

employee benefits update

year end 2008

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Take advantage of automatic enrollment in safe harbor plans

The Pension Protection Act of 2006 (PPA) provided significant incentives and changes to the rules surrounding automatic enrollment plans. An automatic enrollment safe harbor is just one type of safe harbor 401(k) plan, and you don't necessarily have to have automatic enrollment to have a safe harbor plan. So why would you choose automatic enrollment? One reason is that it allows for a less expensive employer matching contribution. Let's take a closer look at these plans.

Opting in

Automatic enrollment first became popular in the late 1990s as a way to increase enrollment in retirement plans. Now, with the PPA automatic enrollment rules in place, participation in your plan has the ability to increase even more.

Here's how it works: If an employee doesn't wish to participate in the plan, he or she must complete the

paperwork to opt out of it. If the participant chooses not to do anything, he or she will be automatically enrolled. This can help you increase plan participation.

No more concerns

Before the PPA rules regarding automatic enrollment, some plan sponsors were leery about using automatic enrollment, because some states have laws prohibiting involuntary wage withholding. The sponsors were unsure whether ERISA preempted those laws. But the PPA rules make clear that ERISA does preempt any involuntary wage withholding laws in states that prohibit such transactions.

Another concern before PPA was that, in situations where employees were automatically enrolled, they couldn't get their money back until they had a qualifying event that allowed their money to be distributed to them (such as a termination or in-service distribution). And many employees didn't fully understand the ramifications of automatic enrollment until their paychecks actually had 3% deducted from them. Meanwhile, employers didn't like the costs of maintaining the inactive and small balance accounts.

Under PPA, an employee can be automatically enrolled if he or she doesn't initially opt out of the plan or sign up for a certain deferral percentage. Employees who discover that they're automatically enrolled, and don't wish to be, have until 90 days after the first amount was deferred into the plan to opt out and request a refund.

The refund amount will be included in the participant's gross income in the year the distribution is made but isn't subject to the 10% excise tax on early withdrawals. Any employer match made on the distributed deferrals will be forfeited.

Notifying participants

To qualify for the safe harbor treatment, you must provide annual notices to participants about your plan. You must give this notice to employees before the start of the plan year. The notice has to accurately explain



the employees' rights and obligations and be written so that the average eligible employee can understand it.

You must explain the employees' right to opt out of the automatic enrollment or to elect a different deferral percentage. You also need to explain default investment provisions and give employees a reasonable time frame after receipt of the notice and before the first contribution to make contribution and investment decisions.

Compliance

So what do you need to do to comply with the safe harbor plan requirements? First, all automatic enrollment safe harbor plans must contain the automatic enrollment provision. Your plan will qualify for the auto-enrollment if the contribution rate for auto-enrollees is at least 3% in the first year of participation. It must then go up each year in 1% increments up to a 6% minimum. But it can go as high as 10%, depending on your plan document.

Your plan must provide for a minimum employer match of 100% of employees' elective deferrals up to 1% of compensation plus 50% of elective deferrals between 1% and 6% (for a grand total of 3½%). Alternatively, the plan can provide a 3% nonelective employer contribution to all eligible employees. In contrast with the normal safe harbor 401(k) rules, which require a matching contribution of at least 4% of compensation,

as an employer you may want to take advantage of the reduced 3½% matching contribution by using the automatic enrollment safe harbor.

If an employee doesn't wish to participate in the plan, he or she must complete the paperwork to opt out of it.

Normally the vesting schedule for any safe harbor contribution is immediate 100% vesting. But the vesting for the PPA automatic enrollment safe harbor plan is 100% only *after* the employee completes two years of service. This may result in money being forfeited. Sponsors can redistribute this money to participants or use it to reduce employer contributions or pay plan expenses.

The advantage is yours

With all the advantages of the automatic enrollment safe harbor, it may be the right time to implement automatic enrollment in your plan. Contact your plan administrator to find out whether it's right for you. 🗨️

Is your plan ready for rollovers?

