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Establishing Practices and Procedures to Support Self-Correction of Operational Failures

by Eric D. Altholz and William D. Jewett on June 27, 2023

The self-correction of retirement plan operational failures under IRS correction principles has been conditioned upon a plan sponsor's establishment of compliance practices and procedures since the creation of the Employee Plans Compliance Resolution System ("EPCRS") 25 years ago. This condition was articulated in IRS Revenue Procedure 98-22, which refined and consolidated several prior correction programs to create the modern day EPCRS, and it remains a core requirement in the most recent iteration of the program, IRS Revenue Procedure 2021-30.[1] So it is not surprising that the SECURE 2.0 Act of 2022 ("SECURE 2.0") expressly preserves this requirement in its widely praised expansion of self-correction opportunities for "eligible inadvertent failures." This post considers whether the codification of the practices and procedures requirement newly elevates its importance and suggests a renewed need for plan sponsors to take affirmative steps to satisfy the requirement as a precondition for the confident self-correction of failures that may occur in the future.

Eligibility for self-correction under EPCRS

Section 4.04 of Revenue Procedure 2021-30 describes the practices and procedures eligibility requirement for self-correction. To qualify for the self-correction of an operational failure under EPCRS, a plan sponsor or administrator "must have established practices and procedures (formal or informal) reasonably designed to promote and facilitate overall compliance in form and operation with applicable Code requirements." The Rev. Proc. affirms that a written plan document does not itself satisfy the requirement. Moreover, merely establishing the practices and procedures is not sufficient. To satisfy the eligibility requirement for self-correction, the practices and procedures "must have been in place and routinely followed" such that the failure occurred because the procedures, while reasonable, were not sufficient or because a mistake was made in following them. The Rev. Proc. also implies, but does not state, that in addition to producing documentation evidencing the corrective action, the plan sponsor should be prepared to show that it had established practices and procedures upon request of an IRS agent in connection with an audit of the plan for a year in which

[1] See Section 1.03 and Section 4.04. IRS Revenue Procedure 92-89, which established the predecessor of the modern-day Voluntary Correction Program component of EPCRS did not authorize self-correction, but conditioned the issuance of the compliance statement upon the establishment of compliance practices and procedures designed to ensure that operational failures will not recur.

an operational failure occurred. These provisions make one wonder how "informal" the practices and procedures can be and still satisfy the requirement.

Expansion of self-correction opportunities under SECURE 2.0

Much has been written about the expansion of self-correction opportunities under SECURE 2.0. (Find our summary **here**.) In short, under Section 305 of SECURE 2.0, an "eligible inadvertent failure" to comply with the tax law requirements that govern retirement plans can be self-corrected at any time, so long as meaningful steps are taken to fix the error before the IRS discovers it. The provision also expands the scope of participant loan errors that can be self-corrected. Of course, consistent with long time EPCRS limitations, egregious errors (such as a misuse of plan assets) cannot be self-corrected. The dramatic expansion of opportunities for self-correction makes it all the more important for plan sponsors to consider whether and how they satisfy the eligibility requirements.

Section 305(e) of SECURE 2.0 defines "eligible inadvertent failure" as a failure that occurs despite the existence of practices and procedures that satisfy the "standards" set forth in Section 4.04 of Revenue Procedure 2021-30. Nothing in IRS Notice 2023-43, which provides interim guidance regarding self-corrections pending modifications to Revenue Procedure 2021-30, suggests that the IRS intends to modify the practices and procedures requirement as it is currently formulated. Notice 2023-43 does, however, make it explicit that a plan sponsor must be able to provide documentation demonstrating that such practices and procedures were in place when the failure occurred, and it is possible that this new emphasis will focus auditors' attention on documented practices and procedures. So the questions remain: (1) exactly what kinds of practices and procedures might be considered "reasonably designed to promote and facilitate overall compliance in form and operation" with the rules governing retirement plans; (2) if the practices and procedures can be either formal or informal, what's the difference, given the documentation requirement; and (3) what would such practices and procedures look like?

Practices and procedures

Given the range of tax law requirements that apply to various types of retirement plans, and the differing administrative capacities and inclinations of plan sponsors, it would be difficult to develop a single comprehensive collection of practices and procedures appropriate for every plan sponsor. And so long as the practices and procedures are "reasonably designed to promote and facilitate overall compliance," they should be sufficient to support the plan sponsor's eligibility for self-correction. However, a compliance-oriented plan sponsor should consider adopting practices and procedures that cover:

- Keeping plan documents up to date
- Following the written terms of plans

- Correctly applying the plan's definition of compensation
- Correctly applying annual limits on elective deferrals, total contributions, covered compensation, and the like
- Proper calculation of employer matching and nonelective contributions
- Annual coverage and nondiscrimination testing, and top heavy testing
- Timely deposit of elective deferrals
- Compliance with service crediting rules for eligibility and vesting
- Compliance with required minimum distribution requirements
- Compliance with joint and survivor annuity requirements
- Timely distribution of required participant notices and disclosures

Keeping in mind the documentation requirements that apply to self-corrections, these practices and procedures could be memorialized in a single written document, formally adopted by the plan sponsor or administrator. Under that approach, as is the case with any corporate or compliance policy, the plan sponsor should be prepared to follow the policy consistently, even if mistakes may occur from time to time. (If there is one thing worse than failing to adopt a useful policy, it is failing to follow a policy that has been adopted.) Alternatively, a less formal checklist describing the compliance tasks that will be attended to on a regular basis without the details of how each task will be done may suffice to demonstrate that identifiable practices were consistently followed.

Documenting the establishment of practices and procedures

Revenue Procedure 2021-30 provides that compliance practices and procedures should be established either by the plan sponsor or plan administrator. Many plan sponsors, even some large and mid-size employers, have not appointed fiduciary committees to oversee the administration of their retirement plans. For those plan sponsors, the employer effectively serves as the plan administrator so the distinction will not matter much. But for plan sponsors that have developed more robust fiduciary governance structures, it may make more sense for the employer to take the step of formally adopting compliance practices and procedures – as a "settlor" function – rather than having the fiduciary committee adopt them. As a practical matter, many compliance tasks are likely to be carried out by finance or human resources staff not in a fiduciary capacity. In addition, the decisions of whether and how to correct an operational or document failure in a retirement plan is ultimately going to be made by the employer even if the correction is implemented under the direction of an administrative committee.[2] The adoption of practices and procedures does not, in our view, require approval by the governing body of the plan sponsor. A simple memorandum or other formal action taken by an officer or

[2] The question of whether a failure to correct a known operational failure amounts to a breach of fiduciary duty under ERISA is beyond the scope of this post, which focuses solely on self-correction of tax-qualification failures.

senior manager with authority to bind the plan sponsor in matters relating to the retirement plan should be sufficient. If formal action is difficult for some reason, informal adoption of written (and dated) practices and procedures should enable the plan sponsor to demonstrate its eligibility for self-correction.

Please contact a member of Verrill's **Employee Benefits & Executive Compensation Group** if you have any questions regarding the correction of retirement plan operational or document failures under EPCRS.

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