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Winners and Losers Now that the Original DOL Investment Advice Fiduciary Regulations Are Back in Effect

By Anthony L. Scialabba, Esq.

For much of the past eight years, the Department of Labor ("DOL") has attempted to change its regulations that cause a person or entity to become a retirement plan fiduciary under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), because the person or entity provided investment advice. As a result of the government's efforts in this regard, many major investment advisories changed the manner in which they operate in the retirement plan field. The companies who underwent this transformation spent a great deal of money to do this. However, recently, the Fifth Circuit Court of Appeals struck down the DOL's latest attempt at changing the original investment advice regulations. The DOL did not challenge the Circuit Court's decision. Thus, the original investment advice regulations are generally the current law in this area.

The article will discuss the general background concerning the DOL's efforts to change the original regulations. Subsequently, the current rules in effect and the significance of the government's capitulation will be discussed. This will be accomplished by addressing the so-called "winners" and "losers" involved with the DOL's cessation of efforts to change the rule. Finally, it is noteworthy that the Securities and Exchange Commission ("SEC") has proposed rules that concern advisor's acts in this area. However, since as of the date of the writing of this article, such rules have not been finalized. Thus, this article will only address the rules that are currently in effect in connection with this matter.

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I. Background

Section 3(21)(A) of ERISA defines the term "fiduciary" by setting forth three categories of functions in connection with a plan that would cause a person to become a fiduciary. The second category applies fiduciary status to someone who is providing "investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of" an ERISA-covered plan. In 1975, the DOL dealt with the question of whether broker-dealers would be deemed to be providing investment advice for compensation (and, therefore, be fiduciaries) because they provided routine stock buy-and-sell recommendations to plan fiduciaries. In this regard, the DOL issued a class exemption (PTE 75-1) to permit broker-dealers to execute securities transactions for plans without engaging in technical violations of the prohibited transaction restrictions of ERISA. The government recognized that it was not the intent of Congress that such activities would make these broker-dealers "fiduciaries" under ERISA [DOL PTE 75-1]. In 1975, the government issued the regulations in an effort to clarify that such recommendations would not make persons fiduciaries by reason of providing "investment advice" ("Original Regulations"). [*See* Labor Reg. § 2510.3-21(c)(1), 40 Fed. Reg. 54842 (Oct. 31, 1975)]

A. Duties and Liabilities of Being a Fiduciary

ERISA generally provides two sets of rules that a fiduciary must satisfy. The "first" set of rules are set forth under section 404(a) of ERISA. They provide certain "seminal" duties that a fiduciary with respect to a retirement plan must satisfy. ERISA requires that a fiduciary must act prudently with respect to a plan [ERISA §404(a)(1)(B)]. A fiduciary must operate a plan for the exclusive benefit of participants and beneficiaries [ERISA § 404(a)(1)(A)]. A fiduciary must diversify plan assets, unless it is clearly prudent not to do so [ERISA § 404(a)(1)(C)]. Finally, a fiduciary must operate a plan in accordance with its terms [ERISA § 404(a)(1)(D)].

The "second" set of rules is referred to as the "prohibited transaction" rules. They are set forth under section 406 of ERISA. These rules require, in pertinent part, that a fiduciary with respect to a retirement plan generally must not permit certain transactions to occur between parties that are in a certain relationship to a plan and must not self-deal with plan assets. If an investment advisor seeks to provide products and services to a plan on a commission basis, the prohibited transaction rules generally proscribe this from occurring if the broker is deemed to be a fiduciary with respect to the plan's assets in question. In addition, most of the exemptions from the prohibited transaction rules that a service provider or counter party rely upon to conduct ordinary course business with plans require that the service provider or counterparty not be a fiduciary.

