



# FBA NEWS NOTES

Summer 2006

NEWS AND INFORMATION ON EMPLOYEE BENEFIT PLANS

## What is 401(k) Day?

401(k) Day is an annual celebration spotlighting the importance of employer-sponsored profit sharing and 401(k) plans. As retirement follows work, 401(k) Day follows Labor Day. In 2006, 401(k) Day is on September 8, which is the Friday after Labor Day. ♦

## Preparing – or Not – For Retirement

For Baby Boomers and Retirees living longer often means outliving the nest eggs set up to ensure financial comfort. The following insights can help you avoid the pitfalls and lack of foresight so you can prepare and live comfortably in retirement.

1. *Thinking it's too late to start planning* – Just because you're in your 50s or 60s doesn't mean it's too late to start investing. The power of compounding has been boosted by the growth in tax-deferred programs like 401(k) plans, annuities, and individually owned retirement plans (IRAs). It may not take you as long as you think to build up a nest egg.
2. *Underestimating your Length of Retirement* - It appears, on average that most workers have reasonable expectations on how long they will be in retirement. According to the 2006 Retirement Confidence Survey (RSC) by the Employee Benefit Research Institute (EBRI), half of the men and women that reach the age of 65 have an additional life expectancy of 20 years. Understanding how long you will be likely to live is essential when it comes to planning.
3. *Miscalculating your Savings Needs* – According to the EBRI survey only 42% of workers have tried to determine how much money they'll need to save. Once the results were in, more than half of those increased or reallocated their assets. More than 44% of those investing guess at where to allocate their assets. Make sure that your investments are working for you.
4. *Not Taking Inflation into Account* – It's important to consider keeping money in growth investments such as stock or stock mutual funds. Many workers fail to realize that inflation can potentially eat away most of their investment returns.
5. *Putting Other Financial Goals First* – Other goals like saving for a child's college education or a down payment on a home are important, just don't place them ahead of a financially secure retirement. ♦

## Automatic 401(k) Enrollment

A 401(k) plan typically leaves it up to the employee to choose whether or not to participate, how much to contribute, which of the investment options offered to select, and when to pull the funds from the plan and in what form. These decisions are confusing and with more immediate concerns distracting workers from making sound financial planning decision many do not participate just to avoid the headaches. Workers in the current structure of most 401(k) plans do not participate unless they actively choose to. By implementing an automatic 401(k) they *would* participate unless they actively choose *not* to. Similarly, each major decision thereafter would be made without the workers taking the initiative for any of the steps, but they would still have the ability to override the default options and opt out of the automatic design.

Heavy reliance on self-direction in 401(k) plans made sense when 401(k) plans were first developed. At that time they were mainly supplements to employer-funded defined pension and profit sharing plans. Today, they play a primary role in retirement planning so it's time to update how they operate.

The key features of the Automatic 401(k) are not complicated and can boost participation and savings.

1. *Automatic Enrollment*: Those that procrastinate or who are just not organized would no longer be left out – for they would become participants automatically. Studies have indicated that automatic enrollment can boost plan participation up to 85 to 95 percent of all eligible employees.
2. *Automatic Escalation*: Employee contributions would automatically increase in a prescribed manner over time, raising the contribution rate as a share of earnings.
3. *Automatic Investment*: Funds would be automatically invested in balanced, diversified, low-cost vehicles. Usually, broad index funds or professionally managed funds are chosen to protect employers from potential fiduciary liabilities.
4. *Automatic Rollover*: When an employee switches jobs, the funds could be automatically rolled over into an IRA, 401(k), or other plan offered by the new employer. Automatic rollovers would reduce the number of employees who take a lump sum cash distribution and the tax penalties that entails.

So what did the EBRI find when it did its survey of workers in 2006? A majority of employed workers favor automatic enrollment (69 percent), automatically increasing the percentage of salary contributed when an increase in pay is received (65 percent), and automatically investing contributions for the employee (59 percent). Plan participants and non-participants are equally likely to favor each of these automatic features.

