

Benefits Alert

March 2011

Proposed Regs Could Alter The 401(k) Landscape

Administering your 401(k) plan has become enormously more complicated in recent years. Employees who actively choose to participate in the plan have more investment options, provided by an ever increasing number of third-party providers. Plans themselves must pick investment options for employees who are automatically enrolled into the plan. The Department of Labor (DOL) has proposed a series of regulations covering these issues.

REDEFINING 'FIDUCIARY' FOR 401(K) PURPOSES

After 35 years, the DOL is proposing to update the definition of "fiduciary" to clarify the fiduciary status of third parties who give investment advice for a fee to 401(k) plans and participants. While these

regulations won't directly impact plan sponsors and administrators, you should become familiar with them, since they may influence the third parties with whom you deal.

The proposed regs would build on current regs. The key to fiduciary status, according to the proposed regs, is advice for a fee; it doesn't matter whether that advice is provided once or on a continuing basis. In addition to current requirements, the regs propose that a third party provides investment advice for a fee to the plan, a plan participant, or a beneficiary if he/she:

- provides an appraisal or fairness opinion concerning the value of securities or other property;
- makes recommendations regarding the management of securities or other property;
- represents or acknowl

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edges that he/she is acting as a fiduciary with respect to providing advice; or

- is an investment advisor for purposes of the securities laws.

However, not every contact third parties have with the plan, participants, or beneficiaries would result in fiduciary status. For example, third parties would not be considered fiduciaries if they can show that the recipient of the advice knows or should



Robert S. Golden
M. Dennis Guappone
Stephen H. Peck

Expertise
Innovation
Excellence

181 Wells Avenue
Newton, MA 02459
Phone: (617) 969-0100
www.ubserv.com

Survey: Employers Still Shifting Health Costs To Employees

The health care reform law notwithstanding, 65% of employers surveyed by Aon Consulting have shifted increases in health benefits to employees. The survey also revealed that, for 2011, employers' health benefit costs increased between 5% and 20%.

SURVEY DETAILS

According to Aon, 40% of employers shifted the overall increase in health benefits to employees; 49% of employers shifted less than the overall increase to employees. The survey results also showed that 57% of employers increased employees' premiums, and 65%

increased employees' deductibles, co-pays, co-insurance, or out-of-pocket expenses.

TOO MANY DESIGN CHANGES SPOIL THE PLAN

The health care reform law allows all plans to raise employees' premiums. But current plans (i.e., plans in effect on March 23, 2010) that wish to retain their grandfathered status are restricted in the changes they can make to employer contribution levels, co-pays, co-insurance, deductibles, and annual out-of-pocket expenses before they lose their grandfathered status.

- Plans lose their status if the employer's contribution

decreases by more than 5%.

- Plans lose their status if they impose a co-insurance requirement or increase employees' co-insurance percentage.

- Plans can make minor adjustments to employees' out-of-pocket costs (e.g., deductibles and co-pays), but significant changes imperil plans' status. For deductibles and annual out-of-pocket costs, an increase causes a loss of status if the total percentage of the increase exceeds the rate of medical inflation, plus 15%. For co-pays, an increase causes a loss of status if the total increase exceeds \$5 adjusted upward by the rate of medical inflation (\$5 times the medical inflation rate, plus \$5), or a percentage using the rate of medical inflation, plus 15%, whichever is greater. ♦

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Proposed Regs Could Alter... (cont.)

know that the third parties are not providing impartial advice and that their interests are adverse to the interests of the plan or participants.

MORE DISCLOSURE FOR TARGET DATE FUNDS

Target date funds that are offered as an investment option in 401(k) plans that automatically enroll employees — technically called qualified default investment alternatives (QDIAs) — were thought to address the problem of employees not actively managing their retirement investments by progressively investing in

more conservative vehicles as employees neared retirement. That's not how it's worked out, however.

The DOL is proposing to amend the QDIA regs to require more specificity regarding the information that must be disclosed to employees concerning their investment in these funds.

These regs would primarily impact third-party providers, but to fulfill your fiduciary duty to employees and beneficiaries, you should become familiar with them.

The new disclosures that would be required would im-

part the design and operation of target date funds, and would include the following explanations.

- The investment's asset allocation.

- How that allocation will change over time, with a graphic illustration, such as a chart or graph.

- The significance of the investment's "target" date.

The proposed regs would also require a statement concerning the risk that employees investing in target date funds may lose money in those investments even when they're close to retiring. ♦

Results From An IRS 401(k) Compliance Project Reveal Common Errors

Over the last several years, the IRS has conducted drive-by compliance examinations of 401(k) plans under its LESE initiative. It now has results for four LESE projects, two of which focus on 401(k) plans of small employers. LESE's purpose is to identify common errors that can be corrected through the IRS's Employee Plans Compliance Resolution System (EPCRS).

