Retirement Times

NEWS AND UPDATES FOR RETIREMENT PLAN SPONSORS AND FIDUCIARIES

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No Beneficiary Designation. Who Gets The Money?

According to a recent Wall Street Journal article, retirement plans and IRAs account for about 60 percent of the assets of U.S. households investing at least $100,000.[1] Both state and federal laws govern the disposition of these assets, and the results can be complicated, especially when the owner of the account has been divorced and remarried. Therefore, it is important for plan fiduciaries of qualified retirement plans to understand their role regarding beneficiary designations and the regulations that dictate.

Under ERISA and the Internal Revenue Code, in the case of a defined contribution plan that is not subject to the qualified joint and survivor annuity rules[2], if a participant is married at the time of death, the participant's spouse is automatically the beneficiary of the participant's entire account balance under the plan. A participant may designate someone other than his or her spouse as the beneficiary only with the spouse's notarized consent.

If the owner of a retirement plan account is single when he or she dies, the assets go to the participant's designated beneficiary, no matter what his or her will states. In addition, the assets will be distributed to the designated beneficiary regardless of any other agreements including even court orders. If the participant fails to designate a beneficiary, the terms of the plan document govern the disposition of the participant's account. Some plan documents provide that in the absence of a beneficiary designation the participant's estate is the beneficiary, while others provide for a hierarchy of relatives who are the beneficiaries. Because of the variances in plan documents, it is important that fiduciaries review the terms of their plan document when

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faced with determining who the beneficiary is in the absence of the participant's designation. The beneficiary determination can become complicated when a retirement plan participant divorces. Where retirement benefits are concerned, both the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code contain provisions requiring plans to follow the orders of state courts overseeing domestic disputes that meet certain requirements. These orders are referred to as "qualified domestic relations orders" (QDROs).

Until recently, the federal courts have failed to adopt a reliable and uniform set of rules for adjudicating disputes among beneficiaries with competing claims. Some courts, adopting a strict reading of ERISA, simply pay the benefit based on the express terms of the plan; while others, with a nod to such concepts of "federal common law," look to documents extraneous to the plan (e.g., the divorce decree, a waiver, or some other document) to make the call. In Kennedy v. Plan Administrator for DuPont Savings and Investment Plan, the U.S. Supreme Court settled the matter, coming down squarely on the side of the plan document.

The facts in Kennedy are straightforward: A plan participant married and designated his wife as his beneficiary. The plan participant and his wife subsequently divorced. Under the terms of the divorce decree, the participant's spouse surrendered her claim to any portion of the benefits under the participant's retirement plan. As sometimes happens, the participant neglected to change his beneficiary designation under the plan to reflect the terms of the divorce. As a result, his ex-spouse remained designated as his retirement plan beneficiary. Upon the death of the participant, the plan administrator, following the terms of the plan document and the beneficiary designation, paid the participant's account to the ex-spouse. Predictably, the participant's heir (his daughter in this instance) sued on behalf of the estate. The Supreme Court ruled that under the terms of the plan document, the designated beneficiary receives the participant's death benefits, and in this case, the ex-wife was the designated beneficiary entitled to the participant's account.

Another common example occurs following a divorce, when a plan participant designates his or her children as beneficiaries. If the participant later remarries, and dies while married to the second spouse, the second spouse is automatically the participant's beneficiary unless he or she consents to the participant's children being designated as the beneficiaries.

There are steps that plans can take to make the beneficiary process less prone to error. For example, a plan document can provide that divorce automatically revokes beneficiary designations with respect to a divorced spouse. It also behooves plans to review their communications materials to help ensure that participants are made aware of the rules that apply to the designation of beneficiaries.

Many plans that have had to deal with issues like these have decided to take inventory of their current beneficiary designations on file and attempt to remediate any deficiencies directly with the participants. Some have also requested their recordkeeper to insert a note in participant's quarterly statement reminding the participant to confirm their beneficiary designation is current and accurate. Both are good ideas.

As a plan sponsor you have the best wishes of your participants in mind and helping ensure their beneficiary designations are in order is another way to protect them and help ensure their intentions are carried out. Consider distributing this month's accompanying participant memo that reminds participants of the importance of keeping their beneficiary designations up to date.

[1]*Family Feuds: The Battles Over Retirement Accounts*
[2]*This commentary addresses only plans that are not subject to the qualified joint survivor annuity (QJSA) rules. Typically, retirement plans are designed not to be subject to the QJSA rules by meeting the following requirements: (1) upon death, 100 percent of the participant's vested account balance is payable to the surviving spouse; (2) the participant does not elect a life annuity; and (3) the participant's account balance does not include any assets subject to the QJSA rules, such as a transfer from a money purchase pension plan. Please contact your plan service team for questions related to defined benefit pension plans and money purchase pension plans subject to the QJSA rules.*

Recruit, Retain, Reward

Recruiting, retaining and rewarding key employees are not just goals of the largest companies in America—they are important to all companies. That's why, in today's environment, no plan sponsor can have a truly meaningful conversation about its total rewards package and retirement plan's design without discussing non-qualified deferred compensation plans (NQDCPs).

What is a NQDCP?

As people live longer and lead more active lives, retirement plans and Social Security payments may not provide enough income for the highly compensated to sustain their lifestyle in retirement. That's why NQDCPs have become the primary retirement savings benefit for highly compensated employees and are therefore an important benefit consideration for any plan sponsor.

