

2007 Labor and Employment Law CLE Conference

**Hot Topics in Employee Benefit Plan Design,
Planning, and Negotiations.**

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401(k) Plans

The Good

- Pre-tax contributions or Roth tax-free distributions
- Accessibility (loans, hardship distributions)
- Portability
- Not subject to claims of employer's creditors nor generally to those of participant

The Bad

- Financial inability to make meaningful contribution
- Risk of investment loss on participant
- Effect of excessive fees
- Risk of fraud

PPA Encourages 401(k) Plans

- Automatic enrollment provisions
- Permanent Saver's Tax Credit
- Permanent increased contribution limits and make-up contributions
- Permanent Roth 401(k)
- Investment advice encouraged.
- Excess contributions taxed in year of timely refund, gap period earnings requirement eliminated.

Automatic Enrollment

- Explicit federal preemption of state wage withholding laws.
- Safe harbor default investment.
- Annual notice requirement.
- 90-day window for withdrawal (no penalty).
- Extended distribution period for excess contributions (6 months after year end versus 2 ½ months).
- New safe harbor to avoid non-discrimination testing.

Non-Discrimination Testing

- Regular non-discrimination tests
- Pre-PPA safe harbor design
 - Non-elective contribution equal to 3% of compensation or
 - 100% match to 3% of compensation plus 50% match in excess of 3% up to and including 5% of compensation
- New automatic enrollment safe harbor design

Automatic Enrollment Safe Harbor

- Automatic elective contributions capped at 10% of pay, but must be at least 3% of pay for first year, then additional 1% of pay for each year through 4th year, then 6% per year thereafter.
- Choice of non-elective employer contributions of 3% of compensation or matching contribution (100% up to 1% of compensation then 50% to 6% of compensation). Employer contributions must be 100% vested after 2 years of service.

Saver's Credit

- PPA made permanent and added indexing to saver's credit for low income earners.
- Credit up to 50% on employee contributions up to \$2000.
- Employee can make \$2000 contribution on pre-tax basis and also get up to \$1000 non-refundable tax credit. Employers may publicize to encourage participation.

Roth 401(k)

- PPA made permanent.
- Contributions taxable, distributions tax-free. Can designate portion as Roth.
- Available to all employees eligible to make pre-tax contributions.
- Tax-free if 5-year holding period and distributed on retirement, disability, death.

New Disclosure Requirements for Defined Contribution Plans

- Quarterly benefit statement required for plans permitting participant-investment direction.
- Must include account balance, vested portion, value of each investment, explanation of limits on right to direct, explanation of importance of diversified portfolio, and notice directing participant/beneficiary to DOL website.

Diversification of Employer-Stock Account

- Annual notice required explaining new right to divest employer stock in participant's account. (Limited exception for ESOPs.)
- New rules allow participants/beneficiaries to immediately divest all or portion of employer stock purchased with employee pre-tax or after-tax money. Right to divest employer stock purchased with employer contributions after 3 years of service. Three alternatives required.

Other Defined Contribution Improvements

- Faster vesting for employer contributions.
- Plans may permit direct IRA rollovers for non-spouse beneficiaries.
- Higher contribution limits and deduction rules made permanent.

Single Employer Defined Benefit Plans

- PPA tightened and significantly modified funding rules.
- Mandates new mortality table and use of 3 yield curve interest rates to value liabilities based on due dates.
- Target is 100% funding with maximum of 7 years to amortize deficiencies.
- Special rules for “at-risk” plans.
- Notice rules.

Single Employer Defined Benefit Plans Less Than 60% Funded

- Must freeze benefit accruals.
- Cannot pay shut-down or other contingent-event benefits.
- Cannot pay lump sum distributions.

Plans More than 60% but Less Than 80% Funded

- No benefit improvements
- Can pay up to 50% of participant's accrued benefit in lump sum.

NOTE: Employer can avoid plan restrictions if makes sufficient additional contributions or provides security.

Single Employer Defined Benefit Plans

- Negative tax consequences to applicable covered employees (“ACEs”) if funds set aside or transferred to non-qualified deferred compensation plan when employer’s defined benefit plan (or one of controlled group) “at risk.”
- Plan “at risk” if less than 80% funded (phased in) or less than 70% funded using specified at-risk assumptions.

