



## Workforce Reductions and Partial Plan Termination

**SITUATION:** Because of current economic conditions, our company has been forced to let quite a few people go this year. A colleague told me that if we cut our workforce too much, the reduction could cause a partial termination of our 401(k) plan.

**QUESTION:** Is that true, and what does it mean for our plan?

**ANSWER:** Yes, a partial plan termination can occur on account of participant turnover. When a partial plan termination occurs due to turnover, participant employees who had a severance from employment during the period must become 100% vested in the amounts credited to their plan accounts, regardless of how long they had been employed. If the benefits are not made nonforfeitable, the plan risks the loss of its tax qualified status.

**DISCUSSION:** According to the IRS, a participant turnover rate of 20% or more creates a “presumption” of partial termination. However, the determination of whether or not a partial plan termination has occurred will ultimately depend on the facts and circumstances of the particular situation. In some instances, a facts-and-circumstances test may show that a turnover rate of 20% or more is routine for the plan sponsor or for employers in the sponsor’s industry and, thus, that a partial termination has not occurred.

You can determine your company’s turnover rate by dividing the number of employees participating in your plan who had an employer-initiated severance from employment during the “applicable period” — generally, the plan year — by the total number of employees participating in the plan at the start of that period, plus any employees who became participants during the year. The applicable period can be longer if a series of related severances from employment occurs.

Employer-initiated severance generally includes nonvoluntary severance for any reason other than the employee’s death, disability, or retirement on or after normal retirement age. Severance can be considered employer-initiated even if it is caused by an event outside of the employer’s control, such as an economic downturn.

**COMMENT:** Even if you’ve made a substantial reduction in your workforce, you may be able to show that your turnover rate is routine or comparable to that in your industry and that a partial termination has not occurred.

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## Sign Them Up

Immediate participation (one month or less of service) is the most common type of eligibility used by 401(k) plans, according to the Profit Sharing/401(k) Council of America's most recent plan eligibility survey. In 2008, 55.1% of the plans surveyed allowed employees to begin contributing immediately — up from 51% in 2007 and just 24% in 1998. An even greater percentage of larger plans allow immediate participation — 68.2% of those with 1,000 to 9,999 employees and 74.4% of plans with

10,000 or more employees. Just under 12% of all plans have a three-month or 90-day waiting period.

Employers are not so quick to offer contributions. Employees are eligible for immediate employer matching contributions in only 38% of the plans surveyed. Nearly a third of plans have a one-year eligibility period for these contributions. Non-matching employer contributions are available immediately in 21.8% of the plans surveyed.

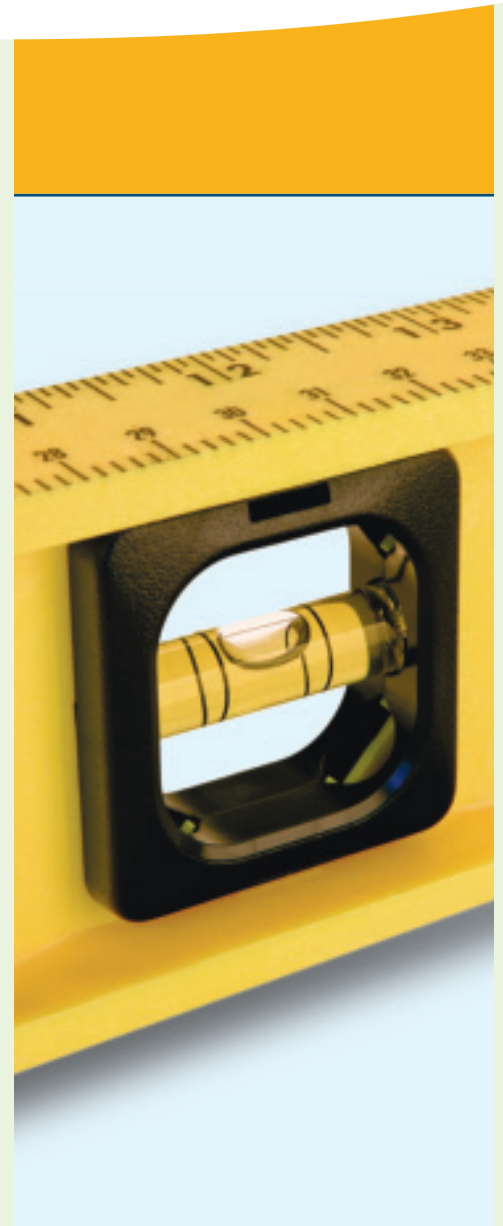
## Reallocation Versus Rebalancing

According to the Center for Retirement Research at Boston College, 401(k) account balances on average dropped 30% in 2008, leaving many employees uncertain about what to do concerning their plan investments. You may be able to help your employees get their accounts back on track by providing them with information about the importance of periodically *rebalancing* their account investments and *reallocating* account assets as they approach retirement — and making sure they understand the difference between the two.

