

**Proposals for  
Enhancing Retirement Security for American Workers**

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**Prepared by  
American Society of Pension Professionals & Actuaries  
Government Affairs Committee**

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## INTRODUCTION

The proposals in this document are intended to enhance the retirement security of American workers, both active and retired, through expanded coverage, simplification, tools to address longevity issues and improved disclosure. The proposals are primarily the work of ASPPA's Government Affairs Committee Legislative Relations Subcommittee.

## COVERAGE

### 1. Payroll Deduction IRA

#### A. Current Law

In the Conference Report to the Tax Reform Act of 1997, Congress stated that “employers that choose not to sponsor a retirement plan should be encouraged to set up a Payroll Deduction IRA system to help employees save for retirement by making after tax payroll-deduction contributions to their IRAs” and encouraged the Secretary of the Treasury to “continue his efforts to publicize the availability of these Payroll Deduction IRAs.”

Both the IRS and the Department of Labor have issued administrative guidance to publicize the Payroll Deduction IRA option for employers and to “facilitate the establishment of Payroll Deduction IRAs.” This guidance has made clear that employers can offer direct deposit IRAs without the arrangement being treated as an employer-sponsored retirement plan that is subject to ERISA or qualified plan requirements. After some years of encouragement by the government, Payroll Deduction IRAs have simply not gained popularity among employers and, consequently, offer little opportunity for employees to save.

#### B. Proposed Change

- (1) Employers, including Tax Exempt Organizations and Governmental entities, that do not sponsor a qualified plan and have at least five eligible employees would be required to provide a Payroll Deduction IRA program. Employers who sponsor a qualified plan would be exempt for this requirement. For this purpose “qualified plan” means a plan that satisfies the requirements of IRC §401(a) or IRC §403(a) (i.e., profit sharing plans, 401(k) plans, money purchase plans, stock bonus plans, target benefit plans, defined benefit plans, IRC §403(b) plans, as well as SEPs, SIMPLE-IRAs and governmental plans).

Employers with 25 and fewer employees would receive a tax credit of \$25 per participating employee to a maximum of \$250 to offset the start-up cost for the Payroll Deduction IRA. To ensure 401(k) plan sponsors are not at a disadvantage relative to employers sponsoring only a Payroll Deduction IRA arrangement, the plan start-up cost credit available to 401(k) plan sponsors (50% of start-up costs not to exceed \$500) could not be less than \$25 per participating employee to a maximum of \$250.

Employees who are at least age 18 would be eligible for the Payroll Deduction IRA.

The Payroll Deduction IRA would generally be subject to the same rules that apply to IRAs (e.g., the IRA contribution limits and the withdrawals rules).

Under current law, the deductibility of IRA contributions for an employee not covered by a qualified plan but whose spouse is covered by a qualified plan is limited based on the couple's Adjusted Gross Income. We propose that the Adjusted Gross Income limitation be ignored for Payroll Deduction IRAs.

The employer would be permitted to deposit the IRA deferrals into IRA accounts with one financial institution for simplicity and ease of auditing that deferrals were actually deposited. The deposit deadlines for these arrangements would be similar to the rules for 401(k) deposits.

IRA contributions reported by employers on the W-2 would be applied to tax years on a cash basis and the employee could use the amount reported on his or her W-2 for each tax year. The W-2 amount could also be used for the employee to easily monitor contribution limits. Any other-than-payroll-deduction IRA contributions within limits for a particular year can continue to be applied at the employee's discretion within current timing rules.

## (2) Automatic Enrollment

Allow the Payroll Deduction IRA to use an Automatic Contribution Arrangement. A participant has the option to make an election to defer. A participant who fails to make a written election will be subject to the Automatic Contribution Arrangement until such written election is made. The deferral amount can be a non-increasing level deferral rate (e.g., 5%). The employee will have a 90-day period to request a refund of the contribution, which will be exempt from the excise tax on early IRA distribution. The employee can elect to terminate the IRA deferral at any time.

## (3) Withdrawal Rules

There would be no additional distribution restrictions on contributions to the Payroll Deduction IRA other than the basic IRA distribution rules under IRC §408. The employee would deal directly with the financial institution that maintains the IRA to make withdrawals.

## (4) Protection of Small Inactive IRA from Fee Erosion

One of the concerns to be addressed with Payroll Deduction IRAs is that workers could accumulate a number of small-balance accounts. Over time, instead of accumulating meaningful retirement savings, the workers' accounts will be eaten up by fees. To minimize this concern, all small inactive Payroll Deduction IRAs would become subject to automatic rollover provisions called Automatic IRA Rollover (AIR) Accounts.

If the balance in a payroll deduction IRA is less than \$1,000, and the account has had no activity for 18 months, the Payroll Deduction IRA trustee can notify the account holder that the balance will be transferred to an AIR account if no activity occurs within a specified period of not fewer than 60 days. If no activity occurs, the account is transferred to an AIR account, and the account holder is notified of the name of the institution holding the AIR account. (We expect many IRA providers will routinely sweep small IRAs to an AIR provider to eliminate the recordkeeping for these small accounts.)

Automatic IRA Rollover (AIR) Accounts would be subject to special requirements, including:

- No individual investment direction is permitted. The trustee would invest all AIR accounts in a single balanced investment fund. Investment expenses for AIR accounts could not exceed the average expense for the federal employees' Thrift Savings Plan (TSP) plus a specified number of basis points.
- Only one account statement per year would be required. To minimize administrative costs, the timing of the statement's mailing could coincide with the due date of the Form 5398.
- An AIR trustee must maintain only one account per individual. All rollovers received by an AIR provider on behalf of that individual would be credited to the same account. (An individual may have an account with more than one AIR arrangement.) There would be no minimum required balance for an AIR rollover.
- An AIR account may, but is not required to, accept additional contributions from the account holder or an employer. Individuals could also elect to transfer IRA or other qualified retirement plan eligible rollover balances to an AIR account, regardless of the size of the account.

### C. Reason for Change

A Payroll Deduction IRA would provide the opportunity for employees of small businesses to accumulate funds on an automatic basis in a tax-preferred retirement vehicle while substantially limiting the additional burden on affected employers. Additionally, the creation of Payroll Deduction IRAs should not unduly create incentives for employers to choose Payroll Deduction IRAs over qualified plans. However, the Payroll Deduction IRAs could create an easy transition into a 401(k) plan.

#### D. Modification to Existing Authority

- (1) IRC §§408 and 414(w)

## 2. **DB(k) Plan Improvements**

#### A. Permit Non-safe Harbor Formulas

- (1) Current Law

The current provisions of IRC §414(x) appear to limit the availability of the DB(k) plan option to certain safe harbor formulas.

- (2) Proposed Change

Permit DB(k) plan sponsors to use the prescribed safe harbor formulas or any other defined benefit or 401(k) formula permitted by law (subject to the regular non-discrimination and top-heavy rules).