The consequences can be adverse if a fiduciary of a retirement plan violates the aforementioned requirements. The most significant sanctions are set forth as follows. A fiduciary could be held personally liable to make restitution for any losses sustained by a plan or on any lost opportunity costs because of the fiduciary's violation [ERISA § 409(a)]. In addition, a fiduciary may also be required to pay for the suing party's litigation costs (typically, a participant's or beneficiary's court and

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attorney fees) [ERISA §§ 502(g)(1), 502(g)(2)(B)]. Finally, a fiduciary could be required to pay certain prohibited transaction excise taxes imposed by the Internal Revenue Service [I.R.C. § 4975]. Individuals and entities would be better served by choosing to be fiduciaries, after having used careful reflection, rather than becoming fiduciaries by circumstance.

B. An Overview of the DOL's Regulatory Efforts

In 2010, 35 years after the promulgation of the Original Regulations, the DOL attempted to revise them by issuing proposed regulations ("2010 Proposed Regulations"). [Prop. Labor Reg. § 2510.3-21(c), 75 Fed. Reg. 65263 (Oct. 22, 2010); *see* A. Scialabba, "The Department of Labor Newly Proposed Regulation to Expand the Definition of Fiduciary Under ERISA," *Journal of Pension Benefits*, Vol. 18, No. 4 Summer 2011.] However, the proposed regulations were withdrawn due to significant industry criticism. [D. Carleen, J. Ross, and J. Gelfand "U.S. DOL ERISA Fiduciary Rule" a Fried Frank Memorandum (2015)]

The DOL reviewed the Original Regulations. Subsequently, in April 14, 2015, the DOL published another set of proposed regulations ("2015 Proposed Regulations") that would revise the Original Regulations to deal with many of the criticisms leveled at the 2010 Proposed Regulations. [Prop. Labor Reg. § 2510.36-21, 80 Fed. Reg. 21928 (April 20, 2015); *see* A. Scialabba, "DOL Proposes Significant Expansion of 'Investment Advice' Fiduciary Definition," *Journal of Pension Benefits*, Vol. 22, No. 4, Summer 2015] In 2017, during the last year of the President Obama's administration, the 2015 Proposed Regulations were finalized in substantially the same form as the proposed regulations ("2017 Regulations"). [*See* A. Scialabba, "The Status of the New DOL Fiduciary Regulations and How Plan Sponsors and Plan Fiduciaries Should Respond to Them," *Journal of Pension Benefits,* Summer 2018, Vol. 25, No. 4. [hereinafter cited as "Scialabba 2017 Regulations Article"]] In this regard, the 2017 Regulations technically became effective June 7, 2016. [Labor Reg. § 2510.3-21(h)(1)] However, they were not made "enforceable" (technically "applicable") until April 10, 2017, for some provisions and not until January 1, 2018, for other provisions. [*See* Scialabba 2017 Regulations Article (providing a more in-depth discussion of the history of the DOL's regulatory efforts in this area from April 10, 2017 to March 2018)]

On March 15, 2018 – The Fifth Circuit Court of Appeals, in the case of *Chamber of Commerce of the USA v. US Dep't of Labor*, No. 17-10238 (5th Cir. 2018), vacated the fiduciary rule in a 2-1 decision, saying it constituted "unreasonableness," and that the DOL's implementation of the rule constituted "an arbitrary and capricious exercise of administrative power." The case had been brought by The U.S. Chamber of Commerce, The Financial Services Institute and other litigants. Subsequently, the DOL decided not to enforce the rule or challenge the Fifth Circuit's decision. Finally, on June 21, 2018, the 5th Circuit Court of Appeals confirmed its decision to vacate the rule.

II. The Impact of Now Having to Comply With the Original Regulations

To understand the impact of now having to comply with the Original Regulations, there must first be a discussion of the 2017 Regulations. In

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general, under the 2017 Regulations, a person that received a fee for providing investment advice to an "ERISA-covered" retirement plan (401(k), profit sharing, and defined benefit plans, Section 403(b) tax-sheltered annuities, and Section 457 plans) or IRA (both traditional and Roth IRAs) was a fiduciary if the person:

- provided the advice pursuant to an agreement that the advice is based on the particular investment needs of the advice recipient,
- directed the advice to a particular recipient(s) concerning the advisability of a particular investment or management decision, or
- represents that he or she is acting as a fiduciary.

