

2009 GREAT LAKES BENEFITS CONFERENCE

William E. Sigler

Washington Update – Brian Graff

- Based on A LOT of voter feedback, there is a lot of concern on Capital Hill that 401(k) plans have failed.
- Hearings began last October before the House Labor and Education Committee.
- \$2 trillion in retirement assets were wiped out.
- 401(k) plans may not be dead though, because 75.4% of people save when covered by an employer plan, while only 4.7% of workers not covered by an employer plan contribute to an IRA.
- 31% of distributions from 401(k) plans benefit workers with AGI less than \$50,000, and 34% with workers AGI less than \$100,000
- So, the focus may end up with the plan investments.
- For example, target date funds held on average 80% of their assets in equities and lost 26%. One question is whether the sponsors are partly at fault for allocating assets to underperforming proprietary funds.
- Other ideas being considered: automatic IRAs for workers without qualified plans (may be a government-run program); expansion of saver's credit; and mandatory automatic enrollment.

IRS Update – Marty Pippins

- DC Plans – technical questions on 2009 RMD waiver; Roth 401(k) rollovers; no gap period income on 402(g) excess.
- DB Plans – end of year valuations; 5.5% interest rate for max lump sums for small plans only; smoothing and other funding relief
- 401(k) – waiver of the 3% nonelective contribution due to the stock market decline and as an alternative to terminating the plan is under review. Brian said that it is “imminent.” Marty pointed out that the requirement is in final regulations and that new proposed regulations usually require a notice/comment period. So, there are practical issues aside from the substantive issues.
- Items that may be completed this year – Rev. Rul. 81-100 group trusts; government plans (anticipate notice of proposed rule-making); 401(a)(35) diversification; 402(f) model notice (ASPPA has a sample available on the internet that it sent to the IRS); HEART Act rollovers; WRERA; Spanish translation of model notices; prototype program for IRAs; hybrid plans (finalize proposed regulations; additional proposed regulations); church plans (notice requirement in regard to church requesting ruling from IRS); 414(x) DB-K plan (notice to collect comments); 430/436 final regulations regarding funding
- Items likely to be deferred until next year – accrual rules; quarterly contributions; multiple employer zone regulations.

DOL Update – Steve Haugen

- VFCP – in Chicago, they closed 350-400 cases last year, each taking on average 68 days
- National projects – employee contributions; REACT; ESOPs; MEWAs/health care fraud; Consultant Advisor Program (CAP)
- Small employer (<100 employees) safe harbor plan asset proposed regulations still have not been finalized, but they are being treated as if they were final. The safe harbor is 7 days from receipt. The DOL is not taking action against qualifying employers satisfying the safe harbor.
- REACT – plan sponsors in bankruptcy or financial distress (Chapter 7 liquidation, Chapter 11 reorganization or shutdown without bankruptcy). Issues include following rules regarding termination, plan sponsor intent with respect to winding up, fiduciary in place, employee contributions, unpaid claims and improper transactions involving plan sponsor.
- ESOPs – consistency with plan document, “qualifying” employer securities, prudence and valuation issues, distribution and liquidation issues, purchase price in buyer/seller transactions.
- MEWAs – improperly marketed as ERISA plans when just selling insurance; excessive fees (as high as 40%) leading to unpaid claims (promoter disappears, leaving employer with the claims).
- CAP – fiduciary/compensation arrangements.
- Change anticipated resulting from financial distress, massive fraud, etc. – retirement plan contribution problems, insurance coverage issues, valuation issues, declining revenue streams, investment manager fiduciary/fee issues, prohibited transactions, etc.
- More Federal/State coordination likely.
- Hedge funds – appropriate as a plan investment (see Grassley letter from a few years ago)?

