

Borrower Be Aware

SITUATION: Our 401(k) plan has been getting a lot of requests from participants for loans. We realize that allowing employees to borrow against their 401(k) plan account balances can help increase plan participation. But administering so many loans is a hassle, and we're concerned that some employees may be hurting their chances for a comfortable retirement by borrowing too much and too often. We already have a minimum loan amount and limit the number of loans a participant can have outstanding.

QUESTION: Other than eliminating the loan feature altogether, what can we do to discourage unnecessary borrowing?

ANSWER: Consider providing employees with a summary of the advantages and disadvantages of borrowing from their plan accounts before processing loan applications. It may cause some employees to stop and reconsider borrowing from their accounts.

DISCUSSION: Employees generally are aware of the advantages of plan loans:

- The loan process is relatively simple and quick — generally, no credit check is required.
- Because the loan isn't considered a taxable withdrawal, the employee pays no income tax on the amount borrowed.
- Loan principal and interest are paid back to the employee's account, rather than to a bank or other lender.
- Loan payments are automatically deducted from the employee's paycheck.

You should make them equally aware of the disadvantages so they can make an informed decision.

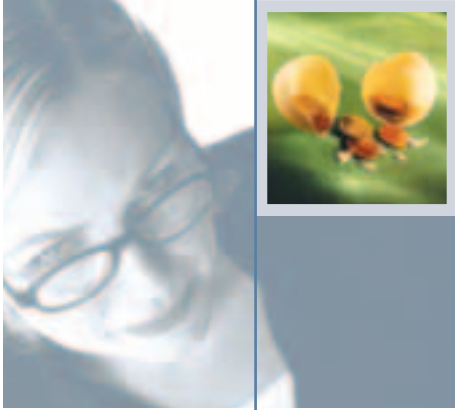
- They'll give up the returns the borrowed money could have earned in the plan.
- If the loan interest rate is lower than the return the employee would have earned on the borrowed plan assets, the loan may reduce the amount he or she will have at retirement.
- Loan payments are made with after-tax money.
- The employee will pay taxes again when the money is distributed after retirement.
- When an employee can't afford to repay the loan *and* continue to contribute to the plan, his or her account balance at retirement may be reduced.
- If the employee can't repay the loan, the outstanding balance will be treated as a taxable withdrawal, subject to income tax and a possible 10% early withdrawal penalty if the employee is younger than age 59½.

2 Who Pays?

2 Getting Employees To Participate

3 Know Your USERRA Obligations

4 Recent Developments in Benefit Plans



Who Pays?

According to a recent study* by the Profit Sharing/401(k) Council of America, slightly more than half of employers (55.3%) pick up the tab for the costs of administering qualified domestic relations orders (QDROs) for their retirement plan participants. QDROs require benefits to be transferred to a spouse, former spouse, child, or other dependent, often in connection with a divorce.

Among the companies that pay QDRO fees from plan assets, 73.9% charge the fees directly to the account of the

participant affected by the QDRO, while 26.1% treat QDRO fees as a general plan expense and deduct the amounts from the assets of all plan participants. Smaller plans are more likely to charge QDRO fees to individual participants. About 40% of the plans allow the fees to be split between the plan participant and the alternate payee(s).

*QDRO Retirement Plan Fee Survey 2005, Profit Sharing/401(k) Council of America, www.pasca.org, psca@psca.org

Getting Employees To Participate

What does it take to get more employees to save — and employees to save more — in a retirement plan? For many employees not currently participating, the answer seems to be “match my contributions,” according to the Employee Benefit Research Institute’s *2005 Retirement Confidence Survey*.*

Matching Contributions

For the first time, the study asked employees who were not contributing to their employers’ retirement savings plan what would persuade them to participate. Nearly three quarters (72%) said a matching contribution of 5% of salary could do the trick. About half (51%) said that a 3% match would make them much more likely or somewhat more likely to participate in their company plans.

But matching contributions aren’t enough to motivate all employees to join their plans. Among the nonparticipating employees surveyed, 13% said their employers already offer a 5% match, and 14% said their employers match up to 3% of salary.

Automatic Features

So what else do employees see as motivating plan features?

- Automatic enrollment (66% said they would be likely to remain in the plan once automatically enrolled).
- Automatic increases in the employee’s contribution whenever he or she received a pay raise (56%).

When asked how they feel about automatic enrollment, only 25% of the respondents said that they have negative feelings. About half (49%) were positive, and 26% said they didn’t care one way or the other.

