BENEFIT BYLINES

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Washington Update

Background

In recent years, various legislative proposals have circulated in Washington which, if enacted, could have a highly detrimental impact on American workers and the private retirement system. ABP has attempted to keep our readers informed through frequent articles in this newsletter. We have also encouraged clients, advisors and plan participants to contact their legislators to urge them to refrain from adopting short-sighted policies in the name of deficit reduction or tax reform.

The tax-favored treatment of retirement plan contributions by individuals and businesses is based on provisions of the Internal Revenue Code. Accordingly, tax legislation passed by Congress and signed into law by the President, is the primary vehicle for determining the way various retirement/savings arrangements are structured and the rules for being able to take Federal tax deductions for contributions made by individuals and businesses.

Gridlock Combined with Flawed Logic

There continues to be an impasse in Washington between Conservatives and Progressives over the aggregate level of Federal spending, budget priorities, and whether there should be tax increases or tax decreases going forward. *(Continued on Page 3)*

Table of Contents

Participant Fee Disclosure-Timing Relief

The Department of Labor implemented regulations that require sponsors of retirement plans with participant-directed investments to provide certain expense disclosures to plan participants. The first round of disclosures (often referred to as 404(a)(5) disclosures) was required by August 2012. Although legal responsibility for issuing disclosure notices resides with the employer/plan sponsor, financial institutions and recordkeepers have assumed most of the responsibility for creating them. The notices focus heavily on investment expenses, and ABP is often required to provide supplemental notices covering our administrative expenses. With ABP's help to facilitate this process, our clients were able to timely distribute the initial round of required disclosures in advance of the 2012 deadline.

It is clear that these disclosures are here to stay. The original regulations required subsequent annual notices to be provided to participants within 12 months of the original distribution date. However, the retirement plan community requested that plan sponsors be able to change the timing window for providing notices in a manner that would not produce negative consequences for plan sponsors and service providers assisting with the disclosure process. The DOL listened to these comments and has recently provided relief. For 2013, the DOL will treat the timeliness standard as satisfied if notices are distributed within 18 months of the last notice distribution date. This provides the opportunity to distribute these notices when the timing may be more meaningful to participants and convenient to plan sponsors rather than having to base the timing on the anniversary of the arbitrary August 2012 initial deadline. For example, for plans that include safe harbor contribution provisions, it may be both more practical for the employer and informative to participants to provide the fee disclosure notice at the same time as the required safe harbor election notice is delivered. *(Continued on Page 2)*

(Participant Fee Disclosure-Timing Relief - Continued from Page 1)

Some additional observations regarding the fee disclosure process are provided below:

- Financial institutions continue to update their disclosures. Many of the first drafts were unnecessarily technical and difficult to understand. This resulted in many participants not fully comprehending the notice. Continued notice revisions will provide better opportunities to satisfy the intended goal of truly informing and educating plan participants.
- The regulations require notices to be distributed to participants after any fund changes within the plan account. Fund changes are often identified by a plan's investment advisor in a quarterly or other periodic review of the account. Accordingly, in many instances it would make sense to include full fee disclosures in conjunction with such announcements. The DOL's supplemental guidance now accommodates doing this.
- The extension provides a window for many plan sponsors to 'reset' their notice timing in ways other than identified above. For instance, fee disclosures could be distributed with other annual plan notices such as 401(k) enrollment notices or election change reminders.

What actions are required by you?

Many of ABP's clients with calendar year end plans have already received and distributed the required notices. If notices for your plan have not yet been distributed, or your plan year end is approaching, ABP will coordinate with you, your financial advisor, and financial institution (as needed) to provide the notices by the new extended deadline.

Under current regulations, plans with trustee-directed investments, e.g. a single pooled plan investment account, are not required to provide these disclosures. If your plan is trustee-directed, ABP will keep you informed should there be any changes in the fee disclosure requirements that would affect your plan.

In Closing

The DOL's recent guidance is welcome news. It provides the opportunity for practical alternatives to administer the fee disclosure process. The timing and strategies for preparing and issuing notices to participants will vary from one plan to the other based on circumstances and employer objectives. While this tends to make the coordination process somewhat more complex for ABP, we believe that customizing the process for each plan is in the best interest of our clients and their plan participants. ▪

New Guidance for the Suspension of Safe Harbor Contributions

Historically, employers who made a safe harbor non-elective contribution election prior to the start of a plan year were committed to making that contribution, irrespective of any unforeseen circumstances that may have impacted the employer's ability to do so. The one major exception to this commitment was business hardship. If the employer could demonstrate that it had experienced a "substantial business hardship", there was relief available. However, most employers who needed relief were unable to meet the strict hardship criteria required to qualify for the exception. As a result, they were still on the hook to make the safe harbor contribution. In contrast, employers who elected the matching contribution version of safe harbor election could suspend those contributions mid-year without demonstrating financial hardship.