Current Fiduciary Issues – Kristen Zarenko, Esq. (DOL) and Richard Hochman

- PPA allowed a new PT exemption for investment advice through the use of a computer model certified as unbiased or through an advisor on a level fee basis. This approach is now under scrutiny by Congress, notwithstanding the fiduciary duties, disclosures, etc. DOL finalized regulations on January 21, 2009, and they were scheduled to go into effect on March 23, 2009. That date was subsequently extended to May 22, 2009. However, the future is cloudy due to questions over the priorities of the new Secretary, potential action by Congress, etc.
- Field Assistance Bulletin 2008-01: responsibility of named fiduciaries and trustees of ERISA plans for collection of delinquent employer and employee contributions (responsibility needs to be clearly delineated in the plan documents, but even where it is delegated the named fiduciary and/or trustee is still a fiduciary and may still have some liability, particularly where the trustee is aware of a problem or should have been aware of a problem).

- Solis v. Plan Benefit Services, Inc., D. Mass., No. 07-11474-DW, 3/20/09 – Judge agreed with DOL that plan provision extinguishing a plan trustee’s responsibility to collect plan contributions would run afoul of ERISA Sections 403 and 410 and further found that a plan’s claim against the employer for unpaid contributions is a plan asset.
- New civil penalties: ERISA section 502(c)(4) for failure to provide the notice under ERISA section 514(e)(3) regarding the participants’ rights and obligations under the automatic contribution arrangement; notice of funding based limitation (section 101(j)); multiemployer pension plan information made available on request (section 101(k)); and multiemployer plan notice of potential withdrawal liability (section 101(l)). The penalties are \$1,000 per day per violation, effective March 3, 2009.
- Fee disclosure – continues to be a major issue.
- John Deere Case – DOL has filed for rehearing on basis that the court made mistakes of law and fact in regard to the extent that 404(c) relieves the employer of responsibility for issues such as the fees charged by investment providers.

PTs & Trust Investments in a Financial Meltdown – Ivan Strasfeld (DOL), Mark Davis, QPFC and Robert Toth, Esq.

- Auction rate securities – PROBLEM: became illiquid due to failed auction – SOLUTIONS: sell to unrelated third party, sell (for cash) or exchange (for highly liquid security) at par to related party, or loan to the plan by related party; MECHANICS: individual PT exemption or PTE 80-26 for interest free loans
- Securities lending – PROBLEM: plan invests in large cap collective investment fund (CIF) which makes loans to banks and broker-dealers; PTE 2006-16 requires cash to be returned when loan is repaid; SOLUTION: plan makes up difference, interest free loan or purchase at par; MECHANICS: individual PT exemption or PTE 80-26.
- Stable value funds – PROBLEM: hold highly rated debt instruments, some of which have dropped significantly in value; SOLUTION: sell to third party at FMV for a loss or sell to issuer at book value or FMV with cash contribution; MECHANICS: DOL exemption.
- Financial services industry consolidation – PROBLEM: conflict of interest (e.g., use of brokerage firm’s index funds by asset manager)
- Dual duties – union employees working both for union and union plan (prohibited under Marshall v. Snyder, 572 F.2d 894 (2nd Cir. 1978).
- ESOP – officer, shareholder and/or director selling stock at higher price than justified; appraisal used was for prior IPO which didn’t take into account subsequent facts (prohibited under Eyler v. Commr., 88 F.3rd 445 (7th Cir. 1996).
- Bribing a U.S. Senator – prohibited under O’Malley v. Commr., 972 F.2nd 150 (7th Cir. 1992).
- Fictitious notes equal to required contribution – prohibited under Baizer v. Commr., 204 F.3rd 1231 (9th Cir. 2000).
- Doctors/lawyers – 23 loans in 10 years (prohibited under Morrissey v. Commr., T.C. Memo 1998-443.