[2017 DOL Reg. § 2510.3-21(a)(2)]

In addition to these actions, the following were considered to be investment advice:

- recommendations as to the advisability of acquiring, holding, or disposing or exchanging plan assets (including after a rollover from a plan to an IRA),
- recommendations regarding investment policies/strategies, or
- recommendations regarding rollovers from a plan/IRA.

[2017 DOL Reg. § 2510.3-21(a)(1)]

The Original Regulations effectively narrowed the concept of "investment advice" the concepts of Section 3(21)(A) of ERISA through the utilization of a five-factor test. [*See* Labor Reg. § 2510.3-21(c)(1), 40 Fed. Reg. 54842 (Oct. 31, 1975)]. In addition to satisfying the "fee or other compensation" to an ERISA-covered retirement plan requirement to be deemed a fiduciary under the Original Regulations, an advisor must: (1) provide investment recommendations or advice on property values; (2) on a regular basis; (3) pursuant to a mutual agreement, arrangement, or understanding with the plan; (4) provide advice that will serve as a primary basis for plan investment decisions; and (5) provide advice that will be individualized, based on the particular needs of the plan. [*Id.*]

When these rules are compared to the 2017 Regulations, the significant differences are as follows. It is clear that there is now a "regular basis" requirement and a requirement that the advice will serve as the primary basis for the investment decision. In addition, there is no longer a need to have a determination as to whether based on the content, context, and presentation, the communication would reasonably be viewed as a suggestion to engage in or refrain from taking a particular course of action. This has been replaced with a need for a mutual understanding between the advisor and the recipient. Finally, the Original Regulations do not apply to investment advice in connection with rollovers from retirement plans to IRAs.

III. Winners and Losers

A. Winners

1. Onesy/Twosy Financial Advisors

Under the 2017 Regulations, a financial advisor would have had to satisfy a certain "Prohibited Transaction" exemption known as the "Best Interest Contract Exemption" ("BIC Exemption") in order to receive "variable" (i.e., commission-based) compensation. The exemption

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was somewhat onerous to satisfy. In addition, compliance with the BIC Exemption would have exposed advisors to significantly augmented compliance costs and obligations and increased risks. For example, the exemption required significant written materials to be provided to a retirement investor.

The full application of the 2017 Regulations would have made it difficult for financial advisors who do not specialize in retirement plans to compete with more established, erudite firms. Therefore, the so-called "onesy/twosy" advisors (i.e., advisors who do not have many retirement plan clients) perhaps would have had to team up with a more established investment advisory firm to do business in the retirement plan investment space or leave the area all together. [*See* Scialabba 2017 Regulations Article at 39] Now these advisors can still work in the retirement plan investment area.

2. Financial Advisors and Investment Advisory Firms in General

The 2017 Regulations placed significant burdens on financial advisors and investment advisory firms. The rules would have generally required these parties to produce significant amounts of paperwork. For example, financial advisors and investment firms would have had to restructure existing investment service contracts in many instances and revise many external and internal documents. The 2017 Regulations would have also exposed these parties to a greater risk of ERISA litigation. The effective repeal of the 2017 Regulations removes the compliance costs associated with the regulations.

3. My Wife

My wife, Linda, is a winner because she no longer has to hear me drone on and on about the twists and turns of the DOL investment advice regulations. I am sure that other spouses may experience similar relief.

B. Losers

1. The DOL

The Fifth Circuit basically ruled against the DOL because the Court felt that the 2017 Regulations represented an overreach of the government's authority. As mentioned above, the DOL not only lost in this case but it repealed its 2010 Proposed Regulations after it received blistering criticism from the Investment Advisory industry. These loses have undoubtedly harmed the prestige of the DOL.

