Plan Sponsor

Outlook

A Current Issues Resource for Plan Sponsors and Administrators 1st Quarter 2007

By the Numbers...

How does your plan compare?

According to the Profit Sharing/401(k) Council of America's (PSCA) *49th Annual Survey of Profit Sharing and 401(k) Plans*, the average participation rate in 401(k) plans was 77.7%. The pre-tax contribution rate for non-highly compensated employees was 5.4%, and for highly compensated employees it was 6.9%.

The survey reflects 2005 plan year experience of 1,100 plans with more than six million participants and more than $500 billion in plan assets.

Most common match formula unchanged

As in previous surveys, the most common formula in plans with a fixed match was 50 cents per $1.00 on the first 6% contributed (33% of plans). A fixed match was found in 79% of 401(k) plans. About 67% of companies matched each payroll period and 22% matched annually.

Automatic enrollment increasingly popular

Nearly 18% of 401(k) plans had an automatic enrollment feature, nearly double the figure from the prior year.

For 60% of plans, the default contribution rate was 3%. About 14% of plans said they raise the default contribution rate over time (for example, coinciding with pay raises), double the percentage from the last survey.

Internet transactions widely available

In addition to balance inquiries, plans offered the following options via the Web:

- Enrollment – 49.5%
- Investment changes – 89.4%
- Loans – 59.8%
- Contribution changes – 61.1%
- Final distributions – 43.1%

Investment advice down slightly

About 47% of 401(k) plans offered investment advice, down from 56% in the last survey. One-on-one counseling was the most common method of providing advice (almost 60% of plans offering advice), followed by Internet providers (40%).

Only 22% of participants used advice when offered.

Other findings offer insight

Among other highlights of the PSCA's survey are:

- Catch-up contributions were permitted in 98% of plans. About 23% of those eligible made catch-up contributions.
- The average number of investment options was 19, up from 18 the previous year.
- About 6% of plan assets were invested in employer stock.
- 79% of plans had an investment policy statement. Of those, 52% conducted quarterly monitoring.
- Nearly 40% of 401(k) plans offered immediate full vesting of employer matching contributions.

To order the full report, go to www.psca.org.

Recommended Reading

Do you have a new staff member involved in the administration of your 401(k) plan? If so, he or she should read the Investment Company Institute's *401(k) Plans: A 25-Year Retrospective*. This informative report looks at the evolution of 401(k) plans, the regulatory environment, changes in plan design and current issues. It's interesting reading for everyone who works with defined contribution plans. Go to http://tinyurl.com/yu2ty9.

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Pension Plan Limitations for 2007

401(k) Maximum Participant Deferral *(*$20,500 for those age 50 or over, if plan permits)*	$15,500*
Defined Contribution Maximum Annual Addition	$45,000
Highly Compensated Employee Threshold	$100,000
Annual Compensation Limit	$225,000

IRS Issues 401(k) Plan Checklist

The Internal Revenue Service (IRS) has published a brochure and checklist to assist 401(k) plan sponsors in conducting a "check-up" of their plans.

The booklet, "*Have you had your Check-up this year?*" describes the 401(k) Plan Checklist, lists publications and forms that are helpful in operating a 401(k) plan, summarizes common mistakes and briefly describes the IRS' correction programs.

The 401(k) Plan Checklist includes ten questions about the plan's compliance with key IRS rules. The Web-based version of the Checklist has links to expanded explanations and IRS resources. For example, one can use links to detailed information about highly compensated employees, nondiscrimination testing and eligible employees.

The booklet, Publication 3066, can be viewed at http://tinyurl.com/ye89au. The 401(k) Plan Checklist, Publication 4531, is at http://tinyurl.com/yk2mah. Both can also be obtained by calling the IRS at 800-829-3676. ■

IRS Review Tools Are Available to Plan Sponsors
During review of retirement plans, the Internal Revenue Service's (IRS) Employee Plans Specialists refer to various tools to assist in their analysis. Many of those are now available to plan sponsors on the IRS' Web site.