While the use of Automatic 401(k) is not sufficiently widespread among employers to produce definitive studies, retirement experts predict that other benefits from auto-enrollment will include:

- Higher account balances for all because employees will have enrolled earlier in their careers,
- Higher account balances among higher-paid employees because employers will have met discrimination tests and
- Potentially lower employee turnover

While employers with high employee turnover may resist automatic enrollment because of cost/paperwork, they may be pleasantly surprised to find that turnover reduces when newly recruited 401(k) participants view their 401(k) account statements. What's more, since non-participants tend to be lower-paid, the practice of automatic enrollment could result in favorable discrimination testing\* that allows the higher-paid to defer more.

#### **FBA, Ltd. Note**

\*nondiscrimination testing is testing to ensure that low-paid workers take advantage of tax-deferred retirement savings plans and that the tax benefits of such plans do not accrue solely to the highly paid.

Some employers are reluctant to implement an automatic 401(k) due to:

- Fiduciary concerns: fear of litigation from employees because their accounts lost money
- State Anti-Garnishment Laws: laws that require employees to receive written notice from employers before money is taken out of their paychecks. ERISA generally is thought to pre-empt these rules though legal advice differs on the matter state by state

Obstacles to Automatic 401(k) s may be resolved with new legislation. The House & Senate are close to approving legislation that should address these concerns. The legislation:

- Encourages employers to automatically enroll their workers in 401(k) plans by giving them protection from lawsuits if the investment options chosen are "reasonable," such as a balanced fund, with investments in stocks and bonds or cash-equivalents.
- Preempts any state garnishment laws when it comes to auto enrollment.
- Establishes provisions for a safe harbor design that will meet employer non-discrimination and top-heavy tests

While all these efforts may lead more employers to offer an Automatic 401(k), employees must remember one thing: Although much will be done for you in these plans, you still must remain engaged in the process. ♦

## **How to Decide Whether or Not to Offer Designated Roth Contributions in a 401(k) plan**

What are some of the factors that should be considered in evaluating whether to offer this option to your 401(k) plan? Evaluating whether the Roth option makes sense for your 401(k) plan requires weighing the potential benefits for your participants with the additional complexity for them and the administrative requirements for your plan.

In assessing whether designated Roth contributions are right for your plan, there are several factors you will want to consider—here are a few of them:

+ *Opportunity to Exceed Roth IRA Limitations.* Higher-paid participants, who are not eligible to make Roth IRA contributions due to the income cap on eligibility, get the opportunity to grow tax-free earnings. What's more, participants who would be eligible to make Roth IRA contributions can get similar tax treatment on substantially larger contributions (\$15,000 for designated Roth in 2006 versus \$4,000 for Roth IRA in 2006).

+ *Hedge Against Tax Rate Increases.* Participants who think their income tax rate will be higher at retirement, or who wish to hedge against that possibility, can make elective deferrals that will be subject to their current (lower) rate instead, thus maximizing their after-tax retirement income (provided they receive a qualified distribution).

+ *Opportunity for Higher Value Contributions.* Participants who are constrained by the dollar limit under Code Section 402(g) can effectively contribute more of their earnings, because after-tax designated Roth contributions are treated the same as pre-tax elective deferrals for purposes of the dollar limit under Code Section 402(g) (i.e., the taxes on the Roth contributions don't count for purposes of Code Section 402(g)).

- *Complexity of the Decision.* Participants deciding whether to make designated Roth contributions will need to consider current and future tax rates, their investment alternatives, and the risk that they will need a distribution before they qualify for the tax-free distribution of earnings and the loss of some rollover options.

- *Participant Communication.* Plan SPDs and other participant communications will be more complex.

- *Administrative Complexity and Record Keeper Capacity.* The separate accounting required for designated Roth contributions may result in higher plan costs and increase the risk of error. Plan administration will be more complicated, including enrollment, nondiscrimination testing, application of contribution limits, and plan error corrections.

In weighing your options, don't forget that the rules regarding designated Roth contributions are scheduled to expire after 2010. Unless the sunset date is extended or repealed, the ability to make designated Roth contributions could end at that time. Guidance to date does not address what would happen to existing designated Roth accounts if the rules expire. On the next page is a table that compares Roth 401(k) plans to Traditional 401(k) plans.

