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NEW RULES GOVERNING DEFAULT INVESTMENTS FOR SELF-DIRECTED 401(k) AND PROFIT-SHARING PLANS

Late last year the U.S. Department of Labor (DOL) issued final regulations addressing the selection of default investment options for participant-directed accounts in 401(k) and profit-sharing plans. The regulations describe how contributions for participants in these types of plans can be invested when the participant *fails to provide* investment instructions. Generally, they encourage making life cycle or targeted retirement date funds or a balanced fund, the default option, as opposed to a money market fund. The regulations provide needed

certainty and relief that will be helpful to employers who maintain these plans.

By way of background, Section 404(c) of ERISA provides that a plan sponsor is generally not responsible for investment losses to a participant's self-directed account if those losses result directly from the participant's exercise of control over the account, provided that a variety of investment options are made available under the plan and disclosure and notice requirements are met.

In the past, the DOL took the position that this protection was not available in the absence of *affirmative* participant investment elections. However, in August 2006, Congress passed the Pension Protection Act (PPA) which made many important changes to the rules governing ERISA-protected retirement plans. Among other things, the PPA extended the relief for participant-directed accounts to default elections that apply when a participant fails to provide affirmative investment instructions.

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U.S. SUPREME COURT: 401(k) PARTICIPANT CAN SUE FOR FIDUCIARY BREACH

A recent U.S. Supreme Court decision, LaRue v. DeWolff, Boberg & Associates, Inc., received a lot of attention in the general press. In that case the Court concluded that a participant in a defined

contribution plan could sue a plan fiduciary under ERISA Section 502(a)(2) when claiming that a fiduciary breach caused a loss of plan assets allocated to his 401(k) account. The Court deter-

mined that in a defined contribution plan, the participant could make a claim without regard to the number of participants affected or the percentage of plan assets im-

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DANZIGER & MARKHOFF LLP WORKING WITH ITS PENSION CLIENTS TO SATISFY STRICTER FUNDING RULES FOR DEFINED BENEFIT PENSION PLANS

The Pension Protection Act of 2006 (PPA) establishes new funding requirements for defined benefit pension plans, effective for plan years beginning in 2008. For calendar year plans, the new funding rules apply for calendar year 2008. Our firm will coordinate with our clients to smooth the way to comply with the new rules.

The passage of PPA was intended to remedy the many poorly funded defined benefit pension plans that exist in the United States. When an employer has a financial setback and goes out of business, the liabilities of its underfunded defined benefit pension plan are generally transferred to the Pension Benefit Guaranty Corporation (PBGC), a quasi-government agency that insures the benefits in defined benefit pension plans. Thus, PBGC, and hence the taxpayers, “bail-out” the employer for sponsoring its underfunded pension plan.

Many companies had been able to satisfy the funding standards under prior law, and nevertheless, had underfunded plans. Therefore, Congress felt that it needed to tighten up the funding rules.

Prior to PPA, the plan’s actuary would choose an appropriate funding method and assume reasonable actuarial assumptions. If the contributions earned a reasonable investment return, generally, the plan assets would adequately satisfy the plan’s liabilities when due.

PPA changes all of this.

PPA mandates the funding method, interest rates and mortality table that must be used to compute the annual minimum required contribution. The flexibility that the actu-

ary previously had has been eliminated. The new funding rules force an employer to generally fully fund an underfunded plan within a seven year period.

Moreover, a new measurement rod has been created called the “Adjusted Funding Target Attainment Percentage” (AFTAP). The AFTAP compares the value of the plan’s assets with the plan’s liabilities with certain adjustments. Under the PPA, an AFTAP certification must be prepared by October 1 for a calendar year plan. The AFTAP percentage will determine whether lump sums are restricted and whether benefits need to be frozen effective as of the AFTAP certification date. Generally, when the AFTAP is less than 80%, lump sum benefit payouts are restricted.

