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situation: Large Company recently acquired Small Company. As part of the acquisition, Small Company's 401(k) plan is being terminated. Plan participants will be able to roll over their 401(k) account assets to Large Company's plan. However, Small Company hasn't been able to locate two former employees who still have accounts with the plan. The pension law (ERISA) requires retirement plan sponsors to make a reasonable, good faith effort to make sure that plan participants and their beneficiaries receive the plan benefits they are entitled to. Small Company has mailed the former employees information about the plan termination, but the post office has returned the correspondence.

questions: Does Small Company have to do anything else to try to locate the missing plan participants? If they can't be found, what should be done with their plan accounts?

answers: Yes, Small Company needs to do a more thorough search. The U.S. Department of Labor (DOL) recently issued guidance on the steps that sponsors of terminating defined contribution plans must take to locate missing plan participants. The guidance also outlines distribution options employers can use for accounts of participants who can't be found or who fail to respond to requests for direction regarding distribution of their account balances.

discussion: The DOL provides four relatively inexpensive search methods that employers must use when routine

contact with the plan participant — first class mail or e-mail, for example — fails.

- Send a certified letter.
- Check related plan records. In some cases, the employer may sponsor another plan (e.g., a group health plan) that may have more up-to-date information about the participant. If privacy concerns arise (as is common with health plans), the retirement plan administrator can ask the other plan to forward a letter asking the participant to contact the administrator.
- Contact the designated plan beneficiary.
- Use the IRS or Social Security Administration's letter forwarding services. Both programs limit their services to forwarding letters. They won't confirm that the participant has received the notice, nor will they provide the participant's current address. More information on these services can be found on the IRS website, www.irs.gov, and the Social Security Administration website, www.ssa.gov.

What if you try all of these methods and still can't locate a missing participant? You may want to try Internet search tools, commercial locator services, and credit reporting agencies. Before using these methods, consider the costs that may be involved versus the value of the participant's account — particularly if you plan to charge the costs to the account.

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When Participants Go Missing

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Once all the search methods have been exhausted, you should consider distribution options. In the DOL's view, employers should always look first at distributing the account balance to an individual retirement account (IRA) set up for the missing participant. The DOL's final regulations on automatic rollovers of involuntary cash-outs, discussed on page three, provide guidance regarding choosing an IRA provider and investing the account.

If you are unable to find an IRA provider that will accept a rollover distribution on behalf of a missing participant, you have two other options. You may establish an interest-bearing federally insured bank account in the name of the participant or transfer the missing participant's account balance to a state unclaimed property fund. Either of these actions will make the deposited amounts subject to income tax, mandatory tax withholding, and a possible early withdrawal penalty for the participant.

Some employers have offered another idea for handling missing participant

accounts: impose 100% federal income-tax withholding on the missing participant benefits — in effect transferring the benefits to the IRS. While this may seem like a workable solution, the DOL guidance specifically says that it is *not* an acceptable distribution option.

comment: All employers should have a policy in place demonstrating that a reasonable good faith effort — as spelled out in the DOL guidelines — will be made to locate missing plan participants. Having such a policy helps ensure that you are fulfilling your fiduciary duties as a plan sponsor.

Telling Employees about Investment Changes

situation: Employer is reevaluating its 401(k) plan investment choices in order to offer plan participants greater investment diversity. However, the last time Employer added and deleted funds from its investment lineup, a small, but very vocal, group of employees protested.

question: How can Employer be better prepared this time to handle employee questions and concerns about the changes?

answer: Communicating with employees before any anticipated changes in a plan's investment options can go a long way toward reducing worries that employees may have.

discussion: It is unlikely that you can please all employees, but you can minimize dissatisfaction about changes you make to your plan's investments by stressing the following points in employee communications.

The plan is designed to meet the needs of all employees. You want your employees to be able to accumulate enough assets over the years so that they have a reasonable chance of a financially secure retirement. Studies show that investment performance is primarily a function of asset allocation. To give your employees an opportunity to effectively allocate their plan assets, you need to consider all of the employees who partic-

ipate in your plan and offer a diversified menu of investment choices.

While some financially sophisticated employees may want the plan to offer investment choices that would appeal to only a small number of participants, your fiduciary duty, as a plan sponsor, is to *all* the employees in the plan. The funds that your plan offers need to be chosen carefully to appeal to employees with different levels of investment expertise, different tolerances for risk, and different retirement dates.

Retirement investing isn't a popularity contest. By their nature, investment markets fluctuate, and investors react to those fluctuations. So, for example, when bonds perform better than stocks, stock funds may lose favor with some investors. This loss of popularity doesn't mean that your plan should stop offering stock investments or offer fewer stock choices.

Based on historical returns, stocks can be expected to perform better than bonds in some future years and vice versa. In addition, certain types of stocks and bonds may perform better than others in different economic conditions.

All investments carry risk. Some employees may worry about losses that they may suffer if your plan replaces an underperforming fund with a better-performing fund that has similar holdings

and objectives. Remind them that every fund experiences day-to-day fluctuations in value. Help them understand that, even though the fund has been changed, they are still invested in the same asset class, and that the new fund may give them better potential to recover any losses generated by the old fund.

