ERISA Roundup

A quarterly recap of recent publications from BDO's ERISA Center of Excellence

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BDO

A Note from BDO's ERISA Practice Leaders

Can you believe 2024 is already over half-way over? For plan sponsors, mid-year can be an opportune time to assess employee benefit plan activities and accomplishments as well as to set plan administrative task priorities for the remaining year.

We hope you're also able to take the opportunity to assess and prioritize. To assist in this process, we have assembled a set of our most recent insights and resources in this ERISA Roundup. In this edition, we look at the impact of workforce reductions on 401k plans and provide information on new Department of Labor Regulations. We also included a bonus link to a recent Accounting Today interview with one of our own (ERISA specialist Norma Sharara) discussing the surprising business impacts of recent legislative expansion of 401(k) eligibility.

Stay current on ERISA topics like these by following along with our regular insights at at bdo.com/erisa and be sure to conenct with us at BDOTalksERISA@BDO.com – we welcome your thoughts and feedback!

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BDO's ERISA Center of Excellence is your source for insights on emerging regulations, industry trends, current topics, and more. Visit us at www.bdo.com/erisa or follow along on Twitter: @BDO_USA and #BDOERISA.

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2024 Deadlines and Important Dates

Sponsors of defined benefit and defined contribution retirement plans should keep the following deadlines and other important dates in mind as they work toward ensuring compliance for their plans in 2024. Dates assume a calendar year plan. Some deadlines may not apply, or dates may shift based on the plan sponsor's fiscal year. For additional support, please contact your BDO representative.

SEPTEMBER

- **15 / Fund:** If an extension was filed, September 15 is the deadline to fund employer contributions for Partnerships and S-Corporations.
- **15 / Fund:**September 15, last date to make 2023 contributions for single and multi-employer defined benefit pension plans.
- **30 / Action:** September 30, Distribute Summary Annual Report (SAR) to participants if the Form 5500 was filed on July 31.

OCTOBER

- **3 / Action:** Distribute annual notices to participants no earlier than October 3 and no later than Dec 2, including notices for: 401(k) Plan Safe Harbor Match, Automatic Contribution Arrangement Safe Harbor, Automatic Enrollment and Qualified Default Investment Alternatives (QDIA).
- **15 / Fund:**October 15 possible third quarter 2024 contribution due for defined benefit pension plans.
- **15 / Action:** October 15 is the extended deadline for filing IRS Form 5500 and IRS Form 8955-SSA.
- **15 / Action:** October 15 is the extended deadline for filing individual and C-Corp tax returns.
- **15 / Action:** If an extension was filed, October 15 is the deadline to fund defined contribution employer contributions for C-Corporations and Sole Proprietors.
- **15 / Action:** October 15 to open a Simplified Employee Pension (SEP) plan for extended tax filers.
- **15 / Action:** Send annual funding notice to participants of single- and multi-employer defined benefit plans with 100 or fewer participants by October 15.
- **15 / Action:** October 15, defined benefit plan PBGC Premium filings and payments due.
- **31 / Action:** Single-employer defined benefit plans that are less than 60% funded or are 80% funded and have benefit restrictions triggered must inform participants by October 31 or 30 days after the benefit restriction applies.

WEBINAR ON DEMAND

Accounting, Audit, and Regulatory Updates Impacting Retirement Plans

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Join BDO and our thought leaders who will provide an update on key developments in Accounting, Audit, and Regulatory Guidance pertaining to retirement plans.

At the end of this session, participants will be able to:

- Identify impact of recent accounting developments on retirement plans.
- Discuss newly effective auditing standards on retirement plans.
- Demonstrate knowledge of legislative and regulatory changes impacting retirement plans.

WATCH HERE

Stay Up to Date with Our Podcast, *BDO Talks ERISA*

BDO TALKS ERISA

Our ERISA Center of Excellence hosts a podcast — *BDO Talks ERISA!* This series covers best practices around all things ERISA and any other HR-related topics, including:

- How to avoid common compliance issues
- How to navigate the ins-and-outs of ERISA's fiduciary provisions
- Our own experiences working for BDO's ERISA Services group
- A deeper dive into the insights we share through our BDO ERISA Center of Excellence

Listen to new episodes of *BDO Talks ERISA* **here** or subscribe on **Apple Podcast** or **Spotify**. If you have suggestions for future topics or have a question for us to answer, please **send us an email**.

