Kidder Benefits Consultants, Inc. 5700 Westown Parkway, Suite 100
West Des Moines, IA 50266
www.askkidder.com
phone 515.254.1178
toll free 800.300.3086

April 2009

National Edition
Volume 3 Issue 2

Consulting Offices:
Omaha, Nebraska
Albuquerque, New Mexico
Rochester, Minnesota

Regional Consulting and
Administrative Office:
Tucson, Arizona

Ask Kidder.®

Do you need to change your plan to suit the changing business environment?

Several clients have recently asked how to reduce or eliminate their plan contributions. Others have asked for new plan designs that would allow them to increase their plan contributions and resulting tax deductions. The changing business environment is creating both challenges and opportunities for plan sponsors. That's why it's good to know your options.

How can we increase our contributions and tax deductions?

For some plan sponsors, the individual contribution limits of a 401(k) plan are too restrictive, maxing out at $49,000 in 2009 ($54,500 for those age 50 or more). That's why a record number of plan sponsors have asked us to help them establish new defined benefit plans over the past year.

Contributions to a defined benefit plan are calculated by an enrolled actuary and are not strictly limited as in a 401(k) plan. Instead, the actuary calculates the contribution necessary to achieve a desired retirement benefit. Although the maximum plan benefit is limited, annual contributions could exceed $200,000 for an employee nearing retirement age. For example, an employee with an annual salary of $195,000 can enter a defined benefit plan at age 52 and retire at age 62 — just 10 years later — with an accumulated benefit worth more than $2.3 million. One of the most popular types of defined benefit plans is a cash balance plan.

What's a cash balance plan?
Cash balance plans define the retirement benefit as a hypothetical account balance and include a hypothetical interest credit to add to the account each year. With a traditional defined benefit plan, the present value of benefits fluctuates up and down as interest rates change, but this doesn't happen in a cash balance plan. Cash balance plans are therefore more stable and predictable. In some cases, a cash balance design actually provides the employer with a lower employee benefit cost.

Cash balance plans are also valued for their simplicity. Participants easily understand the benefit within a cash balance plan — it's their account balance, which is clearly shown on each statement. When they retire, that balance is the exact amount they receive. And since the balance does not decrease, rank-and-file participants are comforted by knowing their account is protected from investment risk. Of course, this means all of the investment risk for portfolio losses is carried by the contributing plan sponsor: the employer. That's why you should work closely with your Financial Professional and Kidder administrator to develop a sound actuarial and investment strategy.

How can we reduce our contributions?

It depends on the specific provisions of your Plan Document.

What if you have a Safe Harbor 401(k) Plan with a 3% Safe Harbor Nonelective?
Currently, the only way to eliminate the 3% Safe Harbor nonelective contribution requirement during the plan year is to terminate the plan. However, the IRS has received letters asking for an additional option. Based on recent comments by Treasury officials, we are optimistic that relief will be provided. However, it is likely that this relief will only apply prospectively. If contributions must be reduced during 2009, this leaves two options:

- Terminate the plan (described below) or
- Wait for relief from the Treasury (45 days?).

To terminate the plan, a resolution and an amendment must be adopted. In addition, unless the plan sponsor is experiencing a "substantial business hardship" or control is changing due to a company transaction, the following actions are required:

- Provide a 30-day notice before the termination date;
- Apply ADP/ACP tests for the year of termination; and
- Fund contributions through the termination date.

The criteria for determining "substantial business hardship" include (but are not limited to) whether or not:

- The employer is operating at an economic loss;
- There is substantial unemployment or underemployment in the trade or business and industry concerned; and
- The sales and profits of the industry concerned are depressed or declining.

Continued on Page 2

The terms "substantial" and "depressed" are not defined by the regulations. Financial hardship can include additional factors, so consider all relevant facts and circumstances when determining whether or not you are experiencing a true financial hardship.

If you terminate the plan, Treasury Regulation 1.401(k)-1(d)(4) prohibits establishing a new 401(k) plan or profit sharing plan until at least 12 months after the assets of the terminating plan have been paid out.

If terminating the plan is out of the question, you can wait for relief from the Treasury, which we hope to see soon (hopefully within 45 days). The risk of taking this approach is that the 3% contribution requirement may continue to accrue. If you do not want to terminate the plan, and the Treasury does not provide relief, the plan must continue as a safe harbor nonelective plan (requiring the 3% contribution) until the end of the current plan year. The plan can be amended to remove the safe harbor contributions for the next plan year, but this amendment must be adopted before the end of the current plan year.