When the AFTAP is less than 60%, not only are lump sums restricted, but future benefit accruals must cease.

While the underfunding problem that PPA came to address generally related to large pension plans, small plans are affected by PPA as well. Even in the case of a small pension plan, the mandated funding method and actuarial assumptions discussed above must be used in computing the minimum required contribution and an AFTAP certification is required. Satisfying the AFTAP requirements means that our office must coordinate more closely with our pension clients as to funding amounts and deadlines, etc., and we will be doing just that.

Importantly, PPA does not disturb the fundamental appeal of defined benefit pension plans. Significant contributions may still be made to these plans. For example, the following chart provides an estimate

of the first year contribution that may be made on behalf of a plan participant of a newly established plan in 2008:

<u>Age</u>	<u>Contribution</u>
40	\$57,500
45	\$78,400
50	\$113,800
55	\$151,000
60	\$202,400

Thus, the defined benefit pension plan still provides outstanding tax advantages.

Moreover, while stricter funding rules normally apply, a pension plan may still be amended to provide the flexibility that an employer may want. For example, if the computed contribution is too much under the current terms of a pension plan, that year’s contribution may be decreased to an acceptable level if an amendment is timely executed. The amendment must, however, be executed before the benefit accrues for the current year.

IRS is continually publishing new guidance. Danziger & Markhoff LLP will keep you posted as to any new developments that may occur. ▀

For more information about this topic, please contact William Miller, M.S.P.A., M.A.A.A., COPA.

NEW RULES GOVERNING DEFAULT INVESTMENTS FOR SELF-DIRECTED 401(K) AND PROFIT-SHARING PLANS

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In order to take advantage of this rule, the statute requires that (1) the plan must give participants notice that in the absence of affirmative participant direction, their account will be invested in a default investment, and (2) the assets of the plan must be invested in default investments in accordance with DOL regulations.

Those regulations were finally issued in October 2007. Under the Regulations, relief is provided to plans that offer a broad range of investment alternatives if the account of a participant who has been provided an opportunity to provide investment directions, but fails to do so, defaults into a "Qualified Default Investment Alternative" (QDIA).

Under the Regulations, **a QDIA is (1) a life cycle fund or targeted retirement date fund or (2) a balanced fund or (3) a professionally managed account that takes under consideration the participant's age or retirement date.**

Significantly, a money market account or other capital preservation

or stable value fund does not qualify as a QDIA beyond the first 120 days after the participant's first elective contribution to the plan. (As an exception, under a transition rule, a capital preservation or stable value fund may continue to serve as a QDIA with respect to investments made in these funds before December 24, 2007.) Accordingly, plan sponsors that used to use money market accounts as their default investment in participant-directed plans should consider moving these account balances into a life cycle fund, targeted retirement date fund or other QDIA.

Under the Regulations, Section 404(c) relief applies to default investments in a QDIA if all of the following requirements are met:

- Contributions are invested in a QDIA;
- The participant had the opportunity to, but did not, direct the investment of his account;
- *The participant receives a notice at least 30 days before the default investment provision goes into effect and for each subsequent year providing information about the*

QDIA and the participant's transfer rights;

- Appropriate material about the QDIA that is provided to the plan is furnished to the participant;
- The participant has the right to transfer out of the QDIA consistent with the terms of the plan, but not less frequently than quarterly and, during the first 90 days of a participant's investment in the QDIA, can do so without restrictions, fees or expenses (*i.e.*, no surrender charges or exchange fees); and
- There are at least three diversified investment options available with materially different risk and return characteristics.

If you are interested in taking advantage of these rules in order to reduce your exposure to fiduciary liability, please contact Jay Fenster, Esq. or Ira Langer, Esq. and they will work with you and your plan's financial advisor to make your plan's investment arrangements compliant with ERISA 404(c) and the QDIA requirements.