<b>Roth 401(k) plan</b>	<b>Traditional 401(k) plan</b>
Employee contributions are made with <i>after-tax</i> dollars.	Employee contributions are made with <i>before-tax</i> dollars.
Investment growth accumulates without any tax consequences.	Investment growth accumulates without any tax consequences.
There is no income limitation to participate.	There is no income limitation to participate.
Contributions are limited to \$15,000 in 2006 (\$20,000 for employees 50 or over).	Contributions are limited to \$15,000 in 2006 (\$20,000 for employees 50 or over).
<p>*Taxes on earnings Since contributions have already been taxed, earnings are not subject to taxation if participant is:</p> <ul style="list-style-type: none"> <li>• At least 59 ½ or</li> <li>• Disabled or</li> <li>• Deceased and contributions are held for at least five years.</li> </ul>	<p>*Taxes on earnings Withdrawals of both contributions and income earned are subject to taxation.</p>

These include Schedules P (trustee information) and SSA (separated participant information). The IRS has indicated that plan administrators, employers, and certain other entities must continue to satisfy any applicable requirements in accordance with IRS guidance.

#### **FBA, Ltd. Note**

It is not yet clear what other filing requirements may stem from the elimination of these IRS-required schedules, and we hope the IRS will issue clarifying guidance soon. For example, the elimination of the Schedule P requirement, which has been instituted for the 2006 Form 5500, raises at least one concern. Under current IRS guidance, Schedule P must be filed for 401(k) and other retirement plan trusts to start the running of the three-year statute of limitations under Code Section 6501(a) (under which the IRS can assess taxes for plan disqualification).]

- *Identification of Insurers and Service Providers That Fail to Supply Information.* Proposed revisions to Schedules A and C would require plans to identify any insurer, fiduciary, or service provider that fails to provide requested information and the type of information not provided.
- *Increased Reporting of Fees and Commissions.* Further revisions proposed to Schedule C are designed “to ensure that plan officials obtain the information they need to assess the reasonableness of the compensation paid for services rendered to the plan.” The current reporting limitation is retained that only service providers receiving \$5,000 or more must be reported, but reporting is no longer limited to the 40 highest paid. In addition, the definition of compensation is clarified and revised. For example, the instructions clarify that compensation includes “float” or similar earnings on plan assets or plan deposits that are retained by the service provider. A revision to the instructions eliminates an existing reporting exemption by including in reportable compensation all brokerage commissions and fees charged to the plan on purchase, sale, or exchange transactions, regardless of whether the broker is granted discretion. In addition, small plans that use either Schedule I or new Form 5500-SF would be required to disclose direct compensation paid for administrative expenses.
- *Schedule C Service Codes.* The DOL is proposing to expand and modify certain codes used on Schedule C to identify services provided to the plan. Some changes are to provide clarity and others are to reflect changes in the plan services industry.
- *New Compliance Questions.* New compliance questions added to Schedules H and I include whether the plan has failed to pay any benefits when due and, for defined contribution pension plans (including 401(k) plans), whether a blackout occurred and, if so, whether required notice was given. These compliance questions are also contained in the new Form 5500-SF.
- *Model SAR Language for Small Plan Audit Waiver.* Among the changes contained in the DOL’s proposed regulations is an appendix that contains model language for inclusion in an SAR for small ERISA pension plans (including 401(k) plans) that are taking advantage of the audit waiver provisions. ♦

## **Electronic Filing of Form 5500 Required for 2008 Plan Year; Changes to Form, Schedules, Instructions, and Regs Proposed**

From the July 27, 2006 EBIA Weekly

The DOL has issued a final rule requiring all Form 5500s to be filed electronically for plan years beginning on or after January 1, 2008. The DOL believes that a wholly electronic system will result in reduced errors, more timely enforcement (which will increase protection for participants), and lower annual reporting costs. The design of the new electronic filing system, which will replace EFAST, is still being developed. The DOL indicates, however, that it will include a secure Internet-based filing method and will continue to support approved, privately developed filing software.