FROM ACCOUNTING TODAY

Expanded 401(k) Eligibility is Taking Businesses by Surprise

Potentially millions more long-term, part-time employees are now eligible to join 401(k) retirement plans, thanks to recent legislation, and there's a new method of counting defined contribution retirement plan participants on the Form 5500 Annual Return/ Report that accountants, their clients and companies will need to know.

The Setting Every Community Up for Retirement Enhancement Act of 2019 (also known as the SECURE Act) expanded long-term, part-time employee access to employer retirement plans by requiring 401(k) plans to allow employees that meet the LTPT requirements to make elective deferrals starting with the first plan year beginning on or after Jan. 1, 2024. It's important to understand the new rules because LTPT employee eligibility can potentially affect two other administrative functions for plan sponsors: Form 5500 filing and the annual employee benefit plan audit requirement.

Click here to read the full article on Accounting Today.

New DOL Regulations May Bring Clarity to ESOP Valuation Process

While a legal framework for employee stock ownership plans (ESOPs) was established by the Employee Retirement Income Security Act of 1974 (ERISA), formal guidance for determining the fair market value (FMV) of private company shares sold to an ESOP has not been issued in the 50 years since then. The U.S. Department of Labor (DOL) is now poised to issue proposed regulations (perhaps as early as March 2024 according to the DOL's most recent regulatory agenda) clarifying what constitutes adequate consideration for such shares, which has been a long-standing concern for the ESOP community.

LACK OF GUIDANCE VEXES THE ESOP COMMUNITY

Historically, the ESOP community has relied on the DOL's audit findings, process agreements, and the courts for interpretive guidance on the valuation process, which has led to inconsistencies. This leaves ESOP trustees unsure of how to determine an appropriate share price. Using the correct share price for the sale of private company stock to the ESOP is of paramount importance since the sale would be a prohibited transaction if the ESOP paid more than "adequate consideration" for the shares. Technically, the sale of employer stock to the ESOP is an ERISA prohibited transaction, but a statutory exemption allows such sales, so long as the ESOP pays no more than "adequate consideration" for the shares.

Additionally, the industry has dealt with costly litigation and investigations associated with ESOP valuations. According to the **National Center for Employee Ownership**, ESOP court cases have cost defendants an estimated $385.5 million over the past decade. Between 2007 and 2017, the **Employee Benefits Security Administration** found ERISA violations in more than 1,000 cases; ESOP valuation and loan term issues were the most common violations found.

REQUESTED CLARIFICATION AND SECURE 2.0

Over the years, ESOP groups requested clarification on this issue. Enacted on December 29, 2022, the SECURE 2.0 Act requires the DOL to issue regulations for what constitutes "adequate consideration" for sales of private company stock to an ESOP for purposes of the ERISA statutory exemption.

During 2023, the DOL met with ESOP industry professionals to gather preliminary input about the proposed regulations. Early discussions indicate that the regulatory focus is more about the general valuation process than on issuing specific rules that might limit the ability of ESOP trustees and other advisors to exercise their professional judgment.

INTERIM BEST PRACTICE CONSIDERATIONS

While the industry awaits the DOL's proposed regulations, the following are some best practices to consider when seeking to mitigate ESOP valuation risks:

- Work with skilled advisors who have deep experience with ESOP valuation analysis.
- Interview and thoroughly vet a potential ESOP trustee prior to engaging them. Look for a trustee who has developed a process and strong track record for determining FMV of private company stock.
- Use a trustee who has no ties to the company being appraised (i.e., is independent) and has experience with similar size companies in the company's industry.
- Hire valuation firms that understand both ESOPs and the industry of the company sponsoring the ESOP.

An ESOP valuation process should be transparent and balanced for all stakeholders (i.e., the trustee, sponsor, and ESOP participants). It is crucial to address potential valuation concerns at the earliest stages of ESOP planning. BDO's multidisciplinary teams include the **ESOP Advisory team at BDO Capital Advisors**[1] that can help you fully explore your ESOP potential, from preliminary analyses to full implementation, and **ERISA compliance professionals** who can assess current employee benefit programs for compliance and risk mitigation, providing advice that helps fiduciaries uphold their responsibilities.

1 Investment banking products and services within the United States are offered exclusively through BDO Capital Advisors, LLC, a separate legal entity and affiliated company of BDO USA, P.C., a Virginia professional corporation. For more information, visit www.bdocap.com. Certain services may not be available to attest clients under the rules and regulations of public accounting. BDO Capital Advisors, LLC Member FINRA/SIPC.