In addition to a loss of stature, the DOL stated that the 2017 Regulations were enacted because the government concerned about advisors providing conflicted advice. [Preamble to Labor Reg. § 2510.3-21, 81 Fed. Reg. 20946] However, there may have been another, subtler rationale for the creation of the rules. In this regard, the preamble to the 2010 Proposed Regulations which were also aimed at expanding the scope of who could be an investment advice fiduciary is informative. The preamble provided that the broadened definition of who is a fiduciary was intended to improve the DOL's ability to redress violations of ERISA by investment advisors. [Preamble to Prop. DOL Reg. § 2510.3-21(c), 75 FR 65263 (10/21/10)] In addition, the DOL noted that this could be accomplished by reducing the amount of time, costs and resources required to establish that an investment advisor is a fiduciary under ERISA, as

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was necessary under the Original Regulations. [*Id.*]

However, it is interesting to note that this rationale was not stated by the DOL in the preamble to the 2015 Proposed Regulations or to the 2017 Regulations.

Defendants in an ERISA law suits often aver that they are not fiduciaries. The DOL found itself litigating this issue often when trying to include financial advisors in lawsuits. Thus, an unstated purpose behind the enactment of the 2017 Regulations could have been that they make it administratively convenient for the government in litigation. [*See* Scialabba 2017 Regulations Article at 35]

Now that the 2017 Regulations will not be enforced, the DOL will again be forced to litigate the issue as to whether an investment advisor is a fiduciary every time that an advisor litigates with the government. This will be a burden on the DOL's time, costs and resources.

2. Participants and Beneficiaries

To the extent to which the 2017 Regulations required investment institutions and investment advisors to provide services at a higher standard of not providing conflicted advice than the Original Regulations, this would have helped participants and beneficiaries of retirement plans. However, the cost to financial institutions to comply with the 2017 Regulations may have been passed through to the participants and beneficiaries. Thus, this could have potentially offset any gains provided by the application of the standards set forth in the 2017 Regulations.

In addition to a lesser standard of compliance associated with conflicts of interest and investment advice, the more fiduciaries that exist with respect to a particular retirement plan, the more pockets which are available to pay money in settlements or damages in law suits. The 2017 Regulations would have added to the number of fiduciaries with respect to a retirement plan. Thus, the effective repeal of these regulations hurts the retirement security of participants and beneficiaries.

3. Plan Fiduciaries

The aforementioned "additional" pockets theory would have also helped plan fiduciaries to share in settlements and damage claims.

4. Financial Institutions that Complied With the 2017 Regulations Early

Major investment advisory firms early on had "geared-up" to comply with the 2017 Regulations. [NAPA Net Staff, "Merrill Moves Back to Commissions on Retirement Accounts" NAPA Net (2018) ("Back in October 2016, with…the fiduciary regulation headed toward an April 10, 2017 implementation, Merrill Lynch announced that it would no longer give retirement savers the option of paying a commission for trades once the new fiduciary regulation to effect.") [hereinafter cited as "NAPA Net Staff Article"]] These firms expended significant amounts of time and money in this regard. [B. Kelly, "DOL fiduciary rule compliance costs exceed $4.7 billion: SIFMA [Securities Industry and Financial Markets Association] study" Investment News (2017)] Unfortunately, the 2017 Regulations were only in force from April 10, 2017 to until June 21, 2018

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when the Fifth Circuit Court of Appeals issued the order to vacate the rules. Thus, the efforts that the firms spent to comply with the 2017 Regulations was arguably wasted.

