

Help! I Found a Mistake in my Employee Benefit Plan!



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To err is human.... The bad news is that nearly every employee benefit plan (such as a 401(k) plan, health plan, cafeteria plan or pension plan) will experience some sort of mistake over the course of the plan's life (and many will have multiple mistakes). The good news is that most benefit plan mistakes are rectifiable at a relatively reasonable cost if prompt, appropriate action is taken.

Because mistakes in plans are so common, the laws that govern such plans and the regulatory agencies that enforce them generally favor prompt, voluntary correction. Although every plan is different and every mistake is different, (so every situation will need to be evaluated based on its own unique facts and circumstances), certain common themes and risk mitigation strategies run throughout. This article outlines some of these common themes and related steps that can (and, in most cases, should) be taken when a mistake is found in an employee benefit plan.

Step I – Prioritize

When an error or multiple errors are found in employee benefit plans, the first step is to prioritize. Although most errors should be corrected promptly, some errors may be more urgent than others. For example:

- If a 401(k) plan fails its required non-discrimination testing, the statute allows penalty-free correction within 2½ months after the end of the plan year (6 months in some cases). If that deadline is missed, the next potential correction deadline is after 12 months. The sooner these errors are found and handled, the better.
- If a required COBRA notice has not been timely distributed, excise taxes will not apply if the failure is corrected within 30 days after discovery of the error and certain other conditions are met – again time is of the essence.
- If a form 5500 is not filed when due, only minimal penalties will apply if it is filed promptly afterwards under the Department of Labor's Voluntary Compliance Program.
- If a plan sponsor leaves or joins a controlled group, a transition period may be available until the end of the next plan year before the related employers must test their plans together.
- If a benefit formula is incorrect, but under the terms of the plan, no benefit accrues until a certain number of hours of service have been performed, it will be important to get a correcting amendment adopted before those hours are completed by any affected participant.

IMPORTANT: When prioritizing, an assessment and application of legal risk mitigation strategies for which deadlines may also apply is also a critical first task:

1. **Legal:** notify your in-house legal department or outside counsel, and consider whether anyone needs independent counsel and what type of counsel is needed (e.g., an ERISA/benefits attorney, a class action defense attorney or other specialist such as a criminal attorney);
2. **Insurance:** review applicable errors and omission or fiduciary insurance policies (and in some cases the plan's fidelity bond) - insurance policies generally require immediate notice of claims, prohibit settlement or compromise of claims without the insurer's approval and may require prompt notice of facts and circumstances that could lead to a claim, even if no formal claim has yet been made (this is especially true where there is insurance coverage for governmental regulatory investigations or use of the government voluntary correction programs described below, which typically have strict notice requirements); and
3. **Claims:** review potential claims against plan fiduciaries and service providers for which statutes of limitation may apply. Where potential claims exist and statutes of limitation are running, it may be possible to enter into tolling agreements with potential defendants to allow time to mitigate damages and then reach settlements without the need to file a lawsuit. And if settlement is not possible, knowing applicable statutes of limitations becomes even more critical.

So, the first step will be to assess the matter, determine urgency and any applicable deadlines and prioritize resources accordingly.

Step II – Take Immediate Action if Needed

Once priorities have been established, immediate steps can be taken to prevent additional damage. These may involve prompt restoration of plan assets, quick distribution of a missed notice, immediate adoption of applicable plan amendments, termination of service contracts, removal of breaching fiduciaries and other immediate similar urgent steps.

Prompt action will generally result in a better outcome than delayed action. Even though dealing with a mistake may be stressful, embarrassing or costly, not dealing with the mistake is likely to be even more stressful, more embarrassing and more costly. Over time, the potential for loss of important records and personnel with historical knowledge can make correction difficult (although rarely impossible) and is not an excuse for non-compliance. See [[ERISA's Records Retention for Employee Benefit Plans](#)]. In addition, if a correction involves restoration of lost earnings, the amount that will need to be restored will likely be lower if correction is undertaken sooner rather than later.

Step III – Correction

Once the situation has been stabilized, the next step is to use the various voluntary correction techniques and programs that are available:

1. **EPCRS: the “Employee Plans Compliance Resolution System”** – allows correction of a wide variety of mistakes in tax qualified plans, 403(b) plans, some SIMPLE and 457(b) plans. Some mistakes may be self-corrected [[Self-Correction of Operational Defects](#)], some must be corrected through a filing with the IRS [[To VCP or Not to VCP? That is a Plan Sponsor's Question: Part 2](#)] and others may be corrected even during an IRS audit (the IRS Audit Closing Agreement Program);
2. **Walk-in Closing Agreement Program** – this program allows retirement plans such as IRAs to voluntarily disclose plan defects to the IRS that are not eligible for correction under EPCRS and to allow taxpayers to then negotiate the tax consequences of correction;
3. **DFVCP: “Delinquent Filer Voluntary Correction Program”** - allows correction of late filings of Form 5500s [[Correcting Late or Missing Form 5500s](#)];
4. **VFCP: “Voluntary Fiduciary Correction Program”** – allows correction of certain enumerated breaches of fiduciary duty resulting in a “no action” type letter from the United States Department of Labor;
5. **RAP: “Remedial Amendment Period”** – plan sponsors may be able to correct certain plan document issues if correction is made within a designated “remedial amendment period”; and
6. **Other:** even if a mistake does not fit neatly into an established correction program, informal correction may often be made outside of the formal voluntary correction programs, e.g., fiduciaries may choose to make restoration payments to plans for breaches of fiduciary duty outside of VFCP, plan sponsors often correct late deposits to 401(k) plans outside of VFCP, many plan benefit claims are resolved through a plan’s administrative claims procedure, plan sponsors and administrators may make proactive informal requests for waivers of penalties based on reasonable cause (however, be aware that if a formal notice of a penalty is received, it is critical to respond in the manner and timing specified in any applicable regulations), etc.

Step IV – Monitoring/Prevention/Internal Controls

Once a mistake has been corrected (or the plan is on a path to correction), it is time to take stock of how the mistake happened and put in place procedures to make sure it does not happen again. In fact, to use self-correction under EPCRS, the plan must have utilized reasonable administrative procedures and to use the VCP program, the plan sponsors must affirmatively state what changes in administrative procedures have been or will be implemented internally as a part of the process of bringing the plan into compliance.

This is also a good time to review contracts with plan service providers, performance under those contracts and applicable insurance coverage (or lack of coverage). Fiduciary insurers will generally require representations about compliance and compliance reviews in their applications for insurance. Failure to demonstrate good internal controls may lead to higher premiums or even denial of coverage.

For these reasons, good internal controls [[Internal Controls Part 3: Policies and Procedures for Eligibility Determinations](#)] and careful negotiation with service providers [[10 Questions to Ask Before Signing That New Service Agreement](#)] coupled with careful monitoring of outside

service providers [[Avoiding Liability for a "Failure to Monitor" an Appointed Investment Manager Under ERISA](#)] will be key to mitigating risks and avoiding or reducing potential costs going forward.

If you would like further information about any of the issues or tips described in this article, please contact Sherrie Boutwell or any of the other attorneys with Boutwell Fay LLP.

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