supporting documentation for hardship distribution requests. Plan administrators must

request and retain documentation (as required under the applicable guidance) to substantiate a participant's financial hardship, and maintain hardship distribution records to avoid plan qualification failures.

Other types of distributions that might be available under a defined contribution retirement plan include: (i) qualified distributions to reservists who are ordered or called to active duty for a minimum 179-day period or for an indefinite period; (ii) deemed severance distributions to reservists who have been absent for uniformed service for more than 30 days; or (iii) qualified disaster or other disaster-relief oriented distributions. Further, where the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) reduced the minimum age for pension plans to offer in-service distributions as part of a phased retirement provision from age 62 to age 59½, the CAA provides for certain multiemployer pension plans that cover employees in the building and construction industry that the minimum age limit is reduced from age 59½ to age 55 for those individuals who were participants in the plan before April 30, 2013. As rules for these and other in-service distributions change or new laws become enacted, plan amendments need to be made and updated disclosures, distribution forms, and communications need to be provided to participants.

Eligible Rollover Distributions

Within a reasonable period of time before making an eligible rollover distribution, Code Section 402(f) requires the plan administrator of a plan qualified under Code Section 401(a) (as well as for Sections 403(a), (b), and Section 457(b) plans) to provide a written explanation as described in the Code and applicable guidance to any recipient of an eligible rollover distribution explaining the right to elect a direct rollover and the tax consequences of receiving a distribution. Under Code Section 3405, there also is a written notice requirement of the right to elect to not have withholding apply to a distribution that is not eligible for a rollover.

QDROs

Qualified retirement plans must also adopt reasonable, written procedures to determine whether a domestic relations order meets the requirements of a qualified domestic relations order (QDRO), and for administering distributions under a QDRO. These procedures must be set forth in the plan's SPD or the SPD would need to contain a statement indicating that participants and beneficiaries may obtain a copy of the plan's QDRO procedures from the plan administrator, free of charge. [IRC § 414(p)]

De-Risking Communications

In recent years, many plan sponsors have adopted de-risking approaches for single employer pension plans by offering a cash-out window to terminated, vested participants for a limited period of time. Windows allow these participants to voluntarily elect a lump sum cash distribution or immediate annuity, rather than having to wait until early or normal retirement age to obtain a lifetime or joint and survivor annuity distribution from the plan. These cash-out windows or risk transfers have been part of a trend in de-risking techniques, as opposed to a full pension plan termination or freeze, as plan sponsors strive to find ways to reduce plan liabilities and/or overall costs associated with managing a pension plan program.

While the decision to amend a plan to provide for such a window or risk transfer mechanism is a business or settlor decision, the implementation of that decision is a fiduciary responsibility, and prudent participant communications regarding any window opportunity are critical. The 2013 ERISA Advisory Council (Council) recommended that disclosures be provided to participants at least 90 days prior to the date an election for a distribution has to be made. This disclosure would include relevant information to enable a participant to make an informed election, including equivalent comparisons of a lump sum distribution to the normal form of benefit under the plan. In 2015, the Government Accountability Office (GAO) also released a report entitled *Private Pensions: Participants Need Better Information When Offered Lump Sums that Replace Their Lifetime Benefits*. The issues identified by the GAO as requiring further explanation include the calculation of the lump sum and its relative value versus the monthly annuity, positive and negative ramifications of opting for the lump sum, tax implications, the role of the PBGC with regard to the pension benefits, and assistance and general instructions for accepting the lump sum during the window. In 2015, the Council also continued to focus on advocating for the provision of unbiased information that participants need to make informed decisions when faced with lump sum risk and insurance annuity risk transfer. Plan fiduciaries should consider the issues that were raised in these various reports when

designing plan communications regarding any lump sum cash out window or risk transfer.

Lifetime Income Distributions

On August 18, 2020, the Department of Labor's Employee Benefits Security Administration (EBSA) announced an interim final rule (IFR) for administrators of defined contribution retirement plans, such as 401(k) plans, in response to the SECURE Act requirement to include two lifetime income illustrations on participants' benefit statement at least once every 12 months. While the IFR was intended to be effective one year after its publication, a final rule (which may be issued by EBSA prior to this column's publication), taking into account comments on the rules, would supersede the IFR. This disclosure will be required regardless of whether the employer's plan includes a lifetime income or annuity distribution option. Plan fiduciaries should determine if these disclosures (under the rules) necessitate additional communications to plan participants, especially if an annuity is not actually an option for a plan distribution. It remains to be seen whether this disclosure obligation will be useful to participants, and whether it will become a factor which leads to the proliferation of available lifetime income distribution options.

Portability of Lifetime Income Options

Prior to the SECURE Act, participants in defined contribution plans could request an in-service distribution only in limited circumstances if the plan so allowed, thereby preventing a participant from avoiding fees or preserving an otherwise discontinued lifetime income investment through a distribution or rollover. Effective for plan years beginning after 2019, the SECURE Act provides for certain allowances where a lifetime income investment ceases to be an option under a qualified defined contribution plan, a 403(b) plan, or governmental 457(b) plan. In such cases (except as otherwise provided in the guidance), the plan may allow certain qualified distributions to another employer retirement plan or individual retirement account, or may allow distributions of a lifetime income investment in the form of a qualified plan distribution annuity contract, if made within a 90-day period ending the date that the investment is no longer authorized to be held as an investment option under the plan. Plans with such provisions will need to address these issues in plan documents and communications.

Plan Terminations

In the event of a retirement plan termination, there will be many notices and communications to plan participants including information regarding plan distributions and when they will commence. Any plan sponsor contemplating a plan termination should create a timeline to complete required tasks associated with the event and provide ample time to design and issue participant communications. It also is important to have procedures well in advance to address missing participant issues and develop protocols for handling of any uncashed checks that may arise during the plan termination process.

Enhanced Educational Materials

There is increasing awareness around the need for educational materials addressing financial literacy and financial wellness. Plan sponsors and fiduciaries should consider the scope of educational materials and tools to provide participants that address plan distributions, including those that enable participants to analyze their distribution options and weigh the pros and cons of taking distributions at certain times. General plan information will likely include basic descriptions of the impact of preretirement withdrawals on retirement income, but there may be more enhanced resources that can be provided to participants through plan service providers. Also, whether there is a need for any special targeted messaging to participants should be evaluated, such as for those who may have experienced furloughs, taken coronavirus-related or disaster distributions, be approaching normal retirement age, or had other special circumstances. When designing the scope of such communications related to plan distributions, it is also important to recognize that there is a recurring debate that participants do not read, understand, or cannot even locate all of their plan materials. Thus, any enhanced communications program should consider ways to provide information in digestible formats and to utilize modern tools for doing so from among those that are available in the marketplace.

Conclusion

The foregoing suggestions are a starting point for reviewing plan compliance with plan distribution disclosure obligations and developing a strategy that supplements the required communications in a brief and engaging manner. It also is important to monitor new guidance and update disclosures in a

timely manner consistent with the operation of plan terms. Plan sponsors and fiduciaries will find that it is a worthwhile exercise to take a high-level view of the various required disclosures and communications concerning plan distributions to determine not only level of compliance, but also how they work together and play an important role in their plan participants' retirement savings and benefit payment story. ■

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