



## Time To Revisit Your IPS?

**SITUATION:** Because of the continuing volatility in the financial markets, we've made several changes to the investment choices we offer our 401(k) plan participants, including our default investment.

**QUESTION:** Should we revise our investment policy statement (IPS) to reflect these changes?

**ANSWER:** Yes, if these changes have caused your investment program to deviate from the plan's investment goals stated in the IPS. Even if your changes are in line with directives and constraints in your current policy statement, you should review your IPS to see if it allows plan participants to adequately address the prevailing market conditions.

**DISCUSSION:** A written IPS is documentary evidence that your plan has a carefully considered investment policy. It provides the employer and other plan fiduciaries responsible for plan investments with investment management guidelines. An IPS provides a process for making broad investment management decisions, setting investment goals, and communicating the policy to employees. Without a prudent investment policy, an employer could be found liable for fiduciary shortcomings.

The specific needs of each individual plan and sponsor determine what should be included in an investment policy statement. Topics to consider include:

- The plan's investment goals, including

reference to the plan's qualified default investment alternative if it has one

- Roles and responsibilities of those involved with plan investments
- Considerations and guidelines used in selecting and replacing investments and investment managers
- Procedures for monitoring investment performance, directions as to how managers should report performance, and a review schedule
- A description of how participants may control their plan account investments, the manner and frequency of participant-level investment performance reporting, and what educational materials will be provided to help participants make informed investment decisions
- A statement deferring to the plan document's provisions if a conflict arises

When reviewing the section on educational materials, consider whether plan participants might need more investment education or personalized advice to manage their plan accounts in today's uncertain markets.

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## Plan Compliance

Although many retirement plan experts recommend that plans conduct annual general compliance reviews, fewer than half of the plan sponsors surveyed in a recent study\* reported that they had reviewed their entire plan's operations in the past three years. Sponsors were also asked what compliance problems they had corrected within the past three years. Here are their responses:

- 10% corrected eligible compensation problems.
- 5% corrected eligibility participation

issues, such as improper inclusion or exclusion of participants.

- 5% corrected service-crediting problems (eligibility, vesting, or determination of benefits).
- 4% corrected participant loan issues.
- 3% corrected distribution issues including timing, form and/or amount of distributions.
- 22% said they corrected other issues not listed above.

*\* Retirement Plan Survey 2010: Discovering new trends and overcoming challenges, Grant Thornton*

## QDRO Update

Your plan should have reasonable written procedures in place to determine the qualified status of domestic relations orders and to administer distributions made under them. You may want to review these procedures in light of the U.S. Department of Labor's recently issued final regulations on the timing and order of QDROs.

A QDRO is a judgment, decree, or order issued under a state domestic relations law relating to child support, alimony payments, or marital property rights to a participant's spouse, former spouse, child, or other dependent. A QDRO creates or recognizes the right of an "alternate payee" to all or part of an employee's retirement plan benefits.

Here are some of the points illustrated in the final regulations:

- An order won't fail to be a QDRO simply because it is issued after, or revises, a QDRO that was previously issued to the same individual(s), even if it reduces the benefits payable under the first QDRO.
- A QDRO can be issued to an employee's spouse from a second or subsequent marriage after the spouse from a previous marriage has already been issued a QDRO, as long as the new order doesn't assign any of the benefits already payable under the original QDRO.
- An order received after an employee's death or divorce can be a QDRO.
- An order issued after an annuity starting date can be a QDRO. For example, a participant is receiving benefits as a single-life annuity. The spouse has waived surviving spousal rights. They divorce. An order directing that the former spouse receive half of the participant's future benefit payments can be a QDRO. However, as the final regulations clarify, an order after the original annuity starting date requiring reannuitization with a new annuity starting date would disqualify the order, unless the plan specifically provides for the option.

**The U.S. Department of Labor recently issued final regulations on the timing and order of QDROs.**



## The Top-heavy Trap

Have deferrals to your 401(k) plan by nonowner, nonofficer, and lower paid employees dropped off this year? Lower deferral rates by these employees, plus distributions of account assets to departing employees, could set you up for a surprise at year-end. Your plan could be deemed “top heavy.”

