retirement
plan news

MARCH/APRIL 2009

Interim Valuation of a Balance Forward Plan

The steep decline in the stock market that took place last year resulted in a significant drop in the value of retirement plan assets. This is a particular problem for balance forward plans, and it raises an important question: Is a special valuation required before a distribution may be paid?

A plan document may permit a plan administrator to require a special plan valuation. However, conflicts may arise if former employees have statements showing significantly higher account balances as of the plan's usual valuation date. These employees will undoubtedly want to realize those balances, regardless of the fact that the value of the plan's assets has plummeted in the interim.

Twofold Responsibility for Fiduciaries. The Employee Retirement Income Security Act (ERISA) requires plan fiduciaries to 1) operate a qualified plan in the best interest of *all* plan participants and beneficiaries and 2) administer the plan at a reasonable cost. However, when the market value of the plan's assets decreases (or increases) significantly, there is an inherent conflict between participants who have a distributable event (including a severance of employment) or are eligible to take an in-service distribution and those not receiving a distribution.

Plan fiduciaries have both a legal and a moral obligation to decide what is best for all participants. Ideally, all participants should share in the gains or losses incurred by a balance forward plan. Thus, those with a distributable event should not be paid amounts that would be detrimental to the remaining plan participants (assuming there are no other facts that may dictate a contrary result).

Special Valuations. In times of rapid market increases or decreases, the question of whether it is permissible to pay a distribution request based on an annual or even a semiannual valuation is critical, especially when a significant amount of time has elapsed since the plan's last valuation. However, many issues must be evaluated before the decision is made, as this example demonstrates.

Fact Set:

- The plan is a balance forward plan that is valued semiannually.
- As of June 30, 2008, the plan has $1.5 million in assets.
- As of June 30, 2008, Participant A's account is valued at $500,000.
- There are 10 other employees whose accounts, together, make up the remaining $1 million.
- On October 22, Participant A requests an in-service distribution of her June 30, 2008, account value.

- On October 22, the total value of the plan's assets is $1,200,000.

May the employer pay Participant A $500,000 when the value of the trust has dropped 20% in a matter of weeks? Would doing so have a negative impact on the other participants? In this example, it is rather clear that the fiduciary should

(Continued on page 2)

CONTENTS

Interim Valuation of a Balance Forward Plan

Safe Harbor 401(k) Nonelective Contribution

Worker, Retiree, and Employer Recovery Act of 2008

Recent Developments

Kibble & Prentice
A USI Company

601 Union Street, Suite 1000
Seattle, Washington 98101-4064
206/441/6300 PH
206/441/6312 FX
www.kpcom.com

Interim Valuation of a Balance Forward Plan *(Continued from page 1)*

consider whether an interim valuation is necessary before paying Participant A.

Keep in mind that if one participant is overpaid at the expense of the others, the fiduciary has potentially breached his/her fiduciary duties and could be personally liable for the amount of the overpayment.

Timing Is a Consideration. Hindsight most likely played a role in Participant A's distribution request. Would she want to stay with the June 30 valuation if the market was up 20% instead of down? Most of the elections in plan documents relating to the timing of distributions allow for payment only after the next valuation date or the close of the plan year so that participants cannot take advantage of earlier valuations and market timing. It is recommended that the employer select one of these options rather than one that allows participants to choose an earlier valuation.

Legal Issues. Unfortunately, the employer in this example is unlikely to please everyone. And there is always the threat of a lawsuit. Suppose 10 employees (instead of one) requested withdrawals totaling $500,000, and one of the 10 was the employer's spouse, whose account represented $100,000 of the $500,000. A special valuation would still be the safest course, because overpayment to a highly compensated employee and/or a relative could violate both ERISA fiduciary and Internal Revenue Code nondiscrimination standards. If a special valuation is required, its negative effect could be eased by allowing individuals to cancel their distribution requests once the revalued amounts are known.

Employer Option. Employers may want to consider adopting an administrative policy that requires interim valuations when there has been a market change, up or down, of a set percentage (based on a standard market index).