On November 15, 2013, the Internal Revenue Service (IRS) provided relief by issuing final regulations that now allow mid-year discontinuance of safe harbor **non-elective contributions**. In order to qualify for this relief, the Employer must either (1) be operating at an economic loss or (2) have included language in the safe harbor notice issued in advance of the plan year informing participants that a contribution suspension/reduction is possible.

An Employer that finds it necessary to stop making safe harbor contributions during the plan year after having distributed a safe harbor notice containing the required language must take the following actions:

1. Amend the plan to reduce or suspend the safe harbor contribution. This amendment cannot be effective earlier than its adoption date or 30 days after the employees have been provided a supplemental notice.
2. Provide employees with a supplemental notice that details the actions being taken by the employer (suspension/reduction of the contribution), how this directly affects them and when it will be effective. In addition, participants need to be given sufficient time and instructions for making changes to their current elective deferral elections, should they wish to do so.
3. Fund all contributions through the effective date of the amendment.

4. Conduct actual deferral percentage (ADP) testing and, if applicable, actual contribution percentage (ACP) testing, on a current year basis, and take corrective actions if either test fails.
5. Satisfy all applicable top heavy plan requirements.

As a matter of prudence, ABP will include language referencing the possibility that employer safe harbor contributions may be suspended mid-year in all of the safe harbor notices we prepare in the future for clients who make either the 3% non-elective or matching safe harbor contribution election, unless a client specifically requests that such language not be included.

Safe Harbor "Maybe" Notice

It is important to note that the opportunity continues to exist for an employer who hopes to be able to make a safer harbor non-elective contribution to issue a "maybe" notice. The "maybe" election provides additional time (until 30 days prior to the end of the plan year) for the employer to fully commit to making the 3% safe harbor contribution. If, at that time, the employer decides that it is unable to make the safe harbor contribution for the year, a process similar to that outlined above is followed (amendment, 30 day notice, non-discrimination testing). Whereas, an employer who decides to take advantage of the latest guidance must fund pro-rata nonelective contributions up to the time of suspension, the "maybe" notice enables the employer to totally avoid a contribution commitment for the year if necessary. Finally, it is important to note that the "maybe" election is only available for safe harbor non-elective contributions; it is not allowed for safe harbor matching contributions.

If you have any questions regarding your plan's safe harbor election alternatives, please contact your ABP administrator. ▪

Washington Update – continued from page 1

The initial loss of tax revenues resulting from deductions for retirement savings by individuals and businesses is treated like any other expenditure in the Federal budgeting process. This is actually flawed logic because most contributions to retirement/savings vehicles defer taxes but do not totally avoid them. As a result, most of the upfront loss of revenue to the Treasury for retirement/savings plan deductions is recovered down the road when funds are withdrawn from these arrangements, generally at retirement age. On the other hand, Federal expenditures for items such as defense spending, entitlement programs, home mortgage interest expense, and employer health insurance premiums are never recovered by the government. Unfortunately, the flawed logic being employed when combined with the magnitude of funds going into retirement/savings vehicles, make them attractive targets for short-sighted policymakers.

What to Expect in 2014

At the end of December, Congress enacted legislation that avoided the automatic budget cuts (the so-called "sequester") that would otherwise have gone into effect for a two year period. The fact that this legislation, which President Obama signed into law on December 26, 2013, was passed with bi-partisan support was generally viewed as a positive development. Nonetheless, most Washington pundits caution not to get too excited about the possibility of a major tax or budget agreement anytime soon. As we begin 2014, there continues to be a deep-rooted philosophical divide in Washington regarding the direction that the nation should take when it comes to spending and taxes. Although private retirement savings issues are not the lead topic in the tax and budget policy debate, they have been a pawn in the process for the reasons identified above.

For several years, many of us in the pension industry have anticipated that there would be some type of tax/budget compromise by now that could adversely impact private retirement plans and the retirement security of American workers. It now appears unlikely that major tax legislation will become law in 2014. As a result, the chances of major legislative initiatives impacting retirement/savings programs being implemented also appears to be much lower, at least for now.