Included are Alert Guidelines, also called Worksheets, which are questions about plan provisions, and Explanations, which explain the Worksheet questions and give guidance on the applicable law. Topics range from minimum coverage and participation standards to top-heavy requirements.

For insight into the IRS' analysis of plan provisions and issues, go to http://tinyurl.com/jasop.

PPA Added and Changed Disclosures

The Pension Protection Act of 2006 (PPA) made significant changes in the disclosure obligations that face plan sponsors. You may want to review this summary of key items with your plan's legal counsel.

✔ ***Automatic Enrollment Notice***
Effective upon the enactment of PPA last year, ERISA preempts state wage withholding or anti-garnishment laws prohibiting automatic elective deferral payroll deductions. If automatic enrollment is a plan feature, a notice must be given to employees before every plan year to advise them of their right not to have such deferrals made.

✔ ***Diversify Out of Employer Stock***
A newly required notice, effective for plan years beginning on or after January 1, 2007, informs participants of their right to diversify their plan assets out of company stock and explains the importance of investment diversification. The right to divest applies to both elective deferrals and employer contributions, though special rules apply to the latter.

The Internal Revenue Service's model notice to participants is at http://tinyurl.com/ycgz63.

✔ ***Default Investment Option Disclosure***
For plan years beginning in 2007, ERISA Section 404(c) relief is available if participants have a "qualified default investment alternative" (QDIA) available to them. An initial notice must be distributed to employees at least 30 days prior to the initial investment in the QDIA, and at least 30 days in advance of the beginning of each subsequent plan year.

Final Department of Labor regulations on QDIAs are expected early in 2007.

✔ ***Quarterly Account Statements***
Though already the norm, quarterly benefit statements for participants and beneficiaries in participant-directed defined contribution plans are required in plan years beginning on or after January 1, 2007.

The Department of Labor is expected to issue a model statement which would include newly required content such as accrued benefit amount, vested portion, and the value of each investment held in the participant's account. In addition, rules restricting participants' ability to direct their investments must be described, and a warning about the risk of having more than 20% of their assets in the securities of one entity is required. ■

Plan Sponsors Ask…

Q: Was there a recent change in the distribution rules that would allow those in active military service to make special withdrawals from their 401(k) accounts?

A: Yes. The Pension Protection Act of 2006 (PPA) includes a unique distribution rule for reservists called to active duty from September 12, 2001 through December 30, 2007 for at least 180 days or for an indefinite period.

Such a provision is optional, and a plan sponsor choosing to add a qualified reservist distribution (QRD) provision would do so by plan amendment.

A QRD is a distribution of the reservist's elective deferrals (and associated earnings) taken during the period beginning when he or she is ordered to active duty and ending at the close of the active duty period. If the reservist wants a distribution of other types of contributions, such as matching, profit sharing or after-tax contributions, he or she could request such a distribution only if the plan permits hardship withdrawals or other in-service withdrawals.

The 10% penalty on early distributions does not apply to QRDs, but regular income tax does. Relief from the 10% penalty is retroactive to QRDs made after September 11, 2001.

Q: We just discovered that participants' contributions withheld from one payroll several months ago weren't sent to the plan's trustee. How should we correct this?

A: Department of Labor (DOL) regulations provide that elective deferrals are plan assets that must be paid to the plan's trust as soon as they can reasonably be separated from the employer's general assets. The latest date that these amounts may be deposited in the trust is the 15th business day of the month following the month in which they would otherwise have been payable to participants in cash.

Delayed deposit of participant deferrals is viewed as a prohibited loan between the plan and the employer, since the employer has the use of the funds when they should be held in the trust. Therefore, failure to remit participant contributions (and loan repayments) to the plan's trust constitutes a prohibited transaction for which excise taxes are due.