How should you communicate investment changes to employees? You can:

- Announce and discuss the changes at a company meeting,
- Provide the information in a payroll stuffer,
- Include an article about the changes in your employee newsletter,
- Send company-wide e-mail messages with the information, and
- Use posters announcing the change, followed by a payroll stuffer or e-mail that provides more details.

comment: Before making changes to your plan's investment choices, consider employee and company needs along with your responsibilities as a plan fiduciary. We can help you review your current investment choices and work force characteristics to determine whether changes or additions to your plan's investment menu are needed.



Automatic Rollover of “Cash-Outs”

Because maintaining small account balances for former employees can be an administrative burden, many plans automatically cash out accounts valued at \$5,000 or less unless the departing employee elects a rollover to another plan or an individual retirement account (IRA). New rules related to cash-outs take effect soon.

What are the new rules?

Plans must transfer cash-outs of more than \$1,000 directly to an IRA set up for the former participant — unless the participant elects to receive his or her distribution or have it paid directly to an eligible retirement plan or another IRA.

Has the U.S. Department of Labor (DOL) issued regulations regarding the new automatic rollover rules?

Yes. Under recently issued final DOL regulations*, employers can fulfill their fiduciary duties with respect to selecting an IRA provider and investing the funds by meeting these requirements:

- The rollover can't exceed \$5,000.
- The rollover must be to an IRA.
- The employer must have a written agreement with the IRA provider that addresses account investments and fees.
- Certain disclosures must be provided to plan participants.
- The plan fiduciary cannot engage in a prohibited transaction when selecting the IRA provider.

How should plans treat cash-outs of accounts valued at \$1,000 or less?

Accounts valued at \$1,000 or less can be paid out instead of rolled over. But employers may decide to treat all mandatory cash-outs the same way for administrative convenience.

What investments are permitted?

The investment should be designed to preserve principal and provide a reasonable rate of return, consistent with liquidity. Examples include money market mutual funds, stable value funds, and certificates of deposit.

Can an employer choose a permitted investment product from any financial institution for the rolled over funds?

The investment must be offered by a state or federally regulated financial institution. Regulated financial institutions are generally defined as a federally insured bank, a savings association or credit union, an insurance company whose products are protected by a state guarantee association, or a registered investment company.

How much can the IRA provider charge for creating and maintaining the rollover IRA?

These charges can't be greater than those of a comparable rollover IRA. Examples of possible account expenses include set-up charges, maintenance fees, investment expenses, termination costs, surrender charges, and similar fees charged by other IRAs.

What disclosures are required?

You must include a description of the plan's automatic rollover provisions for mandatory cash-outs in the summary plan description (SPD) or a summary of material modifications (SMM). The description must include:

- An explanation that the mandatory distribution will be invested in a product designed to preserve principal and to provide a reasonable rate of return and liquidity,
- A statement indicating how fees and expenses will be allocated to the IRA, and
- The name, address, and phone number of a plan contact (if not otherwise provided in the SPD or SMM) that can provide further information about the plan's automatic rollover provisions, the IRA provider, and the fees and expenses charged.

When do the safe harbor rules go into effect?

The safe harbor rules become effective March 28, 2005.

Where can we get assistance adding an automatic rollover feature to our plan?

We would be happy to talk with you about adding an automatic rollover feature to your plan. In addition, the IRS will be issuing a model amendment in the near future that may be used to apply the automatic rollover provision to both preapproved and individually designed plans. Along with the amendment, the IRS is expected to answer other questions concerning the automatic rollover provisions.

*Federal Register, September 28, 2004

2005 Cost-of-living Adjustments

The IRS has released the annual cost-of-living adjustments for various retirement plan limitations. Most of the limitations have increased for 2005. In addition, some limitations, such as the maximum 401(k) plan, 403(b) plan, SIMPLE plan, and 457 plan elective deferrals, are increased by statute.

Also, the Social Security Administration announced in October that the Social Security taxable wage base will rise on January 1, 2005, to \$90,000 from \$87,900. This change affects retirement plans that take Social Security into account in determining benefits or contributions.

	2005	2004
Defined Contribution Plan Dollar Limit on Annual Additions	\$42,000	\$41,000
Defined Benefit Plan Limit on Annual Benefits	\$170,000	\$165,000
Maximum Compensation Used To Determine Benefits or Contributions	\$210,000	\$205,000
401(k), SARSEP, 403(b), and 457 Plan Deferrals/Catch-up	\$14,000/\$4,000	\$13,000/\$3,000
SIMPLE Deferrals/Catch-up	\$10,000/\$2,000	\$9,000/\$1,500
IRA Contribution/Catch-up	\$4,000/\$500	\$3,000/\$500
Compensation Defining Highly Compensated Employee	\$95,000	\$90,000
Compensation Defining Key Employee (Officer)	\$135,000	\$130,000
Social Security Taxable Wage Base	\$90,000	\$87,900

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