LESE — WHAT DOES IT MEAN?

Government agencies are fond of acronyms, and the IRS is no exception. LESE stands for:

Learn — discover everything the IRS can discover about the retirement plan's compliance issues using small examination case samples.

Educate — inform the targeted group of what the IRS has learned and how it expects the group to correct errors.

Self-Correct — the IRS will give non-compliant groups a chance to correct their plans using EPCRS.

Enforce — the IRS will reexamine the plans, taking a firm position with those that have not corrected.

LESE PROJECT RESULTS

LESE's first project looked at 50 plans with less than \$250,000 in assets, but more than \$100,000; with effective dates of January 1, 1997, or earlier; and from which distributions have been made. The most common errors, according to the IRS, were failure of plan fiduciaries to secure adequate

bonding, and failure to timely amend plans to comply with current law and regulations. Proper bonding is not less than 10% of the amount of funds handled, with a minimum of \$1,000 and a maximum of \$500,000. Internal controls and meetings with outside pension professionals will ensure that the plan is current.

LESE's second project examined 50 small plans that made participant loans. The most common error was prohibited transactions involving improper loans. According to the IRS, the primary factors that caused the prohibited transaction were the failure to limit the amount borrowed, the failure to provide adequate security, and making loans that weren't *bona fide* (loans lacking documentation, a repayment schedule, etc.). *Solution:* Discuss with your outside pension professional whether the plan terms and loan policy are properly administered. ❖

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Form 8955-SSA: Be Prepared

Form 5500 filers no longer need to file Schedule SSA, beginning with the 2009 plan year. But that doesn't mean they're off the hook. Instead, they'll be required to file Form 8955-SSA with the IRS. However, plan administrators aren't required to file the form for the 2009 plan year until the IRS issues guidance, which isn't anticipated until later this year.

A REASONABLE TIME TO FILE

The IRS said that once it issues guidance, plan administrators will have a reasonable time to file for the 2009 plan year. The information to be reported on the form is similar to what was reported on the old Schedule SSA, the IRS added. *Important:* The special due date for the first Form 8955-SSA filing doesn't affect the time for filing Form 5500 or Form 5500-

SF through the Department of Labor's EFAST2 system.

Forms may be filed on paper by mailing them to: Department of Treasury, Internal Revenue Service, Ogden, UT, 84201-0024, or electronically through the IRS's FIRE system after January 1, 2011.

First-time electronic filers must apply for a Transmitter Control Code by filing Form 4419. Specifications for e-filing are available in IRS Pub. 4810. Call the IRS at 866-455-7438, ext. 4, for e-filing questions, as described in Pub. 4810. ❖

What's That Smell? IRS Says Medicinal Herb Is Deductible

Beginning this year, health flexible spending accounts (FSAs) can reimburse employees only for prescription medication, other expenses that qualify as deductible medical expenses, and over-the-counter (OTC) medications, provided they have prescriptions and substantiate their expenses. But the limitation on OTC items isn't as strict as it may appear to be. The IRS recently concluded in an information letter that FSAs

can reimburse for the cost of a medicinal herb that an employee obtained under a doctor's prescription.

NATUROPATHIC CURES TAKE OFF

The IRS dealt specifically with a herb prescribed to alleviate migraine headaches. But this ruling can have a far wider application, as the number of states enacting medical marijuana laws keeps expanding. According to the IRS, the

cost of a herb may be an expense for medical care if the taxpayer can substantiate that he/she:

- has a medical condition (i.e., a disease, illness, or injury);
- is purchasing the herb to treat or alleviate the medical condition; and
- would not have purchased the herb but for the medical condition.

The IRS suggested that taxpayers may wish to review their letters of medical necessity that their doctors completed to determine if their medical circumstances are clearly and fully described. ❖

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Ask The Experts

Q. *An employee who borrowed \$27,000 from his 401(k) account still owes \$18,000. His vested balance before the loan was \$80,000. He's now requested a second loan. How much can he borrow the second time around?*

A. At the outset, this employee can take a second loan only if your plan allows it. If your plan allows employees to take out additional loans, the rule is that the new loan, plus the outstanding balance of previous loans, can't exceed the lesser of \$50,000, reduced by the excess of the highest outstanding balance of all loans during the 12-month period ending on the day before the new loan (here, \$27,000), over the outstanding balance of plan loans on the date of the new loan (here, \$18,000), or the greater of \$10,000 or 50% of the employee's vested account balance. It sounds like a lot of legalese, but it's really not that hard to figure out. Here's how it's calculated.

1. $\$50,000 - (\$27,000 - \$18,000) = \$41,000$ or

2. $\$80,000 \times 50\% = \$40,000$.

So, the employee's permissible balance is \$40,000, of which \$18,000 represents the balance of the first loan. Therefore, the new maximum permissible loan balance is \$22,000 ($\$40,000 - \$18,000$).