

# Legislation Made Real



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Second Quarter 2009

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## Monitoring What Matters

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Every quarter, we strive to keep you current as to what's happening in both the legislative and regulatory world of retirement plans.

We hope you continue to find this information useful. As always, we appreciate the opportunity to serve you.

### SCRUTINY OF 401(K) PLANS INCREASES

On Sunday, April 19, the CBS news show "60 Minutes" included a segment on 401(k) plans and the impact of the current financial market situation on workers' accounts. This media attention demonstrates that the scrutiny of 401(k) plans that began last year in Washington is not only continuing, but is becoming more widespread. Legislators and regulators are continuing their efforts to protect the retirement savings of American workers who are investing in defined contribution retirement plans. At the same time, the increased media attention is raising employer and employee awareness, particularly in regard to the costs of participating in 401(k) plans and how these are disclosed.

Although President Obama and Congress have been focusing on the economic recovery plan during the first 100 days of the new Administration, there has been recent legislative activity that may impact employer-sponsored defined contribution plans (i.e., plan fee disclosures and investment advice).

**The 401(k) Fair Disclosure for Retirement Security Act of 2009.** On April 22, 2009, the House Education and Labor Subcommittee on Health, Employment, Labor, and Pensions held a hearing on the 401(k) Fair Disclosure for Retirement Security Act of 2009 (H.R. 1984). This legislation was introduced on April 21 by Representative George Miller (D-CA), Chair of the House Education and Labor Committee, and Representative Rob Andrews (D-NJ), Subcommittee Chairman.

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## Monitoring What Matters *(continued)*

This bill is almost identical to the fee disclosure bill that was approved by the Education and Labor Committee in April 2008 (H.R. 3185) and covers four general areas that apply to employer-sponsored defined contribution plans subject to ERISA:

- Disclosures to employers — prior to contracting, providers must disclose annual fees and charges to plan sponsors based on specific categories of cost; disclosures must also include any potential conflicts of interest
- Disclosures to employees — before investing and on a quarterly basis, workers must be provided details of their costs for participating in the plan, along with investment returns and an explanation of risk
- Index fund requirement — at least one low-cost index fund must be offered in the plan to comply with ERISA Section 404(c); the index fund can track the entire U.S. equity market, entire U.S. bond market, or a combination of both, and it must be designed to produce an adequate level of income
- Department of Labor (DOL) assistance and enforcement — DOL is charged with providing assistance to employers to comply with these new requirements and has authority to assess penalties for non-compliance

This bill is expected to move quickly through the House Education and Labor Committee and additional provisions could be added during the committee mark-up, for example:

- Repealing the 2006 Pension Protection Act (PPA) investment advice provision
- Directing the DOL to regulate target date funds
- Requiring an annuity or fixed income investment option (in addition to an index fund) to be included in the plan

Representative Richard Neal (D-MA) is also working on fee disclosure legislation, similar to a bill he introduced in 2008 — the Defined Contribution Plan Fee Transparency Act. This bill was not as onerous in regard to the level of fee disclosures that would be required but covered the defined contribution plans of both public and private sector employers, not just those subject to ERISA. It is likely that legislation pertaining to 401(k) plan fee disclosures will be brought to the House floor for a vote, and it may well combine elements of the Miller and Neal bills.

On Feb. 9, 2009, Senator Tom Harkin (D-IA) introduced the Defined Contribution Fee Disclosure Act of 2009

(S. 401). This bill requires that certain disclosures be made by service providers to plan sponsors and participants regarding the fees and costs of defined contribution plans. For participants, disclosure information (including performance information and investment risk) must be provided in advance of investment decisions as well as on a quarterly basis on benefit statements. There has been no additional activity on this topic in the Senate, and the House will likely lead the way when it comes to fee disclosure legislation.

As to DOL regulations on this issue, rules that were previously released by the Bush Administration requiring specific plan fee disclosures to plan sponsors and participants continue to be on hold. The Obama Administration could potentially reopen this process and consider more aggressive regulations to address fee disclosure requirements. It is likely that some form of fee disclosure requirements — either via regulation or legislation — will be instituted by the end of 2009 or in 2010.