Studies show that plan participants typically do not adjust their asset allocations when returns on one type of investment outpace other investment returns — as stocks did running up to 2008. Nor do they tend to reallocate as they approach retirement age. This inaction may account for some employees having higher stock allocations at the beginning of 2008 than were appropriate given their risk tolerance and suffering greater losses than they might have with more appropriate allocations.

For employees approaching retirement age, focus on asset reallocation. Provide information that can help them develop a new asset allocation in line with their risk tolerance and investment horizon. For those who may not want to sell stock investments now at a loss in order to move money to fixed income choices, explain how they can direct new contributions to fixed income investments to achieve their new allocation.

Employees with a longer investment horizon should be encouraged to rebalance their accounts to their targeted asset allocation, unless their situation or risk tolerance has changed. All 401(k) investors should review their accounts periodically and rebalance them as necessary. For most people, rebalancing annually, if needed, is sufficient.



## Handling Former Employees' Account Balances

The combination of 2008's steep stock market decline and workforce reductions have left some employers with an abundance of low-balance plan accounts owned by former employees.

These accounts can be costly to maintain and burdensome to administer. What can employers do? Below we answer questions about handling these small accounts.

**Can we cash out small accounts?** Check your plan's provisions. Under federal law, plans can provide that, if a former employee has not made an affirmative election to receive a distribution of his or her account assets or to roll those assets over to an IRA or another employer's plan, the plan can distribute the account — as long as its balance does not exceed \$5,000. For accounts valued at \$1,000 or less, the plan can simply send the former employee a check for his or her balance. Distributions of more than \$1,000 must be directly transferred to an IRA set up for the former employee. Accounts valued at \$1,000 or less may also be rolled over for administrative convenience.

**Do all account assets have to be counted in determining whether mandatory distributions are permitted?** No. You only have to include the value of the former employee's nonforfeitable accrued benefit. If the employee was not fully vested in any portion of the account when he or she left your employ, you do not have to count the nonvested portion. In addition, a plan may provide that any amounts that the former employee rolled over to your plan from another employer's plan (and any earnings on those rolled over assets) are to be disregarded in determining an employee's nonforfeitable accrued benefit. Thus, you may be able to cash out and roll over accounts greater than \$5,000. Note that rolled over amounts are included in determining whether a former employee's accrued benefit is greater than \$1,000 for purposes of the automatic rollover requirement.

**What are the fiduciary requirements for rolling over a small account?** To fulfill your fiduciary duties as a plan sponsor, the following requirements must be met:

- The rollover must be a direct transfer to an IRA set up in the former employee's name.
- The IRA provider must be a state or federally regulated financial institution, such as an FDIC-insured bank or savings association or an FCUA-insured credit union, an insurance company whose products are protected by a state guarantee association, or a mutual fund company.
- You must have a written agreement with the IRA provider that addresses appropriate account investments and fees.
- The IRA provider cannot charge higher fees than would be charged for a comparable rollover IRA.

(Other fiduciary responsibilities apply.)

**How should the rollover IRA be invested?** The investments chosen for the IRA must be designed to preserve principal and provide a reasonable rate of return and liquidity. Examples include money market mutual funds, interest-bearing savings accounts, certificates of deposit, and stable-value products.

**What, if any, disclosures are required?** Before you cash out an account, you must notify the former employee in writing, either separately or as part of a rollover notice, that, unless the employee makes an affirmative election to receive a distribution of his or her account assets or roll them over to another account, the distribution will be paid to an IRA. As long as you send the notice to the former employee's last known mailing address, the notice requirement generally will be considered satisfied. In addition, you must include a description of the plan's automatic rollover provisions for mandatory distributions in the plan's summary plan description (SPD) or summary of material modifications (SMM).

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.



## RECENT DEVELOPMENTS In Benefit Plans

### Employee Expectations

**Plummet.** A record low 13% of employees surveyed in the Employee Benefit Research Institute's (EBRI's) *19th Annual Retirement Confidence Survey* (released in April 2009) said that they are very confident of having enough money to live comfortably in retirement, and a record high 22% said they are not at all confident. Employees also expect to have to work longer and supplement their

income in retirement by working for pay. Of those surveyed, 28% said the age at which they expect to retire has changed in the past year, with 89% of them saying they have postponed retirement to try to increase their financial security. Also, the proportion of employees who said they plan to work after they retire increased to 72% in 2009, up from 66% in 2007. About 34% of retirees surveyed reported that they actually

worked for pay at some time during retirement.

### How Much Are Employees

**Saving?** Not nearly enough, according to the same EBRI survey. More than half of the workers surveyed reported that the total value of their household's savings and investments, excluding the value of the primary home and any defined benefit plan benefits, is less than \$25,000. A fifth said they have less than \$1,000 in savings.

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