employee benefits update

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RETIREMENT PLAN EXPENSES

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Getting better value, not just cheaper services

During times of cost cutting, it's understandable that plan sponsors are looking for ways to save money on their retirement plans. Sponsors may be negotiating price discounts, fund and fee ratios, and employer contributions.

Yet, while containing costs is at the top of many sponsors' minds, using an inexpensive service provider isn't always the best option. Before taking a swing with the axe, make sure you're receiving the best value — not just the least expensive provider. Let's look at how plan expenses operate, whether it's from company pockets or plan assets.

Important background

In recent years, both the Department of Labor (DOL) and the IRS have investigated the use of plan fees and the reasonableness of plan expenses. As a result, some plans were found to be in violation for fee-related infringements. And, in some cases, DOL or IRS assessments were costly to plan sponsors.

Plan sponsors may use certain retirement funds to pay allowable administrative and other plan-related expenses.

Plan assets are designated for the exclusive purpose of providing a retirement benefit to plan participants, and plan sponsors cannot directly benefit from plan assets. In other words, excessive use of retirement funds for company purposes is against the law.

But plan sponsors may use certain retirement funds to pay allowable administrative and other plan-related expenses. The plan document, however, must authorize any payments for expenses; the payment must be in the plan participants' and beneficiaries' interest; and the amount paid from the plan must be reasonable. The "reasonable" test is somewhat subjective but ultimately boils down to common sense.

Investment fees

Investment fees make up most of plan expenses. They're sometimes referred to as the *expense ratio* within an investment and are paid to the firms that manage the participants' investments within the plan. For example, if a participant invests in mutual fund A, mutual fund company A can

deduct fees from any income related to that fund to pay itself.

These fees can be tricky to locate because they're factored into the *net total return* that's often reported to participants. For example, if a particular fund has generated an 8% return for the year, but 1% of that return is used to pay the related investment fees, this results in a net total return of 7% and the fund will report an expense ratio of 1%. Common types of investment fees include:

Sales charges. Also known as loads or commissions; the investment advisor charges these fees to participants for buying or selling shares of an investment.

Management fees. These are the fees paid to the investment advisor managing the fund. They can vary drastically by manager and usually become more expensive as the investment manager spends more time actively managing the fund. However, as with any financial investment, higher management fees don't necessarily ensure better performance.

12b-1 fees. These fees represent continuous amounts paid from fund assets and are usually used to pay for things such as advertising, account servicing and broker commissions. They've been a hot topic in the past few years because of their reclusive nature.

Third-party administrators

In cases of hiring and paying fees to third-party administrators (TPAs), as plan sponsor you should make a reasonable attempt to understand local market prices for this service. Most important, research the integrity and ability of the TPA, as the TPA will guide you with respect to your fiduciary duties. Often, the TPA receives remuneration directly from the trust assets, which both the IRS and DOL allow. Generally, allowable expenses from a plan include costs of:

- Calculating and communicating benefits to participants,
- Nondiscrimination testing amending the plan to comply with tax law changes,
- Obtaining an IRS determination letter,
- Certain amendments and distribution and loan fee expenses,
- QDROs, and
- Administrative fees to vested participants.

Expenses that generally aren't allowed include costs of:

- Plan design changes, and
- Financial accounting, such as adhering to the requirements of FASB 87 (pension accounting) and FASB 88 (defined benefit pension plan settlements and termination benefits).

Along with the DOL, the IRS also carefully monitors plans for reasonableness and mirrors many of the DOL's actions.

Key questions

It's important that plan sponsors be aware of how any fee arrangement works. The DOL requires plan sponsors to periodically monitor fee changes.

Ask your service provider what fees are being paid directly from the plan and what it's going to cost the company out of pocket. Both TPAs and investment advisors must provide this information on request.

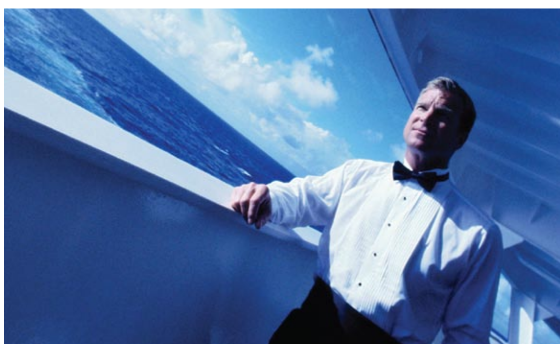
Where to learn more

Both the DOL and IRS Web sites offer excellent resources for plan sponsors when it comes to fees. Knowing what questions to ask is invaluable when making choices about retirement plan fees.