### ***Conflicted Investment Advice Prohibition Act of 2009.***

On April 23, Representative Rob Andrews (D-NJ) introduced the Conflicted Investment Advice Prohibition Act of 2009 (H.R. 1988). This followed the Health, Employment, Labor, and Pensions Subcommittee hearing that was held on March 24 entitled “Retirement Security: The Importance of an Independent Adviser.” The hearing explored investment advice in defined contribution plans and the final regulations released by the DOL during the Bush Administration that were placed on hold shortly after the inauguration of President Obama.

The proposed bill repeals the PPA provision that loosened the restrictions imposed on investment providers in regard to their ability to provide advice to participants of 401(k) type plans and individual retirement accounts (IRAs). Addressing concerns that were raised at the hearing about the potential for conflicts of interest to exist within the PPA provision, the bill imposes the following requirements:

- Plans that offer investment advice must provide an independent investment adviser as defined in the proposed legislation
- Independent investment advisers cannot provide or manage any plan assets and must not receive any fees for the advice from “any person or persons (or anyone affiliated with such persons) that market, sell, manage,

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## Monitoring What Matters *(continued)*

or provide investments in which plan assets of any individual account plan are invested”

- Fees that are charged by advisers cannot vary based on the advice provided and must be calculated based on a per participant basis as either a flat dollar amount or a flat percentage of assets
- There must be a written agreement with the participant that discloses all associated fees, identifies the independent investment adviser as a plan fiduciary with respect to the given advice, and identifies any real or potential conflicts of interest
- New requirements are imposed on computerized investment advice models

This bill could potentially be incorporated into the 401(k) Fair Disclosure for Retirement Security Act of 2009 that was recently introduced by Representative Miller (see above). However, it is unclear if there is much support for this bill in the House, and there is no indication at this time that the Senate is preparing to take up a similar measure.

As to the status of the DOL investment advice regulations that were released by the Bush Administration and are currently on hold, the effective date has been delayed from March 23 to Nov. 18 to further evaluate law and policy concerns regarding the pending rules. Whether via legislation or regulation, we do expect the PPA investment advice rules to be made less flexible, if not repealed altogether.

***The Savings for American Families’ Future Act of 2009.*** On April 3, Representative Earl Pomeroy (D-ND) introduced legislation to enhance the current Saver’s Credit. This federal tax credit of up to \$1,000 encourages low- and moderate-income families and individuals to invest for retirement in an individual retirement account (IRA) or employer-sponsored 401(k), 403(b), or 457 plan.

The changes that would be made to the Saver’s Credit by the Savings for American Families’ Future Act include:

- Make the Saver’s Credit refundable — even those not subject to federal income tax would be eligible for the credit
- Require that the credit be paid directly into the taxpayer’s retirement accounts
- Expand eligibility requirements to cover more families and individuals by increasing the adjusted gross income limit for the full credit to \$32,500 for individuals and

\$65,000 for joint incomes; a phaseout range is provided for those earning slightly above these limits

- Increase the maximum amount of the taxpayer’s contribution eligible for the credit by \$100 for an individual (from \$500) and \$200 for joint incomes (from \$1,000) each year until 2020, with additional increases based on inflation after this date
- Outline how the Saver’s Credit interacts with the annual retirement plan and IRA contribution limits and retirement account nondiscrimination testing of employee elective deferrals

This legislation follows a proposal made by President Obama and could see Congressional consideration later this year.

***Savings Recovery Act.*** On April 22, the Savings Recovery Act of 2009 (H.R. 2021) was introduced by House Minority Leader John Boehner (R-OH) along with several other House Republicans who are participating in the *House GOP’s Solutions Group for Savings Restoration*. This group has been formed to offer alternate solutions to those being introduced by the Obama Administration and the Democratic majority. It is being led by Representative Boehner and includes Representatives Howard P. “Buck” McKeon (R-CA), John Kline (R-MN), Dave Camp (R-MI), Pat Tiberi (R-OH), Sam Johnson (R-TX), Ed Royce (R-CA), Michele Bachmann (R-MN), Lynn Jenkins (R-KS), Erik Paulsen (R-MN), Dean Heller (R-NV), Bob Latta (R-OH), and Brett Guthrie (R-KY).