- Plan disappears – stockholders sell property to plan, sign a line of credit on behalf of the plan (which was engaged in a trade or business) and take multiple loans, and then the company liquidates and disappears (prohibited under Janpol v. Commr., 101 T.C. 518 (1993)).
- Trustee loans funds to company; sole participant is 18% owner and plan administrator; trustee of plan is a bank (NOT a PT – Greenlee v. Commr., T.C. Memo 1996-378).
- 412(i) plan – sole participant buys life insurance from plan for less than FMV, rolls it to IRA and terminated plan.
- ESOP – employer redeems stock for less than 50% of FMV and then terminates plan.
- 401(k) – pattern of late deferrals.
- Doctor plan – plan assets consist of real estate and loans (transfer of property and leasing – IRC 4975(c)(1)(A); loans – IRC 4975(c)(1)(B)).
- Civil fraud (IRC 6663) - \$646,000 in loans from \$667,000 account balance (one participant plan).

Form 5500 – Jeffrey Milling (IRS) and Janice Wegesin, CPC, QPA

- Case of Jeffrey Thomas – plead guilty to filing a false Form 5500 not reporting loans (that were all repaid); court imposed \$153,000 in penalties and fines and one year in federal prison.
- Annual funding notice replaces SAR – applies only to PBGC-covered DB plans; large plan due date is 120 days after plan year end; small plans have until earlier of date 5500 is filed or due date (with extensions) for filing 5500.
- EFAST2 – scheduled to become operational January 1, 2010; will overlap with EFAST1 for a short time (paper filings post-marked through October 15, 2010, but will stop accepting electronic filings as of June 30, 2010); beginning in 2010, all filings for prior years that are late or amended must be submitted on EFAST2; two filing options are available for 2010 (paper using 2008 form or automatic extension until 90 days after EFAST2 goes “live,” provided plan files 2009 report electronically).
- Schedule B (actuarial information) has been replaced with schedule SB for single employer plans and schedule MB for multiemployer plans and money purchase plans with funding deficiencies.
- FAS 157 – new uniform definition of “fair value” for marketable securities, non-marketable securities, and custodial pricing details; based on “level 1 inputs” (quoted prices), “level 2 inputs” (observable inputs other than quoted prices, and “level 3 inputs” for unobservable inputs (e.g., situations where there is little market activity)

Cash Balance Plans – Joan Gucciardi

- Need 3 consecutive years of at least \$195,000 in earnings to maximize benefit

- Traditional DBs – final average pay plans weigh benefits heavily in favor of final years of work; hard for employees to understand; contributions also weighted heavily by age
- Cash balance – actual investment rates and fixed crediting rates differ from traditional DB plan (more like career average benefit pattern); easier to understand; age neutral “contribution” for employees
- Ideal candidate – two or more owners; want to contribute more than \$49,000/\$54,000 to a plan; willing to commit to CB plan for at least 5 years (permanency requirement).
- Ideal demographics – owners age 45 or older; staff on average 5-10 years younger
- Crediting rates – “market rate”(little guidance, but rates tied to various treasury indices are acceptable); if an index is used for the crediting rate, the crediting rate can be negative, but then the aggregate value of the annual credits must be protected, i.e., if market rate is negative the account can decline, but not below the accumulated credits. Joan mentioned that she is aware of at least one mutual fund that matches the 30 year Treasury bill rate, so that assets always equal benefits.
- Whipsaw – old rules required taking accruals to NRA for benefit purposes and then bringing them back to PV for lump sum purposes using the 30 year Treasury bill rate. Thus, using the same rate eliminated the whipsaw. Under PPA, you look at the funded target normal cost, which is a current cost, and then you discount that back at the segment rate. This gives you more of an allowance and makes it easier to avoid any whipsaw.
- Design of the credits – determined at sponsor level; one approach “tops-up” an existing PS/K plan; another approach uses different credits based on an age/service schedule; age band approach based on age at first entry
- CB/DB combo plans – a foregone DC contribution can never be made up, but can delay a CB plan and get the same benefits; for younger professionals, it generally makes sense to maximize their DC contributions; PS/K provides top heavy minimums; if plan is top heavy, you cannot use a last day of year requirement, so anyone who participates gets 5% minimum; DB/DC gateway generally requires minimum 7.5% gateway contribution; 3 % nonelective safe harbor in K plan helps with testing.
- Examples: Add-on; Maximum Cash Balance Plan (may have to limit contributions to DC plans for HCEs to 6% under the DB/DC multiple plan limits); Split Plan (i.e., don’t cover all NHCE in CB plan); Maximum/Maximum Plan (not professional service plan, so plan is subject to PBGC and no limit on contributions)
- Note: most designs are variations of the foregoing four concepts.
- Shareholder termination – HCE can’t receive LSD unless plan assets exceed 110% of the plan liabilities after the distribution. Otherwise, SH must leave benefits in plan, begin taking annuity payments, or the employer must pre-fund contributions so that the 110% threshold will be met. If SH leaves money in plan, then remaining shareholder have risk associated with making the additional contributions to make up any investment losses.
- Plan termination – if covered by PBGC, can terminate only if assets sufficient to cover CB account; otherwise, must contribute shortfall or majority owners (50%

