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Ask Kidder.®

Do you need to modify your deferral deposit process to comply with the new Department of Labor requirements?

On January 14th, the Department of Labor (DOL) released final regulations regarding the seven-day safe harbor standard for depositing employee salary deferrals and loan repayments applicable to plan sponsors of "small plans" covered by the Employee Retirement Security Act of 1974 (ERISA). This regulation (29 CFR Part 2510), which amends paragraph (a)(1) and (f)(1) of Section 2510.03-102, is immediately effective and applies to plans which have fewer than 100 participants at the beginning of the plan year.

Under the new regulations, if an employer deposits withheld amounts in the plan trust no later than the seventh business day following the employee payday, then the employer has satisfied the requirements to pay the contributions as soon as reasonably practical.

Background

The reason for this safe harbor is to help determine when a deferral from a participant's wages is considered a "plan asset" for purposes of Title I of ERISA and the prohibited transactions rules of the Internal Revenue Code (IRC). In the past, by not depositing deferrals on a timely basis, some employers effectively utilized the deferred dollars as a form of interest free loans or additional cash flow. As a result, the DOL issued a final rule (29 CFR 2510.3-102) in 1988, defining the timeline as the "earliest date on which such contribution can reasonably be segregated from the employer's general assets, but in no event to exceed 90 days from the date on which such amounts are received or withheld by the employer." Amendments were published in August 1996, reducing the outside limit to the "15th business day of the month following the month in which participant contributions are received by the employer."

However, neither of those timelines was considered a "safe harbor" protecting the employer from potential liability. The 1988 regulation, the subsequent 1996 amendments and the new regulation were created to assist employers, plan fiduciaries, record keepers and plan service providers in satisfying the overriding "general rule" which has not changed since the original 1988 regulation. The general rule, as restated in the new regulation, is to provide "that amounts paid to or withheld by an employer become plan assets on the earliest date on which they can reasonably be segregated from the employer's general assets."

What is "safe harbor" protection?

Simply put, if deferrals are deposited within the seven-day safe harbor window, employers can be assured that they are not unnecessarily holding plan assets. No other proof is required to show that deferrals were deposited at the earliest reasonable date. While the seven-day window is a safe harbor, it is not mandatory. If an employer makes a deposit after the safe harbor date, they may still be able to demonstrate that the deposit was made as soon as practical. The safe harbor applies separately to each payroll.

There is a penalty for not satisfying the general rule. The employer must calculate losses and lost interest on late contributions, starting with the actual date (not the safe harbor date) that the contributions reasonably could be segregated. In such a case, the employer uses the Voluntary Fiduciary Correction Program (VFC) of the DOL to make penalty calculations and corrections for delinquent contribution violations.

Impact

The DOL has noted that many small employers will have to immediately modify their internal processes in order to satisfy this new regulation. The DOL estimates that only 21 percent of eligible single-employer defined contribution plans (about 64,000 plans) currently contribute all participant contributions within seven days. Nearly 70 percent (about 215,000 plans) contribute some but not all within seven days, and 10 percent (about 32,000 plans) are consistently later than seven business days.

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Scope beyond 401(k) plans

In addition to 401(k) plan deferrals and loan payments, this regulation covers participants in any contributory plan covered under ERISA, including 403(b) plans and welfare benefit plans. Even non-ERISA plans, such as SIMPLE IRAs and salary reduction SEP plans are subject to the regulation. However, for SIMPLE IRAs (operating under Section 408(p) of the IRC), the maximum period that a deferral may be treated as other than plan assets remains 30 calendar days.

What about plans with over 100 participants?

The general rule discussed above remains the rule for all plans of any size. An extension of the safe harbor was considered for large plans. But the DOL did not believe it had sufficient information to evaluate the practices and assess the costs, benefits and risks of extending the safe harbor to these groups at this time. Unofficial comments from DOL representatives have indicated that large plans should be making their deposits even sooner than small plans.

Conclusion

Review and consider modifying your deferral deposit processes in order to satisfy the seven-day safe harbor. Contact your Kidder Consultant and Primary Administrator with any additional questions.

Reminder - Form 5500 Electronic Filings Required this Year

For plan years beginning on or after January 1, 2009, every qualified retirement and welfare plan under Title I of ERISA is required to file Form 5500 electronically. (See November 2009 Ask Kidder newsletter for more details.) This includes 401(k), 403(b), Defined Benefit, Cash Balance and ESOP plans. At Kidder, we are prepared to submit Form 5500 on behalf of our administration and compliance clients.

We are finalizing a step by step communication piece for our clients which will outline the required steps that need to be taken by the plan sponsor. This will be available within the next 30 days.