Employee Benefit Fundamentals for Education Institutions and Non-profits

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PART 1: WHY IS THIS SO COMPLICATED?

Unique Challenges

- Institutions face unique challenges with regard to the design and administration of their benefit plans, including:
  - Diverse Workforce Needs: At universities, faculty, staff, adjunct and student employees have different needs and expectations
  - Tenure and Long-Term Employment: Tenured faculty and other positions often have non-traditional retirement dates
  - Academic Calendar: In education, structure must accommodate sabbaticals, summer breaks, and varied work schedules; similar challenges at non-profits
  - Budget Constraints: Limited funding may impact type and scope of benefits
  - Traps For the Unwary: Rules that impact tax-exempt organizations can be complex and sometimes counterintuitive

Questions That May Keep You Up At Night

- How do I help prevent my retirement plan from being a fee litigation target and joining the long list of institutions that have been sued in recent years?
- TIAA is taking care of all I need to know regarding my 403(b) plan administration, right?
- I'm generally aware there are rules governing the compensation arrangements of the institution's President and other senior administrators, are we missing anything important?
- I haven't given much thought to ACA compliance since 2015 when we established our eligibility and reporting systems, should I?

PART TWO: PLAN GOVERNANCE AND ADMINISTRATION

Plan Governance Best Practices

- Identifying Fiduciaries and Obligations
- Committees, Governance Documents, and Understanding Roles
- Staying Out of Trouble
- What’s New

Identifying Fiduciaries: Are You a Fiduciary?

- Is your plan subject to ERISA's fiduciary rules? Probably
- Named fiduciaries: At least one fiduciary must be identified in the written plan document with authority over the plan, generally the plan sponsor
- Functional fiduciaries: A person will be a fiduciary if
  - Exercises discretionary control or authority over the plan or its administration or provides investment advice for a fee (directly or indirectly)
  - Includes those who exercise discretionary control over plan assets
- Personal liability for fiduciaries

Fiduciary Obligations: ERISA Fiduciary Duties Generally

- According to ERISA:
  - A fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and (A) for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan
- Key duties of prudence and loyalty.
  - Following the plan documents (unless inconsistent with ERISA)
  - Diversifying plan investments
  - Paying only reasonable plan expenses

Identifying Fiduciaries and Obligations: Takeaways

- Fiduciary status can be named or functional
- Personal liability for breaches of fiduciary duty
- Fiduciaries must act in the interest of plan participants

Charters and Other Governing Documents

- Plan fiduciaries have a duty to follow plan documents
- Committee charter: establishes a committee and defines its responsibilities
- Investment policy statement:
  - Sets forth the investment goals and objectives of the Plan
    - Can be essential in documenting how investment options are chosen
  - Do you have an investment policy statement? Is your investment committee following it? Litigants will look to whether you've followed your investment policy statement

Using Committees Effectively: Service Providers

- An investment committee is responsible for the selection and monitoring of plan investments and service providers
- Selecting service providers
  - Request competing bids
  - Evaluate credentials
  - Understand and document fee structures, direct and indirect
  - Fiduciaries must engage in a sufficient level of due diligence to determine if engagement beneficial to participants and beneficiaries by considering expertise, fees, etc.; usually fulfilled by the RFP process
  - Document your process and document that you followed it

Case Study: Committees and Understanding Roles

- Large university sued for breach of duties of loyalty and prudence to its 403(b) plan. Plaintiffs allege:
  - Plan selected investment options that were too expensive
    - Plan used "big player" recordkeepers
  - Paid too-high per-participant recordkeeping costs
- Nine-member committee established 2007; investment policy statement approved 2011
  - Committee members didn't understand they were fiduciaries
  - Thought they could defer entirely to investment advisor
  - One didn't know whether he was even on the committee

Using Committees Effectively: Investment Options

- Give a range of options for risk and return
- Review performance history – you can’t just set it and forget it
- Evaluate fees
  - Can you get the same value for less?
  - Can you document and justify investment fees?
  - Be able to show how you came to include an investment option
- Select appropriate default investments, i.e., what happens to the money when your participant doesn’t make a selection?