The Savings Recovery Act is designed to be the Republican blueprint on savings solutions and addresses issues such as:

- Increasing retirement contribution and catch-up limits for individuals and families
- Doubling the earnings limit for retirees receiving Social Security benefits
- Extending the Saver’s Credit to include contributions made to 529 college savings accounts
- Suspending the capital gains tax on newly acquired assets for the next two years, then raising and indexing to inflation the amount of capital losses allowed against ordinary income to \$10,000, and suspending taxes on dividend income through 2011
- Providing additional funding relief for defined benefit plan sponsors

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## Monitoring What Matters *(continued)*

Most of these proposals lack bipartisan support and are not expected to see legislative action. Further information about this Republican proposal can be found here: <http://gopleader.gov/savings/>.

**Required Minimum Distribution (RMD) Waiver.** At the beginning of this year, bills were introduced in both the Senate and House — Retirement Account Distribution Improvement Act of 2009 (S. 157) and Protecting Senior's Nest Egg Act of 2009 (H.R. 424) — to extend the temporary waiver of required minimum distribution rules originally provided in the Worker, Retiree, and Employer Recovery Act of 2008 through 2010. (The Savings Recovery Act discussed above would extend the RMD waiver through 2012.) The new bills would also allow individuals who have taken an RMD distribution to re-contribute these amounts to a retirement account before July 1, 2009. Legislative action on these proposals looks fairly unlikely at this point.

**Temporary Money Market Funds Guarantee Program Extended.** On March 31, 2009, the Department of Treasury announced they are extending the temporary Money Market Funds Guarantee Program that was scheduled to expire on April 30, 2009. This extension

will provide coverage to certain shareholder investments in participating money market funds through Sept. 18, 2009.

Only money market funds already participating in this program are eligible for the extension, under certain conditions, and it only covers investors who were participating in these funds as of the close of business on Sept. 19, 2008, up to the amount invested at that time. Information about this extension can be found at: <http://www.ustreas.gov/press/releases/tg76.htm>

**Conclusion.** As this article makes clear, there are a number of different retirement savings proposals under discussion in Congress. The most likely to see legislative action are proposals for 401(k) fee disclosure and to revise the rules on investment advice. While not yet introduced in legislative form this year, proposals to create automatic payroll deduction IRAs ("Auto IRAs") for employees who lack retirement plan coverage are being discussed in Congress. The Auto IRA proposal, which was first introduced in the last Congress, has support from President Obama and a bipartisan group of members of Congress, and is likely to be discussed later this year.

## Suspending Matching Contributions

These challenging economic times have made it imperative for many employers to look at cutting benefits that were previously regarded as necessities for companies that wanted to compete for and retain talented employees. Eliminating a matching 401(k) plan contribution is one example. The issue has raised a number of questions.

***If an employer is going to stop a discretionary match that has been given on an annual basis for a number of years, must employees be informed before the plan year begins?***

No. Although it may seem strange in this world of full disclosure, a discretionary matching contribution allows an employer to decide year by year (with no advance notice) whether or not to make matching contributions. There is no legal requirement to give notice when such a contribution will not be made; contributions may be discontinued or modified without any prior notification. However, many employers do inform their employees of such changes for employee relations purposes.

Even if employers provide the same level of "discretionary" matching contribution year in and year out, there is no legal requirement to notify employees of changes in matching contributions.

There is no need to amend the plan document to discontinue a discretionary matching formula.

***What is the procedure for suspending, or removing, a required matching contribution?***

To remove a matching contribution formula that is written into a plan document, a plan amendment is required, and employees must be informed of such an amendment through either a new Summary Plan Description (SPD) or a Summary of Material Modifications (SMM). Strangely, the deadline for providing an SMM is 210 days after the close of the plan year in which the employer makes the amendment, which is likely to be long after the participant receives a benefit statement showing that no contribution was made. Many employers notify employees immediately when their plans are amended to remove matching contributions.

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## Suspending Matching Contributions *(continued)*

### **May an employer amend a plan to remove a matching contribution that is written into the plan document after the plan year has started?**

Yes. However, if employees have satisfied the requirements to receive a matching contribution already, then matching contributions must be made through the amendment date (the amendment must be prospective in that case). **Important Note:** 401(k) plans with **safe harbor** matching contributions are subject to different (and

more complicated) rules regarding 30 days' advance notice, funding of matching contributions, and testing of matching contributions.