- (3) Reason for Change

Because of unique workforce demographics or other considerations, some small employers will prefer to use the usual nondiscrimination rules available under current law, which could result in even more generous contributions on behalf of rank-and-file workers than are available under the current law safe harbor formulas. The required use of the safe harbor could prevent these employers from offering the DB(k) plan option, thus eliminating a significant opportunity for employees to save additional retirement funds on a tax-favored basis.

- (4) Modification to Existing Authority

- (a) IRC §414(x)

- (b) ERISA §210(e)

#### B. Safe Harbor Cash Balance Formula Deemed to Meet Requirements of §401(a)(4) and §411(b)(1)(B)

- (1) Current Law

Cash balance plans generally must meet the 133 1/3% rule of IRC §411(b)(1), which provides that the benefit accrued in any year cannot exceed 133 1/3% of the benefit

accrued in any earlier year.

(2) Proposed Change

A plan with a benefit formula that complies with §414(x)(2)(B)(iii) is deemed to satisfy the 133 1/3% rule of §411(b)(1)(B), and the general non-discrimination requirements of §401(a)(4) provided the ratio of the credit for an age bracket relative to the next lower bracket is not greater than the corresponding ratio in the statutory safe harbor formula.

(3) Reason for Change

The safe harbor cash balance formula in IRC §414(x)(2)(B)(iii) does not satisfy any of the benefit accrual rules of §411(b)(1).

(4) Modification to Existing Authority

(a) IRC §414(x)

(b) ERISA §210(e)

C. Permit Single Participant DB(k) Plans

(1) Current Law

DB(k) plans can be offered by small employers, which are defined as from 2 to 500 employees.

(2) Proposed Change

Permit DB(k) plans that cover only one participant.

(3) Reason for Change

There is no practical reason to prohibit a sole proprietor or business with only one employee from operating a combined plan instead of two separate arrangements.

(4) Modification to Existing Authority

(a) IRC §414(x)

(b) ERISA §210(e)

D. Permit Matching Contributions to be Made to the DB(k) Plans

(1) Current Law

Matching contributions under a DB(k) are to be made to the 401(k) component of the arrangement.

(2) Proposed Change

Permit matching contributions based on elective deferrals under the qualified cash or deferred arrangement of an eligible combined plan to be made under the cash balance component of the eligible combined plan.

(3) Reason for Change

Allowing an employer to make matching contributions to the cash balance component of the plan would provide participants with the additional retirement security provided by a defined benefit plan.

(4) Modification to Existing Authority

(a) IRC §§401(a), 401(k), 401(m), 411(a), 411(b) and 414(x)

**3. Permit of Adoption of a 4% Non-elective 401(k) Safe Harbor After the beginning of the Year**

A. Current Law

- (1) To satisfy the requirements for being a safe harbor plan for a particular plan year, existing plans must issue a safe harbor notice within a reasonable time prior to the first day of the (safe harbor) plan year. See IRC §§401(k)(12)(D) and 401(k)(13)(E)(i). The IRS deems a reasonable period to be 30 to 90 days prior to the first day of the plan year. See IRS Notice 98-52 section V.2.b and Treas. Reg. 1.401(k)-3(d)(3)(ii). There is a more relaxed rule for new (non-successor) plans. See Treas. Reg. 1.401(k)-3(e)(2) and IRS Notice 98-52 section X.
- (2) The advance notice requirements apply to both matching safe harbor contributions and 3% (of pay) non-elective safe harbor contributions. However, the matching safe harbor contribution has a different effect on participants' deferral elections than the 3% non-elective safe harbor contribution.
- (3) Under the matching safe harbor contribution feature, a plan sponsor must make a mandatory commitment to the matching contribution. Advance notice of a mandatory safe harbor match will influence many participants to defer more compensation over the entire plan year than they would otherwise have deferred.

- (4) Under the 3% non-elective safe harbor contribution, the plan sponsor, prior to the plan year, may issue either a mandatory or conditional commitment to make the contribution. If the plan sponsor makes a conditional commitment, the sponsor is then obligated to confirm whether or not the contribution will be made (and be a safe harbor plan) no later than 30 days prior to the end of that plan year. In other words, a plan participant would not know whether a conditional 3% non-elective safe harbor contribution will be made until the plan year has nearly ended. Moreover, in either case, a participant's receipt of the 3% non-elective safe harbor contribution does not depend upon whether the participant defers income and, as such, it is reasonable to conclude that the 3% non-elective safe harbor contribution will not motivate a participant to defer income.
- (5) Employers, on the other hand, are usually motivated to adopt a 401(k) safe harbor provision after the end of the plan year during annual compliance testing and administration. For example, changes in the size or makeup of the sponsor's eligible workforce are often not fully known or assimilated until well after the end of a plan year. The sponsor of a plan that has failed an ADP or ACP test for the preceding year may prefer to make a 3% non-elective safe harbor contribution in the future, instead of refunding excess deferrals or (non-safe harbor) matching contributions. Merely refunding elective deferrals or matching contributions does not create retirement savings for any participant, highly or non-highly compensated. Unfortunately, under current law, by the end of a plan year, it is too late to adopt safe harbor measures for that plan year as well as the following plan year. As such, the process is repeated and non-highly compensated participants continue to miss out on 3% non-elective safe harbor contributions they very likely may have received.
- (6) In particular, the current rules negatively affect small employers who generally have neither the budget nor human resources/finance staff available to prepare advance analysis to determine whether a safe harbor approach would be the best approach for the following plan year.

#### B. Proposed Change

- (1) Allow employers to adopt a 4% non-elective safe harbor contribution plan provision for a given plan year up to the deadline for making ADP refunds.
- (2) No notice would be required.

#### C. Reason for Change

- (1) The existence of a non-elective safe harbor does not influence the behavior of NHCEs (except possibly to reduce elective deferrals since the employer will contribute).

- (2) Permitting an employer to decide on whether or not to use the non-elective safe harbor after the end of a year allows the employer to avoid making a commitment that may turn out not to be affordable. Adding a 1% contribution to the safe harbor requirement accounts for the fact that the employer has removed a level of risk by not choosing the safe harbor in advance.
- (3) Employers who fail to provide timely notice for the 3% safe harbor could self-correct by increasing the safe harbor contribution for the year from 3% to 4%.

#### D. Modification to Existing Authority

- (1) IRC §401(k)(12)(D) and
- (2) IRC §401(k)(13)(E)(i)

### 4. New Plan Types

#### A. Current Law

- (1) Current law provides strict rules for providing definitely determinable benefits under defined benefit plan arrangements. Generally, an employer cannot vary rates of accrual under a defined benefit plan to reflect a business' financial position.
- (2) When a new defined benefit plan is established, generally only five years of past service can be recognized for benefit accrual purposes, prohibiting employers from providing adequate benefits for long-time workers who are near retirement age.
- (3) Employers that choose to fund defined benefit plans liberally in profitable years run the risk of overfunding those plans and being unable to access assets not needed to fund benefits without terminating the plan, and paying a 50% penalty on excess amounts.

