Participant Statement Requirements for 2007

“…a defined contribution plan (such as a 401(k), profit sharing, or money purchase plan) that permits participants to select their own investments must provide statements quarterly.”

Before the Pension Protection Act of 2006 (PPA), employers were only obligated to give active plan participants an account or accrued benefit statement once a year; and then, only if a participant requested a statement in writing. The only other statement requirement applied to a terminated participant with an account balance or accrued benefit, or a participant who had a “break in service” during the year.

The Rules
Under PPA, a defined contribution plan (such as a 401(k), profit sharing, or money purchase plan) that permits participants to select their own investments must provide statements quarterly. When participant investments are directed by a fiduciary, only annual statements are required.

Active participants in defined benefit plans who have nonforfeitable accrued benefits must generally be given a benefit statement at least once every three years, or annually upon written request. Under an exception for defined benefit plans, it appears that if active participants are provided with an annual notice about their right to request a written statement, then statements are required only for participants who formally request them.

Defined Contribution Statement Requirements
The quarterly benefit statements for participants or beneficiaries who have the right to direct their own investments must disclose the value of each investment, including employer securities, determined as of the plan’s most recent valuation date. The statement must also include the following:

1. An explanation of any limitations or restrictions on the individual’s rights to direct an investment;
2. A plain English explanation of the importance of a well-balanced and diversified investment portfolio for the long-term security of participants and beneficiaries, including a statement of the risk that holding more than 20% of a portfolio in the security of one entity (such as an employer’s securities) may not provide adequate diversification; and
3. A notice directing the participant or beneficiary to the Internet website of the Department of Labor for sources of information on individual investing and diversification.

(continued on page 2)
Participant Statement Requirements for 2007 (continued from page 1)

The quarterly statement mandate applies to both daily valued and balance forward plans that permit participants to direct their investments. This will mean that balance forward plans that usually issue one or two statements a year will now have to issue quarterly statements, resulting in additional administrative complexity and expense. Similarly, plans with both pooled and participant-directed assets will also have to issue quarterly statements — at least for the participant-directed portion.

Effective Date
These requirements generally go into effect for plan years beginning after 2006. The DOL has been instructed to issue model benefit statements within 12 months after August 17, 2006 (PPA’s enactment date). Obviously, there is a gap between when the quarterly notices must be provided and when the DOL models may be available. (Use of the DOL’s model benefit statements is optional.)

Statements may be provided in written or electronic form as long as they are accessible to participants. Regulations could permit benefit statements to be made available on a continuous basis on a secure website. Average plan participants must be able to understand such statements.

IRS and Social Security Cost-of-Living Adjustments

<table>
<thead>
<tr>
<th>IRS LIMITS</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Defined Contribution Plan Limit on Annual Additions</td>
<td>$45,000</td>
<td>$44,000</td>
</tr>
<tr>
<td>Defined Benefit Plan Limit on Annual Benefits</td>
<td>$180,000</td>
<td>$175,000</td>
</tr>
<tr>
<td>Maximum Compensation for Allocation and Accrual Purposes</td>
<td>$225,000</td>
<td>$220,000</td>
</tr>
<tr>
<td>401(k), SARSEP, 403(b), and 457 Plan Deferrals/Catch-up</td>
<td>$15,500/$5,000</td>
<td>$15,000/$5,000</td>
</tr>
<tr>
<td>SIMPLE Deferrals/Catch-up</td>
<td>$10,500/$2,500</td>
<td>$10,000/$2,500</td>
</tr>
<tr>
<td>IRA Contributions/Catch-up</td>
<td>$4,000/$1,000</td>
<td>$4,000/$1,000</td>
</tr>
<tr>
<td>Compensation Defining Highly Compensated Employee</td>
<td>$100,000</td>
<td>$100,000</td>
</tr>
<tr>
<td>(2007 amount for use in 2008 plan year tests)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Compensation Defining Key Employee/Officer</td>
<td>$145,000</td>
<td>$140,000</td>
</tr>
<tr>
<td>Social Security Taxable Wage Base (SSTWB)</td>
<td>$97,500</td>
<td>$94,200</td>
</tr>
</tbody>
</table>

Current Automatic Enrollment Rules

Much has been written about the automatic enrollment plan enhancements included in the Pension Protection Act (PPA). As a result, there is a growing interest in these arrangements. There is also a great deal of confusion about which automatic enrollment plan provisions are available — and when.

Automatic enrollment plans have existed since 1998. The automatic enrollment rules that apply today will continue to be available in future years. The PPA rules that have been receiving so much attention, however, are not effective until the 2008 plan year.

Why is there so much interest? The cost of funding traditional defined benefit plans that provide lifetime retirement benefits to former employees has increased dramatically. Automatic enrollment 401(k) plans are portrayed as the retirement plan of the future because they present solutions to a number of challenges.

(continued on page 3)
The CODA Advantage. Defined contribution plans allow employers to better budget their costs and avoid financial and competitive disadvantages. The switch not only to defined contribution plans, but specifically to cash or deferred arrangements, addresses an additional issue — employee participation. Unlike the more traditional defined benefit and defined contribution plans where participants automatically shared in all employer contributions, typical cash or deferred arrangements require employees to **elect** to make contributions if they wish to receive an allocation of employer matching contributions.

