

# Outlook

A Current Issues Resource for Plan Sponsors and Administrators 3rd Quarter 2006

## Pension Law Changes 401(k) Landscape

*Many changes are effective in 2007*

The Pension Protection Act of 2006 (PPA) recently became law, and many changes are ahead for 401(k) plans next year and beyond.

### *Vesting is accelerated*

Under the law, all employer contributions must be fully vested by either a 3-year cliff (100% after three years of service) or 6-year graded (20% per year beginning not later than the second year of service) schedule. This change is generally effective for plan years beginning on or after January 1, 2007.

### *Automatic enrollment is encouraged*

The PPA protects automatic enrollment plans from state wage laws that prohibit this type of feature, provided advance notice is distributed to employees prior to the beginning of every plan year.

It also provides, effective for plan years beginning on or after January 1, 2008, a new safe harbor for avoiding ADP, ACP and top-heavy testing. The safe harbor requirements include an automatic enrollment percentage of at least 3% in the first year, 4% in the second, 5% in the third and 6% thereafter. There must also be an employer match of at least 100% of the first 1% and 50% of the next 5% of employee contributions, or at least a 3% nonelective contribution. Full vesting must occur after no more than two years.

### *Advice may be provided*

Through an exemption from prohibited transaction rules, the law allows plan fiduciaries to be compensated for giving investment advice to participants. Advice can be provided by a registered investment company or broker-dealer, bank or insurance company if its fee does not vary based on the investment selections made by participants or if the recommendations are based on a computer model certified by an independent investment expert. The exemption applies to advice given on or after January 1, 2007.



### *Diversification is required*

Effective for plan years beginning in 2007, participants must be permitted to diversify their elective deferrals and any after-tax contributions out of employer stock. Participants with three or more years of service must be allowed to reallocate employer contributions.

### *Other changes are wide-ranging*

Among the many other PPA provisions are:

- ERISA Section 404(c) relief is provided for “mapping” investment choices from an old fund selection to a new fund menu, if certain requirements are met.
- The ERISA fidelity bonding requirement for plans that hold employer stock is raised to \$1 million.
- The content of quarterly participant account statements is specified.
- Various EGTRRA provisions that were to expire in 2010, such as increased contribution limits and catch-up contributions, were made permanent.

For more information, review the Profit Sharing/401(k) Council of America’s summary at <http://tinyurl.com/jw55w>. Also, see summary by the American Society of Pension Professionals and Actuaries at <http://tinyurl.com/l8vof>. ■

## Pension Plan Limitations for 2006

401(k) Maximum Participant Deferral <i>(*\$20,000 for those age 50 or over, if plan permits)</i>	\$15,000*
Defined Contribution Maximum Annual Addition	\$44,000
Highly Compensated Employee Threshold	\$100,000
Annual Compensation Limit	\$220,000

## Self-Correction Made Easier by DOL

An expansion of the Department of Labor's Voluntary Fiduciary Correction Program (VFCP) makes it easier for plan sponsors to correct failures. The updated VFCP was effective on May 19, 2006.

The program enables sponsors to voluntarily correct certain ERISA violations. Applicants must correct errors, restore to the plan any losses or profits with interest, and distribute any supplemental benefits owed to participants and beneficiaries. Successful applicants are not subject to Department of Labor enforcement action or penalties related to those violations.

The updated VFCP includes new eligible transactions such as loan delinquencies and defaults, and the use of plan assets to pay expenses that should have been paid by the plan sponsor.

A very helpful addition with respect to loans is relief for fiduciaries when loan failures are corrected through the Internal Revenue Service's Employee Plans Compliance Resolution System. (See article on page 4.)

The VFCP provides a model application form and checklist for use by plan sponsors. The updated program reduces required documentation, simplifies the determination of the correction amount and provides an on-line calculator for lost earnings and interest.

The Department of Labor's Fact Sheet on the VFCP is at <http://tinyurl.com/r6ymu>. ■

## Are Participants Overly Confident?

The Employee Benefit Research Institute's (EBRI) 2006 Retirement Confidence Survey showed that workers may be more confident in having financial security in retirement than their savings suggest they should be.

The survey found that 24% of respondents were very confident about their financial security in retirement, and 44% were somewhat confident. But, of those who were very confident, 22% were not currently saving for retirement, 39% had under \$50,000 in retirement savings and 37% had not calculated their financial needs in retirement.

Broad indicators regarding planning have changed little in recent years. About 70% of respondents were saving or had saved for retirement, and 42% had tried to calculate their financial needs during retirement.

It appears that employees may have unrealistically low expectations about their income replacement ratio. Half of the respondents said they could have a comfortable retirement on 70% or less of their pre-retirement income.

More than two-thirds of those surveyed favored automatic enrollment. Automatic contribution increases were viewed favorably by 65%, and almost 60% liked the idea of having their contributions automatically invested by the employer.

EBRI's Issue Brief ("Will More of Us Be Working Forever? The 2006 Retirement Confidence Survey") is at <http://tinyurl.com/mxbsf>. ■

### There Is More Overconfidence Evidence

**Only 53% of workers said they were building a sufficient retirement account, according to Transamerica Retirement Services' Seventh Annual Transamerica Retirement Survey. Over 70% of survey respondents said they don't know as much as they should about investing for retirement. One-third admitted to guessing their financial security needs in retirement.**

**Half of those surveyed said they want more information and advice from their employer about reaching retirement goals, and half said they would rather rely on outside experts to monitor and manage their retirement savings.**

# Plan Sponsors Ask...

**Q:** Our plan permits hardship withdrawals, and we allow them only for the Internal Revenue Code's safe harbor events. What documentation should we require from the participant?