#### B. Proposed Change

Develop new plan designs that meet the needs of employers and employees such as those developed by the Conversation on Coverage.

#### **Proposal 1:**

Allow for annual DB accruals that are re-set automatically to \$0 at the end of each plan year for the following year. This would allow an employer to make an irrevocable commitment to provide a pension benefit (with DB limits and the type of DB guarantees that are meaningful) each year so long as that benefit can be funded.

By allowing the automatic re-set, it incorporates a profit-sharing type of component that would eliminate the fear for some employers that they are making a long-term commitment in an uncertain world that could have very real implications as to their operations, long-term competitiveness and/or survival.

**Proposal 2:**

Establish a simplified hybrid arrangement called a Guaranteed Account Plan (GAP). A GAP would provide minimum contribution credits for NHCEs of 6.5% of pay, and minimum interest credits of no less than 3% per year. A GAP arrangement would provide unlimited past service credits, and would permit companies to place contributions that result in assets in excess of 110% of target liability plus normal cost in a “side car fund.” Side car fund balances could be withdrawn by the employer subject to an 18% excise tax plus ordinary income tax.

C. Reason for Change

Many employers are afraid to commit to the rigid contribution requirements of current defined benefit arrangements, but could be encouraged to provide traditional or hybrid defined benefits if there were more flexibility in cash requirements from year to year.

D. Modification to Existing Authority

(1) IRC §§411, 430 and 4980

(2) ERISA §§204 and 303

**5. Encourage Early Eligibility in Top Heavy Plans**

A. Current Law

(1) A plan is top heavy if the account balances (or accrued benefits in a defined benefit plan) of key employees exceeds 60% of the account balances of all plan participants as of the determination date.

(a) An employer sponsoring a top-heavy defined contribution plan must provide a minimum contribution that is equal to the lesser of the following:

- (i) 3% of the participant’s compensation, or
- (ii) A percentage of compensation equal to the highest allocation rate of any key employee for the plan year.

The highest allocation rate is determined by dividing a key employee’s total contribution and forfeiture allocations for the year

(including elective deferrals) by compensation.

- (2) The minimum contribution must be provided to all employees meeting the following requirements:
  - (a) The employee is an eligible participant for the plan year,
  - (b) The employee is actively employed on the last day of the plan year, and
  - (c) The employee is not a key employee.

**B. Proposed Changes**

- (1) Exempt defined contribution plans that, in a given year, consist solely of elective deferrals from the top heavy minimum allocation requirement.
- (2) Exclude participants in top-heavy defined contribution plans who are otherwise excludable under 410(b)(4) (such as those who could be excluded because of not having completed 1 Year of Service and/or attained age 21) from the top heavy minimum contribution allocation.

**C. Reasons for Change**

- (1) Small businesses that would otherwise implement a deferral-only 401(k) plan for their employees are dissuaded from doing so due to their inability to risk the financial obligation of making the minimum contribution should the plan become top heavy. Creation of the proposed exemption will expand plan coverage to employees of these small businesses by eliminating this uncertainty.

**Example:**

	<b>Key</b>	<b>Compensation</b>	<b>Elective Deferrals (\$)</b>	<b>Elective Deferrals (%)</b>
Owner	Yes	\$230,000	\$15,500	6.7%
Employee 1	No	\$ 50,000	\$ 2,500	5.0%
Employee 2	No	\$ 45,000	\$ 2,250	5.0%
Employee 3	No	\$ 40,000	\$ 2,000	5.0%
Employee 4	No	\$ 35,000	\$ 1,750	5.0%
			\$24,000	

The plan is top heavy because the owner’s deferral represents more than 60% of the total ( $\$15,500/\$24,000 = 64.6\%$ ). Although this deferral-only plan satisfies the minimum coverage requirements under IRC §410(b) and the Actual Deferral Percentage test under IRC §401(k)(3), the owner is still required to make the top-

heavy minimum contribution on behalf of the employees.

(2) According to the Bureau of Labor Statistics' Employee Tenure Summary, the median job tenure for workers from age 18 to 34 is only 2.9 years. With statutory requirements for plan eligibility and entry that can require participants to be employed for up to 18 months before they are able to make elective deferrals, workers in this age group may be precluded from saving for retirement for more than half of their employment. Employers commonly provide for more lenient eligibility to provide the immediate ability to make 401(k) deferrals while maintaining longer waiting periods for employer contributions. However, plans of smaller employers are discouraged from allowing workers to immediately contribute to the plan because the top-heavy minimum allocation is required for all employees eligible for any component of the plan. Since the employer is "penalized" for being small and for being more generous than required, the employer is discouraged from including younger workers in the plan. The result is that the penalty is really assessed on the younger workers who are not able to contribute to the plan. Congress and the IRS have previously recognized this problem and allowed for the exclusion of short-service employees for purposes of nondiscrimination testing under 410(b)(4) and 401(k)(3)(F), but no similar exclusion has yet been provided with respect to this top-heavy issue.

(3) Modification to Existing Authority

(a) IRC §416(c)(2)

(b) Treas. Reg. §1.416-1, Q&A T-29

(c) Treas. Reg. §1.416-1, Q&A M-10

## SIMPLIFICATION

### **6. Permit Intra-plan Transfers from Traditional Accounts to Designated Roth Accounts**

#### A. Current Law

A participant may transfer an eligible rollover distribution from a qualified retirement plan directly to a Roth IRA. However, participants are not permitted to transfer amounts accumulated in a traditional 401(k) elective deferral account or other eligible rollover distributions to a designated Roth account within the same plan.

#### B. Proposed Change

- (1) If a plan so permits, a participant who has a distributable event could transfer the benefits that the participant would elect to receive as an eligible rollover distribution to a designated Roth account under the plan.
- (2) If the plan so permits, a participant in a plan that offers a designated Roth account would be permitted to transfer all or part of an existing elective deferral or after-tax employee contribution account to a designated Roth account without regard to whether or not there is a distributable event.
- (3) The amount transferred would generally be subject to ordinary income tax in the year of transfer. The plan would report the amount on a form 1099-R. However, amounts transferred in 2010 would be eligible for the same special tax treatment as rollovers to Roth IRAs from eligible retirement plans in 2010.

#### C. Reason for Change

- (1) Qualified retirement plans provide participants with protections under ERISA that do not apply to IRAs.
- (2) Without this modification, participants who want the benefit of Roth account tax treatment will be encouraged to take funds from qualified retirement plans prematurely, in order to take advantage of the transfer feature that is currently only available through the use of Roth IRA accounts.