According to Brian Graff, Executive Director of ASPPA, the enthusiasm for comprehensive tax reform is now waning. In a post dated December 2, 2013, Graff went on to say "It is now less than a year until the next mid-term congressional elections, and the protracted talk about the critical need to reform our nation's tax laws has yet to result in an actual piece of legislation. So is it time to send the issue of tax reform into hibernation --- until 2015 at the very least after next year's elections?" While tax bills continue to be marked up in committee, Graff closed his post by saying "The tax reform bear is getting very, very sleepy." *(Continued on Page 4)*

(Washington Update - Continued from Page 3)

ABP Observations

We tend to agree that the passage of comprehensive tax reform legislation appears less and less likely as we move closer to the mid-term elections. This is pure speculation, but we think the controversy over health reform is likely to cause legislators to pause before tinkering with another important segment of our economy, the private retirement system. So, absent further developments, we enter 2014 with the presumption that the rules impacting plan design and the tax deductibility of contributions to employer-sponsored retirement plans will remain untouched for at least the next couple of years. ▪

Auto Enrollment Pros and Cons

Background

The automatic enrollment feature for 401(k) plans was introduced in the late 1990s and has experienced a surge in popularity in the last decade, particularly among sponsors of larger plans. When a 401(k) plan contains an automatic enrollment feature, any employee who is eligible to participate is automatically enrolled unless the employee makes a negative election declining participation. Elective deferral payroll deductions then commence at the plan's default salary deferral rate, which is generally set at 3% of pay. Although not required, some plans will provide for an automatic increase in the default salary deferral rate each year that a participant remains in the plan. Contributions resulting from an automatic enrollment are invested in a default investment vehicle generally chosen to provide long-term growth with minimum risk.

The pros associated with automatic enrollment arrangements include:

- Encourages employees to begin saving for their retirement, especially lower compensated employees who tend not to affirmatively elect to participate in their employer's 401(k) plan when offered the opportunity.
- Increases overall plan participation. This tends to help the plan satisfy nondiscrimination testing which in turn enables highly compensated employees to contribute more to their retirement accounts.
- Provides considerable financial advantages, including tax-deferred accumulation of the employee's own salary reduction contributions and the possible receipts of matching contributions from the employer.

But, automatic enrollment arrangements also have potential disadvantages such as:

- Possible negative reaction from employees when they see amounts deducted from their paychecks that they did not specifically authorize.
- Adds complexity to the plan administrative process.
- Added employer liability if employees are not properly enrolled and de-enrolled or if automatic deferral rate increases are not implemented when scheduled.
- Default contribution rates may be too low to provide meaningful savings. The Wall Street Journal reported that 40% of employees automatically enrolled in their company's 401(k) plan would have chosen to participate at a higher rate than the default rate. Once they have been automatically enrolled many employees do not take the steps necessary to increase their designated deferral rate.
- If default contribution rates are set too high, some employees may opt out entirely rather than elect a lower level of contribution.
- Employees may become complacent about their retirement savings under the mistaken perception that their employer is assuring that their retirement goals will be met by auto enrollment. Auto enrollment is intended to jump-start participants; it is not intended to be the sole retirement planning tool.

In Summary

Auto enrollment can be a valuable tool to increase overall 401(k) plan participation while encouraging individual participants to begin saving for retirement. However, auto enrollment is not the only method an employer can use to increase participation rates. Smaller employers, in particular, may be able to obtain similar levels of participation by working with their plan's financial advisor to educate employees and proactively promote the advantages of plan participation through employee meetings and other strategies. ▪

IRS Modifies "Use it or Lose it Rule"

Healthcare Flexible Spending Accounts (Health FSAs) are a popular feature in many employer-sponsored Section 125/Cafeteria plans. They enable an employee to make pre-tax payroll deduction contributions to an account in his or her name. Funds can then be withdrawn from the account tax-free and applied to pay medical expenses not covered by insurance which are incurred by the employee and the employee's dependents.

Although participating in a Health FSA offers significant potential tax advantage, some employees have been reluctant to participate because of the "use it or lose it rule". This rule, which is set forth in Section 125 of the Internal Revenue Code, stipulates that any remaining balance in a participant's Health FSA account at the end of the plan year must be forfeited. As a result, employees who do not incur covered medical expenses at least equal to the contributions they have made for the year lose those contributions.