In addition, to accommodate the change to mandatory electronic filing, the DOL, IRS, and PBGC have jointly issued proposed revisions to Form 5500 (including Schedules and Instructions) and the DOL has issued proposed amendments to its regulations on annual reporting and disclosure requirements, all of which are to be finalized for the 2008 reporting year. Highlights of the proposed revisions include the following:

- *New Short Form 5500 for Certain Small Plans.* A new, two-page Form 5500-SF is proposed for certain small plans (generally, plans with fewer than 100 participants) with secure and easy-to-value investment portfolios. Potentially eligible plans include certain small pension plans that qualify for the audit waiver and small welfare plans that do not otherwise qualify for a filing exemption.
- *Elimination of Schedules SSA and P.* Because the Code contains no mandatory electronic filing requirements for Form 5500, it is proposed that those portions of the Form 5500 filing that satisfy obligations imposed solely by the Code (and not by ERISA) be removed to effectuate mandatory electronic filing.

## **DOL Extends Filing Deadline for Form 5500 for those in the Affected Gulf Coast Region**

The U.S. Department of Labor's Employee Benefits Security Administration (EBSA) is extending the deadline for filing the 2004 and 2005 Form 5500 series annual returns/reports to Oct. 16, 2006. This additional reporting relief is being granted to filers in 31 parishes in Louisiana, 46 counties in Mississippi and 11 counties in Alabama.

On September 28, 2005, the agency announced an extended deadline of February 28, 2006, for those Form 5500 series filers affected by Hurricane Katrina. After closely monitoring the effects of Hurricane Katrina in the Gulf region and, due to widespread devastation from the hurricane and subsequent flooding, EBSA, the Internal Revenue Service (IRS) and the Pension Benefit Guaranty Corporation have determined that filers in certain parishes and counties require additional time to prepare and file complete and accurate Form 5500 reports.

The new extension for reporting applies to plan administrators, employers and other entities affected by Hurricane Katrina and located in one or more parishes or counties listed in the IRS's notice IR-2006-30 dated February 17, 2006. The extension also applies to firms located outside the affected areas who are unable to obtain the necessary information from service providers, banks or insurance companies whose operations were located in the areas listed in IR-2006-30 and affected by Hurricane Katrina.

Form 5500 filers using this extension should check Form 5500, Part I, box D and attach a statement labeled "Form 5500, Box D – Hurricane Katrina Disaster Relief Extension." Similarly, Form 5500 EZ filers should check Form 5500 EZ, Part I, box B, and attach a statement labeled "Form 5500 EZ, box B – Hurricane Katrina Disaster Relief Extension."

For more information about disaster relief, the Internal Revenue Service at [www.irs.gov](http://www.irs.gov) under "Disaster Area Tax Relief." Filers who have additional questions may contact EBSA's EFAST Help Line at 1.866.463.3278. ♦

## **IRS Provides Additional Time to File Individual Tax Returns in Areas Hardest Hit by Katrina**

The Internal Revenue Service is providing additional time to file 2004 and 2005 individual income tax returns through Oct. 16, 2006 for certain affected taxpayers hit hardest by Hurricane Katrina.

Earlier this year, the IRS granted a postponement through Aug. 28, 2006, for certain time-sensitive acts for Katrina victims in the most severely damaged parishes and counties of Louisiana and Mississippi. The IRS is now granting additional time through Oct. 16, 2006, for these affected taxpayers to file certain individual income tax returns. The additional time to file individual income tax returns applies only for affected taxpayers in 31 Louisiana parishes, 49 Mississippi counties and 11 Alabama counties.

Specifically, the IRS is granting additional time through Oct. 16, 2006, for affected taxpayers to file the following individual income tax returns:

- 2004 individual income tax returns, originally due on April 15, 2005, for which taxpayers obtained an extension of time to file until Oct. 15, 2005, and for which the previous grant of disaster relief postponed the due date to Aug. 28, 2006.
- 2005 individual income tax returns, originally due on April 15, 2006, for which the previous grant of disaster relief, postponed the due date to Aug. 28, 2006.

This additional postponement of time is not available for any other time-sensitive acts besides these two types of returns.

To ensure that they receive the relief to which they are entitled, affected taxpayers should mark "Hurricane Katrina" in red ink on the top of their returns. In addition, affected taxpayers may identify themselves as eligible for relief by calling the IRS Disaster Hotline at (866) 562-5227.

