Plan Sponsor

Outlook

A Current Issues Resource for Plan Sponsors and Administrators 2nd Quarter 2008

Financial Literacy Affects Participation

A report* from the Center for Retirement Research at Boston College shows that employee decisions to participate in 401(k) plans are strongly affected by financial literacy and the level of trust in financial institutions. The researchers went beyond the usual reasons why employees don't participate, such as low income or procrastination, to explore these other aspects of financial decision-making.

Financial literacy was low for non-participants

Participants in both voluntary enrollment and automatic enrollment plans were surveyed. Based on responses to financial knowledge questions, 42% of respondents were in the low financial literacy group. Non-participants in both types of plans were more likely to be in this group than participants.

Trust was also low for non-participants

Overall, about 14% of those surveyed had what the researchers concluded was low trust of financial institutions. Those not participating in automatic enrollment plans were significantly more likely to have a low level of trust than any other group of respondents.

Literacy and trust have high impact

As in earlier research, this study found that the likelihood of participation increases with level of education and salary in voluntary enrollment plans. Also, as expected, education and pay weren't significant factors in auto enrollment plans.

But, when the financial literacy and trust variables were added to the analysis, the results were surprising. An employee with low financial literacy was found to be 34% less likely to participate in a voluntary enrollment plan and 11% less likely to be participating in an auto enrollment plan.

**Do Financial Literacy and Mistrust Affect 401(k) Participation?* Agnew et al, Center for Retirement Research at Boston College, Nov., 2007.

In the voluntary enrollment plans, low trust in financial institutions was not a significant factor. It was, however, in auto enrollment plans, where those with low trust were less likely to be participating. In considering the difference in the effect of trust in the two types of plans, the authors suspected that procrastination may be more influential on non-participation than low trust. Those opting out of automatic enrollment plans could be driven by low financial literacy or low trust.

Results point to education's importance

The researchers concluded that ongoing 401(k) education efforts are extremely important in supporting participation rates. Participation in voluntary enrollment plans would likely be enhanced, and opt-out rates in automatic enrollment plans reduced, by increasing financial literacy through education. Also, stressing plan benefits at the time of enrollment may reduce opt-out numbers in auto enrollment plans. Finally, ongoing education about the plan's features and benefits may also reduce automatic enrollment plans' drop-out rates by focusing on raising the level of trust of financial institutions.

The report is at http://tinyurl.com/yvy4u4. ■

QPA

Qualified Plan Administrators, Inc.

306 Sixth Street • Augusta, GA 30901
P. O. Box 1171 • Augusta, GA 30903
Phone (706) 724-4557 • Fax (706) 722-1208

5000 Thurmond Mall, Suite 355
Columbia, SC 29201
Phone (803) 252-0393 • Fax (803) 252-1056

Email Info@qpainc.com • Web www.qpainc.com

Pension Plan Limitations for 2008

401(k) Maximum Participant Deferral *(*$20,500 for those age 50 or over, if plan permits)*	$15,500*
Defined Contribution Maximum Annual Addition	$46,000
Highly Compensated Employee Threshold	$105,000
Annual Compensation Limit	$230,000

DOL Introduces Short Form 5500

A simplified Form 5500 for use by certain small plans for the 2009 plan year has been introduced by the Department of Labor (DOL). Known as the Short Form 5500 (officially as Form 5500-SF), the new annual return/report consists of just two pages of entries. Most Short Form 5500 filers will not be required to include any schedules with their submission.

To be eligible to use Form 5500-SF, the plan must:

- cover fewer than 100 participants,
- be eligible for the small plan audit waiver,
- hold no employer securities at any time during the plan year,
- have 100% of its assets in investments that have a "readily determinable fair market value," and
- not be a multiemployer plan.

The DOL noted that easy-to-value investments include mutual fund shares, investment contracts with insurance companies and banks valued at least annually, publicly traded securities held by a registered broker dealer, cash and cash equivalents, and plan loans to participants.

To see the new Short Form 5500, go to http://tinyurl.com/2jfqzn, which is the Federal Register notice, and see pages 64758 and 64759.

The Department of Labor has again delayed the effective date of the requirement that Form 5500 be filed only electronically. All Form 5500 filings must be electronic for plan years beginning on or after January 1, 2009. So, calendar year plans have until July 31, 2010 to file their 2009 Form 5500 electronically.

Auto Enrollment's Effectiveness Is Mixed

An analysis of auto enrollment plans including nearly 119,000 participants found that while automatic enrollment does raise participation rates, contribution rates appear insufficient to result in adequate retirement savings.

Under auto enrollment, the participation rate of new hires was significantly higher than new employees in voluntary enrollment plans (86% vs. 45%). The automatic enrollment feature results in higher participation rates across most demographic categories, particularly for lower-wage and younger employees.

But, overall contribution rates in auto enrollment plans decline because participants who would have selected a higher deferral rate in a voluntary enrollment plan stay at low initial default rates (often 3%). As expected, automatic contribution rate increases lead to much higher savings rates.

Savings are further reduced by participant inertia: new hires in auto enrollment plans are more than three times as likely as those in voluntary enrollment plans to direct 100% of their contributions to the default investment (67% vs. 21%).

Encouraging findings were that, after about two years, only 30% of participants still contributed at the default rate and only 51% remained in the default investment.

The researchers suggest that employers can help raise the level of adequacy of retirement savings by targeting a total contribution rate, including employer and participant contributions, of 9% to 12%.

Details of the study are at http://tinyurl.com/2nl799.

The Investment Company Institute's *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2006* provides a comprehensive overview of services provided to 401(k) plans and their costs, and investment expenses related to mutual funds. See this informative review at http://tinyurl.com/3attov.