Bond … ERISA bond

YOU MAY NEED ONE, SO LEARN THE REQUIREMENTS

ERISA requires that all fiduciaries of qualified retirement plans be bonded. These bonds are sometimes referred to as ERISA bonds, fidelity bonds, surety bonds or fiduciary bonds. The bond reimburses the plan in the event that plan assets are lost because of fraud or dishonesty, which includes acts such as theft, larceny, forgery, embezzlement, misappropriation or willful misapplication of plan assets.



Who needs a bond

ERISA requires anyone who handles plan funds or property or is responsible for the assets of a qualified plan to be bonded.

Where an individual or an individual and spouse wholly own a business, and there are no other participants other than the individual and spouse, ERISA doesn't require a bond in a partnership. ERISA doesn't require a bond if there are no employee participants other than the partners and their spouses.

Required amount

Effective for all plan years beginning on or after Jan. 1, 2008, each individual that handles funds must be bonded for at least 10% of the amount of the plan funds but never for less than $1,000 or more than $500,000 with respect to a single plan.

If the plan holds employer stock or other employer securities, the maximum required bond amount goes up to $1 million. However, if employer securities are simply held within a mutual fund, insurance company separate account or similar broadly diversified fund, the maximum bond amount remains at $500,000.

Other bond issues

To satisfy ERISA's requirements, the bond has to name your plan. If your company has more than one retirement plan, however, you can name them all under the same bond. But you must have the correct amount of insurance per plan as each would if it had separate bonds. (If you obtain separate bonds, you don't have to get them from the same surety company.)

In addition, an ERISA bond doesn't have to state a specific dollar amount — it can state that an individual is covered under the bond for the greater of $1,000 or 10% of funds handled up to $500,000. The amount of the bond is fixed based on the estimated assets at the beginning of the year, so the bond's amount is based on the highest amount of funds handled by a person in the preceding plan year. If there isn't a preceding plan year to determine the amount, you'll estimate the amount. Bear in mind that an ERISA bond doesn't have a deductible.

Finally, beware that fiduciary liability insurance isn't the same thing as an ERISA fidelity bond. An ERISA fidelity bond is required, but fiduciary liability insurance isn't. Fiduciary liability insurance covers claims and losses arising out of breaches of fiduciary duty. (Fiduciaries are personally liable for losses due to breaches.) Employers — or the fiduciary — can purchase this insurance.

Get your bond

You must buy the bond from a company approved by the U.S. Treasury Department. Department Circular 570, available at FMS.Treas.Gov/c570/c570.html, lists these approved surety companies.

Upcoming compliance deadlines:

4/15 Deadline for corrective distribution of 2009 excess deferral failures

4/15 Deadline for filing of 2009 individual and/or partnership tax returns and making contributions eligible for deductibility

5/15 Deadline for filing 2009 Form 990, "Return of Organization Exempt from Income Tax"

Why making changes to your employer contributions is important

Following a dismal financial fourth quarter in 2008, many companies in 2009 elected to forgo funding their qualified plan employer contributions. This includes employer matching contributions, profit sharing contributions and other employer funding arrangements. As a result, many qualified plans consisted solely of employee contributions during the year.

While the financial markets recovered by the end of 2009, many participants' retirement funds may not show signs of recovery. Adjusting your matching contributions may be one way to help your employees recover some lost ground.

Understanding employer contributions

What can plan sponsors do to gain recovery of these lost plan opportunities? If an employer can make contributions, it's often advantageous to do so. Generally, employers can make two types of matching contributions:

1. Discretionary contributions. Your plan document can provide that you may choose to fund a dollar amount at your discretion. Typically, when you make changes to a discretionary contribution, it's customary to give notice to your employees and pass a board or corporate resolution stating what the contribution will be for the year. Your plan document can subject these contributions to a vesting schedule, and fund them on an annual, per pay or some other basis.

Discretionary contributions are relatively easy to suspend. As long as you're not taking away a benefit already earned by the participants, all you need to do is notify them.

Is an IRA-based plan the way to go?

For companies that eliminated their retirement plans altogether and wish to re-establish one, some relatively simple solutions may help. IRA-based plans, for instance, may provide a quick way to offer a retirement plan. Examples include:

Employee IRAs. These allow employees to establish either a traditional or Roth IRA with a financial institution. The employee then has a specified amount deducted post-tax from payroll and deposited directly into the IRA. The employer isn't responsible for monitoring contribution limits, maintaining plan documents or making contributions.

