EMPLOYEE BENEFITS

Legal News™

FOLEY

FOLEY & LARDNER LLP

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Legal News is part of our ongoing commitment to providing legal insight to our Employee Benefits clients and colleagues.

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Employee Benefits Developments for November 2007

Qualified Retirement Plans

The Internal Revenue Service (IRS) posted to its Web site a sample notice that plan sponsors may use to inform participants about their rights and obligations under the 2006 Pension Protection Act (PPA) "eligible automatic contribution arrangements" (EACAs) and "qualified automatic contribution arrangements" (QACAs). The IRS recently published proposed regulations on EACAs and QACAs, and employers adopting such plans when they first become available in 2008 must furnish a notice to participants at least 30 days before the beginning of each plan year. ***If applicable to your plan, the first notice for 2008 should be provided by December 1, 2007.***

The sample notice is for a hypothetical QACA that permits EACA withdrawals and has certain other characteristics. An employer must modify the sample notice to meet its own plan's individual circumstances. The sample notice also contains text that will satisfy the information requirement for participant notices under the U.S. Department of Labor's recently issued final rule under Employee Retirement Income Security Act (ERISA) Section 404(c)(5) on "qualified default investment alternatives" (QDIAs). The sample notice may be found at: http://www.irs.gov/pub/irs-tege/sample_notice.pdf. We can provide an edited version applicable to your plan on request.

New acronym descriptions from Proposed U.S. Department of Treasury Regulations issued November 8, 2007 (72 Fed. Reg. No. 216). Two new acronyms are coming into common usage in the defined contribution world:

- **EACA:** An eligible automatic contribution arrangement (generally a broader category of plans than QACAs) is an arrangement under which:
  1. The participant has the option to take compensation in cash or in the form of a pretax contribution to a plan with a cash-or-deferred arrangement (such as a Code Section 401(k) plan, 403(b) plan, or 457(b) plan);
  2. The participant is treated as having made a pretax contribution election at a rate specified in the plan until the participant specifically elects a different percentage (including zero contributions);
  3. The participant's contributions are invested in a qualified default investment option (QDIA) until the participant provides other investment directions; and
  4. The participant is provided a notice of the participant's rights as required by the regulations.

An EACA may permit a participant to elect to receive a distribution equal to the participant's contributions and earnings on the contributions made since the first payroll period to which the automatic contribution arrangement applies through the effective date of the election, provided the election is made within 90 days after the date of the first elective contribution. Such withdrawals, made possible by new Code Section 414(w), are taxable to the participant in the year they are withdrawn and are not subject to the usual prohibitions against premature withdrawal of pretax contributions from such plans or any early withdrawal excise taxes.

- **QACA:** A qualified automatic contribution arrangement (pronounced "Quack-Ah") is an alternative design-based cash-or-deferred arrangement, available beginning in 2008, that provides for automatic contributions at specified levels of contribution and meets certain contribution, notice, and other requirements. A cash-or-deferred arrangement (such as in plans under Code Sections 401(k), 403(b), and 457(b)) that satisfies these requirements is referred to as a QACA and is treated as satisfying the actual deferral percentage (ADP) and actual contribution percentage (ACP) tests.

The U.S. Department of Labor (DOL) issued final rules regarding "qualified default investment alternatives" (QDIAs) (29 CFR Section 2550.404(c)-5). Advance notice of use of a QDIA by a plan is necessary to obtain the fiduciary relief available under the new rules. The sample notice described in the first newsletter item in this section may be used to provide the required notice in the case of an EACA. A sample notice has not been provided for a plan that is not an EACA, but uses a QDIA. The guidance for a stand-alone QDIA notice, indicates that it should include:

1. A description of the circumstances under which assets in an individual account may be invested on behalf of the participant in the QDIA; and, if applicable, an explanation of the circumstances in which elective contributions will be made on behalf of a participant, the percentage of such contributions, and the right of the participant to elect not to have such contributions made on the participant's behalf (or to elect to have such contributions made at a different percentage);
2. An explanation of the right of a participant to direct the investment of assets in the participant's individual account;
3. A description of the QDIA, including a description of the investment objectives, risk and return characteristics, and fees and expenses attendant to the investment alternative;
4. A description of the right of the participant on whose behalf assets are invested in a QDIA to direct the investment of those assets to any other investment alternative under the plan, including a description of any applicable restrictions, fees, or expenses in connection with such transfer; and an explanation of where the participant can obtain investment information concerning the other investment alternatives available under the plan.

For QDIAs in effect on and after December 24, 2007, the required advance notice should be provided as soon as possible.