Daily Valued Plans Not Free of Market Risk. Employers may wish to tighten procedures for processing distribution requests by clearly defining the date upon which a final distribution amount is determined and avoiding serious "hang time" between when a distribution is requested and when the check is cut. ❖

Safe Harbor 401(k) Nonelective Contribution

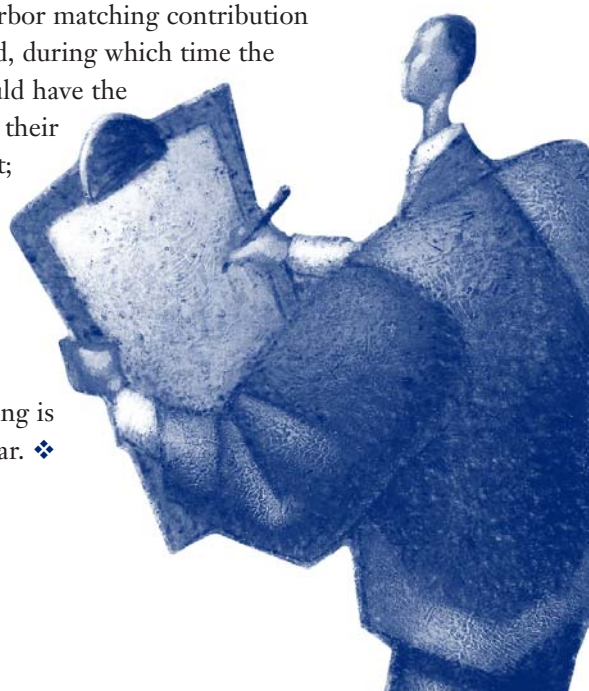
Through the last half of 2008, it became clear that numerous employers, who never fathomed that they might have trouble funding a guaranteed safe harbor nonelective contribution (NEC), were having difficulty meeting their obligation. Here is a suggestion for plans completing the EGTRRA restatement for a safe harbor 401(k) plan. If a plan is using the guaranteed safe harbor nonelective contribution (3% or more), we suggest using the flexible safe harbor nonelective contribution (3% or more) instead.

Guaranteed NEC. When safe harbor plans were first introduced, the guaranteed NEC was often chosen. Now, many employers are seeking a way to get out of the guaranteed NEC. Unfortunately, other than terminating the entire 401(k) plan, there is no way out during the current plan year. The provision can be amended out of the plan document for the following plan year, but it must be amended before that year begins.

Flexible NEC. The flexible safe harbor NEC can help employers avoid all these issues. With a flexible NEC, employers do not have to decide whether to make a contribution until December 1 of the year for which the contribution is to be made, after preliminary tests are completed. The employer provides a flexible notice informing employees that a contribution *may* be made the following year. The next year's flexible notice can be used to indicate whether a contribution will be made for the year and announce that a contribution *may* be made in the subsequent year. ADP/ACP testing will be required in any year the contribution is not made.

Another Option. Instead of providing either a guaranteed or flexible NEC, the employer could choose to amend the plan for the next year to provide for a basic or enhanced safe harbor matching contribution. Safe harbor matching contributions may be stopped during the plan year, provided that:

- The plan document is amended to remove the provision;
- A notice is sent to employees 30 days in advance stating that the safe harbor matching contribution is being stopped, during which time the employees should have the right to change their deferral amount;
- The contribution is actually funded up to the specified date; and
- ADP/ACP testing is done for the year. ❖



Worker, Retiree, and Employer Recovery Act of 2008

The Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) passed the House and the Senate in December 2008 and was signed into law by President Bush on December 23, 2008. The law includes technical corrections to the Pension Protection Act of 2006 (PPA) and short-term relief to help individuals and plan sponsors through the sharp market downturn.

PPA Technical Corrections. The Treasury Department now has the authority to write guidance regarding benefit restrictions and quarterly contributions for small defined benefit (DB) plans with end-of-year valuation dates. The corrections include:

- DB plans may cash out terminated participants without participant consent if the present value of the vested benefit is $5,000 or less, regardless of whether the plan is subject to benefit restrictions.
- For employers with both a DB and a defined contribution (DC) plan, if contributions to the DC plan are less than 6% of compensation, the DB plan is not subject to the overall deduction limit (25% of compensation). If contributions to the DC plan exceed 6% of compensation, only the contributions in excess of 6% of compensation count toward the overall limit.
- Rollovers by a nonspouse beneficiary will generally be subject to the same rules as other eligible rollover distributions, effective for plan years beginning after December 31, 2009. Plans are required to provide a direct rollover option for nonspousal beneficiaries (as required for any other direct rollover distribution). Additionally, the Section 402(f) notice must be sent to nonspouse beneficiaries.
- Permissible withdrawals during the first 90 days under an automatic contribution arrangement (ACA) are no longer contingent upon satisfying the qualified default investment arrangement (QDIA) rules of ERISA Section 404(c)(5). Permissible withdrawals are also now available to SIMPLE plans and SEP IRAs. In applying the annual limit on elective deferrals under IRC Section 402(g)(1), permissible withdrawals are disregarded.
- The calculation of gap period income on the distribution of excess deferrals is eliminated. Since it was previously eliminated (by PPA) from refunds due to a failed ADP/ACP test, calculating gap period income is no longer required for any purpose.
- Effective for plan years beginning after 2008, small employer DB plans can use a fixed 5.5% interest rate for determining maximum lump-sum benefits.
- There is special funding target relief for DB plans due to the economic downturn.

