THE EMPLOYEE BENEFIT
Forum
current issues in retirement benefit planning

qualified PLANS LLC

Curbing Enthusiasm for Plan Loans

SITUATION: We allow our employees to borrow against their 401(k) plan account balances. We understand that the ability to take out a loan can reassure employees that they have access to their account assets if they need them and can increase plan participation and contribution rates. However, we have to spend time and money administering the loans. And we're concerned our employees may be hurting their chances for a comfortable retirement by borrowing too much and too often.

QUESTION: Other than not offering loans, what can we do to discourage employees from taking unnecessary plan loans?

ANSWER: You can take a number of actions to limit plan loans, including educating employees about the pitfalls of plan loans and placing restrictions on loans.

DISCUSSION: Eliminating plan loans entirely might hurt plan participation. Instead, to discourage employees from taking plan loans they may not really need, provide information about both the advantages *and* disadvantages of borrowing from a 401(k) plan account. While employees may already know about the ease and convenience of plan loans, they might not be aware that:

- Loan repayments are made with after-tax money.
- Taxes will be paid again when the money is distributed from the plan.
- It can be difficult to continue to save for retirement *and* pay back a loan.
- If they leave employment, loans generally must be repaid at that time.
- If a loan isn't repaid, the outstanding balance would be treated as a taxable withdrawal subject to both income tax and a possible 10% early withdrawal penalty.

Before processing a loan request, provide employees with a summary of the potential disadvantages of a plan loan.

Other actions you can take to discourage excessive loans include:

- Limiting the number of outstanding loans an employee can have at one time.
- Limiting the number of loans an employee can take in a 12-month period.
- Restricting borrowing to only money that the employee has contributed.
- Increasing the loan origination fee.

To potentially reduce the number of loan defaults, arrange for repayment to be made through payroll deductions or automatic checking account deductions.

Target Date Funds — A Popular Choice

Target date funds are an increasingly popular 401(k) plan investment choice, especially among participants in their 20s. A study recently released by the Employee Benefit Research Institute and the Investment Company Institute found that at the end of 2012 (the most recent data available):

- 42.6% of the 401(k) account balances of employees in their 20s who had worked for their employer for two or fewer years were held in target date funds (up from 40.2% at the end of 2011).
- For all participants in their 20s — both those newly hired and those not — 34.2% of their assets were invested in target date funds.
- Only 12.5% of the 401(k) assets of participants in their 60s were invested in target date funds.

Nearly three quarters of the 401(k) plans in the study (72.3%) offered target date funds in their investment lineup in 2012, versus 72.2% in 2011. The database examined in the study covers over 60,000 401(k) plans of varying sizes.

Four Basics Participants Need To Know

Studies show that employees who understand the need to save for retirement and the fundamentals of their employer's plan are more likely to participate in and contribute to the plan. Receiving information on the following four topics can help participants successfully save for retirement. How many of them are covered in your employee education materials?

When To Start Saving. Ideally, employees should start contributing to their retirement plan accounts as soon as they're eligible. The earlier an employee begins to set aside money for the future, the longer that money can benefit from potential long-term compounding. Your materials should clearly explain all of the advantages of starting early.

How Much To Save. While saving any amount is good, many employees aren't saving enough to provide the retirement income they'll need. One way to encourage employees to increase their contributions is to offer an employer match of up to a certain percentage of pay. If you already offer a match, you may want to review it.

Investment Returns. Employees need to choose investments with the potential to earn returns that will help them reach their long-term goals. It's essential to educate and inform plan participants about their investment options, diversification, risk, and the potential impact of inflation. Increasing participant knowledge of these investment concepts can help them make better retirement planning decisions.

When To Retire. Help preretirees transition from working full-time and accumulating savings to being retired and spending their retirement savings. To help employees determine when to retire, provide information about assessing retirement income needs, retirement readiness, plan distribution options and their potential tax consequences, and when to start receiving Social Security benefits.

Your materials should clearly explain all of the advantages of starting early.

