IRS Publishes Final Report on 401(K) Compliance

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During March of 2013, the Internal Revenue Service published its final report containing the results from questionnaires sent out to a random group of 1200 401(k) plan sponsors. The questionnaires asked about participation, contributions, nondiscrimination testing, distributions, loans, automatic contribution arrangements, Roth features, compliance and correction programs, and plan administration generally.

It may be of interest to readers to note how their plan design compares with other plans of the same size. For purposes of reporting, the IRS considered a small plan to have 0 to 5 participants, a medium plan to have 6 to 100 participants, a large plan to have 101 to 2500 participants, and a very large plan to have more than 2500 participants.

The results are as follows:

- Employee Before-Tax Contributions
  - — One year wait prior to employee eligibility: 54% of all plans
  - — Age-21 eligibility requirement: 64% of all plans
  - — Plan permits after-tax Roth contributions as well: 4% of all plans
  - — *Very large plans are more likely to not have an age requirement and more likely to permit after-tax contributions.*
- Company Contributions
  - — Matching contributions: 68% of all plans
  - — Plans that are top-heavy: 20% of all plans
  - — *Large and very large plans are more likely to have matching contributions. Small and medium plans tend to be top heavy.*
- Nondiscrimination Testing
  - — Correct excessive employee before-tax contributions within 2.5 months of the end of the relevant plan year: more than 50% of all plans
  - — Correct excessive matching contributions by distributing to participants: more than 75% of all plans
  - — Use the Code Section 401(k)(12) safe harbor to avoid nondiscrimination testing: 43% of all plans
  - — *Small and medium plans are more likely to use the safe harbor provisions.*
- Automatic Employee Contributions
  - — Provides for automatic employee contributions: 5% of all plans
  - — *Large and very large plans are more likely to have this feature.*
- Distributions, Withdrawals, and Loans
  - — Force out small accounts at termination: 72% of all plans
  - — Permit in-service withdrawal: 62% of all plans
  - — Permit hardship in-service withdrawal: 76% of all plans
  - — Permit loans: 65% of all plans
  - — *Very large plans are more likely to permit in-service withdrawals and loans.*
- IRS Correction Programs
  - — Have used the IRS correction program: 6% of all plans
- Plan Document
  - — Use a preapproved plan (either prototype or volume submitter): 86% of all plans
- Administration
  - — Use a third-party administrator for administration: 53% of all plans
  - — Use a third-party administrator for amendments: 73% of all plans
  - — Use a third-party administrator for Form 5500: 83% of all plans

While a final decision as to plan design must be made in light of both the financial needs of the employer and attractiveness of employee benefits to current and prospective employees, it is useful to see the features of a "typical" 401(k) plan.

DOL ISSUES GUIDANCE ON TARGET DATE MUTUAL FUNDS

Target date mutual funds have increasingly become components of 401(k) plans. The Department of Labor (DOL) has recently expressed concerns about possible misunderstanding by participants as to how such funds operate. In order to advise a plan sponsor of its duty to properly evaluate, monitor, and communicate a target date fund to participants, the DOL issued informal guidance in February 2013.

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While the guidance provides more detail, the general principles of the guidance are as follows:

- A target date fund needs to be evaluated in light of the ages and likely retirement dates of plan participants along with other relevant factors such as participants also participating under a defined benefit pension plan.
- The glide path of a target date fund needs to be fully understood. Does the fund assume participants will cash out at retirement, and therefore by that date the investments are very conservative? Or does the fund assume the participant will make withdrawals throughout retirement, thereby requiring more exposure to the growth and risk of the market?
- As is the case for other plan investments, a target date fund must be examined to see how investment fees are determined and how they compare with those of other similar funds.
- It is very important for the plan sponsor to effectively communicate the costs and risks of a target date fund so participants who self-direct fully understand the nature of the investment.

Most of this guidance reflects actions that should be taken by a plan sponsor with regard to all offered investments. But due to the marketing of target date funds that could lead a participant to mistakenly believe it is a risk-free investment that will maximize at the time he or she wishes to retire, it is crucial that the risks and rewards of this type of investment be properly communicated.

NOT ALL MEDICAL INFORMATION IS CONFIDENTIAL

The Seventh Circuit issued a decision in late 2012 rejecting an aggressive Equal Employment Opportunity Commission (EEOC) posture on employee medical information. In *EEOC v. Thrivent Financial for Lutherans,* issued November 20, 2012, an employee had an unexplained absence from work. In the past, the employee had always notified the employer in advance of any absences. His supervisor sent him an e-mail asking why he was absent. In his reply, the employee explained in detail his medical condition consisting of severe migraine headaches. The employee resigned about a month later over a job responsibility dispute. He had not been disciplined in any way for missing work due to his migraines.

When the employee failed to secure another position, he hired a reference checking company called RMI to find out what sort of reference Thrivent was giving to prospective employers. During the course of RMI's call to Thrivent, Thrivent revealed the employee's migraine condition although it stated it had no problem with the condition but rather with the employee's failure to notify Thrivent when absent. Following this, the employee filed a complaint with the EEOC, and the EEOC brought suit against Thrivent for revealing confidential information protected by the Americans with Disabilities Act (ADA). The initial trial court said the information was not protected because it was not obtained through a medical inquiry.

The Seventh Circuit agreed with the trial court and stated "medical examinations and inquiries" are protected, not medical information obtained through other inquiries that occur on the job. The court further stated that it was unreasonable to construe this as a medical inquiry since Thrivent had no idea why the employee was absent, just the fact he was absent and had not called in as required.

The Court made the following statement about the EEOC's attempt to try to argue all medical information was entitled to confidentiality under the ADA regardless of how it was obtained such as being voluntarily disclosed as was the case here:

> *We reject the EEOC's argument that the term "inquiries" as used in [the Americans with Disabilities Act] refers to all job-related inquiries, and not just medical inquiries. Because the EEOC concedes on appeal that Brey's email to Messier was not a medical inquiry, Thrivent was not required to treat the medical information that Messier sent in response to Brey's email as a confidential medical record. Thus, Thrivent did not violate the requirements of 42 U.S.C. § 12112(d) by revealing Messier's migraine condition to RMI because the statute did not apply.*

While this decision should be welcomed by employers in that not all medical information is entitled to confidentiality under the ADA, this is not to say an employer should not be cautious about disclosing medical information, legally confidential or not. In retrospect, a better reference statement would have been to merely state the employee was absent on several occasions without notifying the employer and not delve into the medical reasons for the absences.

The above discussion is intended to briefly summarize certain recent legal developments in employee benefits, but is not intended to be legal advice and must not be relied upon as such. All readers are urged to raise any concerns they may have based on matters discussed in this column with experienced benefits legal counsel.