RMDs Waived for 2009. Required minimum distributions (RMDs) for 2009 are waived for qualified plans (such as profit sharing and 401(k) plans), IRAs, 403(a)s, 403(b)s, and 457(b) plans. This law change permits individuals who attain age 70½ in 2009, as well as individuals who already receive required minimum distributions, to avoid having to take a minimum distribution for 2009. Guidance was issued by the IRS (Notice 2009-9) regarding the waiver of the 2009 RMD. It reflected that a distribution, up to the RMD amount, will not be subject to the mandatory 20% withholding rules. Amounts distributed above the RMD amount will, as usual, be considered eligible for rollover and subject to the mandatory 20% withholding.

There had been a great deal of media speculation that the 2008 RMD would be waived. At the time this was written, there was no change in the 2008 RMD rules. Though the relief for 2009 is helpful, the use of much higher 2007 valuations to determine 2008 distributions and the need to liquidate assets at depressed prices have caused real problems, for which no relief was granted. ❖

recent developments

403(b) Document Deadline Relief. IRS Notice 2009-3 extended the deadline for 403(b) plans to adopt a written plan document to December 31, 2009 (effective January 1, 2009). The relief is contingent upon the following requirements:

1. On or before December 31, 2009, the sponsor of the plan adopts a written Section 403(b) plan that satisfies the requirements of Code Section 403(b) and the final regulations, effective as of January 1, 2009;
2. During 2009, the sponsor operates the plan in accordance with a reasonable interpretation of Code Section 403(b) and the final regulations; and
3. Before the end of 2009, the sponsor makes its best effort to retroactively correct any operational failure during the 2009 calendar year to conform to the terms of the written Section 403(b) plan.

This relief applies solely with respect to the 2009 calendar year. Note that the IRS will be introducing a 403(b) prototype document program with model language during 2009. The fact that the IRS did not announce the extension until December 11, 2008, means that many sponsors pushed to get documents in place that may need further amendment in 2009 to comply with the language that the IRS will ultimately release as part of the forthcoming prototype program.

Fidelity Bond Guidance. The Department of Labor issued Field Assistance Bulletin (FAB) 2008-4 containing 42 FAQs on bonding requirements. An ERISA Section 412 bond (sometimes referred to as an ERISA fidelity bond) must protect the plan against loss by reason of acts of fraud or dishonesty on the part of persons required to be bonded, whether a person acts directly or through connivance with others. The term "fraud or dishonesty" for this purpose encompasses risks of loss that might arise through dishonest or fraudulent acts in handling plan funds or other property. This includes, but is not limited to, larceny, theft, embezzlement, forgery, misappropriation, wrongful abstraction, wrongful conversion, willful misapplication, and other acts where losses result through any act or arrangement prohibited by 18 U.S.C. Section 1954. Not covered are wrong but not imprudent investment decisions, especially those that produce significant losses in a down market. The bond must provide recovery for loss occasioned by such acts of fraud or dishonesty, even though no personal gain accrues to the person committing the act. ❖

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.

Copyright © 2009 by NPI and McKay Hochman

ABOUT KIBBLE & PRENTICE

For more than 35 years, Kibble & Prentice has helped individuals and companies make decisions that create value and manage risk. We provide regionally-based services, world-class expertise and service in insurance and risk management consulting, employee benefits, retirement plan services, executive benefits and business continuation planning. Through our strategic partnerships and national platform, our clients have access to a full range of products and services. Our client-tested service model and personal focus enable us to provide our clients with objective advice — and the attention they deserve. By customizing each client's total risk management, investment and benefits strategy to meet their needs, we ensure a uniquely tailored and comprehensive approach to financial services. For more information, please visit www.kpcom.com.

Kibble & Prentice
A USI Company