march/april 2012

Retirement PLAN news

Gearing up for participant fee disclosure

The U.S. Department of Labor (DOL) has been working to improve transparency regarding the fees and expenses charged to 401(k) plans and plan participants.

The first step was to require plans to report such charges on Schedule C of Form 5500. The second requires covered service providers to disclose to plan fiduciaries the fees the plan pays the providers. The final step requires plan sponsors to provide participants who direct their own investments with information about the fees and expenses that are charged to their 401(k) plan accounts.

The general consensus within the industry is that the vast majority of participants are not aware that they pay any fees or expenses and will be surprised — to say the least — by the new disclosure. Here are some details about the regulations to help employers handle questions from participants.

What is the purpose of the fee disclosure?

It is important for plan participants to be aware of the fees and expenses they are paying and to understand that fees can affect return on investment. The new fee disclosure will provide participants with the information they need and encourage them to consider fees when making decisions about their accounts.

Fees and expenses explained

There are three different types of expenses that may be incurred.

- Plan administrative fees. These are the fees involved in operating the plan (i.e., fees for recordkeeping, accounting, and legal services) that are charged to participant accounts.
- Individual fees. These are charged when a participant elects to use a service offered by the plan. Examples include distribution fees, loan application fees, etc.
- Investment costs. These include shareholder-type fees and operating expenses for the investments participants have selected.

Sponsors will want to let participants know that these fees are not new. What *is* new is the disclosure they'll receive, which will provide a breakdown of the fees and expenses participants pay out of their accounts. Sponsors should also point out that the plan fiduciary is continually monitoring the fees and expenses to ensure that they are reasonable and competitive.

User-friendly investment information

The fee disclosure will feature a chart reflecting all the investment choices in a format that will permit participants to compare investments in a whole new way. The investment options will be grouped by category (i.e., variable return investments, fixed return investments, and annuities).

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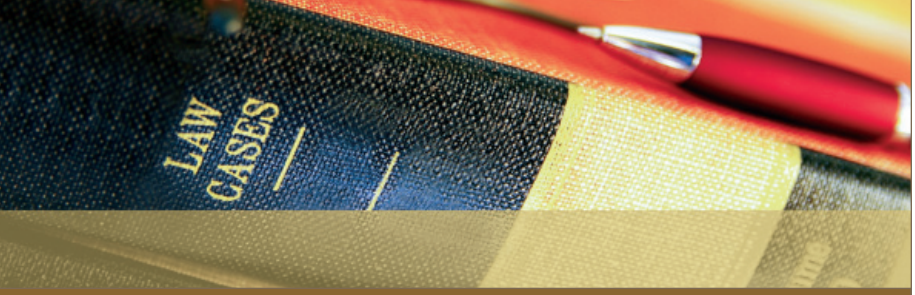

QDRO court case

In 2011, a U.S. Court of Appeals for the Fifth Circuit upheld the U.S. District Court ruling that a plan administrator may not refuse to accept a qualified domestic relations order (QDRO) when they have reason to believe the divorce is a "sham" (*Brown v. Continental Airlines, Inc.*, No. 10-20015). The court found that ERISA does not permit an administrator to investigate the legitimacy of a divorce when receiving a domestic relations order (DRO) that has been deemed to be qualified.

Continental filed suit against nine pilots and their spouses, alleging the couples obtained sham divorces for the purpose of obtaining lump-sum pension distributions from the Continental Pilots Retirement Plan (the Plan). The amounts distributed could not otherwise have been distributed to the pilots until they separated from employment. According to a plan provision, if a pilot is at least 50 years old and gets divorced, an ex-spouse can elect to receive pension benefits (even if the pilot is currently employed).

The pilots and spouses in this case divorced and obtained DROs from state courts, which, in most cases, assigned 100% of the pilot's pension benefits to the ex-spouses. The couples then remarried after the ex-spouses received the benefits. Many of the couples continued living together during the time they were divorced. And, in most instances, the couples did not inform friends or family that they were divorced.