#### D. Modification to Existing Authority

- (1) IRC §402A

## 7. Simplify Rules for Hardship Distributions

### A. Eliminate Restriction on Distribution of Gains Attributable to Employee Elective Contributions

#### (1) Current Law

- (a) Participants in 401(k) plans can access certain funds in their accounts in the event of a financial hardship. The rules governing these distributions are found at Treas. Reg. §1.401(k)-1(d)(3).
- (b) The amount of a hardship distribution is limited by three factors:
  - (i) The distribution is limited to qualifying “events” such as medical expenses, avoiding eviction or foreclosure on mortgage, purchase of a principal residence, post secondary college expense up to the next 12 months, burial or funeral expenses and repair of the employee’s principal residence that would qualify for the casualty deduction.
  - (ii) The “needs” test limits the amount of the hardship distribution to the amount necessary to satisfy an immediate and heavy financial need of the employee and is necessary to satisfy the financial need.
  - (iii) The maximum distributable amount is limited to the employee’s total elective contributions as of the date of distribution, reduced by the amount of previous distributions. It cannot include earnings on the deferrals or any employer contributions attributable to QNECs or QMACs and contributions that are used to satisfy certain safe harbor alternatives to nondiscrimination tests.

#### (2) Proposed Change

- (a) Amend the maximum distributable amount to remove the restriction against accessing earnings on elective contributions to fund the hardship.

#### (3) Reasons for Change

- (a) The cost of the recordkeeping needed to comply with the requirement to exclude earnings on deferrals outweighs the benefit and this cost is increasing. The cost is frequently borne by all the plan participants at a time when their 401(k) expenses are considered overly high.
- (b) The dollar amount of deferrals exclusive of earnings is often impossible to calculate: The current rule creates significant administrative cost and complexity and often cannot be calculated correctly. For employee elective

contributions, there is no other reason to separately account for the earnings and contributions. If a plan does not initially provide for hardship withdrawals but is later amended to do so, this information is not available without extensive retroactive calculation or research.

- (c) Particularly problematic in plan takeover situations: This is the case both for individual plan takeovers as well as block conversions occurring when record keepers consolidate. Employee elective contribution history and prior hardship history is generally not included in the data file, requiring a manual retrieval and exchange of information that is often inaccurate. In the interim, hardship withdrawals must be manually processed and the efficiency of electronic processing is lost.
- (d) The cost and complexity are getting worse: The cost associated with limiting hardship withdrawals to employee elective contributions will increase under the Pension Protection Act (PPA) of 2006. Increases in automatic enrollment plans will hopefully improve participation by low income employees although they are expected to increase the volume of hardship withdrawal requests. Roth 401(k) accounts introduced substantial new complexity and cost in processing hardships, since both pre-tax and Roth accounts are combined for determining the amount available, but the distribution can be from either or both accounts. Further, the accounting for tracking hardship withdrawal basis in a Roth account does not line up with tracking basis to pre-tax accounts which adds further record keeping costs and complexity.
- (e) There are already sufficient restrictions in place. The proposal is good policy – a win for participants and for plan sponsors. Hardship withdrawals are restricted on the front end by the “events” and the “needs” tests and on the back end by the aggressive taxation and penalties on the withdrawal. If the participant gets through these, the need is presumed to be high. Relatively speaking, the amount of earnings on employee elective contributions is not substantial enough to significantly impact retirement savings, certainly not at a level justifying the substantial costs outlined above.

#### (4) Modification to Existing Authority

- (a) IRC §401(k)(2)(B)(i)(IV)
- (b) Treas. Reg. §1.401(k)-1(d)(3)(ii)

### B. Eliminate Requirement to First Take Available Participant Loan

#### (1) Current Law

- (a) The safe harbor test for establishing that the distribution is necessary to satisfy the financial need of a participant is met if all of the following requirements

are satisfied:

- (i) The distribution does not exceed the amount of the financial need (including taxes and penalties).
- (ii) The employee has received all currently available distributions (other than hardship), and all available nontaxable loans, from the 401(k) plan and all other plans maintained by the employer.
- (iii) The plan prohibits the employee from deferring or making employee contributions to all plans maintained by the employer for at least 6 months after the hardship distribution.
- (iv) For hardship withdrawals made before 2000, the employee's IRC §402(g) limit for the next calendar year had to be reduced by the amount of elective contributions made by the employee in the calendar year of the hardship distribution. This was eliminated effective January 1, 2002.

## (2) Proposed Change

- (a) Eliminate the requirement for participants to take available loans before taking a hardship distribution regardless if the loan would increase the need.

## (3) Reason for Change

- (a) Explaining this requirement to the participant, calculating the maximum loan first and then the amount of the remaining available hardship is cumbersome to the administrator, confusing to the participant, and slows down access to needed funds. There may be fees associated with processing both the loan and the hardship that would take away from the available funds a participant has to satisfy the "need".
- (b) The regulations have already addressed that loans should not increase the "need". Eliminating this requirement would remove the coordination of determining the maximum hardship amount for plans that allow for loans.
- (c) Eliminating this requirement would not increase hardship requests, but would create less administrative burden on the plan sponsor. The request for withdrawing available funds is usually warranted by the "need" of the participant and meeting all the requirements. This change will not negatively impact the goal to preserve retirement plan savings.

## (4) Modification to Existing Authority

- (a) Treas. Reg. §1.401(k)-1(d)(3)(iv)(D)

(b) Treas. Reg. §1.401(k)-1(d)(3)(iv)(E)(1)

C. Allow Hardship Withdrawals from Safe Harbor, Qualified Non-Elective Contributions (QNECs) and Qualified Matching Contributions (QMACs)

(1) Current Law

Qualified nonelective contributions (QNECs) and qualified matching contributions (QMACs), as defined in IRC §§401(k)(3)(D) and 401(m)(4)(C), may not be distributed in a hardship withdrawal. Consistent with the treatment for QNECs and QMACs, the IRS interprets the 401(k) safe harbor rules under IRC §401(k)(12) and IRC §401(m)(13) to prohibit the hardship withdrawal of safe harbor 401(k) contributions.

(2) Proposed Change

Permit safe harbor contributions, QNECs and QMACs to be distributed in hardship withdrawals.

(3) Reason for Change

- (a) Hardship is the only distribution event listed under §401(k)(2) that is limited in this manner. Safe harbor contributions of QNECs and QMACs may be distributed under any of the other distribution events listed in IRC §401(k)(2) or (10) such as severance from employment or attainment of age 59 ½.
- (b) Plans that have adopted the safe harbor plan design do so to avoid corrective distributions to the highly compensated and/or to meet the top heavy minimum rules. Since this is an employer plan design issue and is a required contribution, it should not penalize the participant. If the plan was not a safe harbor plan, but was top heavy and the key employees were deferring, the employer would be required to make a minimum top heavy contribution and this contribution could be eligible for hardship.
- (c) Plans that utilize the correction method of contributing a QNEC or QMAC to pass the non-discrimination testing are increasing retirement plan savings for the rank and file employees. By utilizing this testing corrective measure the employer is providing additional benefits to his or her employees and avoiding the leakage caused by returned deferrals and forfeited matching contributions. The participants should have the same right to the availability of these balances. The restrictions necessary to qualify for a hardship withdrawal will preserve retirement plan savings.