**When is a plan top heavy?** Defined contribution plans, such as 401(k) plans, generally are considered top heavy when the accounts of “key employees” represent more than 60% of the total value of all employee accounts. A plan that tests as top heavy on the last day of the 2010 plan year will be subject to the top-heavy rules for the 2011 plan year.

**Who are key employees?** For purposes of the top-heavy rules, key employees include: (1) owners of more than 5% of the business, (2) company officers with compensation greater than \$160,000 in 2010, and (3) individuals who own more than 1% of the business and earn more than \$150,000 a year. In determining the 1% and 5% ownership, an individual is considered to own stock owned by certain family members.

**What happens when a plan becomes top heavy?** Plan documents must include provisions that take effect whenever the plan becomes top heavy. Under the top-heavy rules, the employer sponsoring the plan generally must contribute at least 3% of compensation on behalf of non-key employees. However, there are exceptions. For example, if the highest allocation, including elective deferrals, to any key employee is less than 3%, the sponsor can contribute that lower percentage of compensation to non-key employees’ accounts. Not making required minimum top-heavy contributions can jeopardize a plan’s tax-exempt status.

**Who must receive top-heavy contributions?** All non-key employees who are plan participants at the plan’s year-end must receive the minimum contribution. No additional contributions are required for employees who leave the company before the end of the year.

### **What can we do before year-end to avoid being subject to the top-heavy rules in 2011?**

Here are two strategies that might help you stay clear of the 60% threshold. Consider depositing all employer contributions for non-key employees before the end of the plan year and delay employer contributions for key employees until after the end of the plan year. Except for the first plan year, the top-heavy determination is made on a cash basis, so contributions that are accrued but not yet deposited at year-end are not included in the calculation. Or, if your plan permits, make additional profit sharing contributions on behalf of a designated group of non-key employees before year-end.

**What can we do in the future to avoid top-heavy status?** You could adopt a safe harbor plan design. 401(k) plans that meet certain safe harbor contribution requirements — basically, a nonelective employer contribution of at least 3% of compensation or a qualifying matching formula — avoid annual nondiscrimination testing *and* the top-heavy rules. Adopting a qualified automatic contribution arrangement (QACA) — essentially, the automatic contribution version of the safe harbor plan design — also avoids top-heavy treatment.

**Is there anything else we should know?** If you adopt a safe harbor design, check your plan’s forfeiture allocation provision. Only plans that consist solely of elective deferrals and contributions qualify for the top-heavy safe harbor. The plan should provide for forfeitures to be allocated to pay plan expenses or reduce the employer’s safe harbor (nonelective or matching) contribution or as a permitted safe harbor discretionary match.

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## RECENT DEVELOPMENTS In Benefit Plans

**A 2010 Snapshot of 403(b) Plans.** The Profit Sharing/401(k) Council of America recently released the results of a survey that provides a broad overview of 403(b) plans. Some of the survey's highlights include:

- Average participation rate is 75.8%.
- Average account balance for active plan participants is \$71,879.
- 83.2% of sponsors make contributions to the plan.
- Common contribution formulas include a guaranteed

percentage of the participant's pay only (17%), stated employer match only (13.9%), and a fixed match only (8.9%).

- Roth after-tax contributions are permitted by 13.9% of plans.
- 72.7% of plans allow loans.

**No Obligation To Make Discretionary Employer Contribution.**

Construction Company's 401(k)/profit sharing plan had a provision for a year-end 3% of compensation discretionary profit sharing employer contribution. When the company didn't make any contribution to his plan

account for the year, Nathan sued. He charged that Construction Company had failed to make required employer matching contributions to his account. "Not so," said a U.S. District Court (*Lindell v. Landis Construction Co.*, DC-D.C., No. 08-1462). The court ruled that the employer was under no legal obligation to match Nathan's contributions for the year in question because the employer showed that the plan had a discretionary employer contribution, not an ongoing required match.