What if you have a Safe Harbor 401(k) Plan with a Safe Harbor Match?
A plan with a traditional safe harbor matching formula generally provides a matching contribution equal to at least 100% of the first 3% of pay deferred, plus 50% of the next 2% of pay deferred. This type of plan can be amended during the year to remove the safe harbor match. A resolution and amendment must be adopted to officially stop the match, and the following actions are also required:

- Provide a 30-day notice before the match ends;
- Apply ADP/ACP tests for the year of the amendment; and
- Fund the safe harbor contribution through the date the match ends.

But take care. Removing the safe harbor match will subject you to top heavy minimum contributions, which may end up costing you more. The top heavy minimum applies to all eligible non-key employees, not just those who contribute salary deferrals. Thus, removing the safe harbor match should only be done after careful analysis by your Kidder administrator.

The plan could also be terminated, following the same steps described above for a 3% Safe Harbor Nonelective 401(k) plan. But again, watch out for the top heavy minimum. In addition, the plan could continue as a safe harbor plan, requiring the safe harbor match until the end of the current plan year. Or the plan could be amended to remove safe harbor contributions for the next plan year, but the amendment must be adopted before the end of the current plan year.

What if you have a traditional 401(k) Plan with a Fixed Match?
A traditional 401(k) plan may be amended any time during the year to eliminate or reduce its fixed matching contribution. If a participant meets the allocation conditions before the plan is amended, the plan must fund the matching formula up to the date of the amendment. However, if a participant has not satisfied the allocation conditions before the plan is amended, the match does not have to be funded for the year. Unlike with Safe Harbor formulas, a traditional 401(k) plan is not required to provide an advance notice when the formula is reduced or eliminated. The amendment will only need to be described in a summary, which is not due until 210 days after the end of plan year.

What if you have a traditional 401(k) Plan with a Discretionary Match?
If the plan and the SPD are clear that the match is discretionary, there are no IRS rules that would prevent the match from being reduced or ignored. However, if participants have already received notice of the matching formula for the current plan year, they might sue. To avoid the possibility of litigation, it may be prudent to provide participants with a second notice that the match will end, then funding the match through that date.

What if you have a Defined Benefit Plan (including Cash Balance Plans)?
The contribution required for a defined benefit plan must be determined by an enrolled actuary. There are two main factors that determine the required contribution amount.

The first factor is based on the value of benefit accruals for the year, known as the normal cost. The plan's normal cost can be reduced or possibly eliminated during the year. Most defined benefit plans require a maximum of 1,000 hours of service in order to accrue a benefit for the year (some plans require less). If the participants have already satisfied this requirement for the year, an amendment will have little or no affect on the plan's normal cost until next year. Thus, it's important to notify your Kidder administrator as early as possible if you're considering reducing your contributions for the year.

If you need to reduce your plan's normal cost, a plan amendment must be adopted to officially change the benefit accrual formula, and the following actions are also required:

- Provide advance notice (15 or 45 days) before the date the accruals change; and
- Provide a notice describing the magnitude of the reduction.

The second factor is the amortization amount. This is the difference between plan assets and plan liabilities as of the

Continued on Page 3

5700 Westown Parkway, Suite 100
West Des Moines, IA 50266
www.askkidder.com
phone 515.254.1178
toll free 800.300.3086
April 2009
National Edition
Volume 3 Issue 2

actuarial valuation date. This portion of the plan cost cannot be changed by amending the plan.

Qualified Plans are very adaptable to changing economic and business conditions, but meeting the various regulations and timing deadlines can be tricky. That's why you should visit with your Kidder Primary Administrator and Kidder Pension Consultant to discuss the appropriate alternatives.

What are Kidder's administrative policies regarding Cash Balance and Defined Benefit plan investments?

Cash Balance and Defined Benefit plans are funded with employer contributions. The investment risk of satisfying the actuarial return assumptions for the plan is the responsibility of the plan sponsor/employer, not the individual plan participant. In other words, if the plan's investments lose money, the plan sponsor/employer must make up for the losses in the investment pool.

As a result, it is very important to match the investment returns achieved in the investment pool to the actuarial rate of return being utilized by the plan actuary. Since most Cash Balance and Defined Benefit Plans currently utilize an actuarial rate of return ranging from 5% to 6%, investment asset allocation is typically much more conservative than the typical allocation for an individual 401(k) plan participant. The investment policy statement (IPS) for the plan should clearly outline investment goals.

Because contributions are required, it is equally important to minimize your investment risk. As discussed above, when liabilities exceed assets, the plan cannot be amended to change required contributions due to amortization costs. In addition, if any employees are accruing maximum benefits under the plan, even a large investment return will not allow benefits to increase beyond the 415 limits imposed by the Internal Revenue Code.

NOTICE: No Required Minimum Distributions for 2009

If you are over age 70½, you may skip your required minimum distribution for 2009. Congress is considering extending this even beyond 2009. If your first minimum distribution is for calendar year 2008 (due on April 1, 2009), this distribution is considered a 2008 minimum and cannot be skipped.