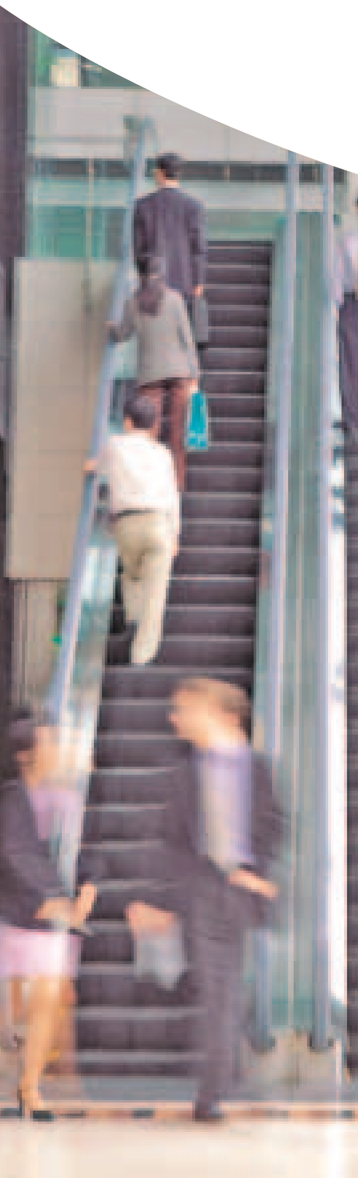
THE EMPLOYEE BENEFIT

Forum

current issues in retirement benefit planning

NORTH CENTRAL TRUST COMPANY

Established 1913



Is Automatic the Way To Go?

SITUATION: We are thinking about adding automatic enrollment and contribution increases to our 401(k) plan.

QUESTION: What factors should we consider before we go ahead?

ANSWER: You need to look at what you expect the automatic features to accomplish, the costs, and how they can be implemented to fit your work force.

DISCUSSION: With automatic enrollment, a set percentage of the employee's compensation is withheld and then deposited in a plan account for the employee — unless the employee chooses not to participate or wants to contribute a different amount. Before enrollment, employees *must* be given the opportunity to opt out of participating. Employees also must have the option of changing the election in the future.

Numerous studies show that, once in a plan, few employees choose to discontinue their participation. So, if you simply want to increase plan participation, automatic enrollment and deferral percentage increases can be effective ways to do so.

However, if your intention is to increase plan participation by lower paid employees in order to satisfy the nondiscrimination requirements, you may want to look at the cost of adding automatic features as opposed to the cost of other methods you might use to pass the nondiscrimination tests.

For example, consider how much automatic enrollment and/or automatic contribution increases might cost in employer matching contributions. It could be a considerable amount. Automatic enrollment could increase your employee communication costs, as well.

If you determine that automatic enrollment and/or contribution increases would be a good move for your plan, take care when you choose the initial deferral rate and the deferral increases, the timing of increases, and at what point increases should stop. A common initial deferral rate is 3%. But, if the employees you are trying to reach are lower paid, you may want to start at 2% and limit automatic increases to 1% or 2%.

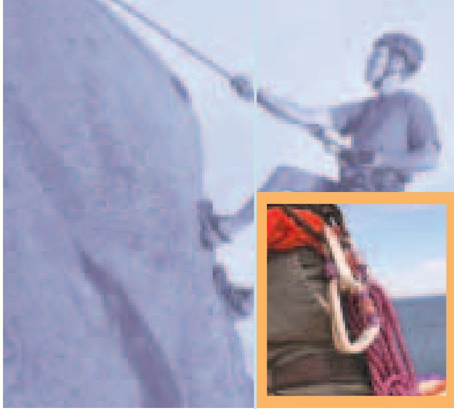
While there is a natural inertia that seems to keep employees in a plan, too large a bite out of their take-home pay may cause some to opt out. Keep this in mind when you schedule automatic increases. You may want to tie them to pay raises. You also need to set a point at which automatic increases stop. Again, consider your work force composition when you set your ceiling.

2 Survivor! Retirement Plan Style

2 Covering All the Beneficiary Bases

3 Meeting the Annual Reporting Requirements for Your Plan

4 Recent Developments in Benefit Plans



Survivor! Retirement Plan Style

A recent survey of "investor survivor skills" by the Securities Investor Protection Corporation (SIPC) contains some findings you may be able to use to fine-tune your employee education program:

- 66% of those surveyed understood that stocks have the best potential long-term returns.
- 57% correctly defined a prospectus. About the same percentage (58%) said they had "ever" read a prospectus.
- 41% understood that, as interest rates go up, bond prices tend to fall.
- 14% incorrectly identified certificates of deposit as having the best potential long-term returns.

The study also identified desirable investment traits for investors, including reading prospectuses, regularly reviewing account statements, and having a financial plan in place.

Note that the survey focused on the most active investors. But, if savvy investors are deficient in certain investing knowledge, the typical retirement savings plan participant probably is even more so.