or more) may “forego” benefits (with spousal consent); if not covered by PBGC, then must contribute shortfall or forego benefits.

EGTRRA Restatement – Zuckerman, Pippins & Hochman

- 90,000-130,000 Form 5307s expected.
- Almost all cycle A cases are out, except for ESOPs.
- Have about 1,100 cash balance plans in process as well, about 900 of which are almost finished.
- Have about 1,000 government plans.
- Zuckerman: “We really need to find another way to do this.” By this, he seems to mean focusing on higher risk plans and issues. The problem is limited staffing.
- 403(b) – “big step” for pre-approved plans, and sets groundwork for proceeding with non-preapproved 403(b) plans (note: it took IRS almost 1-1/2 years to get the pre-approved plan package out, and the non-preapproved package may take quite a while as well). Rich asked if they have to amend plans that don’t match the LRMs, and Marty said no, as long as you are comfortable that your language is consistent with the regulations. The LRMs are intentionally more limited than what might be permissible in an individually designed plan.
- Pre-approved cash balance plans – maybe, but it would be intended more for the “small” market, not the Fortune 500 market, and there would be correspondingly fewer options, etc.
- Quality Assurance Bulletin – note that there is one dealing with how far it is reasonable for the IRS to go back to look at prior plan documents in connection with a determination letter request.
- New adopters of pre-approved plans – new adopter might have to wait for up to four years to get a determination letter, which is recognized as an issue, but there hasn’t been a determination as to how to deal with that problem yet.
- Cycle D plans can wait until Cycle E if they do not want to put in their PPA changes prior to the last day of the 2009 plan year, but they need to adopt a good faith PPA amendment by the end of the 2009 plan year.
- DB plans – hoping to open the window for reviewing pre-approved plans by next February.
- Interim amendments for PPA – amendments due in 2006, 2007 and 2008 were all delayed until 2009; the interim amendment requirement does not depend on whether guidance has been issued; Marty indicated that they are working on a list of the required amendments, but he is not expecting to issue any model language, i.e., there will be no “snap-on” model amendment; ditto the HEART Act; so, the objective of the IRS is simply to list the areas that need to be covered in the interim amendments; Rich said that if a McKay client has adopted a brand new EGTRRA document, they still need a 415 amendment, a PPA interim amendment, etc., plus, if they are terminating, everything else that is out there, like HEART, so, for terminating plans, he is now having his clients adopt an EGTRRA document and then tacking on what is left to that (instead of starting with a GUST document and adding everything since then to that).