Plan Sponsors Ask...

Q: As we prepare to issue a revised Summary Plan Description, we're wondering how "beneficiary" is defined by ERISA. Who is a beneficiary for this purpose?

A: Plan sponsors must provide a Summary Plan Description (SPD) to each participant "covered under the plan" and each beneficiary "receiving benefits" from the plan.

In a 401(k) plan, beneficiaries may include surviving spouses, an alternate payee identified in a qualified domestic relations order (QDRO), and those designated by the participant. These persons are not considered to be "receiving benefits" until benefit payments are started. But, for administrative simplicity, most sponsors routinely provide an SPD to alternate payees and other beneficiaries who are not yet receiving plan benefits.

The law requires that an SPD must be provided to a beneficiary within 90 days after he or she starts receiving benefits. Again, most plan sponsors do not wait for this deadline. For example, some provide an SPD along with the initial communication to an alternate payee regarding acceptance and approval of a QDRO.

Q: How should loan repayments be handled during a leave of absence?

A: Plans may allow for a suspension of a participant's loan repayments, up to one year, during an unpaid leave of absence. A suspension may also be approved for a paid leave when the amount of the repayment is more than the participant's pay (after income and employment taxes are deducted). These are permissible approaches, not required provisions. Interest continues to accrue during any suspension.

The full loan amount must be repaid within the maximum allowed term for the loan (generally five years). To meet this requirement, the loan could be reamortized to require larger repayment amounts, or provide for a balloon payment as the last payment. Further, if the original loan term was less than the maximum allowed term, it could be extended to the maximum term and reamortized.

Loan suspension actions are more generous for those in military service, although interest continues to accrue during the suspension. The suspension period can exceed one year, and the plan may extend the maximum five-year term by a period equal to the period of military leave. Also, if the service member provides the required notice to the plan, the interest rate must be capped at 6% per year during the period of service.

Your plan document and/or loan policy must define any rules concerning suspension of repayments.

Q: Did the ERISA bonding requirement change recently?

A: Yes. For plan years beginning on or after January 1, 2008, the maximum bond for plans that hold employer stock is raised to $1 million.

By way of background, the required fidelity bond must be for at least 10% of plan assets at the end of the previous plan year. The minimum is $1,000 and the maximum is $500,000, except as noted above for plans having company stock.

There's an important difference between the ERISA-required bond and fiduciary liability insurance. The ERISA fidelity bond offers protection to the plan, not the employer or any fiduciaries, for losses due to fraud or dishonest actions of those who are named in the bond. Fiduciary liability insurance, on the other hand, can provide broad types of coverage for employees and others who handle fiduciary functions for the plan, but usually does not cover fraud and dishonesty. ■

Web Resources for Plan Sponsors

Internal Revenue Service, Employee Plans
www.irs.gov/ep

Department of Labor,
Employee Benefits Security Administration
www.dol.gov/ebsa

401(k) Help Center
www.401khelpcenter.com

BenefitsLink
www.benefitslink.com

BenefitNews
www.benefitnews.com

Profit Sharing/401(k) Council of America
www.psca.org

Employee Benefits Institute of America, Inc.
www.ebia.com

Employee Benefit Research Institute
www.ebri.org

Trend Toward Early Eligibility Continues

A survey conducted by the Profit Sharing/401(k) Council of America (PSCA) found that eligibility requirements for 401(k) plans are becoming less restrictive.

By 2007, 51% of all plans surveyed permitted employees to make 401(k) contributions immediately upon employment. (In 1998, only 24% did so.) Immediate participation was available in 64% of plans with 1,000 or more employees.

About 71% of respondents allowed participation within the first three months of employment. Only 17% had a one-year waiting period.

For matching contributions, the trend is also toward shorter eligibility. About 49% of those surveyed had a waiting period of three months or less for the company match. Slightly more than one-third required a year or more of service.

About 52% of surveyed employers required a year or more of company service to be eligible for non-matching employer contributions. The PSCA's survey results are at http://tinyurl.com/2y3raw. ■

Plan Sponsor's Quarterly Calendar

Consult your plan's counsel or tax advisor regarding these and other items that may apply to your plan.

JULY

- Ensure that the plan's Form 5500 is submitted by July 31st, unless an extension of time to file applies. (Calendar year plans)
- Conduct a review of second quarter payroll and plan deposit dates to ensure compliance with the Department of Labor's rule regarding timely deposit of participant contributions and loan repayments.
- Verify that employees who became eligible for the plan between April 1st and June 30th received and returned an enrollment form. Follow up on forms that were not returned.

AUGUST

- Confirm that participants who terminated employment between January 1st and June 30th elected a distribution option for their plan account balance and returned their election form. Contact those whose forms were not received.
- Submit employee census and payroll data to the plan's recordkeeper for mid-year compliance testing. (Calendar year plans)
- Begin preparing for the distribution of the plan's Summary Annual Report to participants and beneficiaries by September 30th, unless a Form 5500 extension of time to file applies. (Calendar year plans)

SEPTEMBER

- Begin preparing and planning the distribution of the annual safe harbor notice to employees between October 3rd and December 2nd. (Calendar year plans electing the safe harbor to automatically satisfy nondiscrimination requirements)
- Distribute the plan's Summary Annual Report to participants and beneficiaries. (Calendar year plans)
- Send a reminder memo or e-mail to participants to encourage them to review and update their beneficiary designations for all of their employee benefit plans.

Kmotion, Inc., P.O. Box 1456, Tualatin, OR 97062; 877-306-5055; www.kmotion.com