Understanding the Impact of Workforce Reductions on 401(k) Plans

Employee turnover often triggers a wave of issues for a company and its human resources department. Even 401(k) retirement plans — one of the most sought-after employee benefits — can be impacted when a substantial number of employees are involuntarily terminated. This can constitute a partial 401(k) plan termination where full vesting of the affected employees must occur to satisfy legal and regulatory requirements, yet partial terminations are often easy to overlook.

IDENTIFYING PARTIAL 401(K) TERMINATIONS

An important part of 401(k) management is understanding how workforce reductions can affect the plan itself, as complete disqualification of the plan by the IRS is on the table when a partial termination goes unnoticed or is mishandled.

According to IRS regulations, a **partial 401(k) termination** may occur upon the involuntary termination of 20% or more of employees who are plan participants at the beginning of the year. It's likely that some of the employees will be fully vested, while others will not meet the plan's requirements for 100% vesting of employer contributions.

Employers, and HR departments specifically, should monitor fluctuations in employee headcounts and watch for events that can trigger a large workforce reduction that, in turn, could result in a partial 401(k) termination. However — and this is where confusion sometimes occurs — the 20% workforce reduction count is cumulative, can span more than one plan year, and can be triggered by events other than layoffs and plant closings, such as:

- Business restructuring that decreases the size of the workforce.
- Amendments to the 401(k) plan where the number of eligible employee participants decreases.
- Employee turnover for positions that are not expected to be replaced.

The **IRS calculates the turnover rate** using a specific formula: *TR = A / X + Y*. TR means the turnover rate equals the number of participants who were terminated (A) divided by the number of participants at the end of the prior year plus any added during the plan year (X+Y). For example, if 20 employees were terminated at a company that had 80 participants, the turnover rate would be 25%.

If it appears that a company's workforce has dropped or is expected to drop by 20% or more, employers, HR professionals, and plan administrators should closely scrutinize 401(k) plan documents and the laws and regulations governing such retirement plans.

WORKFORCE REDUCTIONS AND THE 401(K) PLAN

How does the termination of employee participants affect a company's 401(k) plan? Between the complexity of 401(k) plan regulations and vigorous IRS oversight, it's crucial to understand that significant employee turnover and other workforce-related events can have an impact on retirement plan operations and forfeiture accounts.

If it is determined that a partial 401(k) termination occurred, employers must fully vest the affected employees regardless of plan requirements. For example, plan documents might require an employee to work six years to become fully vested in the employer's contributions to the 401(k) plan. A layoff occurs which includes employees with less than six years of service. The employer must vest these employees at 100%, in part because they were not given the opportunity to meet that six-year benchmark. The same is true for other events, such as business restructuring and plan amendments that affect employee eligibility.

Immediate vesting of a large number of departing employees could potentially create financial hardship for the business. The plan's forfeiture accounts may be available to fund the vesting of employees without a significant immediate impact on cash flow. However, any required adjustments to vesting must occur whether the forfeiture accounts will cover the cost or not.

It's important to identify and plan for any event that could jeopardize the 401(k) plan. Failing to recognize a partial 401(k) plan termination is common, but companies can enhance their monitoring procedures and increase awareness.

AVOIDING PARTIAL TERMINATION MISSTEPS

The IRS can completely disqualify a 401(k) plan if vesting is not handled properly after a partial termination. Consider the following best practices to help mitigate the risk:

- **Learn the rules.** Rules and regulations surrounding partial terminations tend to be complex, consider consulting with an employee benefit plan professional or ERISA attorney to understand the rules.
- **Know your plan.** Become familiar with plan document provisions related to partial plan terminations, vesting provisions and the use of forfeiture accounts.
- **Establish oversight policies and procedures.** Monitoring employee voluntary and involuntary terminations by the plan sponsor and management should be ongoing. Consider turnover trends during the plan year as well as across multiple years.
- **Document all terminations.** It may be necessary to prove to the IRS whether a departure was voluntary or involuntary for the turnover calculation. The IRS may classify voluntary terminations as involuntary terminations if the employer cannot provide support for the nature of the employee's departure.
- **Manage forfeiture accounts.** The balance of the forfeiture account can include a variety of sources, including funds previously forfeited from participant accounts that are affected by a partial plan termination. The funds in the forfeiture account may be needed to reinstate the accounts of the affected participants.
- **Correct vesting failures.** The IRS offers the **IRS Employee Plans Compliance Resolution Systems** that can be used to correct this compliance failure.