Single Employer Defined Benefit Plans

- If transfer or set aside for non-qualified deferred compensation plan, ACEs will be subject to immediate income tax and 20% additional tax regardless of whether assets are subject to claims of creditors. No deduction for employer's gross up of compensation.
- ACEs are chief executive officer and 4 highest paid officers and employees subject to Section 16(a) of Securities Exchange Act of 1934.

More Disclosure for Single Employer Defined Benefit Plans

- Annual, more detailed, funding notice that replaces summary annual report. Due 120 days after end of plan year (exception for small plans).
- PBGC report required by plans less than 80% funded, even if unfunded vested benefits don't exceed \$50 million (prior standard).
- Participants, beneficiaries, unions may request plan to provide information submitted to PBGC in connection with plan termination.

Multiemployer Defined Benefit Plans

- Funding rules changes less drastic than those applicable to single employer plans.
- Commencing with 2008 plan year, plan's actuary must certify plan's funding status as endangered/seriously endangered, critical, or neither.
- Status based on funded percentage, imminence of funding deficiency and cash flow shortfall.

Notice of Funded Status

- Within 30 days of required actuarial certification, notice must be provided to participants, beneficiaries, unions, contributing employers, PBGC and DOL.
- In case of critical status, notice must warn participants of possible reduction/elimination of “adjustable benefits” and advise employers that mandated contribution surcharge is in effect.

Employer Surcharge

- After notice, employers contributing to critical status plan required to pay an additional contribution, equal to 5% of amount otherwise owed under CBA. For each succeeding plan year, surcharge is 10%. Surcharge ceases on effective date of new CBA that complies with Rehabilitation Plan schedule provided by Board.

Adjustable Benefits

- PPA allows critical plan sponsor to reduce benefits that otherwise would be protected by ERISA and IRC from reduction. This includes early retirement subsidies (e.g., 30 and out benefits), lump sum payments, disability benefits not in pay status, and forms of benefit (other than a qualified joint and survivor annuity) that actuarially exceed the value of a single life annuity at normal retirement age. Normal retirement benefits may not be reduced.

Underfunded Multiemployer Plans

- After certification of endangered/seriously endangered or critical status, plan sponsor cannot accept new (amended) CBA with actuarially unsound provisions, such as exclusion of new employees from plan participation, contribution holidays.

Underfunded Multiemployer Plans

- Plan sponsor must adopt funding improvement plan (“FIP”) for endangered/seriously endangered plan or rehabilitation plan (“RP”) for critical plan by 330th day of 2008 plan year.
- FIP or RP must be designed to meet PPA funding improvement target over funding improvement or rehabilitation period. Must be updated annually.

Underfunded Multiemployer Plans

- Within 30 days of adoption of FIP or RP, plan sponsor must provide to bargaining parties one or more schedules showing revised benefit/contribution structures. Default schedule shows reductions/elimination of benefit accruals with only those contribution increases necessary to meet benchmarks after future accruals are eliminated. For critical plan, cannot reduce future accruals below monthly benefit equal to 1% times contributions at normal retirement age.

Underfunded Multiemployer Plans

- If bargaining parties can't agree on schedule, PPA imposes default schedule on earlier of date DOL declares impasse or 180 days after CBA expired.
- Employers that fail to make required contributions to underfunded plan subject to ERISA provisions (contributions, interest, liquidated damages) and to new excise tax (payable to IRS).

Multiemployer Defined Benefit Plan Disclosure

- Expanded funding notice (replaces SAR) must be sent to participants, beneficiaries, unions, employers, and PBGC.
- Notice of amendment reducing future accruals must be sent to employers and unions as well as participants.

Multiemployer Defined Benefit Plan Disclosure

- On request of participant, beneficiary, union, or contributing employer, must provide periodic actuarial reports, and quarterly, semiannual, annual financial reports, that have been in the plan's possession for at least 30 days.
- Proposed regulations allow certain charges for providing the reports.

Multiemployer Defined Benefit Plan Disclosure

- Upon request of contributing employer, plan must provide notice of estimated withdrawal liability upon withdrawal from plan at end of preceding year and explanation of calculation. Because information may not be available at time of request, plan administrator has 180 days to respond.

Miscellaneous

- Currently, ERISA-covered plans must maintain fidelity (theft) bonds equal to 10% of plan assets, up to \$500,000. PPA increased maximum bond to \$1 million for plans that hold any employer securities.
- Criminal penalty for coercive interference with exercise of ERISA rights increased to \$100,000 and up to 10 years in prison.