### **If the employer matches on a payroll-by-payroll basis, may the match be stopped?**

Again, this may only be done prospectively (since employees will have satisfied the requirement to receive a matching contribution each payroll cycle).

## 2009 RMD Suspension Issues

The Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) provides for the suspension of required minimum distributions (RMDs) for the 2009 calendar year. While this was a well-intentioned measure aimed at providing relief to older Americans whose retirement accounts' values have dropped greatly since Jan. 1, 2008, the change has created some operational issues for qualified retirement plans. This article explores some of the issues. Hopefully, the IRS will clarify these waiver provisions in the near future.

### **PAYMENT OPTIONS**

The first question is whether the suspension of payments is mandatory or whether the suspension is optional. Some employers are taking the approach of contacting plan participants in RMD status and offering the *option* of choosing whether or not they would like to receive a 2009 distribution. A complicating factor is that retirement plans are required by law to contain RMD language, and employers are required by law to administer plans in accordance with their terms. WRERA allows RMD plan amendments to be delayed until the 2011 plan year, *provided* the plan is operated (from 2009 through 2011) in conformance with the future amendment. So employers have to decide how to address 2009 RMDs right now, even though amendments can be delayed another two years.

Finally, even though WRERA does not include participant notice requirements regarding RMD waivers for 2009, employers need to consider informing retirees about the payment process and how it will be administered this year.

### **DIRECT ROLLOVER OPTION**

With RMDs suspended for 2009, a distribution in the amount that would have been considered the 2009 RMD is not to be treated as an RMD. Thus, it can be rolled

over to another retirement plan or IRA. Employers are permitted, but not required, to treat the amount as an eligible rollover for direct rollover purposes (but not for mandatory 20% withholding — if the participant takes a "2009 RMD" distribution in cash, 10% withholding applies instead of 20%).

Why would an employer not permit the employee to directly roll over the amount? We are not sure (it could be system driven), but this option was provided to the employer by the law. Accordingly, a plan can choose to offer the participant a direct rollover option, or it may require a participant distribution, leaving the participant 60 days to complete a participant or indirect rollover.

Again, whatever course of action is taken will ultimately have to be reflected in the plan amendment, which is not required until 2011. However, many practitioners and employers feel it may be better to amend the plan now (in 2009).

### **OTHER PAYMENT TYPES THAT MAY NEED TO BE CONSIDERED**

**(1) Stream of payments distributions.** What about individuals whose 2009 distribution is calculated based on a stream of payments, such as over 15 years? Suppose a participant started a 15-year series of payouts at age 67 and the individual is now 74. Clearly, this payment method would satisfy both the stream of payments and the RMD amount. However, an issue arises about whether the payment can be waived, and, if the payment is actually received, it is not clear that it is eligible for rollover.

**(2) Substantially equal payments based on the RMD rules under Rev. Rul. 2002-62.** Are these amounts also suspended for 2009 if the individual is over age 70½? Though less likely to be affected, what if the individual is under age 70½?

## Testing Changes for Plan Year 2008

There are three basic changes from the Pension Protection Act of 2006 that affect ADP/ACP testing starting with the tests performed for plan year 2008.

**Gap period income eliminated.** Gap period income has been eliminated on all refunds due to a failed ADP/ACP test effective with testing performed in 2009 for the 2008 plan year. Thus, interest will no longer have to be calculated from Jan. 1 of the current year up until the distribution date. PPA had eliminated gap period income from being used when determining refunds due to failed ADP/ACP tests. The Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) eliminated gap period income on the return of excess deferrals (amounts contributed in excess of the \$15,500 or \$20,500 limit in 2008) effective for plan years starting after Dec. 31, 2007.

**EACA six-month refund period.** Eligible automatic contribution arrangement (EACAs) will have six months

after the plan year-end to make a refund for a failed ADP/ACP test without a 10% penalty to the employer, versus two and a half months for 401(k) plans without an EACA.

**Note:** Final regulations just issued for EACAs will apply the two and a half month refund rule to some (but not all) EACAs beginning in the 2010 plan year.