“Cruise Control” for Plan Sponsors.

Automatic enrollment plans introduce a new twist. Employees are automatically enrolled and must take specific action to **opt out** of their employer’s plan. Generally speaking, automatic enrollment increases participation, which usually helps plans pass nondiscrimination testing.

From an employee standpoint, automatic enrollment encourages greater retirement savings. Further, expanded portability rules allow employees to more easily move their retirement savings from one employer’s plan to another, or roll over their accounts to individual retirement accounts (IRAs), so their savings can continue to grow until retirement.

Automatic Enrollment in the Beginning.

Automatic enrollment was approved by the IRS in 1998. Under automatic enrollment, a new plan participant is deemed to have consented to defer a stated percentage of compensation (as specified in the plan document). The participant must be permitted to either elect to defer a different amount or to opt out of deferring altogether.

A follow-up ruling released in 2000 permitted a plan to apply the automatic enrollment rules to current plan participants who make elective deferrals that fall under a minimum annual threshold (as stated in the plan document).

Expanded Rules. In 2004, the IRS issued a General Information Letter that expanded and clarified the application of the automatic enrollment rules, and they were reiterated in the final 401(k) and 401(m) regulations. Under the expanded rules:

1. The deferral percentage selected in the plan document may be any amount that is otherwise permitted under the terms of the plan. It is not limited to 3%, which had been the limit (based on the example in the 1998 IRS authorization) until this guidance.

2. The plan may provide a schedule of automatic deferral amounts that change over time. For example, the deferral amount may be 3% for the first five years of participation and 5% thereafter.

3. The deferral percentage normally applies to increases in compensation (including raises and bonuses).

The plan document (including the Summary Plan Description) must clearly state and explain the automatic enrollment rules, including the option to elect out of deferring altogether.

Notice Requirements. Employers that sponsor plans with the automatic enrollment feature must provide notices to employees explaining the feature and giving them a chance to vary their contribution amount or elect not to participate. This notice must be provided when employees are hired, when they become eligible to participate in the plan, and prior to the start of every plan year.

Two New Provisions. Although most PPA provisions are effective beginning with the 2008 plan year, two automatic enrollment provisions are effective immediately.

Override of State Withholding Laws. PPA eliminates conflicts between automatic enrollment rules and state wage and hour laws. However, preemption is only available if employees are provided with an annual notice before the start of each year.

Default Investments. PPA amends ERISA Section 404(c), which provides rules for investment liability relief for plan fiduciaries. Under the new provision, as long as a participant receives a notice explaining the right to designate how his or her contributions and earnings are invested and describing the plan’s default investment (i.e., the investment to which contributions and earnings are directed should no designation be made), and as long as the investment meets the applicable rules, then the participant will be considered to have exercised control over a default investment, and the fiduciary will be “safe harbored” from liability for the participant’s investment choices. (See the DOL’s proposed default investment rules on page four.)

“Generally speaking, automatic enrollment increases participation, which usually helps plans pass nondiscrimination testing.”
Recent Developments

DOL Proposes Default Investment Rules.
As part of the Pension Protection Act of 2006 (PPA), the Department of Labor was instructed to create safe harbor criteria for default plan investments made on behalf of participants who fail to make investment selections. If the default investment criteria are met and notice requirements satisfied, plan fiduciaries will not be liable for investment selections because participants will be deemed to have “exercised control” over their investments. Here are the DOL’s proposed rules for a qualified default investment alternative (QDIA).

- Participants or beneficiaries may not be restricted from transferring funds from a QDIA to any other investment alternative available under the plan.
- Transfers must be permitted with the same frequency as other plan investment transfers, but not less than on a quarterly basis.
- No financial penalties may be charged for transferring the funds from a QDIA to other plan investments.
- The QDIA must be managed by an investment manager or an investment company registered under the Investment Company Act of 1940.
- The QDIA must be diversified to minimize possible investment losses.
- The QDIA may not be invested in employer securities.
- The QDIA may be a life cycle fund, a target retirement date fund, a balanced fund, or a professionally managed account.

Participants and beneficiaries must be notified of the QDIA rules 30 days in advance of their first investment and at least 30 days before the start of every plan year thereafter. The QDIA rules, which apply to the 2007 plan year, will become effective as specified in the final regulation when it is published in the Federal Register.

Qualified Charitable Distributions from IRAs. Under PPA, an individual age 70½ or older may make a tax-free donation of up to $100,000 a year directly from his or her IRA, payable to a qualified charitable organization — but only for tax years 2006 and 2007. Such distributions satisfy the IRA’s minimum distribution requirements. This option does not apply to distributions from qualified retirement plans. Anyone interested in making such a donation should seek the advice of a tax advisor.

“The DOL’s proposed rules for a qualified default investment alternative (QDIA).”

Can We Help?
Our firm offers a broad range of employee benefit plan services. If we can be of service to you, please call.

©Copyright 2006 by NPI and McKay Hochman