Some of the investment advisory firms that complied early with regard to the 2017 Regulations have stated that they will still operate in compliance with certain features of the rules (e.g., the "Best Interest Standard" and non-variable compensation). [NAPA Net Staff Article ("Along with the shift in commissions, the firm [Merrill Lynch] reiterated its commitment to a fiduciary [best interest] standard….")] However, competitive pressures (from, for example, the onesy/twosy advisors who also wish to work in the retirement plan investment industry) and client demands have caused some investment advisory firms to pull back from their intended compliance with the 2017 Regulations. [*See* J. Horowitz, "JP Morgan to Remove Some Fiduciary Rule Handcuffs, Others May Follow" AdvisorHub (2018); NAPA Net Staff Article quoting Andy Sieg, head of Merrill Lynch Wealth Management stating "In response to client feedback, we're announcing steps today that will provide our clients with greater choice and flexibility, while maintaining our support for a Best Interest standard for investment advice across all accounts….".)]

5. RIAs

RIAs charge at flat fee rates. Thus, they do not charge their fees on a commission basis. The 2017 Regulations generally proscribed investment advisors from charging fees on a variable compensation basis. With regard to complying with the 2017 Regulations, RIAs would have had a marketing advantage because they were already not charging fees on such basis. Thus, RIA stood to gain market share in the retirement plan investment space by arguing that they were already "out in front" of the 2017 Regulations. Now that the 2017 Regulations have been effectively repealed, this competitive edge has vanished.

Conclusion

ERISA itself and the DOL's enforcement of this statute have been successful in providing retirement income security to many Americans. This is why the DOL's failures to craft acceptable investment advice regulations are significant. However, although the DOL has taken a blow with respect to its attempts in to change the investment advice fiduciary regulations, as mentioned above, like the 2017 Regulations, the SEC has proposed new regulations that apply a "best interests" standard on investment advisors that could be servicing retirement plans. [Securities and Exchange Commission 17 CFR Part 240, Release No. 34-83062; File No. S7-07-18, RIN: 3235-AM 35, Regulation Best Interest] Since these SEC regulations are only in "proposed" form, it is unclear as to whether they will be finalized, particularly in the current "anti-regulatory" climate created by President Trump's administration. However, if the SEC regulations do become finalized and if the DOL's 2017 Regulations encouraged the SEC to issue somewhat similar rules, then, to some degree, the DOL's efforts may have paid off and its stature may be restored.

ERISA's Fidelity Bond Requirements

By Anthony L. Scialabba, Esq.

The Employee Retirement Income Security Act of 1974, as amended ("ERISA"), generally provides rules for how fiduciaries must operate and manage retirement plans. One of ERISA's requirements is that individuals who handle plan assets must be covered by a fidelity bond to protect a plan from losses due to fraud or dishonesty ("ERISA Bond"). The following summarizes the requirement to obtain an ERISA Bond in connection with retirement plans.

What an ERISA Bond Is

An ERISA Bond is insurance that protects a plan from losses caused by acts of fraud or dishonesty. A plan is named (or otherwise specifically identified) as an insured party on the bond. This allows the plan to recover losses covered by an ERISA Bond. Deductibles or other similar features are precluded for coverage of losses within the maximum amount for which the person causing the loss is required to be bonded.

An ERISA Bond Is not Fiduciary Liability Insurance

An ERISA Bond protects the participants of a retirement plan from acts of fraud or dishonesty. The bond does not protect the fiduciaries of a plan from liability of breaches of the requirements of ERISA. An ERISA Bond protects participants of a retirement plan, for example if a trustee absconds with plan assets.

Individuals Who Must Be Bonded

Every individual who "handles funds or other property" of a retirement plan is required to be bonded unless covered under an exemption under ERISA. The Department of Labor ("DOL") which is responsible for enforcing ERISA has established criteria for determining whether a person is handling plan funds. In this regard, a person is considered to be handling plan funds if he or she has a realistic opportunity to steal plan funds in the ordinary course of his or her everyday duties.

The Amount of Coverage that the Bond Must Provide

In general, each individual must be bonded in an amount equal to at least 10% of the amount of funds he or she handled in the preceding year. However, the amount of the ERISA Bond amount cannot be less than $1,000, and it is not required to be for more than $500,000, or $1,000,000 for plans that hold employer securities.