Continental sought restitution of the pension benefits paid to the spouses, arguing that the statutory requirements of a QDRO were not met because the divorces were a sham. Continental's view was that the pilots got divorced because they were worried about financial troubles in the airline industry that could result in the Plan being taken over by the Pension Benefit Guaranty Corporation (PBGC). If that happened, the lump-sum benefit option would not be available and the benefits the pilots received at retirement might be lower than expected because maximum PBGC benefits are less than the amounts the pilots accrued under the Plan.

The pilots filed a motion for dismissal, and the district court dismissed Continental's claims for failing to state a claim on which relief could be granted. On appeal, the Fifth Circuit Court of Appeals affirmed the district court's dismissal, concluding that ERISA "requires an administrator to determine that a DRO is a QDRO if it satisfies all of the statutory criteria, and the participants' good faith in obtaining a divorce is not among those criteria." It was the court's view that a plan administrator does not have the authority to determine that an otherwise valid DRO is not a QDRO due to a sham divorce. The court recommended that Continental seek assistance from Congress to amend the statutes of ERISA applicable to QDROs to include a "sham transaction doctrine" if Continental feels strongly that such a provision is necessary.

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The chart will be broken down into several tables that compare investment returns, fee and expense information, and annuity options. The chart will tell participants how to get additional investment information (including more current performance information) and provide Internet addresses. Each designated investment alternative must be identified by name.

Impact of expenses on returns

For each plan investment with a variable rate of return, the disclosure will show the investment's total operating expenses as a percentage and provide an example illustrating the effect, in dollars, of the annual operating expense on a $1,000 investment for a one-year period. The disclosure will also include descriptions of the investment's shareholder fees (if any) and any restrictions or limitations on purchases, transfers, or withdrawals.

Empowering participants

All of this information is being provided to help participants make informed decisions about their plan investments and to help them save as much as possible for retirement by underscoring the long-term effect that fees can have on the total amount a participant has available when it comes time to retire. It's also important for participants to understand that investment selection should not be based solely on fees. There are a number of other factors to consider, such as risk tolerance and potential investment return.

Disclosure timing

Fee disclosure information will be provided annually. It is hoped that each participant will carefully review this information at least once a year. Note that website addresses are provided for each investment option, so participants can look up current information at any time. Participants will also receive quarterly statements that identify any activity in their individual accounts for the previous quarter along with a description of the fees paid.

Under newly issued final regulations from the DOL, calendar-year plans must provide participants with the first annual fee disclosure by August 30, 2012, and the first quarterly fee and expense statement by November 14, 2012.

Understanding participant loan limits

As a plan sponsor, you are not required to offer plan loans. Many employers make this feature available, however, to encourage participation. The reasoning is that if your employees — particularly younger, lower paid employees — know they can access the money in their plan accounts, they'll be more comfortable contributing to your plan.

Not surprisingly, as money has gotten tighter over the past few years, employers have seen an increase in requests for plan loans. Following is an overview of the rules governing how much participants may borrow.

Calculating maximum loan amounts

The law places a cap on the maximum loan amount(s) a participant may take from an employer's combined qualified retirement plan or plans. The maximum allowable loan amount is the *lesser of* 50% of a participant's vested account balance, less any outstanding loan balance, or $50,000. If the participant has had a loan in the preceding 12 months, the $50,000 limit is reduced by the highest outstanding loan balance during that time, even if the loan has been repaid.

Example 1: Plan participant Wayne requests a loan of $50,000 on January 15, 2012. His vested account balance on that day is $150,000. Wayne had an outstanding loan in the last 12 months, and the highest outstanding balance during that period was $37,000. He repaid the loan in its entirety on December 31, 2011. Even though the loan was repaid, the $50,000 is reduced by $37,000, so the maximum amount Wayne may borrow on January 15 is $13,000.

Example 2: Plan participant Chuck requests a loan for the maximum amount possible. His vested account balance is $32,000, and he currently has an outstanding loan of $3,000. The highest outstanding balance of that loan in the previous 12 months was $6,000. The maximum allowable loan for Chuck is the lesser of $50,000 – $6,000 = $44,000 *or* 50% of $32,000 = $16,000. Since Chuck has an outstanding loan balance of $3,000, the most he can borrow is $16,000 – $3,000 = $13,000.