SEP plans. Simplified Employee Pension (SEP) plans enable companies to make employer-funded contributions into traditional IRAs set up for employees. The IRS provides a basic plan document for employers to complete and keep on record. An attorney can also draft a custom plan document.

SIMPLE IRA plans. Under a Savings Incentive Match Plan for Employees (SIMPLE), the employer sponsors a plan that allows both the employee and employer to make contributions to an employee's traditional IRA. The IRS provides a basic plan document for employers to complete and maintain. The employer must have fewer than 100 employees and cannot have any other retirement plan. Of the IRA plans discussed, this has the most complex contribution rules.

All types of employers may offer these arrangements. The IRS has made setup of these plans quick and relatively easy. Better yet, none have to comply with qualified plans' strict requirements, such as filing a Form 5500, conducting discrimination testing and properly maintaining plan documents. If you want to quickly establish a retirement plan with minimal costs, an IRA-based plan may be the way to go.

2. Mandatory matching contributions. If your plan document has a fixed formula, you'll need to make a plan amendment to forgo the match. Safe harbor plan designs require mandatory matching contributions and also have an option for a mandatory profit sharing contribution. Previously, a sponsor could generally only suspend these contributions mid-year if the plan terminated. But during 2009, the IRS allowed these plans to suspend these contributions if the plans were amended, timely notice was given to employees, participants were allowed to change their deferral elections and the discrimination tests were performed for the plan year.

Increasing employee morale

Matching contributions increase employee morale. Safe harbor contributions allow highly compensated employees to put away the maximum 401(k) contribution. And returning to match funding is advantageous to key executives who wish to defer the maximum. Doing so could help retain these valuable and key personnel during these highly competitive times.

Safe harbor contributions guarantee that the plan passes discrimination testing. And as the plan sponsor, the company can take a tax deduction for such funding. If your company terminated high safe harbor matching contributions, simply adding a discretionary matching contribution at any amount will encourage employees to participate.

Starting a new plan

Some companies may have frozen the plan or terminated it entirely. In cases of termination, the plan participants may have been paid out their account balances so there's no further opportunity to participate in a plan.

If you want to start a new retirement plan, consider employee involvement. Use a poll of employee options and interests to determine if employees will even make pretax deferrals into a plan. Consider your company's cash flow to determine whether to make a matching contribution or not. If key employees or highly compensated employees want to defer the maximum without failing any specific tests, your plan may need a safe harbor matching contribution — especially if employees won't be participating much in the plan.

Changing for the better

Changing your plan contribution rules may be a quick way to help reinvigorate your employees' retirement accounts. Doing so is a great way to retain — and attract — key employees.

Are you ready for your 403(b) plan audit?

Many nonprofit organizations offer 403(b) plans to their employees, just as for-profit businesses offer 401(k) plans. In the past, 403(b) sponsors had a very limited filing requirement compared to their 401(k) sponsor counterparts. But that's all changed.

For plan years beginning in 2009, 403(b) plans subject to ERISA will need to file a detailed return, just like other pension plans. For example, these plans previously had to file only a three-page Form 5500 with primarily just the first page completed, covering very basic plan information. No schedules were required to be attached, and there were no audit requirements.

ERISA 403(b) plan sponsors will have to provide plan financial information by filing a complete Form 5500, as well as all schedules that apply, including the schedule which reports the plan financial information. This applies to both large and small plans.

In addition, organizations that sponsor 403(b) plans with more than 100 participants at the beginning of the plan year will now need to comply with IRS audit requirements. To determine whether your plan has more than 100 participants, add up, as of the first day of the plan year beginning in 2009:

- The number of current employees who were actively participating,
- Current eligible employees who had declined to participate, and
- Former employees with an account balance.

If this total is more than 100, you'll need to obtain a plan audit.

If an audit is required, your CPA will review and comparatively report both current year and prior year plan financial information. The CPA also will analyze data at the participant level and determine whether your organization has the proper internal controls in place. At the end of the process, your CPA will issue an audited financial statement that you'll attach to your annual Form 5500 return.

Because organizations with 403(b) plans haven't had to consolidate plan financial information in the past, these new requirements may pose a challenge. Therefore, ERISA 403(b) plan sponsors who now have to file a more detailed return, whether for a large plan requiring an audit or a small plan, should begin gathering the required financial information for their 2009 403(b) plan Form 5500.

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