



Seasonal Employees

SITUATION: Our company is exceptionally busy the last four months of the year. During this period, we hire extra people to handle the additional work load. Some of these seasonal workers have worked for us for several years.

QUESTION: Do we have to include our seasonal employees in our 401(k) plan? Including them may have an adverse effect on our annual nondiscrimination testing and limit the amounts our highly compensated employees can contribute to the plan.

ANSWER: You might have to include your seasonal employees in your plan, depending on the plan's service requirement.

DISCUSSION: Under the tax law, the maximum service requirement a 401(k) plan can impose for participation is generally one year — usually defined as 1,000 hours of service in 12 consecutive months. The IRS considers plan documents defective if their wording even *could* require more than a year of service.

Thus, excluding employees with “customary employment” of “not more than 20 hours per week” is an invalid service requirement because these employees *could* work 1,000 hours in an eligibility computation period. Having this or another defective participation provision can cause a plan to lose its tax-qualified status, regardless of whether any of the employees defined in the provision actually work 1,000 hours in a year.

You still may be able to exclude your seasonal workers, though. A service requirement that excludes employees classified as part-time or seasonal can be valid if it is worded correctly.

For example: Two plans have provisions that exclude employees classified as part-time or seasonal. Plan A defines a part-time or seasonal employee as an employee who works less than 1,000 hours of service in a 12-month eligibility computation period. Plan B defines a part-time or seasonal employee as an employee who is scheduled to work less than 1,000 hours of service in a year.

Although Plan A provides an exclusion classification that references service, the provision does not impose a service requirement that violates the tax law. Under A's provision, any employee who works 1,000 hours or more during the year doesn't meet the definition of a part-time or seasonal employee and will be eligible to participate in the plan. B's requirement, however, could create a violation because it could result in the improper exclusion of an employee who worked more than his or her originally scheduled hours.

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New Final 403(b) Regulations

New final regulations issued by the IRS for Section 403(b) tax-sheltered retirement arrangements revise the operation and administration of these retirement plans so that they are, in many respects, more like 401(k) plans. 403(b) tax-sheltered arrangements are defined contribution plans for employees of public schools and nonprofit organizations that are exempt from tax under Code Section 501(c)(3). Like 401(k) plans and 457(b) deferred compensation plans, 403(b) plans offer participating employees important tax benefits.

One big change is a requirement that 403(b) arrangements have a written plan document that outlines all material plan provisions (regarding eligibility, benefits, contribution limits, distributions, etc.) and allocates the responsibilities of the employer, the annuity contract issuer(s), any other service providers, and participating employees. The regulations also include new controlled group guidelines, transfer and exchange rules, and distribution rules similar to 401(k) plan rules. The final regulations are generally effective for taxable years beginning after December 31, 2008.

At Long Last — QDIAs Defined

The U.S. Department of Labor (DOL) has released its final regulation on qualified default investment alternatives (QDIAs) for participant-directed plans. Using a QDIA can help you secure liability protection for the investment of employees' account assets when they have been given the opportunity to direct their investments but have failed to do so. Stand-alone stable value funds, money market funds, and guaranteed investment contracts (GICs) are notably absent from the list of approved options.

Under the regulations, a QDIA must be a mutual fund or managed by an investment manager, plan trustee, or plan sponsor who is a named fiduciary and generally cannot invest employee contributions in employer securities. The regulation clarifies that a QDIA may be offered through variable annuity contracts or other pooled income investment funds. Participants must have the opportunity to direct investments out of a QDIA as frequently as from other plan investments, but at least quarterly. Various other requirements apply.

Plan sponsors must furnish a notice to employees and beneficiaries before the first investment in the QDIA and annually thereafter. The regulations describe the information that must be included in the notice. Also, any materials, such as investment prospectuses, that the plan receives from the company providing the QDIA must be provided to participants.

According to the DOL, the regulations are effective December 24, 2007. Default investments made in stable value products prior to the effective date are "grandfathered" for purposes of liability protection.

If your plan currently has a stable value or money market fund as its default investment and you would like assistance in choosing an investment that satisfies the final regulations, or you would like help reviewing the suitability of a different current default investment, please call us. We offer a variety of investment choices for your plan.

DOL-approved QDIAs

- **Lifecycle funds, targeted retirement date funds**, and similar products that take into account the individual's age or retirement date
- **Balanced funds** and similar products with a mix of investments that take into account the characteristics of the group of employees as a whole, rather than each individual
- **Professionally managed accounts** and similar investment services that allocate contributions among existing plan options to provide an asset mix that takes into account the individual's age or retirement date
- **Capital preservation products**, but only for the first 120 days of participation in the plan



Reviewing Your Fiduciary Liability Coverage

When was the last time you checked your retirement plan's fiduciary liability coverage? As more assets accumulate in your plan or different individuals become responsible for managing the plan, coverage needs and bonding requirements may change. Below, we answer questions about fiduciary liability coverage and what you should check.