In an attempt to minimize the negative impact of the "use it or lose it rule", the IRS issued Notice 2013-71 on October 31, 2013. This notice authorizes employers to amend the Health FSA component of their Section 125/Cafeteria plans to allow participants to carry over up to $500 in unused funds at the end of each plan year and apply those funds to pay for medical expenses incurred in the next plan year. It is anticipated that most employers who sponsor Section 125 plans will be inclined to amend their plan documents to provide this additional flexibility for their employees.

However, those employers who previously added a 75 day grace period for incurring claims following the end of the year (to take advantage of earlier IRS guidance) have a more difficult decision. In order to implement the $500 carryover provision, employers who currently have the 75 day grace period must eliminate that provision from their plans. If participants in plans that include the 75 day grace period provision tend to actually carry over more than $500 in expenses from one year to the next, the $500 carryover alternative may not be as attractive to them as their plan's current structure. This is due to the fact that the amount that can be carried over to the next year and applied during the 75 day grace period is not capped.

To summarize, (1) adding the new $500 carryover provision is pretty much a "no-brainer" for plan sponsors whose plans do not currently have the 75 day grace period in place, but (2) if a plan currently includes a 75 day grace period provision, replacing it with the $500 carryover provision will not be as beneficial to those participants who tend to carry over more than a $500 balance from one year to the next.

Feel free to contact any member of ABP's professional staff if you would like to discuss this optional plan provision in more detail. ▪

IRS Sends Filing Requirements Reminder to One-Participant Plans

If you sponsor a "one-participant plan", you may have recently received Notice CP-214 from the IRS. The IRS has instituted a procedure to send this notice to one-participant plan sponsors who have filed either a Form 5500-EZ or a Form 5500-SF in the past. (Generally, a one-participant plan is a plan covering only the business owner(s) or the owner(s) and spouse(s).)

The purpose of the notice is to remind plan sponsors of the annual filing requirements for their retirement plans. According to the IRS website, these notices will be sent annually about two months prior to the end of the plan year. For calendar year plans, this means that the notice will be mailed in late October or early November each year.

What should you do if you receive this notice? If you are an ABP client, the short answer is that you need do nothing. This is a "customer service" action taken by the IRS to assist you in complying with your annual filing requirements. You can simply discard the notice. ABP will prepare the appropriate annual report forms for your plan each year.

Not all notices from the IRS will be this easy to handle. For example, they continue to send erroneous late filing penalty notices. Even though they are incorrect, they still require a timely response. If you have questions about any notice you receive from the Federal government regarding your retirement plan, please contact ABP for assistance. ▪

ACA Impacts Some Section 125 Plans

With all of the attention being given to the roll out of the new health exchanges, it is easy to overlook the fact that the Affordable Care Act (ACA) also impacts some Section 125/Cafeteria plans.

Last October, ABP sent out email blasts to clients for whom we provide Section 125 and Welfare plan compliance services alerting them to circumstances that might result in the need to amend plan documents and related employee disclosure materials. These events include the following:

1. Employee funded Health FSA contributions/benefits cannot exceed $2,500 per year (effective for 2013 and future plan years).
2. Participants must actually be enrolled in employer-sponsored health plans by not later than the 90th day of employment. (While this requirement applies solely to the underlying health coverage, the language in some Section 125 plan documents may also need to be amended.)
3. The plan accounting year of the Section 125 plan is not the calendar year. (A temporary amendment appears to be required to allow employees to opt into health exchanges during the health exchange open enrollment period without violating Section 125 plan change in status rules.)
4. The Anniversary Date (and plan accounting year) of the Section 125 plan and the Renewal Date (and policy year) of the employer-sponsored group health plan are not the same. (They need to be the same to comply with Section 125 plan change in status rules and the renewal underwriting requirements of most group health insurers.)
5. The employer wants to amend its Section 125 plan to enable employees with Health FSA accounts to take advantage of the new $500 carryover provision to minimize the risk of account balance forfeiture (see companion article in this issue of *Benefit Bylines*).

The above issues impact some plans but not others, and it is possible that none of them applies to your group's situation. However, it may be prudent to take a quick look at the provisions of your Section 125 plan and underlying group health plan, particularly if changes have recently been made to one plan or the other. ▪

Associated Benefit Planners, Ltd.

Associated Benefit Planners, Ltd. (ABP) is an independent consultant and third party administrator (TPA) operating from offices located in Berwyn and King of Prussia, Pennsylvania. We specialize in the design and administration of employer-sponsored retirement/savings plans, including 401(k) arrangements. ABP also provides plan document and compliance support for Section 125 Plans and Employee Welfare Plans, operating on a fee-for-service basis.

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