(4) Modification to Existing Authority

- (a) IRC §401(k)(2)(B)

(b) Treas. Reg. §1.401(k)-1(d)(2)(ii)

(c) IRS Notice 98-52

## 8. Calculation of Top Heavy Minimum Allocation

### A. Current Law

- (1) The computation of the top-heavy minimum allocation is based on compensation as defined in IRC §415(c)(3) regardless of how a plan defines compensation for other allocation and/or nondiscrimination testing purposes.

### B. Proposed Change

- (1) Provide for computation of the top-heavy minimum allocation based on compensation as defined by the plan.

### C. Reason for Change

- (1) Plan sponsors have the discretion to use alternative definitions of compensation for allocations and nondiscrimination testing as long as the definition used is not discriminatory. It is common for plans to exclude compensation paid prior to the date a participant becomes eligible for the plan. For example, an employee who becomes eligible for the plan on October 1 of a given plan year may receive allocations based on compensation from that entry date through the end of the year and not on compensation paid from January 1 through September 30. Assuming a constant rate of pay throughout the year, an employer could provide an allocation of up to 11% of compensation as defined by the plan and still not satisfy the top-heavy minimum allocation of 3% of full year compensation for this participant. This creates a compliance trap for otherwise compliant plan sponsors and an unnecessary windfall for participants who have just satisfied the eligibility requirements. Since IRC §414(s) and the regulations thereunder already include a safeguard to ensure that a plan's definition of compensation is not discriminatory, requiring the use of a specific definition for purposes of the top-heavy minimum allocation is overly burdensome and unnecessary.

### (2) Modification to Existing Authority

(a) IRC §416(c)(2)

(b) Treas. Reg. §1.416-1, Q&A T-21

(c) Treas. Reg. §1.416-1, Q&A M-7

## **9. Increase Mandatory Distribution Threshold to \$10,000**

### **A. Current Law**

Plans may mandate distribution of benefits of under \$5,000, but if no affirmative election is made to receive cash, distributions of more than \$1,000 must be transferred to an IRA.

### **B. Proposed Change**

The mandatory distribution threshold would be increased from \$5,000 to \$10,000 and indexed (in \$500 increments).

### **C. Reason for Change**

- (1) The mandatory distribution threshold has not been increased to reflect the cost-of-living.
- (2) Raising the threshold will reduce administrative costs. The cost of processing distributions of relatively small amounts is disproportionately expensive. Since distributions in excess of \$1,000 must be transferred to an IRA unless the participant elects otherwise, increasing the threshold will not increase leakage.

### **D. Modification to Existing Authority**

- (1) IRC §§401(a)(31), 411(a)(11) and 417(e)

## **10. Amend Minimum Participation Rules Applicable to Exempt DB Plans of Employers with no Non-Excludable NHCEs**

### **A. Current Law**

- (1) A defined benefit (DB) plan must satisfy the minimum participation rules of IRC §401(a)(26) even if the employer has no non-excludable NHCEs (i.e., 40 percent of employees or 50 employees, whichever is less, but no less than two employees).
- (2) Each DB plan must be tested separately for compliance with the minimum participation rules of IRC §401(a)(26).

### **B. Proposed Change**

- (1) Employers with no non-excludable NHCEs (i.e., only HCEs or excludable NHCEs) should be exempted from compliance with IRC §401(a)(26). Thus, for

example, a business employing only 4 HCEs and no NHCEs could sponsor a DB plan in which two of the HCEs are expressly excluded.

- (2) If an employer maintains a DC plan under which a group of NHCEs sufficient to satisfy the requirements of IRC §401(a)(26) receive a minimum gateway allocation of at least 7.5 percent of compensation, the employer is not required to separately satisfy IRC 401(a)(26) for a DB plan where the DC plan is aggregated for IRC §§401(a)(4) and 410(b).

**Example:**

- (3) Employer maintains a DC plan and DB plan. There are 40 non-excludable employees for IRC §401(a)(26) purposes, which consist of five HCEs and 35 NHCEs. The DC plan covers all 35 of the non-excludable NHCEs and the DB plan covers the five HCEs. So long as at least 16 NHCEs receive a minimum allocation of 7.5 percent (i.e., 40 percent of the total group of 40), the DB plan would not be required to separately comply with IRC §401(a)(26), provided that, when aggregated, the DB and DC plan pass IRC §§401(a)(4) and 410(b).

C. Reason for Change

- (1) IRC §401(a)(26) was enacted to limit the ability of a company to cover owners and HCEs in one DB plan while NHCEs are covered in a separate DB or DC plan. Split coverage was seen as an abuse. There are, however, situations in which the only employees are owners or other HCEs. The nondiscrimination rules of the Code are not intended to address discrimination against HCEs.
- (2) The minimum participation rules of IRC §401(a)(26) are intended to ensure that a DB plan is not used as a means to disproportionately benefit only a few highly compensated employees (HCEs). This rule was instituted to discourage the use of a comparability analysis under Rev. Rul. 81-202, wherein the HCEs participated in the DB plan and the other employees were covered only by a DC plan. Where there are no non-excludable NHCE's, this concern is irrelevant.

D. Modification to Existing Authority

- (1) IRC §401(a)(26)

## 11. IRC §436 Whipsaw

A. Current Law

- (1) IRC §411(a)(13)(A) and ERISA §203(f)(1) provide that an applicable defined benefit plan (hybrid plan) can pay lump sum benefits equal to hypothetical account balances without violating age discrimination rules of ERISA and the

Code. This treatment is available as long as the plan credits interest on theoretical balances at a rate not to exceed a market rate of return.

- (2) The current provisions of IRC §436 and ERISA §206 provide that certain benefit restrictions apply if the adjusted funding attainment percentage (AFTAP) is less than 80%. The AFTAP is the ratio of the plan's assets to the plan's funding target, adjusted for annuity purchases for non-highly compensation employees over the past two years.
- (3) A plan's "funding target" is the present value of all benefits accrued or earned under the plan as of the beginning of the plan year using mandated mortality and yield curve interest rate assumptions. Determining a cash balance plan's funding target requires (a) projecting forward the current account balances to retirement age at the plan's interest crediting rate and then (b) discounting back (converting) to the current date using the appropriate yield curve interest rate.
- (4) If the plan's interest crediting rate used to project the account balance forward is greater than the yield curve rates used to discount the projected balance, the funding target will be greater than the sum of account balances as of the valuation date. This "funding whipsaw" can result in a prohibition on lump sum payments from a plan where assets are more than sufficient to pay all participants' accrued benefits as of the valuation date.

#### B. Proposed Change

The proposal would limit the funding target (for IRC §436 and ERISA §206 benefit restriction purposes only) with respect to cash balance accounts to the balance of the participants' theoretical accounts.