The Types of Retirement Plans that Are not Subject to the ERISA Bonding Requirement

The ERISA bonding requirements do not apply to retirement plans that are completely unfunded (e.g., the benefits are paid directly out of an employer's general assets (like how many executive compensation plans operate)), or to plans that are not subject to Title I of ERISA (e.g., church plans, governmental plans.)

Other Exemptions From ERISA's Bonding Requirements

ERISA and regulations promulgated by the DOL provide exemptions for some regulated financial institutions, including certain banks, insurance companies, and registered brokers and dealers if certain conditions are satisfied. However, a service provider, such as a third-party administrator or investment advisor, must be bonded

ERISA's Fidelity Bond Requirements?...cont'd

if the service provider or its employees handle funds or other property of a retirement plan.

A Retirement Plan May Pay for the ERISA Bond With Plan Assets

The plan can pay for the bond using the plan's assets.

A Retirement Plan Does not Have to Purchase an ERISA Bond for a Service Provider

A service provider to a retirement plan can purchase its own separate ERISA Bond that insures the plan. The plan may agree with the service provider that the service provider will pay for the bond. In addition, the fiduciaries of a retirement plan can decide to add a service provider to an existing ERISA Bond.

The Individual(s) Who Are Responsible that the ERISA Bond Requirement Is Met

The responsibility for ensuring that the plan has proper bonding coverage may fall upon any persons who handle plan funds or other property. In addition, any other individual who can authorize another person to perform handling functions is responsible for ensuring that those persons are properly bonded.

Failure to Have an ERISA Bond

Failure to have an ERISA Bond is a breach of the fiduciary duty rules under ERISA. In this regard, a fiduciary can be held liable for losses to a retirement plan resulting from the breach.

Where an ERISA Bond May Be Obtained

An ERISA Bond must be obtained from a surety or reinsurer that is named on the Department of the Treasury's Listing of Approved Sureties, Department Circular 570 (available at fms.treas.gov/c570/c570.html). In addition, an ERISA Bonds may be obtained from underwriters at Lloyds of London provided certain conditions are satisfied.

The Top-Heavy Rules for Defined Contribution Retirements Plans

By Anthony L. Scialabba, Esq.

One of the most burdensome requirements that apply to "defined contribution", "tax-qualified" retirement plans sponsored by many small businesses are the "top-heavy" rules. In fact, probably most retirement plans sponsored by professional service companies with less than 20 employees are top-heavy.

The Top-heavy Rules in General

Under the "tax qualification" rules of the Internal Revenue Code of 1986, as amended ("Code"), a defined contribution plan (e.g., 401(k) plan) is generally considered to be top-heavy when more than 60% of plan assets are attributable to "key employees" as of the "determination date". The significance of a retirement plan having "top-heavy" status is that the plan will be subject to certain minimum contribution requirements.

Key Employees

A key employee is an employee who at any time during the plan year:

- Owned more than 5% of the employer*;

The Top-Heavy Rules for Defined Contribution Retirement Plans...cont'd

- Owned more than 1% of the employer* and had compensation in excess of $150,000; or
- Was an officer of the employer with compensation in excess of a specific dollar amount that is indexed annually ($175,000 for 2018).

* Determined after applying certain stock attribution rules.

Determination Date

Top-heavy status must be tested annually. In this regard, for the first plan year, the date for analyzing whether a plan is top-heavy is the last day of the plan year. For subsequent years, the determination date is the last day of the prior plan year.

How Top-heavy Status Is Determined

In general, the "60%" top-heavy ratio is calculated by comparing the account balances of key employees to the account balances of "non-key employees" as of the Determination Date. However, there are certain adjustments that must be made with regard to the comparison.