*2005 Retirement Confidence Survey, Employee Benefit Research Institute, www.ebri.org



Nearly three quarters (72%) said a matching contribution of 5% of salary could do the trick.

Know Your USERRA Obligations

Employees who take a leave of absence for military service have various rights under the Uniform Services Employment and Reemployment Rights Act (USERRA). If you have employees returning from such service, you'll want to be familiar with these rights. The following questions and answers should help.

Who must comply with USERRA? The law applies to all public and private employers, foreign employers doing business in the United States, and U.S. corporations doing business in foreign countries.

What obligation do we have to rehire returning employees? You are generally required to rehire an employee who takes temporary leave to perform qualified military services cumulatively lasting five years or less while employed by you, if the employee meets certain requirements. The employee generally must give advance written or verbal notice of his or her intent to serve and report back to work or reapply for employment in a timely manner. Also, the employee must be honorably discharged from duty.

What's considered timely? It depends on how long the employee serves. If the employee's service is less than 31 days, he or she must report back to you by the beginning of the first regularly scheduled work period after the end of the last calendar day of duty, plus the time required to return home safely and have an eight-hour rest period. For more than 30 days, but less than 181 days, of service, the employee must reapply not later than 14 days after completing his or her service. If the service lasts more than 180 days, the employee must reapply no later than 90 days after the completion of service. If the employee has suffered a service-related injury or illness and is hospitalized or convalescing, the deadlines are extended up to two years.

How does USERRA affect our retirement plan? Under USERRA, military leave generally is not treated as a break in service. For vesting and benefit accruals, returning employees who meet the law's requirements are treated as though they had been continuously

employed throughout the leave period. Employees who would have become eligible for plan participation while they were away should be placed in the plan retroactively to the date of initial eligibility.

When the employee returns from leave, employers with defined contribution plans must fund any employer contributions the employee did not receive because of his or her absence for military service by making retroactive make-up contributions to the plan. The employer doesn't have to replace the earnings these make-up contributions would have generated during the leave period or reallocate any forfeitures that occurred during the leave period.

Can returning employees make up missed contributions to a 401(k) plan? Yes. A 401(k) plan must allow employees to make up any elective deferrals missed during the leave period. If your plan provides for employer matching contributions, you must match the employee's make-up contributions.

How are plan loans handled? Your plan may provide for the suspension of the loan obligations of employees on military leave, but isn't required to do so. If a loan is being repaid through payroll deduction and is not suspended, another method of payment (personal check, for example) should be arranged before the employee leaves.

If loan payments are suspended, the employee must resume the payments when his or her military service ends according to a payment schedule that's at least equal in payment frequency and amount to the pre-military schedule. The full loan amount (including interest accrued during the military service period) must be repaid by the end of the maximum term for the original loan plus the military service period.

Do we have to notify employees of their rights under USERRA? Yes, you must notify all employees, not just members of the military service. The U.S. Department of Labor has prepared a poster with the required information that's available online at www.dol.gov/vets/programs.userra/poster.pdf or by calling 1-866-487-2365. You can post it with other Equal Employment Opportunity posters and distribute it through the mail or other means that will ensure that the information reaches all of your employees.



RECENT DEVELOPMENTS In Benefit Plans

Changing Vesting Schedules.

A 401(k) plan provided that any employee terminated through a work force reduction would be 100% vested in employer contributions. The plan eliminated this provision, and, then, reduced its work force. Under pension law, a plan can change its vesting schedule only if the change doesn't decrease participants' vested interests and participants who have at least three years of service are allowed to continue to vest under the old schedule.

When Z was laid off, he was told that his plan balance wasn't vested and had to be forfeited. Z sued, saying that he had the right to have his vested benefits calculated based on the old full-vesting provision because he had more than three years of service. A federal court agreed, rejecting the plan's argument that the restriction on changing a vesting schedule only applies to service-based vesting schedules, not to those based on events, such as a work force reduction

(*Zhu v. Fujitsu Group 401(k) Plan*, N.D. Cal. 2005).

Bankruptcy Protection. The recently enacted Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 exempts assets in most employer-sponsored plans, as well as funds in traditional and Roth IRAs, from access by the owners' creditors in a bankruptcy proceeding. IRAs are subject to a \$1 million exemption cap, not counting amounts attributable to funds rolled over from employer plans.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is provided with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought.

© 2005 by NPI