Legal guidance is available in IRS Notice 2006-56. A full listing of the affected counties is also described in news release IR-2006-30 and in Notice 2006-20. ♦

## **PSCA Urges the SEC to Reconsider the Rule on Redemption Fees**

The Profit Sharing/401(k) Council of America urges the Securities and Exchange Commission (SEC) to reconsider the Commission's March 7, 2006, proposed amendments to the final rule on redemption fees that was adopted on March 11, 2005. "The final rule and the proposed amendments will impose cost, complexity, and compliance issues that are, in the final analysis, detrimental to the employer-provided retirement plan system," PSCA President David Wray said.

PSCA had previously commented on this issue suggesting proposed rules on redemption fees were premature because the Commission had failed to reinvigorate and enforce an effective fair value pricing requirement. PSCA also argued that a redemption fee rule should permit funds, intermediaries, and retirement plan sponsors to work collaboratively on alternative measures to address any market timing problems. Finally, PSCA asked the Commission to conduct a cost-benefit analysis before issuing a final rule. Neither the final rule nor the proposed amendments has addressed these concerns. ♦

## **Important Changes to the DOL's VFC Program**

*[Voluntary Fiduciary Correction Program; Notice 71 Fed. Reg. 20261 (Apr. 19, 2006)]*

Under the Voluntary Correction Program (VFC), persons potentially liable for fiduciary breaches can voluntarily apply to the DOL and correct specific breaches in exchange for a "no action" letter and relief from ERISA Section 502(l) penalties. The DOL announced revisions to its VFC Program, which simplify and expand the original VFC Program published in 2002. Amendments have also been made to PTE 2002-51, which provides relief from the excise taxes imposed under the Code for certain transactions corrected in the VFC Program.

This update covers 19 categories of transactions, describes acceptable methods for correcting violations and provides examples of potential violations and corrective actions. Here are some highlights of the changes.

### *Expansion of Covered Transactions*

- The VFPC now includes a section entitled “Expenses Improperly Paid by a Plan.” It covers situations when a plan uses its assets to pay expenses, commissions or fees the plan sponsor should have paid, including payments for services appropriately characterized as settler expenses.
- An amendment to PTE 2002-51 eliminates the requirement to provide notice to interested parties for certain corrections of delinquent contributions or loan repayments.
- The new VFPC includes procedures by which an applicant can make corrections involving loans to plan participants that violate certain plan restrictions as to amount, level amortization, or that result in loan defaults.
- The revisions permits a plan to divest a previously purchased asset that is determined to be illiquid (e.g., a limited partnership interest), and/or the subsequent sale of the illiquid asset by the plan. The notice also changes the procedure for correcting participant loan violations to require only that the correction be made under the IRS’s EPCRS procedure for participant loan corrections (when it is published) and that a copy of the EPCRS compliance statement, along with proof of any required payments, be submitted to the DOL.

### *Narrower Definition and Optional Disclosure of “Under Investigation”*

- Eligibility to participate in the VFC Program is conditioned on neither the plan nor the applicant being “under investigation.” The 2005 revisions broadened this definition to include not only a DOL criminal or civil investigation but also to include any other criminal or civil investigation by a federal agency (e.g., the IRS or SEC) involving the plan, the applicant, or a plan fiduciary and any federal agency’s notice of intent to conduct an investigation. The final notice narrows the definition slightly to investigations, either ongoing or for which notice has been given, that specifically involve the plan or that specifically relate to the applicant or the plan sponsor in connection with an act or transaction directly related to the plan.
- The final notice includes an optional disclosure provision under which eligibility is not barred if the investigation is a civil one by the PBGC or certain state agencies (such as a state insurance commissioner) and the applicant discloses the investigation in writing when submitting the correction application.

### *Welfare Plan Provisions*

- Welfare plans will be affected by some of the changes described above. In addition, the final notice also expands the scope of penalty relief to include relief from ERISA Section 502(i) penalties, which generally apply to welfare plans (and nonqualified pension plans).