Establishing a Committee and Understanding Roles: Takeaways

- Committees are an important tool in managing your 403(b) plan
- But to be effective, committee members must know their roles and perform them
- Document, document, document!

Staying Out of Trouble: Fees and Investment Performance Litigation

- Plaintiffs' theories are relatively straightforward. Some examples:
  - The plan paid too much for services like recordkeeping or administration
    - Remember, there is a fiduciary duty to only pay for reasonable expenses
  - The plan included investment options that charge unjustifiable fees
  - The plan selected or failed to remove underperforming funds. Recent cases have involved failure to monitor performance of target date funds, often the default investment option

Staying Out of Trouble: Forfeiture Litigation

- Many plans have vesting schedules for contributions made by employers on behalf of employees
- When an employee leaves employment before vesting fully in employer contributions per a vesting schedule, the employee forfeits the portion not vested
- What happens to that money?
  - Defray expenses that the participants would otherwise pay?
  - Defray expenses that the employer would otherwise pay?
- Plaintiffs' bar says the money must be used to participants' benefit

Staying Out of Trouble: Case Studies

- Case 1: Large university sued by former employees. Plaintiffs alleged:
  - Plan failed to monitor and control recordkeeping fees
  - Used retail, rather than institutional share classes
  - Too many investment options leading to confusion
- Plaintiff argued that including lots of choice excused inclusion of bad investments—Supreme Court said no, duty to monitor includes removing bad options
- Case 2: Large university sued for prohibited transactions involving excessive recordkeeping fees; SC lowered the bar to suit

Staying Out of Trouble: Takeaways

- Even cases without a lot of merit can be expensive to defend
- Good plan governance can go a long way
- The larger the plan, the larger the target

What’s New: Executive Action

- August 2025 executive order to expand types of holdings common in DC plans, proposed rule issued March 2026
  - Alternative assets - includes private equity, real estate, and digital assets
  - 46 thousand comments on the proposed rule
- Fiduciaries must continue prudent selection and monitoring of investments while considering new asset classes
- If you’re interested, watch for future guidance and consider building relationships with advisors now

What's New: ESG Investing

- Recent Fifth Circuit case found ESG (environmental, social, governance) investing to be a breach of the duty of loyalty
  - Just one case—law is not settled
  - No money damages because plaintiffs couldn't show lower investment performance because of ESG
- White House not supporting Biden-era ESG rule; New ESG proposed rule sent to White House June 30, expect to see it very soon
- Caution lights are blinking

What’s New: Takeaways

- Landscape is always changing, and your plan must be proactive to keep up with these changes
- What worked 5 years ago might not work today

403(b) Plan Issues

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403(b) Plan Issues for Non-Profits

- Universal Availability Issues
  - Special issues for students and adjuncts
  - Impact of “long-term part-time rule”
- Recognition of past eligibility credits for similar institution or non-profit
- SECURE Act and SECURE Act 2.0 changes
  - Highlights for 403(b) plans

Universal Availability Rule

- 403(b) plans subject special rule requiring that all employees be given opportunity to make elective deferrals, subject to certain exceptions including:
  - Employees who normally work less than 20 hours per week (“UAPT Exclusion”)
  - “Student” employees
  - Employees eligible to make elective deferral contribution under another 403(b) plan or a 401(k) of the employer
- Eligibility exclusions must be expressly stated in the plan document
- “Student employee” exceptions applies only to students subject to FICA tax exemption (i.e., student enrolled and regularly attending classes whose services are “incident to and for the purpose of pursuing a course of study”)

