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2008 EMPLOYEE BENEFITS UPDATE

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Welcome and Introduction of Presenters

Presenters

- Sharon A. McAuliffe, Esq.
- David G. Burch, Esq.
- Kathleen Faulkham Centolella, Esq.



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Pension Protection Act of 2006 Update

Pension Protection Act (“PPA”) of 2006

- Stated goal – strengthening employee’s retirement security
- Stricter defined benefit funding requirements
- More disclosure to employees
- Accelerated vesting of employer contributions
- Guidance regarding offering investment advice

Automatic Contribution Arrangements (Automatic Enrollment)

- (ACA) Automatic Contribution Arrangement
 - PPA added a new Section 514(e) to ERISA providing preemption of state laws that would prohibit automatic enrollment features.
- (EACA) Eligible Contribution Arrangement
 - New Section 414(w) added to the Internal Revenue Code which provides limited relief to distribution restrictions on elective deferrals.
- (QACA) Qualified Automatic Contribution Arrangement
 - Provides a third option for a 401(k) “safe-harbor” design.
 - A new Section 401(k)(13) added to the Internal Revenue Code.

(ACA) Automatic Contribution Arrangement

- Provides State Law preemption provided minimum standards are met.
- Available in plans allowing participant deferrals – 401(k), 403(b) or 457(b).
- Participant treated as having elected a uniform percentage of compensation.

(ACA)

Automatic Contribution Arrangement

- Notice requirement
 - Must be written in a manner to be understood by the average participant
 - Explain participant's right not to have elective contributions made on the participant's behalf
 - Explain that participant has a reasonable period of time after receipt of notice and before first contribution is made to make an election
 - Explain default investments
- Contributions must be invested according to Section 404(c) [QDIA].

(EACA)

Eligible Automatic Contribution Arrangement

- No minimum deferral percentage for employees or requirement to increase deferral rate
- No minimum required employer contribution and matching contribution can be subject to six (6) year graded vesting
- Subject to non-discrimination ADP/ACP testing required
- Top Heavy testing required
- Notice required
- QDIA investments required for default elective deferrals
- 90 day permissible withdrawals

(QACA)

Qualified Automatic Contribution Arrangement

- Safe Harbor Design
 - Satisfies ADP, ACP and Top Heavy
 - Similar to the regular 401(k) safe harbor designs, the employer must make a safe harbor match or a safe harbor non-elective contribution. However, minimum level of employee automatic deferrals required.
- Required Employee Deferral Contributions:
 - Year one – deferral must be at least 3%
 - Year two – deferral must be at least 4%
 - Year three – deferral must be at least 5%
 - Fourth year and after – deferrals must be at least 6%
 - The automatic deferral rate cannot be more than 10%

(QACA)

Qualified Automatic Contribution Arrangement

- Employer Safe Harbor Contributions
 - Matching:
 - 100% of first 1%
 - 50% of next 5%
 - OR**
 - Non-elective 3%
- Vesting 100% after two years of service
- All employees except any previously eligible employee who made an election to defer or who made an election not to participate must be covered.

Accelerated Vesting of Employer Contributions

- New vesting rules applied for all employer discretionary profit-sharing contributions in 2007 plan years.
- If a plan uses cliff vesting, account balance must vest after three (3) years of service.
- If the plan uses graded vesting, then vesting must be at the rate of 20% per year, with full vesting no later than at end of year six (6).

Plan Amendments

- A Plan Sponsor has until the last day of the 2009 Plan year to amend the Plan retroactively for PPA changes.
- However, Plan must comply operationally with PPA prior to the amendment through the end of the 2009 plan year.
- Discretionary Plan amendments by last day of Plan year
- EGTRRA Remedial amendment process
 - Individually designed five (5) year cycle
- Prototype or Volume Submitted Approval letters received Spring of 2008 restatements must be made by Spring 2010.

(EPCRS) Employee Plans Compliance Resolution Systems

- Under PPA Section 1101 Secretary of Treasury has authority to update and improve EPCRS as well as increase awareness of EPCRS.
- Expanded IRS website information, including expanded 401(k) Fix-it Guide (http://www.irs.gov/pub/irs-tege/401k_mistakes.pdf)
- Changing Audit Climate.