#### C. Reason for Change

The benefit restrictions were intended to protect participant benefits. It makes no sense to restrict benefit payments or accruals on a funding target that exceeds benefits due on a termination basis solely because of "funding whipsaw".

#### D. Modification to Existing Authority

- (1) IRC § 436(j)(1) would be amended to add the following sentence to the end thereof:

"However, for purposes of this section, with respect to any accrued benefits defined as the balance of a theoretical account, the funding target, as defined in Code §430(d)(1), shall take into account the lesser of the present value of the benefits accrued or earned as determined under Code §430 and the sum of the balances of such theoretical accounts."

- (2) ERISA § 206(g)(9)(A) would be amended to add the following sentence to the end thereof:

“However, for purposes of this section, with respect to any accrued benefits defined as the balance of a theoretical account, the funding target, as defined in ERISA §303(d)(1), shall take into account the lesser of the present value of the benefits accrued or earned as determined under ERISA §303 and the sum of the balances of such theoretical accounts.”

## 12. Interim Amendments

### A. Current Law

- (1) Revenue Procedure 2005-66, as modified by Rev. Proc. 2008-56, provides staggered dates for written plan documents to be reviewed by the IRS as to a plan’s qualified status. Individually designed plans are on five-year cycles, and pre-approved documents are on six-year cycles.
- (2) During these cycles, plans must also adopt separate amendments to reflect changes to the qualification requirements, regardless of the reason for the change( e.g., legislative or regulatory). Except as provided by law or other guidance, these “interim amendments” must generally be adopted by the due date (including extensions) for filing the income tax return for the applicable employer’s taxable year. The due dates of “interim amendments” required by statutory and regulatory changes are not coordinated with the cycle for submission of documents to IRS.

### B. Proposed Change

- (1) The deadline for adopting interim amendments would be conformed to a plan’s approval cycle.
- (2) Plans would need to comply with applicable law in operation in the interim.
- (3) Relief would be granted under IRC§ 411(d)(6) until the date the amendment is required.
- (4) A discretionary amendment to a plan could be adopted up to the due date of the employer's taxable year in which the plan year ends, subject to the anti-cutback rule of IRC§ 411(d)(6).

### C. Reasons for Change

- (1) In an era of changing laws and regulations, amendments could be realistically required more than once per year. The cost in time and money creates a

disincentive for employers to sponsor and maintain retirement plans.

- (2) The erratic pattern of required amendments increases non-compliance. A constant need to amend plan documents benefits no one.
- (3) The IRS has not always required annual amendments. During the most recent remedial amendment period for GUST (including changes from the 1994 GATT law) and the prior remedial amendment period for TRA '86, the IRS allowed many changes to be made by retroactive amendments adopted before the end of the remedial amendment period— often many years after the effective date. This was user friendly and cost-effective.
- (4) Small businesses are especially sensitive to the cost of frequent amendments. Order must be created so that the process does not discourage the formation and continuation of retirement plans, especially by small business.

#### D. Modification to Existing Authority

- (1) IRC §411(d)(6)
- (2) Rev. Procs. 2005-66, 2007-44 and 2008-56

### **13. Required Updates to Summary Plan Description**

#### A. Current Law

- (1) ERISA §104(b) generally requires the plan's Summary Plan Description ("SPD") to be restated every fifth year.
- (2) Plan sponsors using individually designed plan documents must generally restate their plans to comply with legislative and regulatory changes every fifth year with a deadline based on the last digit of the plan sponsor's taxpayer identification number.
- (3) Plan sponsors using pre-approved plan documents must generally restate their plans to comply with legislative and regulatory changes every six years with a deadline based on the date the Internal Revenue Service approves the specimen or lead plan.

B. Proposed Change

- (1) The frequency with which a plan must update its SPD should be conformed to the deadline by which the plan must be restated to comply with legislative and regulatory changes. The SPD would be due 210 days after the restatement deadline.

C. Reason for Change

- (1) It is considerably more efficient to update the SPD at the same time a plan document is restated. However, the required cycles for updating plan documents and SPDs are different, creating confusion, unintentionally missed deadlines and unnecessary added cost to the plan sponsor.

D. Modification to Existing Authority

- (1) ERISA §104(b)
- (2) DOL Reg. §2520.104b-2(b)

**14. Base Audit Requirements on Participants with Accrued Benefits**

A. Current Law

Qualified retirement plans covering 100 or more participants are subject to an annual audit requirement. The number of participants is based on a determination of those eligible to participate, not those with account balances or benefits under the plan.

B. Proposed Change

Base the audit requirement on the number of participants that actually have account balances or accrued benefits under the plan, not the number eligible to participate.

C. Reason for Change

Basing the requirement on eligible employees, not actual participants, inflates the size of the plan, and creates unnecessary expense for plan sponsors.

D. Modification to Existing Authority

- (1) ERISA §103(a)(3)

## 15. **Make Electronic Disclosure to the Default Delivery System (with Opt-Out)**

### A. Current Law

- (1) In 2002, the Labor Department issued final regulations relating to electronic communication by ERISA pension and welfare benefit plans. The final rule's safe harbor allows electronic delivery of documents that must be furnished or made available to participants and beneficiaries under ERISA Title I (e.g., summary plan descriptions, summary of material modifications and summary annual reports).
- (2) The safe harbor automatically extends to any employee who can access electronic documents at any location where he or she works and whose access to the employer's electronic information system is an integral part of his or her duties.
- (3) However, participants, beneficiaries or other persons entitled to documents who do not have access to the employer's electronic information system as an integral part of their employment duties must affirmatively consent to receiving documents electronically for the safe harbor to be available. Prior to consenting, the individual must be provided with a clear and conspicuous statement indicating the types of documents to which the consent would apply; that consent can be withdrawn at any time without charge; the procedures for withdrawing consent and updating necessary information; the right to request and obtain a paper version of an electronically furnished document; and any hardware and software requirements.

### B. Proposed change

- (1) Eliminate the affirmative consent requirement for participants, beneficiaries and others whose duties do not require them to regularly access the employer's electronic information system. Instead, required ERISA disclosures for participants and beneficiaries would automatically be made available to such individuals in an electronic manner. The individuals would have the right to opt out and instead receive paper documents. Plan administrators would be required to provide such individuals with an advance notice describing the process and notifying them of their right to opt for paper documentation.

### C. Reason for Change

- (1) Since the Labor Department regulations were finalized in 2002, there have been significant increases in the availability of the Internet for most Americans. The great majority of Americans have home based Internet access. And many Americans are Internet users even if they don't have access at home because of

free public access to the Internet at locations like public libraries.

- (2) Providing ERISA disclosures for participants and beneficiaries through non-electronic media is less efficient, more expensive and less timely than electronic media as a means of delivery.
- (3) Very few employers use the current affirmative consent process because it's costly and burdensome to administer.