IRS Audit – Monika Templeman, Janice Gore and Lisa Burman

- Emphasis, as usual, is on upfront guidance and compliance, which means not much patience for employers who ignore the guidance and don't make a reasonable effort to comply.
- 11,500 exams/enforcement "contacts" anticipated during FY 2009.
- Length of time an audit takes depends on the facts and circumstances.
- FY 2009 exam priorities – 401(k) (entire market segment is being reviewed, because it is so large; issues include, e.g., fee transparencies, late elective deferrals, loans, investments, communication with participants, non-amenders, etc.; IRS expects to issue a report upon conclusion of the study); government plans (also education, outreach, voluntary compliance, etc.; a report is similarly anticipated upon completion of the study); abusive tax avoidance transactions, a/k/a "ATAT" (e.g., civil/criminal fraud, international transactions, rollover business schemes, a/k/a "ROBS" [note: one concern Monika mentioned relates to the issue of a de facto distribution being made without paying tax, premature distribution, etc., but interestingly, she made reference to the possibility of an okay "text book" ROBS; other issues include current availability, payment of promoter fees from trust, and actual availability of employer stock to employees]); phony union schemes (expenses run through it); phony plans (deductions taken without contributions, etc.); 412(i) plans and "son of" 412(i) spin-offs abuses; master & prototype plans (communication with adopters); multi-ER actuarial certification; PTs; 403(b) universal availability; Form 5330 PT reporting
- ROBS question – Monika again mentioned that she has seen the "perfect textbook case" and then indicated that the first problem arises when the employees are not offered stock.

401(k) Plan Design – Richard Perlin and Susan Diehl

- Split testing – 1.410(b)-6(b)(3) [i.e., run two ADP/ACP tests, one for those who have not met the maximum age and service requirements assuming semi-annual entry and one for all others) versus 401(k)(3)(F) [i.e., one ADP/ACP test]
- Bifurcated eligibility – elective deferrals versus employer contributions
- Top paid group election
- Current or prior year testing – advantage of prior year testing is to see in advance how HCE ADP may be limited; advantage of current year testing is availability of QNECs and QMACs
- Safe harbors – matching (basic, automatic contribution [QACA] and enhanced); non-elective (basic and automatic contribution; DB-K (2010 and later; 414(x))
- If objective of owner is to defer \$25,000-\$40,000 per year, the safe harbor match tends to work best, but for cross-testing the nonelective safe harbor contribution works best.
- If safe harbor match is dropped midyear, you must test for the entire year.
- DB-K - - safe harbor starts 2010; safe harbor is part match part DB; assets of each part must be kept separate; can file only one form 5500.

- Automatic contributions – EACA has six months after end of plan year to refund excess contributions.
- Roth 401(k) – young participants; participants with large account balances or a lot of wealth outside plan; will participant be able to select Roth 401(k) or pre-tax for loans, hardship distributions, returns of excess contributions, etc.?
- Compensation earned after severance – vacation, sick pay, non-qualified deferred compensation, military pay, etc.

Take the Money and Stay – Derrin Watson

- Plan loans; hardship distributions; other.
- Greater of \$10,000 or one-half of account balance - \$10,000 usually not helpful due to need for security for loan and inadequacy of balance of plan account.
- Disaster legislation – has doubled the limit in some cases.
- 50% limit under section 72(p) and adequate security of 50% vested account balance both determined as of latest valuation date. But, if account balance declines so vested account balance falls below 50%, there is a deemed distribution to the extent of the difference. So, you either need to not loan 50% of account balance or notify participants of the potential problem.
- Restructuring loan (e.g., to reduce interest) – new loan?
- Can participant terminate payroll withholding agreement under state law – unclear
- Grace period – last day of following quarter (or shorter)
- Deemed distribution versus loan offset
- May suspend loan payments during leave of absence for one year or longer if military leave.
- Re-loan by officer/owner to company of funds borrowed from plan is a PT.
- May not limit loans to employees, but can limit loans to parties in interest. Former employees are generally not parties in interest (e.g., except owners and fiduciaries).
- Regulation Z will cease to apply July 1, 2010 (qualified plans, 403(b) and 457 plans).
- Borrow versus hardship? Hardship wins (easier administratively). Problem is that they are out of the pension system then. So, employees suffer consequences later. With a loan, the money is back in the system (assuming it is repaid).
- After state and federal tax and 10% penalty, you have to withdraw almost twice as much to get the amount you could borrow as a loan.
- Hardship not available from pension plan.
- 401(k) restrictions not applicable to matching or profit sharing accounts. But, do you really want two sets of rules?
- Hardship distributions can be difficult to justify/verify, and are subject to closer scrutiny by the IRS.
- Immediate and heavy financial need (need test), and hardship distribution is necessary to satisfy need (resources need).
- Safe harbor provided for both tests (not required of VS and IDPs) – medical, tuition, funeral, eviction, foreclosure, casualty and purchase of residence).