For questions about plan compliance with these and other provisions of ERISA, as well as benefit plan audits, please contact our **Employee Benefit Plan Audit team**.

Five Tips for Renegotiating Pharmacy Benefits Manager (PBM) Contracts

The U.S. Department of Health and Human Services estimates that $603 billion was spent on prescription drugs in 2021 before accounting for rebates. A significant portion of employers' healthcare costs are attributed to pharmaceuticals, and these expenses continue to climb. As expensive specialty drugs and new gene therapies become more prevalent in the market, companies must do their diligence when choosing a pharmacy benefits manager (PBM) or renegotiating their existing contract.

The complexity, industry jargon, and overall breadth of these agreements might discourage companies from fully exploring their options and seeking the most competitive rates for their business and employees. Fortunately, there are ways that companies can make sure their PBM contracts are appropriate to their business. Here, we explore five tips to help companies navigate the PBM contract renegotiation process.

1. KNOW YOUR DATA

Your data may be the most crucial tool when entering into negotiations on your PBM contract. Having a deep understanding of how your drug spend currently is allocated, how your members are using your plan, your formulary adherence, and utilization by drug class is imperative to understanding your greatest cost levers and potential risks.

A grasp of what therapeutic classes and drug types are used by your in-force membership, where the marketplace is trending in the coming years, and pipeline drugs that may have a signific impact on spend can aid a company in making the best decision for their circumstances.

2. UNDERSTAND KEY DEFINITIONS

Pharmacy contracts are complex, often containing technical legal terminology and concepts that are unfamiliar or difficult to understand. Without a clear understanding of the contract details, companies are vulnerable to coverage risk and might miss out on valuable rebates and discount opportunities.

Clarity around how your PBM defines and administers specialty drugs, limited distribution drugs, and drugs that fall under the 340B categorization is crucial to ensuring that your company is receiving the full value for your contracted terms.

3. NEGOTIATE MARKET CHECKS

The pharmaceutical industry is always evolving, marked by constant innovation, new drugs and therapies entering the marketplace, the introduction of off-label indications, and shorter patent lifespans. As a result, even short-term deals negotiated with PBMs can quickly become outdated. That is why it is crucial to include an annual market review in any PBM contract to protect against changes that result in misalignment with the market.

A market check is an annual review of active contracts and pricing to determine if your current deal is misaligned according to some predetermined threshold. In the instance where you are not receiving pricing commensurate with the marketplace, an adjustment can be made to bring your contract in line with your peers, which provides insurance against unexpected changes.

4. UNDERSTAND CONTRACT ADJUDICATION LANGUAGE

Companies will often find themselves in situations where the contract they signed is not providing the value they had anticipated, simply because they did not fully comprehend the terms by which their contract would be adjudicated. Will guarantee surpluses in one drug class be applied to offset losses in another, or is each line adjudicated separately? Which drugs or classes of drugs are excluded from rebate and discount guarantees? Which entity is entitled to any rebates generated on 340B claims? The answer to these questions and others can drastically affect the size of your discounts and rebates, and the overall value delivered on your contract. Understanding the contract terms and being able to translate them to your financial bottom line is imperative when attempting to compare competing PBM bids or value proposed deals.

5. DON'T OVERLOOK THE SMALLER FIRMS

The **top three largest PBMs** process roughly 80% of all prescriptions in the country. Lack of competition has contributed to shallower discounts, lower prescription rebates, and an overall lack of transparency. In recent years, several smaller PBMs have entered the marketplace and demonstrated the ability to execute and deliver value commensurate with their larger counterparts. In 2024, we saw the first Fortune 500 company eschew the major players in favor of a smaller firm. By including smaller PBMs in your RFP process, companies can force the larger players to come to the table and ultimately help drive value in your renegotiation.

CONCLUSION

Renegotiating your PBM contracts can be incredibly advantageous, but it's important to have a firm understanding of your data, the contract language, and legal concepts so that you can be strategic about what areas you're renegotiating.

BDO has deep experience in PBM contracts and can help you navigate the renegotiation process. With our support, you can feel confident in your understanding of the terms, expected value, and potential pitfalls of your contracts. We can also help you determine whether it's time to seek a contract with a new PBM.

