

CURRENT ISSUES AFFECTING EMPLOYEE BENEFIT PLANS

Knowing the Rules and Proper Planning Will Prevent Problems

Regulatory and legislative changes may affect the operation and qualification of your employee benefit plans. The more significant issues include partial plan terminations, increased pension funding requirements, legislative changes embodied in the Pension Protection Act of 2006, and the timely remittance of participant contributions in salary deferral plans.

Be Aware of Partial Plan Termination Rules

The economic crisis has resulted in the downsizing of businesses and thus, reductions in the workforce and changes in the operation of employee benefit programs. As a result, there may be unanticipated consequences. Sponsors of tax-qualified retirement plans should be aware of the special vesting rules relating to partial plan terminations and should be ready to act as necessary to protect such a plan's status. Affected participants may become fully vested because of a partial termination which, under Internal Revenue Service guidelines and revenue rulings, would occur when organizations reduce their workforces in excess of 20 percent. If it is determined that there is a qualifying partial plan termination, all of the affected employees' benefits vesting becomes accelerated.

Prior to these regulations relating to partial plan termination, an employee would not be entitled to his or her unvested accumulated benefits in the plan. Currently, a participant who is terminated would become fully vested in these benefits. This is something that many plan

sponsors do not realize, since they had not previously experienced such significant workforce reductions.

It is important to note that employee terminations because of poor performance do not trigger a partial plan termination. In addition, the frequency and timing of

have increased the funding levels for plans. Another factor greatly affecting employee benefit plan funding is the stock market downturn that has resulted in large losses in plan asset values. Notwithstanding these effects, companies must still meet actuarial requirements for minimum annual contributions to defined benefit

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separate layoffs may be considered to be linked and together could be deemed to result in a partial plan termination. There have been several court cases dealing with the issue, but the courts have not established any bright-line rules. The determination of whether a partial termination has occurred is an operational determination. Companies need to be familiar with and understand the partial termination rules and the financial effect of this action on their benefit plans prior to announcing any sizable layoff of workers. It is important for employers and plan sponsors to discuss these issues with their plan advisers as necessary prior to a planned termination.

The Challenge of Meeting Funding Requirements

The Pension Protection Act of 2006 was designed to improve the funded status of underfunded plans and to provide a clearer view of the funded status of defined benefit pension plans. The funding rules are complex, and in many cases, they

pension plans. Combine these requirements with the current economic climate and deteriorating business conditions and they pose a significant dilemma for employers and plan sponsors. Not only are asset values down, but plan assets haven't earned the returns of recent years, further affecting the funding requirements for plans and their funded status and causing further financial hardship for the plan sponsor. An additional consequence of these conditions is the impact of the recently adopted accounting rules which require the funded (or in many cases, the underfunded) status of plans to be reflected in the financial statements of plan sponsors, causing large decreases in owners' equity and potentially putting companies in default of credit agreement covenants.

Many companies are exploring alternatives to maintaining their existing defined benefit plans including freezing plan benefits or implementing defined contribution plans. Freezing a plan does not eliminate the

ongoing need to fund the plan, but could result in lower funding by eliminating the service cost element of pension cost. Plan sponsors need to critically review their benefit plans and assess their viability and value in today's regulatory and economic environment. Should the plan be "frozen"? Should the current plan be eliminated and a new one established in its place? These questions must be answered, but only after a full understanding of all related risks to the organization.

the Department of Labor ("DOL") is untimely remittance of participants' salary deferral contributions to defined contribution plans. The DOL has specific guidelines governing the timeliness of depositing participant contributions into plans, including the requirement to deposit these funds into the employee's account as soon as the company can segregate these funds. This generally should coincide with the segregation of the company's tax payments for deposit

itself to DOL and IRS sanctions as well as be required to reimburse each participant's account for the greater of actual plan earnings or the IRS-mandated rate. The best practice is to make prompt deposits into employee accounts as soon as the money is segregated.

The issues posed by today's current economic conditions and more stringent regulations are challenging to all companies that sponsor employee benefit plans. However, awareness of the rules and proper planning and consultation with its advisers can help any organization administer its plans in a more efficient, cost-effective, and compliant manner. ■

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Many companies that have defined benefit plans are retaining those plans. Careful consideration must be given by plan sponsors, in counsel with their advisers, before taking any action to eliminate, freeze, or replace those plans. An appropriate strategy must be developed to minimize the negative impacts to the plan, the participants, and the plan sponsors.

with the government. Because of cash flow constraints, some companies are delaying these deposits and using these funds for working capital purposes. Some employers are now remitting the employee contributions well beyond the point in time when these amounts have been segregated.

Timely Remittance of Contributions: The DOL Is Watching

Another issue that is occurring with some frequency and attracting the attention of

This practice, once detected by the DOL, can cause a company financial hardship through penalties and excise taxes and potentially impact the qualified status of a plan. The company could subject

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