- An NQDCP is an agreement between an employer and one or more employees to defer receipt of future compensation to a later date or dates. The employee's plan account reflects an unfunded, unsecured promise from the employer and is subject to risk of the employer's bankruptcy/insolvency.
- The plans were developed to offer top employees a pre-tax deferral opportunity commensurate with their income.
- Highly compensated executives, who may not need the income right away, contribute to these plans to defer the income and the tax liability associated with it. This allows for the full amount of compensation to operate inside the NQDCP on their behalf over time.
- The plans also offer flexible payment options, making the account balances available at a specified time when employees know they will need it.

Why offer an NQDCP?

Benefits to Participants	Benefits to Companies
The ability to defer more pre-tax compensation in addition to a retirement plan to help meet income replacement goals, with the added benefit of tax-deferred investment returns.	The ability to recruit, retain and motivate key employees with a benefit program designed to help them plan for retirement and other financial goals.
Helping reduce the impact of high income tax rates by lowering current taxable income.	Tailoring the NQDCP to help meet corporate objectives by setting eligibility requirements, designing vesting schedules to strengthen retention and offering company matches.
Choosing from flexible payout options to meet short- and long-term goals, whether for retirement income needs, college tuition expenses, a mortgage payoff or a second home purchase.	Helping manage bottom-line impact by informally funding the NQDCP's liabilities, which can help support the promise to pay future benefits and minimize income statement volatility.

Providing highly compensated executives with effective retirement income solutions can be challenging for employers who do not offer NQDCPs. Conventional qualified retirement planning programs—such as 401(k) plans—have statutory limits on the amount participants can contribute on a pre-tax basis, and restrict employers' matching contributions.

Additionally, many industries face severe challenges driving sufficient retirement plan participation due to their employee demographics. This further limits the ability of highly compensated employees to participate in the retirement plan, and thus, their ability to defer sufficient income to maintain their standard of living once they retire.

NQDCPs offer you an attractive solution to this very real problem for your key employees. For more information on NQDCPs, please contact your plan adviser.

This article was written by Prudential.

NOTE FROM LEBEL & HARRIMAN: A well-constructed NQDCP can provide substantial benefits at multiple levels when objectives of the sponsoring company and participants are served, but as with most products, a complete analysis of benefits and cost is prudent. NQDC assets, whether contributed by employees, the company, or both are considered assets of the company until distribution is made. This tends to benefit the sponsoring company's balance sheet. While there is the ability to hold plan assets in a trust (Rabbi Trust) to disallow the company to use these assets during the active life of the contract and company, in the event of company bankruptcy these assets might become accessible to creditors. As a result, some participants might be reluctant to contribute if they are not convinced of the long-term solvency of the sponsoring company.

In situations, where corporate solvency is not a concern the NQDC can be set up to act as an "excess" plan, allowing contributions that may be disallowed due to qualified plan testing issues or limitations. The excess amounts are directed to the NQDC plan. The NQDC plan can also be used as an employee reward program. By definition a non-qualified plan can be discriminatory in terms of whom, and to what extent, it is designed to benefit.

When NQDC is a fit, it can be very successful. Please consult with your plan advisor to assist further in the evaluation process.

Improper Handling of Hardship Distributions May Result in Significant Problems

These days, many plans are experiencing an uptick in the number of participant requests for hardship distributions. Much of this increased activity may be attributed to our prolonged and tepid economic recovery.

As these requests are considered, you want to be sure not to act to the detriment of your plan. Improper handling of hardship requests can ultimately result in plan disqualification. It is important to understand what the law, and your plan document, allows so your actions do not result in unintended but impermissible hardship distributions.

First, the law requires that any hardship distribution can only be made due to a participant's immediate and heavy financial need.

The law does not permit a distribution in excess of the amount necessary to satisfy the need, which cannot be met by other resources reasonably available to the participant. Unless the plan has knowledge to the contrary, the regulations allow a plan to rely on the participant's written representation that the need cannot be reasonably relieved by insurance, liquidation of other assets, cessation of contributions, distributions, or non-taxable loans from employer plans or commercially available loans.

Also, assets available for distributions are limited to the participant's accumulated elective contributions, exclusive of earnings but reduced by losses.

If the plan allows hardship distributions, the plan document must specifically state so.

A safe harbor set of guidelines for what qualifies as an immediate and heavy financial need can be incorporated into the plan document. Also, regulations provide for the availability of safe harbor provisions to be included in the plan document to aid in determining if the distribution may be deemed necessary as long as any other loan or distribution available under the plan has been exhausted and the participant is suspended for making elective contributions for at least six months.

Take this opportunity to review your plan's hardship provision to make certain that you are following its procedures correctly. Remember, inconsistent, sloppy, or overly liberal distributions may result in significant problems for the plan.

Are You Ready for an Audit?

Several events can trigger a DOL or IRS audit, such as employee complaints or self-reporting under the annual submission of the Form 5500. Often times an audit is a random event, which is why you should always be prepared. Listed below are several key items typically requested in an initial letter sent by the IRS or the DOL in connection with a retirement plan audit. These items should be readily accessible by the plan administrator at all times the plan is in operation.

- Plan document and all amendments
- Summary plan description
- Investment policy statement
- Copy of the most recent determination letter
- Copies of Forms 5500 and all schedules
- Plan's correspondence files (including meeting minutes)
- Plan's investment analyses
- ADP and ACP testing results
- Most recent account statements for participants and beneficiaries
- Contribution summary reports (i.e., evidence of receipt of these monies by the plan's trust)
- Loan application, amortization/repayment schedule (for all loans)

If you have questions about preparing for an audit, or need plan design review assistance, please contact your plan service team at Lebel & Harriman.

COMMUNICATION CORNER: Is Your Beneficiary Designation up to Date?

This month's employee memo reminds participants of the importance of naming a beneficiary to their retirement plan account in the event of death.

Please feel free to call or email Nate Moody at (207) 773-5390 or nmoody@lebelharriman.com, if you have questions

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