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Retirement PLAN news

How to locate missing participants

In 2004, the Department of Labor (DOL) issued guidance (FAB 2004-02) on locating missing participants in terminating defined contribution (DC) plans. One of the steps called for using a federal letter-forwarding program. At the time, both the IRS and the Social Security Administration offered letter-forwarding services, but those programs have since been discontinued.

The DOL recently issued new guidance (FAB 2014-01) on locating missing participants of terminating DC plans. This article is a discussion of the guidance.

Search steps

When a retirement plan is terminated, a plan administrator must generally distribute all plan assets within one year of the plan's termination date. Prior to making distributions, the plan administrator must contact plan participants (and beneficiaries) to explain the process involved in distributing their account balances. The DOL provides a model notice at *www.law.cornell.edu/cfr/text/29/2550.404a-3*.

Administrators often have difficulty locating some former employees. Under FAB 2014-01, the required steps for locating missing participants are:

1) **Use certified mail.** This is an easy and often inexpensive way to determine if a participant can be located.
2) **Check related plan and employer records.** Other employer plans, such as a group health plan, may have more up-to-date information. If there are privacy concerns, a fiduciary can simply ask a provider to forward a letter to the missing participant.
3) **Check beneficiary records.** Contact the individuals the missing participant named on his or her beneficiary form to obtain updated contact information.
4) **Use free electronic search tools.** This step replaces the letter-forwarding requirement. Plan fiduciaries must make reasonable use of free Internet search tools, such as search engines, public record databases (e.g., those with licenses, mortgages, and real estate taxes), obituaries, and social media.

Additional search methods

Other search methods may involve using credit reporting agencies, investigation databases, and commercial locator services. However, fiduciaries must consider the size of a participant's account balance and the cost of additional search methods. A plan fiduciary is permitted to charge a missing participant's account *reasonable* expenses related to efforts to locate the participant (consistent with the terms of the plan).

Next steps for plan fiduciaries

If a participant cannot be located, the plan fiduciary is responsible for deciding where to put the missing participant's assets and is charged with choosing the

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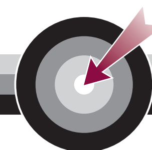

The QLAC is here

Growing concern over retirement income security has led to the development of a new type of annuity contract: the qualifying longevity annuity contract (QLAC). The QLAC is a straight life annuity that begins payout at an advanced age (e.g., 80 or 85). Amounts used to purchase a QLAC are excluded from a plan participant's required minimum distribution (RMD) from age 70½ until the annuity begins. Once annuity payouts begin, they would satisfy the annuity's RMD.

The IRS issued final QLAC regulations on July 1, 2014, and they are effective immediately. Plan sponsors are not required to offer a QLAC. And insurance companies will likely need time to develop these new products. Here are some key features of the QLAC:

- **Maximum permitted investment.** The amount a participant may use to buy a QLAC is limited to the lesser of 25% of the participant's account balance or $125,000. **Example:** If a participant has an account balance greater than $500,000, his or her investment would be limited to $125,000, which is less than 25%. Cost-of-living adjustments will be made in increments of $10,000.
- **"Return of premium" death benefit.** A QLAC can provide that, if a purchaser dies before (or after) the age when the annuity begins, the premiums that have been paid but not yet received as annuity payments will be returned to the purchaser's account. This may appeal to individuals seeking assurance that their initial investment can go to their heirs if they die before receiving payments equal to the annuity's premium. The QLAC may also provide life annuity benefit options for beneficiaries.
- **Correction for exceeding the annuity premium limits.** Individuals who inadvertently exceed the 25% or $125,000 limit on premium payments will be able to correct the excess during a one-year window without disqualifying the annuity purchase.
- **Added flexibility in issuing QLACs.** A contract will not be a valid QLAC unless it states when it is issued that it is intended to be one. Alternatives for providing this statement include furnishing such a statement in an insurance certificate, rider, or endorsement relating to a contract. Contracts issued prior to January 1, 2016, do not have to specifically state they are QLACs, provided the participant is notified in writing that the contract is intended to be a QLAC and a rider containing QLAC language is issued by January 1, 2016.
- **QLAC annual reports.** The insurance company that issues the QLAC will file an annual report with the IRS and the participant (similar to Form 5498, *IRA Contribution Information*). The IRS has yet to develop this form.
- **Plan requirements.** A QLAC must be an annuity purchased by the plan. And the plan must have the ability to distribute the QLAC to the participant, although the QLAC can be provided from within the defined contribution plan. The plan administrator has no responsibility for the QLAC once it is distributed from the plan.