Universal Availability Rule

- Interaction with Long-Term Part-Time (“LTPT”) Employee Rule
  - SECURE/SECURE 2.0 Acts generally require that part-time employees who work two consecutive years of 500 hours of service be eligible to make elective deferrals
    - IRS has clarified that student employee exclusion trumps the LTPT rule
      - Employee excluded based on student employee exclusion does not need to be eligible to make elective deferrals, even if student employees works 500 hours in two consecutive years
    - Employee excluded based on UAPT Exclusion, must be eligible to make elective deferrals if employee works 500 hours in two consecutive years

Universal Availability Rule

- Impact on Adjuncts – For Colleges and Universities
  - Adjuncts cannot be excluded from eligibility to make elective deferrals as a class
    - Can exclude adjuncts as a class from employer contributions subject to satisfaction of nondiscrimination requirements
  - Adjuncts <u>may</u> be excluded based on UAPT exclusion
    - Beware "once in always in" rule - Adjunct who was previously eligible to make elective deferrals (e.g., as a full-time professor) must remain eligible even if no longer working 20 hours per week/1000 hours per year as an adjunct
    - Actual adjunct hours must be counted or an equivalency rule applied to estimate hours

Universal Availability Rules

- Takeaways
  - Review provisions of plan document carefully
    - Exclusions from universal availability rule only available if expressly stated in the plan document
  - Consider allowing <u>all</u> employees to make elective deferrals
    - Avoids universal availability and LTPT employee issues
    - Can exclude adjuncts and student employees from employer contributions, subject to nondiscrimination requirements

Crediting Service with Prior Employers

- 403(b) plans for non-profits and education institutions often credit prior service with other institutions
  - Common, <u>but not required</u>
  - Plan document must specifically provide for prior service credit
    - Must specify for what purpose prior service is credited (e.g., eligibility, vesting, contribution allocation)
    - Must specify what prior service will be counted
      - Acquired/affiliated entities
      - Any other higher educational institution
      - Any 501(c)(3) organization

Crediting Service with Prior Employers

- Prior service crediting provisions must be nondiscriminatory under IRS rules
  - Generally, must be supported by a “legitimate business reason”
    - Examples:
      - Interrelated business operations
      - Acquisition, affiliation, or merger
      - Similar attributes, same industry, same geographic region
    - Must treat non-highly compensated employees the same as highly compensated employees
- Consider how service with a prior employer will be determined
  - May need employment-related information from prior employer

Other SECURE Act and SECURE 2.0 Act Changes

- Changes to required minimum distribution rules
  - Required beginning date increasing to 75 by 2033
- New catch-up contribution rules
  - Additional “super catch-up” contributions available for employees age 60 to 63
  - Mandatory Roth treatment for catch-up contributions for certain highly-paid participants
- Variety of new optional distribution/withdrawal rules
  - Personal emergency, domestic abuse, natural disaster, terminal illness

OTHER DEFERRED COMPENSATION ARRANGEMENTS

Attracting and Keeping Key Talent: Other Deferred Compensation Arrangements

- How Can Non-Profits Attract/Incentivize Key Talent Beyond Salary?
  - 457(b) plans
  - 457(f) plans
  - Split-dollar life insurance arrangements

Attracting and Keeping Key Talent: Other Deferred Compensation Arrangements

- "Eligible" 457(b) Top Hat Plans/Key Features
  - Only for select group of management or highly compensated employees (e.g., President; CFO)
  - Subject to annual combined dollar limitation ($23,500) and other restrictions (e.g., no loans, etc.)
  - Unfunded and subject to claims of creditors
  - Fixed determinable time of payment
  - One-time registration requirement with DOL (No Form 5500 annual filing)
  - Limited ERISA application (claims and appeals procedures)

Attracting and Keeping Key Talent: Other Deferred Compensation Arrangements

- "Ineligible" 457(f) plan
  - Similar to 457(b) plan: unfunded, top hat, deferred compensation plan, subject to DOL filing, but generally exempt from ERISA
  - Common golden handcuff/Retention Bonus for key personnel (e.g., presidents/coaches)
  - No dollar limit on deferrals/contributions
  - Principal and earnings not taxed as income until "substantial risk of forfeiture" lapses (benefit vests)
  - Need to be structured carefully