The expanded scope and coordination of correction procedures with the IRS’s EPCRS for participant loan violations is good news for 401(k) plan sponsors, as is the additional penalty relief for welfare plans. Hopefully there will be additional flexibility for correction procedures, similar to the self-correction program offered in the IRS’s EPCRS. Instead, the DOL noted that the final notice “does not foreclose resolution of fiduciary breaches by other means, including entering into settlement agreements” with the DOL. ♦

## **DOL Releases Fiscal Year 2005 Employee Benefit Plan Enforcement Statistics**

The DOL’s Employee Benefits Security Administration (EBSA) has released its fiscal year 2005 enforcement statistics. EBSA is the agency within the DOL that enforces Title I of ERISA and “is responsible for ensuring the integrity of the private employee benefit plan system.” According to the released Fact Sheet, the DOL’s total monetary results for FY 2005 were more than \$1.7 billion, which included \$709 million in assets restored to plans and benefits recovered for individual workers – an increase of nearly 120% over FY 2004. More than 75% of civil investigations closed in FY 2005 produced monetary results for plans or other corrective action. The DOL received 985 Voluntary Fiduciary Correction Program (VFPC) applications – over twice as many as in FY 2004. The DOL also reported that it restored over \$88 million (up from \$76 million) in benefits on behalf of workers and their families through informal resolution of individual complaints received through its website and toll-free number. ♦

## **A New and Improved EPCRS**

The popular EPCRS, or the Employee Plans Compliance Resolution System, has updated the program for correcting plan mistakes. With the issuance of the long-anticipated update, **Rev. Proc. 2006-27**, the revised EPCRS expands not only the types of failures that can be corrected under EPCRS but also the allowable correction methods.

Introducing the updated program, Carol Gold, Director of EP, said, “The ever-changing laws and regulations covering retirement plans necessitate a correction program that is flexible and responsive to the needs of plan participants as well as sponsors. The newly-enhanced EPCRS does these things even better.”

The new revenue procedure makes several significant improvements, including:

- A new correction method that estimates the economic loss to an employee excluded from participating in a 401(k) or 401(m) plan;
- New correction methods for certain plan loan failures under the Voluntary Correction Program (VCP);
- Rules on the availability of programs under EPCRS in cases where the plan or plan sponsor is a party to an abusive tax avoidance transaction;
- A new streamlined submission process and fee under VCP for failures to amend a plan timely for good faith and interim amendment requirements;
- Reduced VCP compliance fees for SEPs and SIMPLE IRA plans; and
- New various procedural enhancements.

Many of the improvements in the new revenue procedure were the result of feedback from the retirement community. ♦

\*This summary is intended for information and educational purposes only and does not constitute financial, tax, or legal advice. Further, this information is general in nature and is not intended to address the particular needs of any specific plan. Please contact your financial, tax, or legal advisor for information about your specific situation.

## **FULLSERVICE SUPPORT**

FRINGE BENEFIT ADMINISTRATORS, LTD. (FBA) and its strategic alliance partners, delivers all of the features you need to make your plan a success:

### ***Plan Design & Implementation***

- ▲ Flexible Plan Design
- ▲ Installation / Conversion Support
- ▲ Plan Documents & Administrative Manual

### ***Recordkeeping & Compliance***

- ▲ Daily Account Valuation
- ▲ Timely, Consolidated Quarterly Statements
- ▲ INVEST-Net / Internet Account Access
- ▲ Efficient Distribution & Loan Processing
- ▲ Compliance Testing & Government Reporting
- ▲ Newsletters & SuperStatements (Optional)

### ***Education & Enrollment Support***

- ▲ Educational Enrollment Materials
- ▲ On Site Enrollment Meetings
- ▲ Ongoing Participant Communications

### ***Varied Investment Options***

- ▲ Virtually Unlimited Mutual Fund Selection
- ▲ Individually Directed Brokerage Accounts
- ▲ LIFESTYLE "Model Portfolios" (Optional)

### ***Trustee & Custodial Services***

- ▲ Complete Trustee / Custodial Services
- ▲ Tax Withholding & Reporting

## **WHO TO CALL**

For information concerning items in this newsletter, or information about our services, please ask for one of the following people. They will be pleased to assist you.

- ▲ **Your Plan Administrator**
- ▲ **Dick Watson - ext. 1030**
- ▲ **J. R. Piper - ext. 1037**
- ▲ **Steve Cranfield - ext. 1024**
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