The regulations authorize three categories of qualifying default investment alternatives:

- A "life-cycle" or "targeted-retirement date" fund or account. This is an investment fund that applies generally accepted investment theories, is diversified so as to minimize the risk of large losses, and is designed to provide varying degrees of long-term capital appreciation and capital preservation through a mix of equity and fixed income exposures based on the participant's age, target retirement date, or life expectancy.
- A "balanced fund." This is an investment fund that applies generally accepted investment theories, is diversified so as to minimize large losses, and is designed to provide long-term appreciation and capital preservation through a mix of equity and fixed income exposures consistent with a target level of risk appropriate for participants of the plan as a whole.
- A "managed account." This is an investment fund provided by an investment management service in which an investment manager allocates the assets of a participant's individual account to achieve varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures, offered through investment alternatives available under the plan, based on the participant's age, target retirement date, or life expectancy.

If a plan fiduciary selects any of the above as the plan's QDIA, and otherwise complies with the notice and other requirements of the DOL's rules, the plan fiduciary obtains the fiduciary relief provided in the final rule. A plan fiduciary that allows participants to direct investment of their individual accounts and provides a QDIA for participants who do not provide investment directions shall not be liable for any loss, or by reason of any breach under Part 4 of Title 1 of ERISA, that is the direct and necessary result of investing all or part of a participant's account in a QDIA, or of investment decisions made by the entity managing the QDIA.

The plan fiduciary must, however, prudently select and monitor an investment fund, model portfolio, or investment management service within any category of QDIAs, in accordance with ERISA's fiduciary rules. The plan fiduciary must, according to the rule, engage in an objective, thorough, and analytical process that involves consideration of the quality of competing providers and investment products, as appropriate. The fiduciary also must carefully consider investment fees and expenses when choosing a QDIA.

The IRS has issued guidance on interest rates and mortality tables for use in determining lump sum distributions paid by defined benefit plans beginning with annuity starting dates occurring during plan years beginning on or after January 1, 2008. (Revenue Ruling 2007-67) Before 2008, the applicable interest rate is the annual rate of interest on 30-year Treasury securities for a look back month before the date of distribution, and the interest rate had to be held constant for a "stability period" of a month, a quarter, a plan year, or a calendar year. As of January 1, 2008, applicable interest rates become the adjusted first, second, and third segment rates for the month before the date of distribution (segment rates reflect rates of interest for investments of a range of durations). The 2008 applicable mortality table was appended to the Revenue Ruling. Plans may incorporate the 2008 and later mortality tables by reference. Plan sponsors have until the last day of the first plan year beginning on or after January 1, 2009, to amend the plan for the applicable interest rates and mortality tables.

No ERISA Section 204(h) notice of reduction in accrued benefits is required to be provided when a retirement plan is amended to adopt the new required actuarial factors describe above, including when the amendment reduces accrued retirement benefits.

The DOL has issued guidance on benefit statements to be provided by individual account plans without participant direction of investments. (Field Assistance Bulletin 2007-63) Individual account plans that do not provide for participant direction of investment will be in "good faith compliance" with the benefit statement provisions of the 2006 Pension Protection Act, if benefit statements are provided on or before the date the Form 5500 Annual Return/Report is filed by the plan (including extensions) for the plan year to which the statement relates.

The DOL has provided an online calculator for computing penalties under its delinquent filer voluntary compliance program (DFVCP). The Web address is: http://askebsa.dol.gov/dfvc. The DFVCP is offered by the DOL to encourage plan administrators to file overdue annual reports by paying reduced penalties.

The IRS has posted on its Web site a 43-page document entitled "401(k) Plan Potential Mistakes." It provides suggestions on how to identify, correct, and avoid common errors associated with 401(k) plans. The Web address for this document is: http://www.irs.gov/pub/irs-tege/401k_mistakes.pdf.

Executive Compensation

The IRS issued additional interim guidance on reporting and wage withholding for 2007 under Code Section 409A (Section 409A). (Notice 2007-89) In general, the guidance in effect for 2005 and 2006 was extended. For calendar year 2007, employers may omit reporting on amounts deferred under a nonqualified deferred compensation plan. The notice provides guidance on reporting and withholding on amounts "includible in gross income under Section 409A." These are amounts that are both taxable and subject to the additional tax provided for in Section 409A for violation of those rules.

ABOUT FOLEY

The Employee Benefits attorneys of Foley & Lardner LLP counsel employers on employee benefits and executive compensation matters to reduce exposure to employee complaints, governmental agency actions, and union-related problems. We counsel on health, dental, disability, life insurance, severance, cafeteria, and flexible benefits plans. Our counsel also extends to Medicare and Social Security benefits, COBRA compliance, and post-retirement benefits issues. We also advise clients in resolving benefits issues arising in mergers and acquisitions. We work closely with Foley trial lawyers who represent corporations and their benefit plans in litigation involving employment benefits and other obligations under ERISA.

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