How to locate missing participants

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most prudent investment vehicle. Section 404(a) of ERISA requires plan fiduciaries to consider individual retirement accounts or annuities (IRAs), since IRAs preserve assets for retirement.

IRA safe harbor. A regulation published by the DOL in 2006 (Section 2550.404a-3) included a fiduciary safe harbor covering participant distributions from a terminated DC plan for assets moved into an IRA. The safe harbor requires that the plan fiduciary ensure the investment product is designed to preserve principal and that fees and expenses are not excessive.

Other distribution options. If a fiduciary is unable to find a provider that will accept a rollover distribution (which is very unlikely) or determines that a rollover distribution is not appropriate based on facts and circumstances, there are two additional options:

- Open an interest-bearing, federally insured bank account in the name of the missing participant or
- Transfer the assets to a state unclaimed property fund, subject to the applicable state's escheat laws.

However, these options subject the participant's assets to tax, withholding, and possibly a 10% early distribution tax. By choosing one, a fiduciary might well be violating ERISA's prudence and loyalty requirements. The DOL has confirmed that another alternative — a distribution of 100% income-tax withholding (essentially transferring the account balance to the IRS) — is *not* an acceptable way to distribute a missing participant's benefits.

CIP issues

Fiduciaries may have concerns about legal issues that might prevent them from establishing IRAs or bank accounts for missing participants. The DOL states that banks and other financial institutions will not be required to comply with customer identification and verification provisions (CIP) when an employee benefit plan establishes an account and transfers the funds for the missing participant. CIP programs *will* apply when a former participant or beneficiary first contacts the institution.

PBGC missing participant program

The Pension Benefit Guaranty Corporation (PBGC) has a program for terminating defined benefit plans whereby the PBGC holds funds belonging to missing participants after the plan sponsor has taken all the necessary steps to locate them. Under the Pension Protection Act of 2006, the PBGC is required to create a similar program for terminating DC plans. This program has not yet been created.

Understanding RMDs

The close of another year signals different things for different people. Those of a "certain age" will want to remember to take required minimum distributions (RMDs) from their retirement accounts before December 31.

There are several key differences in the RMD rules for individual retirement accounts (IRAs) and 401(k) accounts. Following is an overview.

When do RMDs begin?

Both IRA owners and 401(k) participants must begin receiving RMDs on their "required beginning date" (RBD). RBD for traditional IRA owners is April 1 of the year following the calendar year in which they reach age 70½. **Note:** It is the IRA owner's responsibility to take his or her annual RMD.

Example: John was born on December 7, 1943, and turned age 70½ on June 7, 2014. His RBD is April 1, 2015.

RBD for 401(k) participants is defined by the plan document. Generally, it is April 1 following the year the participant reaches age 70½ or the year he or she retires, whichever is later. However, there are exceptions. Individuals who are 5% owners of the company sponsoring the retirement plan must begin taking their RMDs by April 1 of the year following the calendar year they reach age 70½. Also, the plan document may require that *all individuals* begin taking RMDs by April 1 of the year following the calendar year in which they reach age 70½.

Can RMDs be aggregated?

The IRS allows individuals who own more than one traditional IRA to calculate their RMD for each one and then withdraw the total (aggregate) of all RMD amounts from any one or more of their traditional IRAs.

RMDs from qualified plans, such as 401(k)s, may not be aggregated. So, if an individual has a 401(k) at more than one employer, the requisite RMD is taken from each employer's 401(k) plan.