### **Corrective distributions taxed in year distributed.**

Corrective distributions are now taxed in the year that they are distributed, beginning with plan year 2008 testing. This also includes any earnings on the excess amounts. This change will eliminate the requirement for an off-calendar year plan to use the FIFO (first-in, first-out) method to determine the return of deferrals. Another rule eliminated by this change is the rule requiring taxation in the year of distribution for amounts less than \$100, as all refunded amounts will now be taxed in the year distributed.

## Grab Bag of Miscellaneous Items of Interest for Retirement Plans

### **BENEFICIARY DESIGNATIONS**

The Supreme Court has ruled on whether a spouse who was designated as a beneficiary is still a beneficiary after a divorce. In a 9-0 decision, the Supreme Court has ruled that the employer acted correctly by paying a deceased worker's retirement benefits to his ex-wife — even though she had previously waived her right to the benefits as part of their divorce settlement.

**Background.** A participant initially completed a beneficiary form electing his wife as his primary beneficiary. Later, he and his wife divorced, but he did not name a new beneficiary under the terms of the plan. Upon his death, his daughter requested that plan benefits be paid to his estate, but the employer paid the benefits to his ex-wife (in accordance with his beneficiary form on file). The estate then sued in an attempt to recover the \$400,000 that was distributed to the ex-spouse, claiming the ex-spouse had waived her right to the benefits as part of the divorce settlement.

**Bottom Line:** Divorce decrees (including QDROs) do not necessarily override the plan participant's beneficiary designation. Employers must follow the terms of their plan documents and valid beneficiary designations when distributing death benefits.

**Note:** Many plan documents contain a plan provision which automatically invalidates any existing beneficiary designation naming the spouse as beneficiary (check your plan document to see if yours does!). In that event, the divorce invalidates the beneficiary designation and the plan must pay out death benefits according to a pecking order specified in the plan document.

### **PLAN FORFEITURE OPTIONS**

Account balance forfeitures can arise in retirement plans for many reasons, such as non-vested plan participants, erroneous contributions to participants' accounts, or the inability to find participants when they have benefits payable from the plan.

When these forfeitures arise, the terms of the plan document must be reviewed to see what is supposed to happen to these forfeiture amounts. Depending upon the terms of the employer's plan document, forfeitures can be used to pay administrative expenses or to reduce future employer contributions, or they can be reallocated to remaining plan participants at the end of the plan year.

A plan document can contain a combination of these methods, depending upon the source of the forfeitures

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## Grab Bag of Miscellaneous Items of Interest for Retirement Plans

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(some plans treat forfeitures of matching contributions differently from forfeitures of profit sharing contributions, for example).

**Bottom Line:** Careful attention must be paid to the amount and treatment of forfeitures to ensure that forfeitures do not accumulate year by year. IRS rulings require all forfeitures to be addressed each and every plan year.

### PENALTIES FOR FAILURE TO PROVIDE CERTAIN NOTICES OR INFORMATION

The Department of Labor issued a final regulation authorizing the Secretary of Labor to assess penalties of up to \$1,000 per day, for each violation by any person, against plan administrators who fail to disclose certain documents to participants and beneficiaries as required by the Employee Retirement Income Security Act (ERISA), as amended by the Pension Protection Act (PPA).

The following are included as notices or other information:

(1) Automatic Contribution Arrangement (ACA) notices

— generally required to be distributed 30 to 90 days prior to each plan year

(2) Defined benefit plans — notices of funding based limitations (due 30 days after a plan becomes subject to limitations)

In addition to these most recent PPA-mandated notices, there are many other notices and much other information that must be provided either automatically or upon request to plan participants. Failure to provide these notices may also result in significant DOL penalties:

(1) Sarbanes-Oxley “blackout” notices — generally due 30 days prior to any blackout date

(2) Summary plan descriptions and summaries of material modifications — generally due within seven months after the end of the plan year in which the plan change occurs

(3) Participant statements — generally due 45 days after the end of each plan quarter (for plans that allow participants to direct their own investments)

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***Neither the company nor its representatives give legal or tax advice. Please consult your attorney or tax advisor for answers to specific questions.***

## Questions?

**If you're a plan administrator, call your case acquisition specialist at 1-800-548-6436.**

**If you're an investment professional, call your internal retirement plan consultant at 1-800-626-3112.**

**If you're a plan sponsor, call your plan administrator or investment professional.**



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