

## White Paper - August 22, 2011

### **How does the use of a trust company or the use of a Trust Agreement that is not part of a preapproved Prototype or Volume Submitter plan affect a qualified retirement plan?**

Nearly all qualified retirement plans are required to hold the plan assets in trust. The plan document and Summary Plan Description for the plan must identify the trustee of that trust. It is common for an owner or an officer of the company sponsoring the plan to be named as the trustee. However, on occasion, the plan sponsor may wish to name an external trust company as the trustee. The following describes a couple of items that the plan sponsor should consider before making that decision.

#### Trustee Duties and Responsibilities:

Generally, the trustee of a qualified plan (a plan fiduciary) has the following duties under ERISA:

1. The duty to act solely in the interest of plan participants and beneficiaries;
2. The duty to act for the exclusive purpose of providing benefits to plan participants and their beneficiaries;
3. The duty to exercise the care, skill, prudence, and diligence of a prudent person that is familiar with such matters;
4. The duty to diversify plan investments so as to minimize the risk of large losses; and
5. The duty to act in accord with the documents and instruments governing the plan.

With the exception of number 4 above, which can in some cases be delegated to an investment manager or discretionary trustee, all of these duties are (and would remain) duties of the plan sponsor in its role as the administrator of the plan even if a trust company was named as the trustee. A trust company simply acts as a co-fiduciary to the plan. Typically the trust company also limits its role to that of a directed trustee, which, as the name implies, only acts at the direction of another plan fiduciary (the employer). In the case of a directed trustee, the trustee is not responsible for any investment decisions, only for following the directions of the other fiduciary / employer and meeting the duties listed above. A directed trustee can provide some additional protection to the employer when, in its capacity as a co-fiduciary, it objects to transactions that could fall short of the fiduciary standard.

It is important to note that the decision to appoint and retain a particular trustee is in itself a fiduciary decision. Generally speaking, a good custodian (such as a recordkeeper) functions almost identically to a directed trustee.

#### Trust Agreement that is not Part of the Preapproved Plan Document:

The benefit of adopting a Prototype or Volume Submitter document (a plan document that has been preapproved by the IRS on behalf of the document sponsor) is that if the document is adopted “word-for-word” as preapproved by the IRS the employer that adopts it can “rely” on the approval letter that the document sponsor has received for the preapproved plan to establish that the document complies with the qualification requirements. This contrasts with a so-called “individually-designed plan” document for which the adopting employer needs to apply to the IRS for approval. In an environment in which there are required amendments almost annually to keep a plan in compliance with the law, an

additional benefit of the preapproved plan is that the document sponsor can adopt such amendments on behalf of all adopting employers as a “sponsor-level” amendment and it becomes unnecessary for each of those employers to adopt the amendments individually. This removes an inconvenient operational process and helps to ensure the continued qualified status of these documents.

*Use of an External Trust Agreement: Impact on Preapproved Status:*

Under sections 5.09 and 14.04 of Rev. Proc. 2005-16, which outlines the plan qualification process, minor administrative changes to a trust document which is part of a preapproved plan will not make the plan an “individually-designed plan.” However, if a separate stand-alone trust document is used with a preapproved plan where the trust document has not been preapproved as part of the plan’s approval, “reliance” on the approval letter for the preapproved plan document will be in jeopardy. This does not necessarily cause the plan to lose its qualified status, but the document sponsor loses its authority to amend the plan on behalf of adopting employers. In this event each employer must adopt all amendments to the plan. Thus, all the sponsor-level amendments that otherwise preserve the qualified status of the plan become invalid and must be individually adopted by the employer who wishes to use the document with an outside trust agreement and still have a qualified plan document.

*Use of an External Trust Agreement: Impact on Plan Self-Correction:*

A final consideration is that some type of favorable determination letter (or reliance on a preapproved plan document’s approval letter) is required in order for a plan to take advantage of the IRS self-correction program to correct significant operational failures. Significant operational failures that can be self-corrected are plan administration “mistakes” that can happen to any plan even if it uses a TPA or other professional adviser as the errors may occur during the year before the TPA even learns of it. These mistakes include such things as excluding eligible employees from participation in the plan (forgetting to enroll them on time), enrolling participants too early (not following the plan’s eligibility requirements), loan repayment problems, nondiscrimination test correction errors (neglecting to make distributions to correct ADP or ACP test failures), and the like.

*Suggested Solution:*

Due to the issues described above, it is necessary that plans using our preapproved plan document either i) use TSC’s preapproved trust agreement or ii) obtain a determination letter from the IRS as an individually-designed plan (an expensive and time-consuming process). The preapproved trust agreement can be executed by a representative of the employer or by a trust company. When a trust company is unwilling to sign TSC’s preapproved trust agreement, it will be necessary to have a representative of the employer sign our preapproved trust agreement and be named as a co-trustee along with the trust company. This will allow for reliance on the applicable approval letter, allow for “sponsor-level” amendments, and allow self-correction for certain operational failures.