

Retirement Plans: 2009 Outlook



The year 2008 will likely be remembered for a long time and for many reasons. The economic recession and investment market results of historical proportions left their mark on almost everyone's retirement savings. Its influence on retirement plan funding will last for years to come. Recently, Congress has taken action that we think should encourage retirement plan sponsors, and many participants, to review their plans as they begin evaluating contributions and distributions in 2009 and beyond.

The Worker, Retiree and Employer Recovery Act of 2008 was passed and signed into law in December and addresses several potential plan problems. Because of major investment losses, the Act permits the use of a smoothing calculation at an assumed interest rate instead of actual investment experience to determine the funding obligations for defined benefit plans in 2009. These plans can accrue benefit obligations throughout a plan year and, because of this, we are urging all defined benefit plan sponsors to review the impact of their 2008 investment experience as quickly as possible with their actuary and other plan advisors. If a change is needed in the plan design to balance benefit obligations with funding objectives, that amendment must be prepared and adopted as soon as possible. Otherwise, significant contributions may be required to meet the minimum funding standard for the plan.

Another provision of the Recovery Act relates to required minimum distributions (RMDs) in 2009, due to participants who are over age 70-½. Many plan and IRA participants who are taking annual required withdrawals from their accounts are concerned about depleting their accounts too rapidly after the investment losses incurred in 2008. Under the Recovery Act, no RMD from IRAs or defined contribution plans is required for 2009. **Careful review of this provision is needed.** The waiver does not lift RMD requirements for 2008 that may have been deferred by election to April 1, 2009, nor does the waiver extend to calendar years after 2009.

As an example, participants who reached age 70-1/2 in 2008 must take a distribution for that year. They may have deferred it to April 1, 2009, but the 2008 distribution must be made. They would not, however, need to take a 2009 RMD (which they would have otherwise been required to take by December 31, 2009). Similarly, participants whose required beginning date is April 1, 2010 (because they reached 70-1/2 in 2009) have no RMD for 2009. Therefore, no RMD need be distributed by April 1, 2010, but they must take their regular 2010 distribution by December 31, 2010. The waiver also applies to RMDs made to beneficiaries under the five-year rule (by extending the five-year period by one year).

Another major area of concern to 403(b) plan sponsors in 2008 has been deferred for a year. For years, many tax-exempt employers – nonprofit organizations and educational institutions – who sponsored a retirement plan have operated their plans without the complete plan documentation required of for-profit plan sponsors. These plans were generally funded with insurance annuities that included restrictions required for a tax-qualified retirement account; however, a formal plan document was never drafted or adopted. These plans are permitted under Section 403(b) of the Internal Revenue Code and have similar funding limitations for plan participants and non-discrimination requirements applicable to employer contributions to regular qualified plans.

LONG BEACH OFFICE
111 West Ocean Boulevard
Twenty-Second Floor
Long Beach, CA 90802
Telephone: (562) 435-1191
FAX: (562) 495-1665

IRVINE OFFICE
18201 Von Karman Avenue
Suite 1060
Irvine, CA 92612
Telephone: (949) 271-2600
FAX: (949) 660-5681

www.windes.com



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The Pension Protection Act of 2006 initially required all nonprofit employer plan sponsors to adopt a plan document that details all design features required for qualified status by January 1, 2009. On December 11, 2008, the IRS extended the deadline by which a written 403(b) plan document must be adopted to December 31, 2009, with a three-part relief:

1. **Written Plan Document** - The written plan document that is intended to satisfy the requirements of Code Section 403(b) regulations must be formally adopted by December 31, 2009, with an effective date of January 1, 2009
2. **Operational Compliance** - In 2009, a 403(b) plan sponsor must operate the plan under a “reasonable interpretation” of Code Section 403(b) and the final 403(b) regulations
3. **Retroactive Correction of Operational Failures** - A 403(b) plan sponsor must make its “best efforts” to retroactively correct any operational “failures” to conform to the terms of its written 403(b) plan document in a manner consistent with the correction principles set forth in the IRS’ Employee Plans Compliance Resolution System (EPCRS). A formal EPCRS filing is not required to correct inconsistencies between plan operations and compliance with a plan document

This relief is significant in that it takes the December 31, 2008 plan document compliance pressure off of 403(b) plan sponsors. However, operational compliance under the “reasonable interpretation” standard is required as of January 1, 2009, and all nonprofit plan sponsors should review their plans to be certain all required testing and contribution limitations have been properly met.