#### D. Modification to Existing Authority

- (1) ERISA §104
- (2) DOL Regulation 29 CFR §2520.104b-1

## LONGEVITY

### 16. Exempt Small Balances from Age 70½ Calculations

#### A. Current Law

- (1) As life expectancy continues to increase in the US (now averaging over age 78), EBRI's 2008 Retirement Confidence Survey indicates that, on average, workers of all ages appear to be planning to retire later than similarly aged workers did a decade ago, with an increased percentage planning to retire at age 66 or older for almost every age group. Of those responding, nearly two-thirds indicated they intended to continue working for wages after retirement. Unfortunately, the minimum required distribution (MRD) requirements do not support these older individuals in efforts to preserve their retirement savings until needed. Although the rules do not require actually taking the funds out of savings (as opposed to simply removing them from a tax favored vehicle), many, if not most, retirees over age 70 probably interpret the rules as a signal to comply with the MRD rules by withdrawing the funds from their savings.
- (2) These rules impose a real administrative burden to both plan sponsor and participant where small balances exist. For a balance of \$25,000 and a joint life expectancy of 25 years, the participant would be required to take a \$1,000 distribution. Even a modest \$100 or \$150 administrative processing fee for the MRD represents 10-15% of the distribution itself. Lower-income participants with small balances who are caught in this trap are often forced to pay significant distribution fees before funds are truly needed.
- (3) The current rules (including a 50% excise tax payable by the participant for failure to receive the MRD) are designed in large part to reduce an individual from transferring the benefits of their tax-deferred retirement savings to a trust or subsequent generation at death. Participants with relatively small balances are not the group for whom this provision was intended. Yet they are the most likely to inadvertently lose contact with their former employer; if they fail to receive this distribution, it comes at a very high price.

#### B. Proposed Change

- (1) Exempt individuals whose balance in eligible retirement plans does not exceed \$50,000 from the minimum required distribution requirements of 401(a)(9) and 408(a)(6) and (b)(3).
- (2) Delay the application of these rules to individuals whose aggregate balances fall between \$50,000 and \$200,000 by one year.

- (3) For purposes of determining the balance, income annuity contracts with no cash surrender value are not taken into account. However, distributions from the annuity contract will apply towards satisfying the minimum required distribution for the year.

C. Reason for Change

Participants with small balances should be permitted to hold onto the funds for an emergency, instead of being forced to take minimal withdrawals.

D. Modification to Existing Authority

- (1) IRC 401(a)(9)
- (2) Treas. Reg. 1.401(a)(9)
- (3) IRC 408(a)(6) and (b)(3)

## **17. Amend §401(a)(9) to Allow for Purchase of Longevity Insurance**

A. Current Law

- (1) Deferred to age 85 annuities (with 0 cash value) (longevity insurance) are available in the market place at modest cost relative to immediate annuities.
- (2) Minimum required distribution rules require immediate commencement of installments at age 70 ½ with no adjustment for amounts invested in deferred annuities, effectively precluding the use of longevity insurance to manage accounts accumulated in qualified retirement plans or IRAs.

B. Proposed Change

- (1) Amend IRC §401(a)(9) to allow for purchase of longevity insurance. Example: A 65 year old employee on retirement elects to rollover 90% of his account balance to an IRA. The remaining 10% is used to purchase a deferred to age 85 annuity. He has taken the vast majority of his balance to invest as he sees fit. However, in the event he lives to age 85, he will begin to receive a monthly annuity. This provides him some protection from outliving his assets and/or being unable to manage his assets as he ages. Allow this type of deferred annuity as an optional form of payment in qualified plans.

C. Reason for Change

- (1) These annuities cannot effectively be used inside qualified plans because of IRC §401(a)(9).

#### D. Modification to Existing Authority

- (1) IRC §401(a)(9)

## 18. **Modify Normal Retirement Age to Facilitate Phased Retirement**

### A. Current Law

- (1) ERISA allows any Normal Retirement Age as long as it does not exceed the later of age 65 or the age as of the fifth anniversary of entry.
- (2) Prior to ERISA, Treasury and the IRS had taken the position in Rev. Rul. 71-147 that a different age may be specified, provided that if it is lower than 65, it represents the age at which employees customarily retire in the particular company or industry and is not a device to accelerate funding. However, Rev. Rul. 78-120 conceded that ERISA changed the law and therefore, post-ERISA, there was no restriction on how low Normal Retirement Age can be set.
- (3) In PPA '06, Congress established that plans can offer phased retirement as early as age 62, regardless of the Normal Retirement Age. Treasury and the IRS took this liberalization by Congress as an opportunity to reestablish their pre-ERISA position in the form of Regulation § 1.401(a)-1(b)(2). This regulation sets forth the general rule as: “The normal retirement age under a plan must be an age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.”
- (4) Under the regulation, NRA 62 or higher is deemed reasonable. Ages between 55 and 62 may be reasonable based on relevant facts and circumstances. Ages under age 55 are deemed unreasonable. That said, the preamble to the regulations states that the IRS will give deference to a good faith determination by the employer for ages 55 to 62.
- (5) However, various agents of the IRS have failed to provide such deference and have demanded that employers demonstrate to their satisfaction that a plan’s NRA meets the general rule of the regulation.

### B. Proposed Change

Reduce the age that plans can offer phased retirement under IRC §401(a)(36) to age 55.

### C. Reason for Change

- (1) Employers should be at liberty to set whatever Normal Retirement Age they feel is desirable for their workforce without being restricted by what their competitors are doing. The marketplace should, in general, decide wages and benefits unless the marketplace fails to provide minimum wages and benefits.
- (2) Employees should be able to retire when they see fit and not when the IRS thinks it is reasonable for them to do so. If the employee's plan does not provide the wherewithal for the employee to retire at such age, then the employee will not be able to afford to retire at that age.
- (3) The essence of freedom is economic choice. Choice should be at the core of the phased retirement rules. The most efficient way for these rules to work is to leave as much of the choice as possible to the employees and the employer, creating a minimal level of testing for nondiscrimination under IRC §401(a)(4) and protection of accrued benefits under IRC §411(d)(6).
- (4) In order for defined benefit pension plans to compete against defined contribution plans, the distribution rules should move towards providing the same level of employee and employer choice found in defined contribution plans.
- (5) A small business is simply unable to amass the statistics and to fund the legal fees necessary to "persuade" the IRS that a normal retirement age of 55 is reasonable for its workforce.
- (6) The reduction in benefits due to early commencement under IRC §415 significantly reduces the economic benefit to a participant wishing to retire before age 62.
- (7) The examples of abusive situations the IRS cited in writing the regulations were all Cash Balance type plans with Normal Retirement Ages substantially below age 55. Establishing 55 as the floor for phased retirement will not undermine the IRS effort against true abuse.