Attracting and Keeping Key Talent: Other Deferred Compensation Arrangements

- Split-dollar life insurance arrangements
  - Generally, two types: “economic benefit/endorsement” plans and “collateral assignment/split dollar loan” plans
    - Economic benefit/endorsement arrangements
      - Employer owns policy
      - “Endorses” (assigns) portion of death benefit to employee’s beneficiaries
      - Taxable benefit – each year employee must report value of policy as taxable income due to “economic benefit” paid by employer
      - Employer can retain policy or transfer to employee

Attracting and Keeping Key Talent: Other Deferred Compensation Arrangements

- Collateral Assignment
  - Employee owns policy
  - Employer pays policy premiums for employee
  - Employer premium payments deemed “loan”
  - Employer retains collateral against portion of death benefit
  - Employee, as policyholder, may access cash value of policy via withdrawals or loans

- Prevalence/popularity
  - Collateral Assignment arrangements popular for non-profits due to compensation limitations under IRC Section 4960
  - Not considered compensation and not reportable on IRS Form 990 Schedule J

Takeaways

- There are options beyond base compensation and perks
- 457(b) and 457(f) plans are attractive compensation supplements
- 457(b) and 457(f) plans have limited administrative burdens
- However, if implement, should be carefully monitored
- Split-dollar arrangements are another creative way to compensate highly compensated employees

What if things go wrong? 457(b) Plans

- Common 457(b) plan mistakes
  - Overcontributions
  - Untimely distributions
  - Failure to implement deferral election prior to month services performed
- Consequences
  - No correction procedures exist
  - 457(b) plan is "deemed" 457(f) plan for all participants
  - Entire plan recognizes gross income for deferrals and earnings as of date of failure
  - May also be subject to penalties under 409A including excise tax
- Options
  - Correct by April 15 of following year (limited to overcontributions)
  - Freeze tainted plan/ create new plan/ wait for SOL to expire (generally three years)
  - Correct error as best as possible and wait for SOL to expire

What if things go wrong? 457(f) Plans

- Common 457(f) plan mistakes
  - Untimely vesting
  - Untimely distributions
- Consequences
  - May trigger a 409A violation, and 20% penalty and other taxes on participants.
- Options
  - Some inadvertent operational errors may be corrected under 409A over a period of 2 years from the date of error. Depends on facts and circumstances of error.

Takeaways

- Due to general lack of correction options and unexpected tax consequences for participants, vigilance is key when dealing with 457(b) and 457(f) plans

Compensation Limitations for Executives

- Code Section 4960
  - Imposes 21% excise tax on tax-exmept organization that pays compensation in excess of $1 million to any covered employee
  - $1 million limit includes “wages and remuneration” including benefits (e.g. 457(b); 457(f) deferrals when vested)
  - Employers need to closely monitor not just wages but other benefits when determining whether 4960 limits met
  - Vested 457(f) and 457(b) benefits may affect 4960 limitation
    - 457(f) plan vesting should be carefully structured

Compensation Limitations for Executives

- Code Section 4958
  - "Intermediate sanctions" on "excess compensation" considered "unreasonable"
    - 25% excise tax on "disqualified person's" "excess benefits"
    - 10% excise tax on any board member participating in excess benefit transaction
- Allows entity to create "rebuttable presumption" that compensation is reasonable. Should be:
    - Approved in advance by unconflicted authorized body (e.g., a board or committee)
    - Based on appropriate comparability data
    - Adequately documented

Takeaways

- Compensation arrangements for nonprofit presidents, senior administrators, and other highly compensated individuals need to be carefully considered and adequately recorded. Be mindful of potential adverse tax consequences.

Thank You

The information in this presentation is intended as general background information.
It is not to be considered as legal advice.
Laws can change often, and information may become outdated.

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