What kind of coverage is required? Your plan should have a fidelity bond. The purpose of the bond is to protect the plan against misappropriation of funds by individuals handling the plan's assets. Generally, under the pension law (ERISA), every plan fiduciary — including the sponsoring employer, plan trustee, investment manager, and plan administrator — and any other person who handles plan funds must be bonded.

How large a bond do we need? The face amount of the bond must be at least 10% of the plan assets handled, with a minimum bond requirement of \$1,000 and a maximum, generally, of \$500,000. However, for plans holding employer securities, the maximum is generally increased to \$1,000,000 starting with the 2008 plan year — a change made by the Pension Protection Act of 2006. A plan that holds employer securities only in mutual funds and other broadly diversified funds is not considered to hold employer securities for purposes of the higher bonding limit.

Do we need any additional coverage? Even though ERISA doesn't require it, having fiduciary liability insurance coverage is a good idea. Fiduciary liability insurance coverage extends beyond misappropriation of funds to protect the insured employer against claims for losses sustained because of a breach of fiduciary duty. Fiduciary liability insurance should cover all plan fiduciaries, past, current, and future. Most policies are "claims-made" policies that cover any claims made and reported during the policy period. Another type of policy, called an "occurrence" policy, covers acts that occurred during the policy period no matter when they are reported.

What should the policy cover? The policy should define who is insured, the policy period, and what constitutes a wrongful act. Generally, a wrongful act is a breach of duty under ERISA, another federal law, or state law. Some policies also cover administrative errors and omissions. Others require an endorsement to add this coverage. The policy deductible should apply only once to a single wrongful act or interrelated wrongful acts and not to each claim made for the act. Coverage for the costs of defending a lawsuit is also important. Most policies have either a duty-to-defend or a pay-on-behalf-of provision. Under a duty-to-defend provision, the insurer has the obligation and right to choose defense counsel and provide a defense. A pay-on-behalf-of provision allows you, as the insured, to select counsel and control the defense. With this provision, the insurer's obligation to pay for the defense may be harder to enforce.

Will the policy list any exclusions? Yes, the policy should contain a list of exclusions. You may also find exclusions in other sections of the policy and in the amendatory endorsements attached to the policy. Read them carefully.

Are fiduciaries personally protected? Generally not. If the policy is purchased with plan assets, the insurer can recover any paid losses from the fiduciary whose breach caused the loss. To personally protect individual fiduciaries, the policy must include a nonrecourse rider or a waiver of recourse provision. The premium for such waivers is modest and cannot be paid out of plan assets. Your policy also should include a severability clause to prevent the dishonesty of one fiduciary on an application from voiding coverage for all individuals named as insureds.

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

2008 Cost-of-living Adjustments. cost-of-living adjustments for various retirement plan limitations. The IRS has released the annual

Some of the limitations have increased for 2008, while others, such as the maximum 401(k) plan, 403(b) plan, SIMPLE, and 457 plan elective deferrals remain the same.

	2008	2007
Defined Contribution Plan Dollar Limit on Annual Additions	\$46,000	\$45,000
Defined Benefit Plan Limit on Annual Benefits	\$185,000	\$180,000
Maximum Compensation Used To Determine Benefits or Contributions	\$230,000	\$225,000
401(k), SARSEP, 403(b), and 457 Plan Deferrals/Catch-up	\$15,500/\$5,000	\$15,500/\$5,000
SIMPLE Deferrals/Catch-up	\$10,500/\$2,500	\$10,500/\$2,500
Compensation Defining Highly Compensated Employee	\$105,000	\$100,000
Compensation Defining Key Employee (Officer)	\$150,000	\$145,000
Social Security Taxable Wage Base	\$102,000	\$97,500

Also, the Social Security Administration announced a 4.6% increase in the Social Security taxable wage base effective January 1, 2008. This change affects retirement plans that consider Social Security in determining benefits or contributions.

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NORTH CENTRAL TRUST COMPANY

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230 Front Street North • P.O. Box 489 • La Crosse, WI 54602-0489 • 608-782-1148 • 800-658-9474 • Fax: 608-784-3880
Riverplace • 43 Main Street S.E., Suite 214 • Minneapolis, MN 55414 • 612-339-2343 • 800-658-9474 • Fax: 612-339-2356

www.northcentraltrust.com