Today's employees are changing jobs more frequently than in the past, resulting in the accumulation of retirement assets in multiple plans. Because of this, plan sponsors — and participants — are more conscious of the portability of retirement funds.

In the past, participants were limited to rolling over their retirement assets to IRAs or similar types of qualified plans, such as 401(k) plans. But new pension laws

give participants more options to choose from, and this makes investing for retirement more appealing than it was in the past. Do you know the many variables of what types of plans can be rolled into your retirement plan?

What you need to know

As a plan sponsor, you aren't required to accept rollovers into your plan. However, doing so is appealing to prospective employees and creates an additional benefit

for existing ones. For smaller plans, accepting rollovers can potentially increase the plan's assets, possibly making the plan eligible for additional vendor services and investments. In some situations, you may also reduce your asset management expenses.

If you choose to make this option available to participants, you'll need to follow a few relatively easy steps. First, you'll need to amend your plan document to accept rollovers into the plan. If you decide to make the change, you'll have to notify all your employees of it.

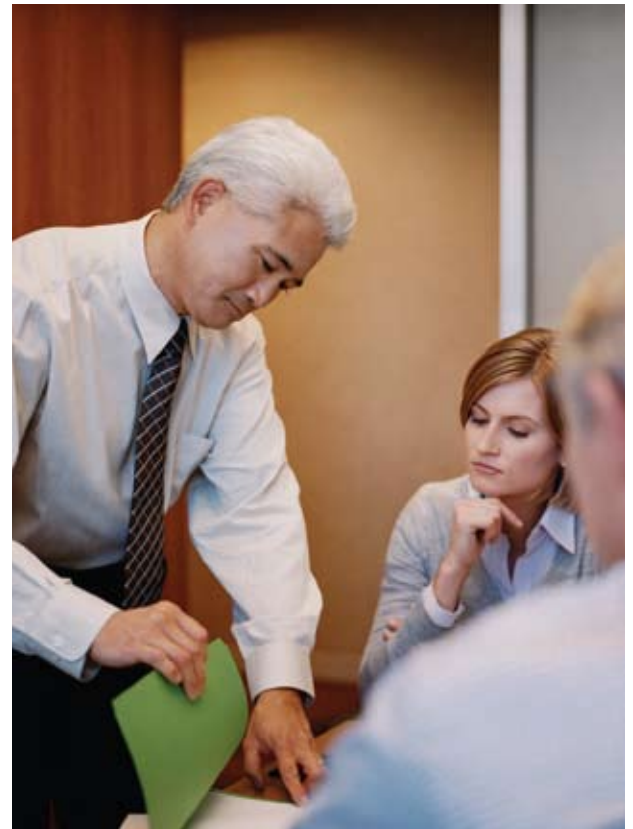
When accepting rollovers into the plan, be sure the funds are indeed valid rollovers. A good way to determine this is by obtaining documentation from the plan administrator of the plan from which the funds are being distributed.

Whether or not you decide to accept rollovers into your plan, you must furnish participants leaving the plan with a notice of their rollover options. The IRS has model language for this, as well as a revised notice that helps you ensure that your plan complies with IRS rules.

What you can roll over

In light of the number of different types of plans, there are also a number of different permissible rollovers that you can choose to allow in your plan document.

For example, you can allow participants to roll over funds from IRAs, SEP-IRAs and SIMPLE IRAs into your qualified plan. Your qualified plan can also accept rollovers from Section 403(b) tax-sheltered annuities, Section 457



governmental deferred compensation plans and other qualified plans. Spouses participating in 403(b), 457 or qualified plans may roll over distributions from their deceased spouse's plan into their own plan.