There are two other important issues we think need to be reviewed early in 2009 by all retirement plan sponsors. The first is the long-awaited regulations on fee disclosure to employees and plan participants. Employers and their third-party administrators now must gather and include all types of expenses and costs as part of the annual administration and IRS Form 5500. The goal of this regulation is for sponsors of defined contribution plans that offer participant-directed investments, including section 401(k) and 403(b) plans, to provide additional transparency of all plan costs and income, both directly and indirectly paid to all parties involved in the administration of the plan. This is a clear indication that plan sponsors are being held to a higher standard of due diligence in monitoring everyday operations of plans and are well advised to secure and review this information to meet this disclosure obligation.

The new disclosure requirements are likely to affect plan sponsors in the following four ways:

1. **Collection and review of information from Service Providers** - Plan sponsors will be required to obtain full and complete information concerning all of the administrative and investment-related fees charged to their plan.
2. **Revise Service Contracts** - The service contracts would need to be revised to require the service provider to provide the information that the sponsor must disclose and to update it with any material changes to the required information. This would include the obligation to provide information necessary for completion of IRS Form 5500 and information necessary for the plan sponsor to comply with the new disclosure obligations to plan participants and their beneficiaries.
3. **Disclosure to Plan Participants** - Plan sponsors would be required to provide general plan and administrative expense information and individual expense information, in an easy-to-read comparative format, on or before the date of eligibility and at least annually thereafter. In addition, the actual dollar amounts charged to each account would have to be disclosed at least quarterly with the individual benefit statement.
4. **Plan Oversight** - Receipt and distribution of the additional information would not relieve plan sponsors of the requirement to monitor services arrangements and the performance of service providers. The proposed guidance emphasizes the basic proposition that participant disclosure does not relieve a fiduciary from the responsibility to prudently select and monitor investment managers and investment alternatives offered.

As we go to press, the Department of Labor withdrew their regulations related to disclosing service provider compensation and conflicts of interest. However, the above provisions generally will be included in pending 2009 legislation.

The second item of note is the arrival of the amendment process that we have discussed in several previous issues of Solutions. The time frame for adopting updated documents to conform to the provisions of The Economic Tax Recovery Reconciliation Act of 2001 (EGTRRA) is currently under way.

All prototype and volume submitter plan sponsors, such as Windes & McClaughry, have received master approval letters from the IRS for EGTRRA conforming documents. This is the first major restatement required of all plans since the cycle known as GUST, and many prototype sponsors are already delivering documents to their clients for review and execution. This amendment is critical to protect the tax-qualified status of all plans, and the updated document must be adopted no later than April 30, 2010.

As with similar amendments in the past, tax reform seems to outpace the process of incorporating updated provisions in retirement plan documents, but all plan sponsors now face this restatement on a six-year revolving cycle. When your third-party plan administrator (TPA) or prototype plan sponsor provides you with the amendment for review and execution, take time to complete it. This will also be an opportune time to consider plan design modifications or changes and to restate all of the plan documentation and participant disclosure materials.

In recent years, many changes have been made to retirement plan reporting and disclosures. Quarterly notice requirements to participants were added last year, and now the fee disclosures and updating documents have kept most TPAs very busy. However, the ability to defer taxation on significant contributions to a qualified plan is, in our view, one of the best ways to help provide resources for retirement income security. The points reviewed here are important areas that should be addressed in the next several months as they may relate to your plan or individual account. For more information on retirement plans, please contact Dorrie Hernandez at (562) 435-1191 or dhernandez@windes.com.