Example: Beth has a 401(k) account with her current employer. She also has 401(k) accounts with two previous unrelated employers. Beth, who turned 70½ on June 7, 2014, is retiring in September of 2014, and her RBD is April 1, 2015. In order to satisfy her RMD requirements, she must take an RMD from each of her three different employer's 401(k) plans. She is unable to aggregate them because each 401(k) plan is separately responsible (under Code Section 401(a)(9)) for distributing an RMD.

Beth also has four traditional IRAs. She can aggregate the RMDs from her IRAs and withdraw the total RMD amount from any one or more of her IRAs. But she *may not* aggregate her 401(k) and IRA RMDs.

Can RMDs be transferred or rolled over? RMDs may be included in a trustee-to-trustee transfer from one IRA to another IRA.

Example: John is age 74 and decides to transfer his traditional IRA to another traditional IRA via trustee-to-trustee transfer. He has not taken his RMD for the current year. John may directly transfer his entire traditional IRA balance to the new IRA and take his annual RMD from the new IRA provider.

RMDs may not be included in an IRA-to-IRA rollover (i.e., when an individual withdraws funds from his or her IRA and rolls it over to another IRA within 60 days). RMD amounts must be distributed from the original IRA.

Example: Shawn, age 75, takes a lump-sum distribution from his IRA. His RMD for the current year is $5,000. Shawn subsequently decides to roll over his IRA proceeds to another financial institution within 60 days. Shawn cannot include the $5,000 RMD amount as part of the IRA rollover.

RMDs from 401(k) plans may not be transferred or rolled over. In addition, the RMD rules require that if any amount is distributed during a distribution calendar year, the first amount distributed is an RMD.

Example: Stuart, a retired participant age 76, has been receiving annual RMDs for several years. He decides to transfer his 401(k) balance to an IRA, but his RMD amount may not be transferred. Prior to making the transfer, the distributing firm must pay Stuart his RMD amount for the current year.

What about Roth accounts?

The RMD rules apply to Roth 401(k) accounts but not to Roth IRAs while the owner is alive. Once the Roth IRA owner dies, his or her beneficiary must begin taking distributions.

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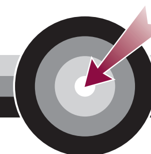

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RECENT developments

Two 2014 plan amendments

In-plan Roth rollover amendment. A 2013 law change modified the in-plan Roth rollover (IRR) rules. Under the revised rules, a distributable event is no longer a required precondition for an IRR. A plan may choose to remove that precondition or keep the more restrictive conditions (allowed since 2010). Plans that have been modified to remove the precondition must be amended by the last day of the first plan year the amendment became effective or December 31, 2014, whichever is later. For 403(b) plans that timely adopted a written plan document, the plan sponsor has until the last day of the yet-to-be announced 403(b) remedial amendment period to adopt an IRR amendment.

DOMA amendment. In *United States v. Windsor*, the Supreme Court struck down Section 3 of the Defense of Marriage Act (DOMA). As a result, for all qualified plan purposes, same-sex marriages are to be recognized as of June 26, 2013. Plans that reference DOMA when defining the terms “marriage” and “spouse” or use language inconsistent with the outcome of the Windsor case must be amended. The deadline to adopt a DOMA amendment is *the later of* December 31, 2014, or the tax-filing deadline (including extensions) for the year the change is effective. **Note:** An amendment may not be needed. Many plans use definitions of marriage and/or spouse that neither refer to DOMA nor to the gender of the marriage partner or spouse.

Defined benefit “smoothing” rules

On August 8, 2014, President Obama signed into law the Highway and Transportation Funding Act of 2014 (HATFA) containing provisions that will temporarily reduce minimum required defined benefit pension plan contributions. The law modifies gradual increases in interest rate corridors for five years. These changes apply retroactively to the beginning of 2013. The increases will become effective after 2017.

The general information provided in this publication is not intended to be nor should it be treated as tax, legal, investment, accounting, or other professional advice. Before making any decision or taking any action, you should consult a qualified professional advisor who has been provided with all pertinent facts relevant to your particular situation.

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