If allowed by your plan, distributions of after-tax employee contributions are eligible to be rolled over into other qualified plans if they are accounted for separately. In addition, participants can roll over

Rollover 101

		TO						
FROM		IRA	SEP-IRA	SIMPLE IRA	Roth IRA	457(b)**	403(b)	Qualified Plan
	IRA	Yes	Yes	No	Yes	Yes	Yes	Yes
	SEP-IRA	Yes	Yes	No	Yes	Yes	Yes	Yes
	SIMPLE IRA*	Yes	Yes	Yes	Yes	Yes	Yes	Yes
	Roth IRA	No	No	No	Yes	No	No	No
	457(b)	Yes	Yes	No	Yes	Yes	Yes	Yes
	403(b)	Yes	Yes	No	Yes	Yes	Yes	Yes
	Qualified Plan	Yes	Yes	No	Yes	Yes	Yes	Yes

*Funds must have been in the SIMPLE IRA account for at least two years before it can roll into another type of account.

**Money rolled into a 457(b) account from another plan type must have a separate account.

distributions of after-tax money from qualified plans or IRAs to a defined contribution plan or IRA. If a participant opts to roll over after-tax money to your defined contribution plan, he or she must do so through a trustee-to-trustee transfer. As the accepting plan, you must then separately account for the after-tax amount.

What you can't roll over

Participants cannot roll over hardship distributions from a qualified plan. Nor can they roll over loans deemed as distributions and required minimum distributions (RMDs) from a qualified plan to an IRA.

Participants also can't roll over life insurance from qualified plans into an IRA, because IRAs cannot invest in life insurance. For a simplified table of what can and cannot be rolled over, see "Rollover 101" on page 4.

When in doubt

Will you know the right answers if a participant or prospective employee asks you about his or her ability to roll over retirement accounts? If you're unsure about rollovers into or out of your plan, the first place to look is your plan document. And be sure to consult with your plan administrator if you have any questions. 🕒

Proposing certainty

SEVEN-BUSINESS-DAY SAFE HARBOR FOR SMALL PLAN DEPOSITS

In 2008, the Employee Benefits Security Administration (EBSA) issued proposed rules that would provide certain employers with a seven-business-day safe harbor for deposits of participant contributions into small plans. Under this proposed rule, employee benefit plans with fewer than 100 participants would be provided with a safe harbor period of seven business days, during which time amounts received from employees or withheld from wages for contribution wouldn't be considered "plan assets."

The existing rule

The existing rule regarding the timeliness of employee contribution deposits to pension and welfare plans is somewhat vague. This can often lead to confusion and unintentional violations by plan sponsors. The current rule states that employers must deposit contributions as of the earliest date on which the employer can reasonably segregate contributions from its general assets without exceeding the 15th business day of the month following the date the employer receives or withholds the amounts.

In other words, if an employer withholds employee contributions on Tuesday, and it's reasonably feasible to segregate the amounts from the employer's general assets on Wednesday, then the deposits are due on

Wednesday. Many employers aren't aware of this part of the rule and instead rely solely on the 15th business-day maximum. If employers are actually capable of depositing these funds *before* the 15th business-day maximum, they may be in violation and not even realize it.

The DOL's input

While EBSA issued the proposed rules, it will be the Department of Labor (DOL) that enforces them. The DOL believes that the existing rule contains uncertainty as to how soon employers must forward contributions to the plan to avoid the requirements associated with holding plan assets. Because of this uncertainty, it expends significant resources enforcing the rule.

Smaller plans typically need more time to deposit funds than do larger plans.

In fact, the DOL has indicated that the vast majority of the applications under the DOL's Voluntary Fiduciary Correction Program (VFCP) involve delinquent employee contribution violations. Employers could

avoid many of these violations if the rule were more specific as to what the timing of employee deposits should be.

The proposed rule

The EBSA's proposed safe harbor provides for greater certainty about when employers with small plans must deposit participant contributions. Under the proposed rule, such employers will be considered to have timely deposited participant contributions with the plan when they're deposited:

- › Within seven business days following the day on which the amount is received by the employer (in the case of amounts that a participant or beneficiary pays to an employer), or
- › On the seventh business day following the day on which the amount would otherwise be payable to the participant in cash (such as wage withholding).

The EBSA believes the proposed rule would eliminate any confusion related to when funds can “reasonably be segregated” from the employer's general assets. Funds would be considered deposited when placed in a plan account — regardless of whether the plan allocates contributed amounts to specific participants or participant investments.