- “Need” can be grossed up for taxes and penalties, but may not rely upon participant’s required certification if employer has actual knowledge to the contrary.
- If creditworthiness is taken into account, be sure to document in loan policy.
- Do not satisfy need if loan taken as pre-condition to hardship distribution increases the amount of the need (e.g., bank refuses home mortgage since participant’s “equity” is other indebtedness, i.e., a plan loan).
- Six month prohibition on elective deferrals under loan rules is part of safe harbor; facts and circumstances rule applies to non-safe harbor loans (all in all, are the more definite rules of the safe harbor better?).
- Regulations don’t specify the documentation needed for a hardship, but be sure to get something to back up the participant’s certification.
- Chapter 13 cannot alter plan loan terms.
- Plan loans exempted from discharge.
- Automatic stay doesn’t apply to withholding to repay loans.

EPCRS – Al Dorevitch, Gary Mitchell and Kathryn Kennedy

- 72(p) participant loan provisions do not need to be in the plan; 50% reduction in VCP fee if loan is sole failure and no more than 25% of employees affected.
- Eligible employee not allowed to make catch-up contribution – missed deferral opportunity is one-half, and required QNEC is one-half of that, adjusted for earnings.
- New employee’s deferrals delayed six months – same (i.e., 50% of missed deferral opportunity determined, and then QNEC 50% of that, adjusted for earnings).
- Election to make Roth deferral not implemented – same, except QNEC cannot be contributed to Roth account, so subject to tax when distributed to participant (also, needs to be adjusted for earnings).
- DL det w/VCP – nonamender; on-cycle correction; correction by retro amendment.
- DL application not required – failure to adopt timely good faith EGTRRA amendment, interim amendment, or amendment to implement optional law change prior to expiration of plan’s on-cycle amendment period; off-cycle correction; adoption of model language or pre-approved plan. See Vol. 9, Spring 2009, issue of Employee Plan News.
- DOL VFCP – online calculator where not feasible to determine actual earnings adjustment. www.dol.gov/ebsa/calculator
- Correction not required to make distribution if cost of processing > \$75.
- IRS may agree not to pursue 4973 penalty if excess rollover to IRA is returned or distributed.
- IRS may agree not to pursue 72(t) penalty if excess amount is distributed or returned to plan.
- Submissions have been delayed by the number of DL requests received last year.

- Liberalized criteria for “substantial completion” of significant failures - 120 days after correction period; provided that correction with respect to 65% of plan’s participants completed by end of correction period.
- Hierarchy of correcting violations of 415 limit – (i) unmatched after-tax employee contributions and then unmatched elective deferrals; (ii) matched after-tax employee contributions and then matched elective deferrals with forfeiture of related match; (iii) forfeiture of non-elective contributions; (iv) forfeited amounts allocated to suspense account.
- Losses (in lieu of plan earnings) – “will be considered” per A1 (see section 6.02(4)(a) of revenue procedure, which specifically refers to losses).
- Termination – there currently is no procedure for including reference on the Form 5310 to a possible failure to “preserve” the right to go through VCP, particularly to accelerate the process of getting a determination letter on the termination.
- Estimating earnings – weighted average rate of funds, except rate of highest earning fund if self-directed; but, reasonable estimate may include use of DOL on-line calculator.