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Department of Labor Compliance Issues

Safe Harbor for Deposit of Contributions to a 401(k) Plan

- **General Rule:** “As of the earliest date on which such contributions can reasonably be segregated from the employer’s general assets.”
- **Current Absolute Deadline:** The 15th business day of the month following the month containing the Participant Contribution Date.
- **Practical Problem:** The DOL has consistently taken the position that the “hard” deadline is always after the earliest date that the contributions can reasonably be segregated, but has never provided clear guidance on a true hard deadline.
- **Consequences:** Fiduciary Violation for Inadvertent Late Transmittal

Safe Harbor for Deposit of Contributions to a 401(k) Plan

- **New Guidance:** The DOL has issued proposed regulation providing that Participant contributions to a plan with less than 100 participants at the beginning of the plan year will be treated as made in compliance with the general rule (i.e., will be treated as made on the earliest date on which they can reasonably be segregated from the employer's general assets) if they are deposited **no later than the 7th business day** after the Participant Contribution Date.
- Although the regulations are not yet effective, employers are entitled to rely on them.

Qualified Default Investment Alternatives

- Final Regulations were issued late last year.
- Must satisfy the following conditions to obtain relief from fiduciary liability for investment outcomes:
 - Must be invested in a “qualified default investment alternative” (QDIA) as defined by regulation
 - Participants must have failed to exercise their opportunity to provide investment direction
 - Special Notice Requirement
 - Investment prospectuses, etc. must be furnished to participants
 - Same rules for changing investment directions must apply to the QDIA as they apply to all other investments
 - Special limitations on fees
 - Plan must offer a “broad range of investment alternatives”

New Compliance Issues After PPA

- Frequency of Benefits Statements Depends on Type of Plan:

Plan Type	Required Benefit Statement
Participant Directed Defined Contribution Plan	Quarterly Statement
Other Defined Contribution Plan	Annual Statement
Defined Benefit Plan	Every three years to participant or upon request if Plan Administrator gives annual notice of the availability of these statements

401(k) Fee Lawsuits

- Participants May Now Sue for 401(k) Plan Losses
 - *LaRue v. DeWolff, Boberg & Associates, Inc.*, recently decided by the Supreme Court
 - likely will increase individual lawsuits against plan fiduciaries
- Pending Class Actions
 - No final decisions yet
 - So far Plaintiffs have had few victories

Other New Liability Concerns

- Proposed Regulations on Fee Disclosures
- Increasing Criminal Prosecutions for False Statements on Form 5500
 - Several cases over last several months
 - Important not to misstate anything on Form 5500, because the DOL has proved that it will resort to criminal prosecution.



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Cafeteria Plans Update: Law Changes Impacting Your Plan

So What's Changed?

- In August 2007, the IRS issued new proposed regulations governing cafeteria plans.
- Effective January 1, 2009
- Changes sought to clarify existing guidance and to incorporate the IRS's informal guidance.
- Several key areas of focus:
 - Written plan requirement
 - Eligible employees
 - Elections
 - Permitted benefits
 - Nondiscrimination rules

Written Plan Requirement

- Plans must be in writing.
- Written plan document must be in place prior to any salary reductions.
 - No retroactive amendments
- No Plan document = No tax savings

Written Plan Requirement

- **Required provisions:**
 - A description of all available benefits
 - Periods of coverage
 - Rules governing participation, eligibility and employer contributions
 - Procedures governing employee elections
 - Plan year (must consist of 12 consecutive months)
 - A description of the grace period, if applicable
 - For FSAs and HSAs, a description of the rules that apply to those arrangements

Eligible Employees

- New proposed regulations provide that only employees are eligible to participate in a cafeteria plan and a clearer definition of what an "employee" is.
 - Self-employed individuals, partners, and shareholder in S-corporations who hold more than two percent of stock are not permitted to participate.
 - Spouses and dependents may not participate directly, but they may receive coverage if the employee chooses to participate in the plan.

Elections

- Automatic elections are expressly permitted.
- 30-day enrollment window for new hires and permit plans to provide benefits retroactive to the new employee's hire date.
- Online enrollment, revocations and changes in enrollment are specifically authorized.