**A:** In general, in addition to a hardship withdrawal application, your procedures should require documentation showing that the hardship exists, what the financial need is and the costs involved. Under the safe harbor, the participant must already have obtained all available distributions from the employer's plans and be suspended from contributing for six months after the hardship withdrawal.

The six safe harbor events and what you might require are:

- Medical expenses—hospital or doctor bill and insurance statement denying coverage for the amount requested.
- Purchase of principal residence—signed purchase contract.
- Tuition costs—invoice or letter from the educational institution.
- Payment to prevent foreclosure or eviction—court or other legal notice regarding overdue amount, final due date, and what will occur if not paid.
- Funeral or burial expenses—copy of death certificate and funeral home invoice.
- Repair to principal residence—copy of repair invoice and proof that insurance did not cover amount of casualty expense.

Keep applications and supporting documents as provided in your plan's records retention guidelines.

**Q:** An employee who returned from military service wants to submit make-up contributions to our 401(k) plan. How are the amounts determined and what are the deadlines?

**A:** The Uniformed Services Employment and Reemployment Rights Act of 1994 requires employers to provide reemployment and benefits rights to employees who perform uniformed service.

Upon reemployment the employee may make up missed 401(k) elective deferrals and after-tax contributions he or she could have made if the military service had not occurred. The employer must make up any matching or profit-sharing contributions that it would have made.



The employee chooses the amount of elective deferrals or after-tax contributions to make up, up to the limits that were in effect for the year to which the contributions apply. Similarly, make-up matching and profit-sharing contributions are calculated on the made-up deferrals or after-tax contributions, using the formula for the year in which the contributions would have been made if military service had not intervened.

The employee's deadline is three times the period of military service, but no more than five years. Experts suggest that employers make matching contributions immediately and follow Department of Labor rules for profit-sharing contributions.

Be sure to adhere to the terms of your plan document, and seek advice from the plan's counsel in handling these cases.

**Q:** How will the various plan dollar limits for next year be calculated?

**A:** The \$15,000 maximum elective deferral and \$5,000 catch-up contribution limits for 2006 will be indexed for inflation for 2007. Adjustments are in \$500 increments.

The current \$44,000 defined contribution maximum annual addition limit will be indexed for inflation in \$1,000 increments.

The highly compensated employee definition, now \$100,000, will be indexed for inflation in \$5,000 increments. The \$5,000 increments apply to the maximum annual plan compensation limit as well.

New limits for the coming year are usually announced by the Internal Revenue Service in November. ■

# Web Resources for Plan Sponsors

Internal Revenue Service, Employee Plans  
[www.irs.gov/ep](http://www.irs.gov/ep)

Department of Labor,  
Employee Benefits Security Administration  
[www.dol.gov/ebsa](http://www.dol.gov/ebsa)

401(k) Help Center  
[www.401khelpcenter.com](http://www.401khelpcenter.com)

BenefitsLink  
[www.benefitslink.com](http://www.benefitslink.com)

BenefitNews  
[www.benefitnews.com](http://www.benefitnews.com)

Profit Sharing/401(k) Council of America  
[www.pasca.org](http://www.pasca.org)

Employee Benefits Institute of America, Inc.  
[www.ebia.com](http://www.ebia.com)

Employee Benefit Research Institute  
[www.ebri.org](http://www.ebri.org)

## IRS Improves Corrections Program

The Internal Revenue Service (IRS) has improved its Employee Plans Compliance Resolution System (EPCRS), which includes three levels of correction programs. The updates are in Revenue Procedure 2006-27 and were generally effective on September 1, 2006. A brief summary of the changes is in the IRS' announcement in Employee Plans News (<http://tinyurl.com/ldypu>).

Two key revisions expand the Voluntary Correction Program (VCP), which allows sponsors to apply to the IRS to correct certain errors and pay a fee. The first change affects plan loans where the loan term has not expired. Loans that exceed the statutory limit, the maximum period or are defaulted may now be corrected using the VCP.

Also, the exclusion of eligible employees in a 401(k) plan can be corrected by the sponsor, who can make a qualified non-elective contribution based on lost opportunity cost.

The IRS has updated its Web site to provide a topic index to the Revenue Procedure and other helpful information. View the "Correcting Plan Errors" page at <http://tinyurl.com/lgj95>. ■

## Plan Sponsor's Quarterly Calendar

Consult your plan's counsel or tax advisor regarding these and other items that may apply to your plan.

### OCTOBER

- For calendar year safe harbor 401(k) plans, issue the required notice to employees between October 3rd and December 2nd (within 30 to 90 days of the beginning of the plan year to which the safe harbor applies).
- Audit third quarter payroll and plan deposit dates to confirm compliance with the DOL's rule regarding timely deposit of participant contributions and loan repayments.
- Verify that employees who became eligible for the plan between July 1st and September 30th received and returned an enrollment form. Follow up on forms that were not returned.

### NOVEMBER

- Conduct a campaign to encourage participants to review and, if necessary, update their mailing addresses to ensure receipt of Form 1099-R in January for reportable transactions in 2006.
- Check supplies of enrollment materials, fund prospectuses, etc., to ensure that all information is current. Also check bulletin boards for current information.
- Prepare and issue a payroll stuffer or other notice to employees to publicize the plan's advantages and benefits, and any plan changes becoming effective in January.

### DECEMBER

- Verify that participants who terminated employment during the second half of the year selected a distribution option for their account balance and returned the proper form. Contact those who did not return a distribution election form.
- Prepare to send year-end payroll and updated employee census data to the plan's recordkeeper in January for year-end compliance testing. (Calendar year plans)
- Review plan operations to determine if any ERISA or tax-related violations occurred this year and if using an IRS or DOL self-correction program would be appropriate.

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