IRS-MANDATED PLAN RESTATEMENTS

The IRS is requiring that all qualified retirement plans be revised in their entirety to reflect a series of tax law changes that were adopted over the last several years. While in operation the changes are already in effect and, in many cases, are already reflected in plan amendments, the IRS is mandating that plans be totally restated and that these changes be incorporated into

the body of the revised plan document.

To ease the burden on the IRS and pension practitioners, the process is being spread out over a series of years. With respect to volume submitter defined contribution plans, which includes most 401(k), savings and profit-sharing plans prepared by Danziger & Markhoff LLP, the plan must be updated and resubmit-

ted to the IRS sometime between May of this year and April 2010. We will be contacting our clients to inform them about the steps that need to be taken to keep their plans in compliance.▪

Please contact Andrew E. Roth, Esq., Ira Langer, Esq. or Jay Fenster, Esq. with any questions you may have.

U.S. SUPREME COURT: 401(k) PARTICIPANT CAN SUE FOR FIDUCIARY BREACH

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pacted by the breach.

In this case, LaRue was a participant in a 401(k) plan that permitted participants to direct investments among a menu of investment options. LaRue claimed that the plan fiduciaries breached their duties by failing to carry out his investment instructions which, in turn, resulted in a \$150,000 diminution in his account balance.

Before this court case, it was widely believed that in order to

bring a law suit under ERISA Section 502(a)(2), the plan as a whole had to be adversely impacted by a fiduciary breach. In LaRue, the Supreme Court decided that while that may be true in a defined benefit pension plan, nonetheless, in a defined contribution plan, such as a 401(k) or profit-sharing plan, Section 502(a)(2) authorizes personal recovery for fiduciary breaches that impair the value of plan assets in a participant's individual account.

The Court's ruling expands the potential ERISA fiduciary claims for

which plaintiffs can seek to be made whole. It reinforces the need for plan sponsors and fiduciaries to act carefully and prudently with respect to plan administration and investment of plan assets, even in plans that provide for participant-directed investments. ■

If you would like to discuss the ramifications of this Supreme Court decision, we invite you to call Jay Fenster, Esq., Andrew E. Roth, Esq. or Ira Langer, Esq.

AVOIDING PENALTIES FOR LATE DEPOSITS OF EMPLOYEE 401(k) CONTRIBUTIONS

The U.S. Department of Labor ("DOL") has proposed a new safe harbor dealing with the time by which an employer must deposit 401(k) and other participant contributions in a 401(k) plan. Under the new proposal, employers with plans with fewer than 100 participants must deposit 401(k) and other participant contributions in the plan's trust account *not later than the 7th business day* after the day such amounts are withheld from payroll or otherwise received. Failure to do so will result in penalties.

Under prior regulations, an employer was required to remit 401(k) contributions as of the earliest date on which such contributions could reasonably be segregated from the

employer's general assets, but in no event later than the 15th business day of the month following the month in which the contributions are received by the employer or, in the case of amounts withheld from wages, would otherwise have been payable to the participant. In plan audits, the DOL consistently took the position that the 15th day of the following month rule was not a safe harbor. Accordingly, in many cases, DOL assessed penalties when contributions were remitted only a few days after they were withheld from payroll.

The Proposed Regulations are a welcome development. First, they provide a 7 business day bright line test. There is no longer a need to

determine when contributions could "reasonably be segregated". Second, they are somewhat more liberal than what some difficult DOL agents were previously asking for, in that they always allow for 7 business days.

While the new rule is in proposed form, plan sponsors are allowed to rely on it immediately, until Final Regulations are issued. It is still to be seen if a similar rule will be adopted for larger plans. ■

Please contact Ira Langer, Esq., Andrew E. Roth, Esq. or Jay Fenster, Esq. if you have any questions about this new proposal.

Let us know if you would like to receive future issues of our newsletters by e-mail. All we need is your e-mail address. Please either fax your request to our office, attention: Paula Peck at (914) 948-1706 or e-mail Ms. Peck at Ppeck@dmlawyers.com.

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