New Safe Harbors for Accepting Rollovers

Plan sponsors are sometimes wary of accepting rollovers from other retirement plans. They're concerned they might inadvertently accept a distribution that's not a valid rollover contribution and, possibly, jeopardize their plan's tax-exempt status. In a move that should simplify the process for many rollovers, the IRS recently issued guidance (Rev. Rul. 2014-9) that provides new safe harbor procedures for confirming that an amount received is a valid rollover contribution. Below, we answer questions about accepting rollovers.

What amounts can be rolled over? To qualify for a tax-free rollover, a distribution must come from an eligible retirement plan. The distribution cannot be a required minimum distribution (RMD) or a defined periodic payment, a hardship withdrawal, or a distribution from an inherited individual retirement account (IRA). Before accepting a rollover contribution, the administrator of the receiving plan (often the plan sponsor) should "reasonably conclude" that the contribution is a valid rollover contribution.

How does a receiving plan determine if a potential rollover contribution is a valid rollover contribution? Existing regulations provide examples of situations in which a plan administrator may reasonably conclude, absent facts to the contrary, that a distributing plan is a qualified plan and that a potential rollover contribution is valid. For example, the receiving plan can obtain a letter from the transferring plan stating that the transferring plan has an IRS determination letter that indicates the plan is qualified. (The regulation notes that a receiving plan could reasonably conclude a potential rollover contribution is a valid rollover contribution in the absence of a determination letter.)

What if the plan administrator later discovers that the rollover contribution was not a valid rollover contribution? The administrator must distribute the rolled-over amount (plus any earnings) back to the participant within a reasonable amount of time or risk plan disqualification.

How does the new guidance help sponsors? The ruling provides two example situations that illustrate new due diligence safe harbors a plan sponsor can rely on to satisfy the requirements for reasonably concluding that a potential rollover contribution is a valid rollover contribution. Under the IRS ruling:

- A plan administrator may reasonably rely on a distributing plan's most recently filed Form 5500 to evaluate whether the plan is qualified for rollover purposes. The U.S. Department of Labor maintains a database with these filings at *www.efast.dol.gov*. If the distributing plan does not identify itself as a non qualified plan on the form, the receiving plan can assume it is a qualified plan.
- If the distribution check from a plan is payable to the receiving plan "for the benefit of" the employee, the receiving plan's administrator can reasonably conclude that the distributing plan treated the distribution as an eligible rollover distribution.
- Rollovers may be transacted by wire transfer or other electronic means, as long as all necessary information is transmitted to the receiving plan.
- In the case of a direct plan-to-plan rollover, the administrator can reasonably conclude that any RMDs for the year have already been distributed prior to the rollover.

Similarly, it is reasonable for a plan administrator to conclude that a check (or wire transfer) from an IRA titled in the employee's name can be rolled over if (1) the amount is payable to the receiving plan's trustee for the benefit of the employee and (2) the employee certifies that the distribution includes no after-tax amounts and that he or she will not reach age 70½ by the end of the year of the transfer. (For an employee who has attained age 70½ by year-end, the administrator should obtain additional information indicating the annual RMD has been made.)

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RECENT DEVELOPMENTS In Benefit Plans

Applying the DOMA Decision. The IRS recently released Notice 2014-19, which includes questions and answers about applying the U.S. Supreme Court's decision in *United States v. Windsor*.* The decision held Section 3 of the federal Defense of Marriage Act (DOMA) unconstitutional, thus recognizing same-sex marriages for purposes of federal law. Here are some key points of the notice:

- Plan qualification rules that apply because a participant is married — for example, spousal consent to waive a qualified joint and survivor annuity — apply to participants who are married to individuals of the same sex.
- Operationally, a plan must recognize a participant's same-sex spouse as of the date of the decision — June 26, 2013. However, a plan will not be treated as failing to meet tax law requirements merely because, prior to September 16, 2013, it recognized a participant's same-sex spouse only if the participant was domiciled in a state that recognized same-sex marriages.
- A plan has to be amended only if the plan's terms are inconsistent with the decision or the related IRS guidance. For example, a plan that defines a spouse by reference to DOMA or only as a person of the opposite sex must be amended.
- Any amendment generally must be adopted by December 31, 2014, or, if later, the due date of the employer's tax return for the year that includes the amendment's effective date.

* 570 U.S. ___, 133 S.Ct. 2675 (2013)