Qualified Benefits

- Cafeteria plans may offer taxable benefits and qualified benefits that are not taxable.
- Certain non-qualified benefits that cannot be included in a plan:
 - Scholarships
 - Employer-provided meals and lodging
 - Educational assistance
 - Fringe benefits
 - Long-term care insurance and services
 - Group-term life insurance on the life of any individual other than an employee
 - Contributions to Archer MSAs
 - Elective deferrals to a 403(b) plan

Health FSAs

- Proposed regulations clarified rules on FSAs:
 - Generally, Health FSAs may reimburse employees after services are rendered.
 - Exception: Certain advance payments of orthodontia services and medical equipment are permissible.
 - Further guidance on the substantiation of claims; and
 - Permitted use of forfeitures (“experience gains”), including paying administrative expenses.

Dependent Care Assistance Program ("DCAP")

- Key change to DCAPs includes allowing spend downs of accounts for terminated employees.
- Provision for spend downs must be in the written plan document.

Nondiscrimination Rules

- Under IRC Section 125(b), cafeteria plans may not discriminate in favor of highly compensated individuals or key employees.
- New regulations provide that "highly compensated individuals" are:
 - Officers
 - Shareholders of the employer holding more than five percent
 - Highly compensated employees
- New tests for both eligibility and contributions and benefits.
- New safe harbors.

So What Should Plan Sponsors Do?

- **Effective Date January 1, 2009**
- **Conduct a self-audit in 2008**
 - Do you have a written plan document?
 - Does your plan document incorporate all the benefits you are operationally providing?
 - Does the plan include nonqualified benefits?
 - Are amendments necessary for some of the new features now available (i.e., online elections)?
 - Do you have ineligible employees in your plan?

Cafeteria Plans

- A cafeteria plan is a type of employee benefit plan offered pursuant to Section 125 of the Internal Revenue Code.
- Benefits available under a plan can include: health insurance, group-term life insurance, and flexible spending accounts (FSAs).
- Primary reason for implementing a Section 125 plan is for the tax savings advantages for the employer and employee.



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Questions and Answers



403(b) Plans - New Requirements

Where is your Plan Document?

- New regulations generally require the adoption of a written 403(b) Plan Document by January 1, 2009.
- **Required Provisions:**
 - Set forth the items required for contributions to a 403(b) plan to be excludible from gross income.
 - Identify the contracts and custodial agreements available under the plan.
 - Provision to allow transfers.
 - Provision permitting plan termination.
 - Provisions setting forth who is responsible for various aspects of plan administration.

Changes in Liability

- Historically, 403(b) Plans were simply an arrangement between employees and their investment providers – not really a "plan" in the sense of an employer created arrangement.
- Because employers could not direct employees as to investment providers, employers were never expected to exercise any responsibility over 403(b) Plans.
- New regulations issued by the IRS in July 2007 now require employers to play a much more active role in administering its employees' 403(b) Plans. This increased responsibility may also trigger an increase in potential liability.

Changes in Liability

- **New Responsibilities:**
 - Withhold participant contributions from pay and transfer contributions within a limited time period to the Plan.
 - Enforce limitations on deferral amounts.
 - Administer distributions (including hardships and loans), coordinate rollovers and plan-to-plan transfers.
 - Coordination of investment providers.
 - Maintenance of the tax benefits of the Plan under Code Section 403(b).

ERISA Concerns

- If an employer satisfies the safe harbor requirements the DOL has set out (DOL Reg. Section 2510.3-2(f)), the DOL will not consider a tax-exempt employer sponsoring a deferral-only plan as an ERISA plan.
- Concurrent with the issuance of the regulations, the DOL issued FAB 2007-02 in which it provided guidance under which an employer could comply with the written plan requirement without compromising its ERISA exemption. However, the employer cannot have responsibility for, or actually make, discretionary determinations in administering the plan.

Information Sharing Agreements

- Trustee-to-trustee transfers without the employer's participation are no longer possible.
- Employers are now required to enter into information sharing agreements with the transferring and accepting providers of 403(b) assets.
- Through these information sharing agreements, the employer and the provider will share information on transfers, rollovers, hardship withdrawals, and loans.



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