With regard to the adjustments, first, the following account balances of participants are excluded:

- Rollover account balances;
- Account balances of terminated participants who did not work for the employer during the plan year; and
- Account balances of former key employees (This means participants were considered to be key employees in a prior plan year, but who are no longer considered as such.).

Second, the following distributions are included:

- Distributions made on account of termination, death or retirement if the participant worked for the employer during plan year (This is referred to as the "1-year rule".); and
- In-service distributions made within the 5-year period ending on the determination date (This is referred to as the "5- year rule".).

Top-heavy status may change from year to year. Thus, a plan can lose its top-heavy status.

The Minimum Contribution Requirements

An employer must generally make a contribution on behalf of non-key employees in an amount equal to the lesser of 3%, or the "highest contribution rate" of any key employee. To determine the highest contribution rate for key employees, all contributions (other than rollover contributions) are considered when calculating the contribution rates for key employees. This means that elective deferral contributions and Roth contributions are included. For example, if an employer does not make any employer contributions to a top-heavy plan for a particular plan year but key employees still make elective deferral contributions, the employer would have to satisfy the top-heavy minimum contribution requirement.

The Top-Heavy Rules for Defined Contribution Retirement Plans...cont'd

The following contributions count towards satisfying top-heavy minimum contributions:

- Employer nonelective contributions,
- Employer matching contributions,
- Forfeiture allocations,
- Safe harbor nonelective contributions,
- Safe harbor matching contributions,
- Qualified Nonelective Contributions (“QNECs”), and
- Qualified Matching Contributions (“QMACs”).

If an active non-key participant received contributions sufficient to satisfy the top-heavy minimum, no additional contributions must be made on his or her behalf.

All non-key employees who were eligible to participant in a plan and who were employed on the last day of the plan year are entitled to receive a top-heavy minimum. This rule applies even if the plan otherwise imposes an allocation condition in order to share in employer contributions (e.g., “1,000 hours of service” requirement).

Top-heavy plans that allow for immediate entry with respect to elective deferral contributions but have a longer eligibility period in connection with employer contributions are still required to make top-heavy minimums for non-key participants who were only eligible for the portion of the plan that concerns elective deferral contributions.

Top-heavy minimums are determined by considering the participant’s compensation for the entire plan year. This rule applies even if the plan otherwise excludes compensation paid prior to the participant’s plan entry date.

Employers With more than One Plan

In general, all qualified plans sponsored by the employer must be amalgamated for top-heavy purposes including (1) each plan that covers at least one key employee, and (2) any other plans that are aggregated in order to satisfy coverage testing or nondiscrimination testing. If an employer sponsors a defined contribution and defined benefit plan, both plans must be considered. Defined benefit plans which are top-heavy are subject to different requirements than rules discussed herein.

Related Employer Issues

Companies that are members of a “controlled group of employers” or an “affiliated service group of employers” are treated as a single employer for purposes of the top-heavy rules. If more than one employer sponsors a plan, the plans must be amalgamated as described above.

Safe Harbor Plans

In general, “safe harbor” 401(k) plans are not required to make top-heavy minimums if the employer makes no contributions to the plan other than (1) safe harbor matching contributions, (2) additional matching contributions that satisfy the safe harbor rules, or (3) safe harbor nonelective contributions. It is important to note that top-heavy minimums in safe harbor plans can be caused by forfeiture allocations.

The Top-Heavy Rules for Defined Contribution Retirement Plans...cont'd

Consequences if an Employer Fails to Make Top-heavy Minimum Contributions

Failure to make top-heavy minimum contributions is an "operational" defect that will jeopardize the tax-qualified status of the plan. The Internal Revenue Service provides a program for correcting defects in tax-qualified retirement plans known as the "Employee Plans Compliance Resolution System" ("EPCRS"). If top-heavy contributions are not funded, the employer contributions must be made, along with related earnings, in accordance with the principles set forth under this program. If you wish to receive additional information about EPCRS, please contact us.

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