### D. Modification to Existing Authority

- (1) IRC §411(a)(8)
- (2) ERISA §3(24)

## 19. **Permit Plans to Modify Normal Retirement Age to Reflect Social Security Retirement Age Changes**

#### A. Current Law

Under current law, normal retirement age cannot exceed age 65 and completion of 5 years of participation. In-service distribution of benefits can begin at age 62 regardless of the normal retirement age specified in the plan.

#### B. Proposed Change

- (1) Permit defined benefit plans to provide a normal retirement age of up to the participant's Social Security Normal Retirement Age for future benefit accruals. Normal retirement age for participants who have reached age 55 or older on the date of enactment would be grandfathered, but only with respect to the plan of their current employer. (Broader application of the grandfather rule would further discourage hiring older workers.)
- (2) To prohibit a reduction in the value of maximum benefits, the § 415 dollar limit would still be increased for post – 65 commencement dates. However, the 5% limit on the interest rate will not apply until after the participant's normal retirement age. (That is, the plan rate would be used between age 65 and the normal retirement age.)

#### C. Reason for Change

The maximum normal retirement age under current law reflected the previous Social Security normal retirement age of 65, and should be updated to reflect adjustments to the Social Security program. Permitting defined benefit plans to defer payment of full retirement benefits until the Social Security normal retirement age will encourage workers to defer retirement until full Social Security benefits are available.

#### D. Modification to Existing Authority

- (1) IRC §§411(a)(8) and 415(E)(iii)
- (2) ERISA §3(24)

## DISCLOSURE

### 20. Improve Fee Disclosure to Plan Sponsors

#### A. Current Law

- (1) ERISA requires plan fiduciaries to discharge their duties solely in the interest of plan participants and beneficiaries, and for the exclusive purpose of providing benefits and defraying reasonable expenses of plan administration. Furthermore, ERISA prohibits the payment of fees to service providers unless the services are necessary, are provided pursuant to a reasonable contract and the plan pays no more than reasonable compensation. Thus, plan fiduciaries must ensure that fees paid to service providers and other plan expenses are reasonable in light of the quality of the services provided.
- (2) In December 2007, the Labor Department issued proposal regulations under ERISA §408(b)(2) which provide sweeping changes on what constitutes a reasonable contract or arrangement between service providers and plan fiduciaries. While the proposed rules would require enhanced disclosures for service providers to 401(k) plan fiduciaries, the proposed regulations would require only an aggregate disclosure of compensation and fees from bundled service providers, with narrow exceptions, and would not require a separate, uniform disclosure of the fees attributable to each part of the bundled service arrangement.
- (3) On January 20, Rahm Emanuel, assistant to President Obama and White House Chief of Staff, signed an order requiring the withdraw from the Office of the Federal Register (OFR) of all proposed or final regulations that have not been published in the Federal Register so that they can be reviewed and approved by a department or agency head.
- (4) The proposed ERISA §408(b)(2) regulations were sent to the Office of Management and Budget (OMB) in final rule form for review and approval. However, the regulation had not yet been released by OMB or sent to the OFR as of January 20. Therefore, the regulations appear to have been stopped by the Emanuel order.

#### B. Proposed change

- (1) Any new plan sponsor 401(k) fee disclosure rules must be applied in a uniform manner to all retirement service providers, regardless of how plan services are delivered. In order to meet their fiduciary responsibilities under ERISA, plan fiduciaries need to make an “apples to apples” comparison of all the various fees

- and services for which they are paying and/or contracting (and therefore, a breakdown of fees must be disclosed). The only way to determine whether a fee for a service is reasonable is to compare it to a competitor's fee for that service.
- (2) Complete and consistent fee disclosures, as well as disclosure of any potential conflicts of interest, should be required for both bundled and unbundled service providers.
  - (3) In order to make 401(k) fee disclosure easier to understand for all plan sponsors, the proposed fiduciary fee disclosure to plan fiduciaries could be simplified into the following three categories: investment management expenses; administrative and recordkeeping fees; and selling cost and advisory fees. By breaking down plan fees into these three simple categories, plan sponsors will have the information they need to satisfy their ERISA duties.

#### C. Reason for Change

- (1) The consequence of not requiring uniform disclosure is that the retirement security of millions of plan participants will be harmed by paying mostly undisclosed higher investment management fees.
- (2) Complete and consistent fee disclosures by both bundled and unbundled service providers will improve the ability of fiduciaries to satisfy their responsibilities under ERISA and create a more efficient and competitive 401(k) marketplace, ultimately to the benefit of both plan sponsors and participants.

#### D. Modification to Existing Authority

- (1) ERISA §408(b)(2)

## **21. Improve Fee Disclosure to Plan Participants**

### A. Current Law

- (1) In general, participants with the right to direct 401(k) plan investments need fee information in order to evaluate the investments offered by the plan and decide whether they want to engage in certain plan transactions. Many 401(k) participants currently do not have easy access to simple, uniform fee and expense information. There are no uniform rules under ERISA in relation to how information is disclosed to participants
- (2) In July 2008, the Labor Department issued proposed regulations under ERISA §404(a) setting forth a complex set of new participant fee disclosure requirements. The proposed rules required the annual disclosure to plan participants and beneficiaries of identifying information, performance data, benchmarks and fee

and expense information in a comparative chart format, plus additional information upon request. The regulation further required an initial and annual explanation of fees and expenses for plan administrative service to plan participants and beneficiaries (disclosed on a percentage basis) except to the extent included in the investment-related expenses.

- (3) On January 20, Rahm Emanuel, assistant to President Obama and White House Chief of Staff, signed an order requiring the withdraw from the OFR of all proposed or final regulations that have not been published in the Federal Register so that they can be reviewed and approved by a department or agency head.
- (4) The proposed ERISA §404(a) regulations were sent to the OMB in final rule form for review and approval. However, the regulation had not yet been released by OMB or sent to the OFR as of January 20. Therefore, the regulations appear to have been stopped by the Emanuel order.

#### B. Proposed change

- (1) Require plan fiduciaries to provide participants with administrative fee and investment cost information on a uniform basis, regardless of whether the service provider is bundled or unbundled. This information should be provided on an annual basis. This will provide participants with a complete picture of the total costs of the plan at a single time, regardless of the business model of the service provider.
- (2) The fee information must be in an understandable format that enables participants to make more informed decisions regarding their 401(k) accounts by allowing them to simply compare the various fees and expenses charged for each investment option, and making them aware of the possible other fees they can incur depending on the decisions they make.
- (3) The fee disclosure must be cost-effective.

#### C. Reason for Change

Plan participants need clear and complete information on the investment choices available to them through their 401(k) plan, and other factors that will affect their account balance. In particular, participants who self-direct their 401(k) investments must be able to view and understand the investment performance and fee information charge directly to their 401(k) accounts in order to evaluate the investments offered by the plan and decide whether they want to engage in certain plan transactions.

#### A. Modification to Existing Authority

- (1) ERISA §404(a)



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