The Practical Guide to AI

5 Steps to an AI-Empowered Organization

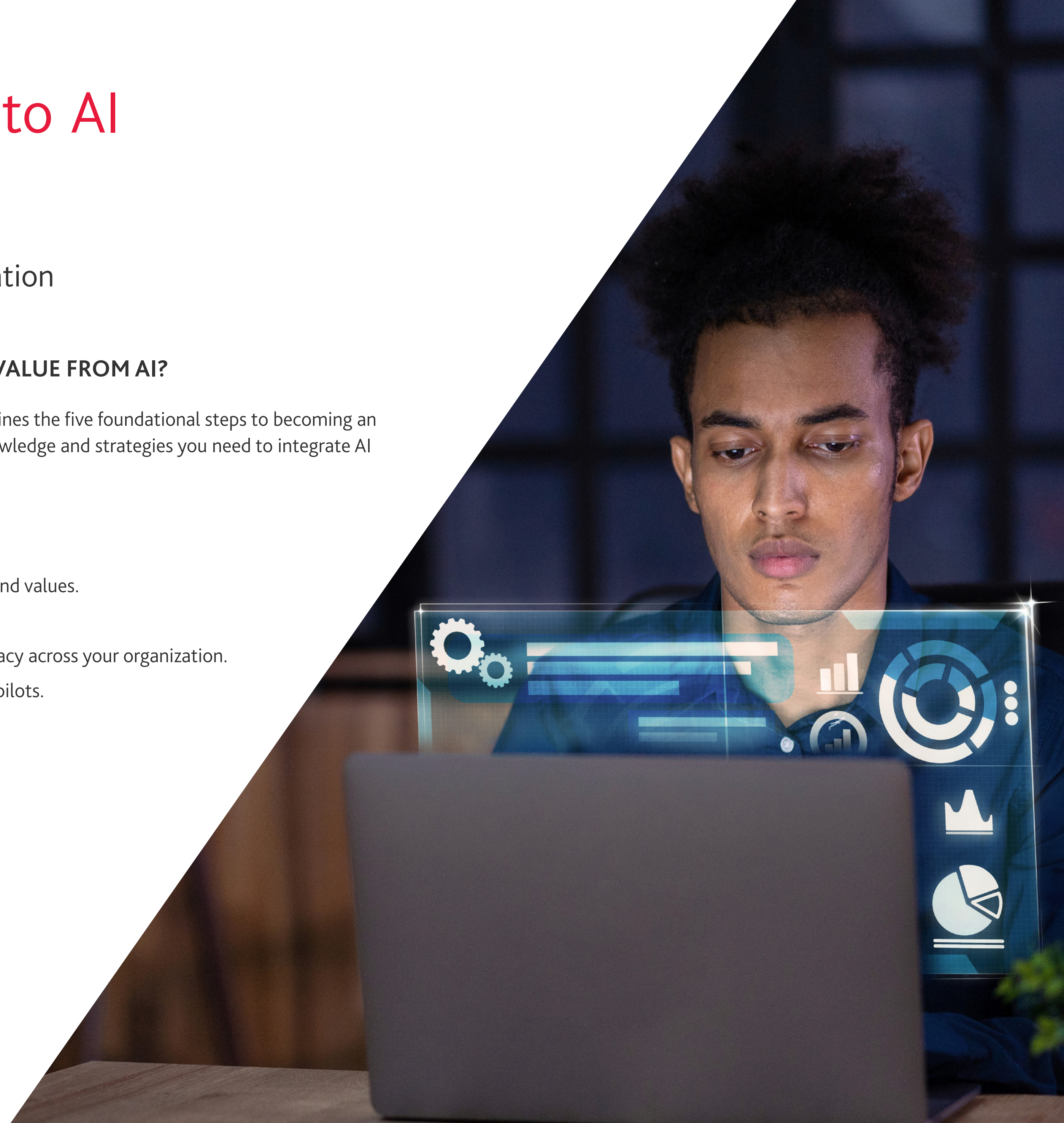
IS YOUR ORGANIZATION READY TO REALIZE VALUE FROM AI?

Our comprehensive e-book, “The Practical Guide to AI,” outlines the five foundational steps to becoming an AI-ready organization. This guide will equip you with the knowledge and strategies you need to integrate AI responsibly and effectively into your business operations.

Included in your e-book are:

- Practical steps to integrate AI into your business.
- Strategies for aligning AI with your organizational goals and values.
- A framework for ethical and responsible AI use.
- Insights for engaging your workforce and building AI literacy across your organization.
- Best practices for launching and scaling up successful AI pilots.

DOWNLOAD THE EBOOK



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