In addition to consulting your plan's legal counsel, you should immediately move the elective deferrals to the trust, including lost earnings, and file Form 5330 with the Internal Revenue Service to pay the applicable excise tax (generally 15% of the amount involved in the prohibited transaction). DOL penalties may also be assessed. You may want to consider whether taking advantage of the DOL's Voluntary Fiduciary Correction Program (VFCP) may be appropriate for correcting this fiduciary violation.

See the next question and answer for where to get information about correction programs.

Q: Is there a convenient source of information about the various Internal Revenue Service and Department of Labor correction programs?

A: Yes. The Internal Revenue Service (IRS) recently updated its *Retirement Plan Correction Programs* CD-ROM. The CD contains helpful details about the IRS' correction procedure as well as the Department of Labor's Voluntary Fiduciary Correction Program.

Topics covered on the CD include common qualified plan requirements, maintaining your plan and frequently asked questions about the various correction programs.

You may order the CD-ROM (Publication 4050) from the IRS at http://tinyurl.com/ehswk, or by calling 800-829-3676.

You might also want to request Retirement Plan Correction Programs (Publication 4224). This booklet outlines the basics of the available programs and lists regulatory agency resources. It's available at http://tinyurl.com/ywh3vk, or call the IRS to order it.

Web Resources for Plan Sponsors

Internal Revenue Service, Employee Plans
www.irs.gov/ep

Department of Labor,
Employee Benefits Security Administration
www.dol.gov/ebsa

401(k) Help Center
www.401khelpcenter.com

BenefitsLink
www.benefitslink.com

BenefitNews
www.benefitnews.com

Profit Sharing/401(k) Council of America
www.psca.org

Employee Benefits Institute of America, Inc.
www.ebia.com

Employee Benefit Research Institute
www.ebri.org

More Evidence of Auto Enrollment's Impact

According to a new Hewitt Associates report, automatic enrollment in 401(k) plans increases participation rates, particularly for younger, lower paid and shorter service employees. But, it doesn't ensure that participants will contribute enough or take the best investment approach for their retirement.

In the sample, the participation rate for automatic enrollment plans was 91%, compared to 68% in plans not having this provision. Opt-out rates below 10% were common in the auto enrollment plans.

Since most automatic enrollment plans had a default rate of 3% or less, these plans saw an average contribution rate of 6.8%. Plans without this feature had an 8% average rate.

With respect to a company match, 42% of auto enrollees did not contribute up to the match threshold, versus 19% of those not in an automatic enrollment plan.

Fewer than 10% of those automatically enrolled took steps to rebalance their accounts, and participants who were automatically enrolled directed less than one-third of their assets to equity investments.

For more information, go to http://tinyurl.com/vkv2k. ■

Plan Sponsor's Quarterly Calendar

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

APRIL

- Conduct a review of first quarter payroll and plan deposit dates to ensure compliance with the Department of Labor's rule regarding timely deposit of participant contributions and loan repayments.
- Arrange with an independent accountant/auditor for a plan audit, if required, to accompany the Form 5500 (calendar year plans).
- Verify that employees who became eligible for the plan between January 1st and March 31st received and returned an enrollment form. Follow up on forms that were not returned.

MAY

- Monitor the status of the completion of Form 5500, and, if required, a plan audit (calendar year plans).
- Send a reminder memo or e-mail to participants to encourage them to review and update, if appropriate, their beneficiary designations.
- Perform a detailed annual review of the plan's Summary Plan Description and other enrollment and plan materials to confirm that all information is current and identify situations in which revisions are necessary.

JUNE

- Confirm that Form 5500, and plan audit if required, will be completed prior to the filing deadline or that an extension of time to file will be necessary.
- Begin planning an internal audit of participant loans granted during the first six months of the year. Check for delinquent payments, and verify that payment periods and amounts borrowed do not violate legal limits.
- Review plan operations to determine if any qualification failures or operational violations occurred during the first half of the year, and determine if using an Internal Revenue Service or Department of Labor self-correction program would be appropriate if a failure or violation is found.

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