What about large plans?

When it comes to large plans (those with 100 or more participants), the Department of Labor (DOL) remains unclear as to whether these plans need the same type of guidance as would be provided by the proposed safe harbor for small plans. (See main article.)

The DOL has indicated that it intends to include a safe harbor for employers with large plans within the final regulation if it receives enough information and data during the comment period that ended last spring. The specifics of that safe harbor — should it actually come to pass — are still unknown.

In creating the proposed seven-day rule, the DOL used data collected during its investigations of possible failures to deposit participant contributions in a timely fashion. One of the major findings was that smaller plans (those with less than 100 participants) typically need more time to deposit funds than do larger plans.

The DOL also found that these small plans can generally deposit participant contributions to the plan by the seventh business day following the date of receipt or withholding, but that most employers with small plans are taking longer. The DOL believes that these plans will take advantage of the proposed rule's increased certainty and expedite the depositing of contributions to meet the safe harbor.

The concerns

Some groups, however, have raised concerns about the proposed seven-day rule. One major criticism is that it doesn't provide for relief in the event of a problem with the process at any given point along the way.

Many employers rely on outside payroll providers to process their payrolls and deposit contributions. What if a problem arises during this process? As it's written, the proposed rule doesn't provide the employer any relief. So, in theory the employer would be in violation even though it did everything necessary to comply with the proposed rule.

The consequences

So what are the consequences if you fail to meet the proposed safe harbor? Missing the safe harbor date will

put your plan out of compliance. You'll need to correct this deficiency using the VFCP.

If you've ever had to correct a late contribution, the VFCP process should already be familiar to you. Under the program, you'll deposit the withholding (along with associated earnings on the late deposit) to the plan. You'll also need to document the correction and submit it to the DOL. Talk to your plan administrator about when and how to do this, as well as the possibility of using the IRS correction method.

The future

Most employers with small plans will welcome the more specific guidance provided by this proposed rule. The hard and fast seven-day rule should eliminate existing confusion — and employers will benefit from not only the diminished confusion, but also the subsequent result of not having to use the VFCP program. But remember, the rule is only in the proposal stage. Until it becomes final, you must still deposit funds as soon as you can reasonably segregate them. 🕒

Plan updates: A call to action

There's a good chance that your retirement plan is one of the many qualified plans that use preapproved IRS plan documents referred to as master, prototype or volume submitter documents. If so, you may not have heard that, during this past year, the IRS has "restated" many of these documents to comply with the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).

As a result, you need to update your plan documents to match those of the IRS. Here are some questions that many employers have been asking about this change:

Q: I'm a small employer. Aren't I exempt from these required changes?

A: All plan sponsors using preapproved plan documents must comply. No plans are exempt from these update requirements, regardless of the size of the plan.

Q: Is this something that my attorney or third-party administrator (TPA) is requiring me to do?

A: While your attorney or TPA has probably communicated with you about the required updates, it's the IRS that is requiring the updates. Your attorney or TPA isn't creating needless work; he or she is keeping your plan in compliance with current law.

Q: Didn't we just do this? Do we have to amend our plan again?

A: Although you may have just recently updated your plan document, the document is required to be updated anytime the IRS issues a new required amendment. This is true regardless of when your most recent amendment was made.

Q: What happens if I decide not to make the required updates to my plan document?

A: Failure to timely update your plan may result in heavy fines or plan disqualification. Although you may be able to use the IRS's Voluntary Correction Program (VCP), you'll have to pay the applicable user fees. The fees currently range from \$750 to \$5,000 for plans with between one and 500 participants. And the fees can go up to \$25,000 for plans with more than 10,000 participants.

Moreover, you'll still have to pay your attorney or TPA for the cost of updating the plan document in addition to the cost of preparing the VCP filing. In the worst-case scenario, if the IRS audits your plan and discovers that it's not an accepted prototype document, the IRS can disqualify your plan.

Q: When is the deadline?

A: The deadline depends on your plan's employer identification number (EIN). Talk to your plan administrator about the deadline for your plan.