Covering All the Beneficiary Bases

When an employee dies and that employee has not named a beneficiary for his or her retirement plan assets, or has a beneficiary designation that isn't clear, distributing his or her plan assets can be problematic for the plan sponsor. Problems can also arise with divorced employees who die without updating their designations to remove a former spouse. This situation can be further complicated by divorce decree provisions concerning employee benefits that conflict with a beneficiary designation.

Background

Most 401(k) plans require that the employee's spouse be the designated beneficiary, unless the participant elects to have the assets go to someone else or be distributed in a different manner and the spouse consents. (The consent must be in writing and meet specific requirements.) Plans that don't include this provision must pay benefits to a participant's surviving spouse in the form of a qualified joint and survivor annuity or a qualified preretirement survivor annuity.

Action

What can you do to help avoid conflicts and problems with beneficiary designations? At enrollment meetings, make a point to stress the importance of naming a beneficiary and keeping beneficiary designations up to date. Reinforce this message by using payroll stuffers, posters, or e-mail to periodically remind employees of changing circumstances that would require them to update their beneficiary designation — such as a divorce or death of a named beneficiary. You could also occasionally include an article on the importance of naming a beneficiary in your company newsletter.

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Meeting the Annual Reporting Requirements for Your Plan

It's about that time again — time for sponsors of retirement plans with calendar-based plan years to file the annual Form 5500 return/report with the government. Below, we answer some basic questions about the annual reporting requirements.

Who has to file? Most pension benefit plans must file a Form 5500 and related schedules. These plans include 401(k) plans, profit sharing plans, and defined benefit plans, among others. A "one-participant" retirement plan may be able to use the simpler Form 5500-EZ. A plan may be considered a one-participant plan if it covers (1) only the owner of a business (or the owner and his or her spouse) or (2) only partners in a business partnership and their spouses. Certain other requirements must also be met.

A few types of plans — SIMPLE IRAs, most simplified employee pension (SEP) plans, and governmental pension plans, for example — are excepted from filing.

What schedules must be filed? The instructions to Form 5500 give details about the pension benefit and financial schedules a retirement plan may have to file. Note that plans with fewer than 100 participants as of the beginning of the plan year are generally classified as small plans. The reporting requirements are somewhat simplified for a small plan.

When does the return/report have to be filed? The deadline for filing the required forms and schedules is the last day of the seventh month after the plan year ends. Thus, for a calendar-year plan, the deadline for 2005 reports is July 31, 2006. An automatic 2½-month extension may be obtained by filing Form 5558 (Application for Extension of Time To File Certain Employee Plan Returns) with the IRS by the due date of Form 5500. Note that Form 5558 is being revised and, under temporary regulations issued in late 2005, will no longer require the filer to sign the form or provide a reason for seeking the extension.

What happens if we don't file on time? An incomplete filing or a filing received after the due date may result in a penalty unless you can show to the government's satisfaction that the failure to file properly was for reasonable cause. The penalties may be severe. For example, the U.S. Department of Labor (DOL) may charge a penalty of *up to $1,100 a day* for each day the plan administrator fails or refuses to file a complete report, and the IRS may assess a penalty of $25 per day (up to $15,000).

Do we have to include audited financial statements in our annual report? Most retirement plans must include financial statements that have been examined by an independent qualified public accountant, along with the accountant's opinion concerning the statements, in their annual reports. Certain 403(b) arrangements and fully insured plans, as well as small plans that meet certain asset or bonding guidelines, are exempted from this requirement.

Are annual reports made available to the public? Yes. The DOL makes annual reports open to public inspection and the plan administrator must make the reports available to plan participants. Schedule E (ESOP Annual Information) and Schedule SSA (Annual Registration Statement Identifying Separated Participants With Deferred Vested Benefits) are not open to public inspection.

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

RECENT DEVELOPMENTS
In Benefit Plans

FDIC Insurance Coverage. Effective April 1, 2006, the Federal Deposit Insurance Corporation (FDIC) has raised the deposit insurance coverage on certain retirement accounts at bank and savings institutions from $100,000 to $250,000. These accounts include IRAs and self-directed Keogh plan accounts, 457 plan accounts for state government employees, and self-directed 401(k) accounts. The FDIC insures deposit accounts such as checking, NOW and savings accounts, money market deposit accounts, and certificates of deposit (CDs). For self-directed retirement accounts, the new coverage applies primarily to CDs. In addition, retirement accounts insured under the new rules are insured separately from other accounts at the same institution. Other accounts continue to be insured up to $100,000.

Voluntary Fiduciary Correction Program. The U.S. Department of Labor has expanded and simplified the Voluntary Fiduciary Correction Program (VFC Program). The VFC Program allows employers and other fiduciaries to avoid potential civil actions and the assessment of civil penalties under the pension law by voluntarily correcting and reporting specific problems with their retirement plans and restoring any losses caused by the fiduciary breach. The updated program includes: (1) additional eligible transactions, (2) reduced documentation requirements, (3) a simplified model application, (4) a checklist, and (5) an online calculator for determining the amount to be restored to a plan.

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