Note: The limit of 50% of the participant's vested account balance is applicable at the time the loan is taken and not thereafter.

Example 3: Liz has a vested account balance of $5,000 and takes a loan of $2,500 on March 1. On March 2, investment losses in the stock market reduce the value of Liz's remaining funds to $2,300. This does *not* violate the 50% rule.

DOL regulations

Regardless of the preceding calculations, U.S. Department of Labor (DOL) regulations permit participants to borrow $10,000, assuming their vested account balance is at least $10,000. In practice, this $10,000 amount may actually be less since only 50% of the participant's vested account balance may be pledged as security for the loan. Therefore, in plans that do not permit alternate collateral,* participants are limited to 50% of their vested account balances.

Example: Margie has a vested account balance of $12,000. She has no outstanding loans. She wants the largest loan amount possible. If the plan document or loan program allows, she may take up to $10,000. However, only $6,000 can be secured with her account balance. She would have to provide alternate collateral on the additional $4,000.

Minimum loan amount

DOL regulations permit a plan to establish a minimum loan amount as long as it is not greater than $1,000.

Determining account balance

Employer contributions plus earnings and employee contributions plus earnings are counted toward a participant's account balance (but not IRA equivalents, such as voluntary deductible employee contributions and deemed IRA amounts).

Aggregation

All plans of an employer, including plans of affiliated service groups or a controlled group of employers, are aggregated for the purposes of determining maximum participant loan amounts.

Example: Companies A and B are a two company controlled group, and John has worked for both companies. He has vested account balances of $80,000 in company A and $70,000 in company B. What's the maximum amount John may take as a loan?

Since the companies are a controlled group, the maximum amount John can borrow is based on the combined value of his vested account balances. In other words, he is not permitted to get one loan based on $80,000 and another based on $70,000. The maximum loan amount is based on the total of his two vested account balances: $80,000 + $70,000 = $150,000. Therefore, the most John can borrow is $50,000.

* The rules and procedures regarding alternate collateral are complicated, and the practice is generally discouraged.

RECENT developments

Determination letter changes

The IRS has made significant changes to the determination letter program by eliminating features that are of limited use to plan sponsors compared with the burdens they impose. The changes are expected to improve efficiency and reduce the time it takes the IRS to process determination letter applications. Preapproved plans such as prototype and volume submitter (VS) plans are not required to obtain a determination letter since they already have an opinion letter (for prototypes) or advisory letter (for VS plans). Effective May 1, 2012, determination letter applications filed on Form 5307 will be accepted only from adopters of VS plans that modify the terms of the preapproved VS specimen plan and prototype plan applications must be submitted on Form 5300 (rather than Form 5307).

IRS prototype audit

A new IRS Quality Assurance Bulletin (QAB 2012-1, "Verification of Prior Plan Documents in the Absence of a Determination Letter") addresses the procedures an IRS determinations specialist must use when reviewing a plan that does not have its own determination letter for the previous restatement submission cycle. Generally, when a plan has no determination letter (such as a prototype plan), the scope of the IRS review includes verification of compliance with the restatement cycle immediately preceding the cycle in which the determination letter application was submitted. So, for example, for an EGTRRA document (i.e., the current restatement cycle), the reviewer could go back to verify compliance with the preceding cycle (the GUST document, circa 2002-2003). Should the reviewer conclude that the application requires verification of compliance with an *older* restatement cycle, IRS managerial approval is required.

Investment advice regulations

The U.S. Department of Labor's Employee Benefits Security Administration (EBSA) recently issued a final regulation that improves participant access to quality fiduciary investment advice. Investment advice may be given in one of two ways: through the use of a computer model certified as unbiased by an independent expert or from an advisor who is compensated on a "level-fee" basis (meaning fees do not vary based on the investments participants select). Arrangements must also satisfy several other conditions, including disclosure of the advisor's fees and an annual compliance audit. **Note:** The guidance does not address exactly who is capable of certifying the computer model or what it is they are certifying.

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