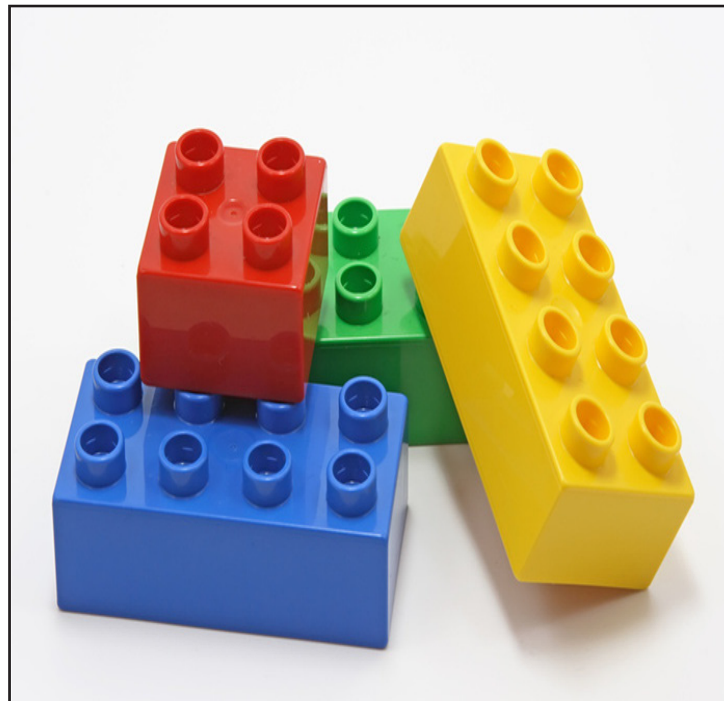
Another 12 Basic Retirement Plan Concepts That Every Financial Advisor Should Understand

By Ary Rosenbaum, Esq.

As stated in my original article on retirement concepts that advisors should understand, financial advisors have enough on their plate. However they should be aware of some very basic concepts on how the industry works in order to stand out among their competition as well as augmenting their client's overall retirement plan experience. It is my belief that better educated retirement plan advisors will help create better retirement plans. This is why my law practice is heavily concentrated on helping advisors with their current and potential retirement plan clients. Hopefully, this article will further help retirement plan advisors understand some more basic retirement plan concepts that can help them develop and maintain their retirement plan book of business.



Plan document: Retirement plans that are governed by ERISA need a written plan document. In addition, the plan document must be updated, as required by the Internal Revenue Code. This may require entirely new plan documents called restatements or tack-on, ancillary amendments to meet a requirement of a new law or regulation. Retirement plans need to be administered according to their terms or risk sanction from the Internal Revenue Service and/or Department of Labor (DOL).

Participant: An eligible employee who has met the eligibility requirements set forth by the plan document that has entered the plan on the plan's entry date is a plan participant. It should be noted that a participant in a 401(k) plan is still considered a participant even if they never defer a cent into the plan.

Investment policy statement: The investment policy statement (IPS) is one of the most important plan documents that too many retirement plans don't have. The IPS sets forth what criteria are used in selecting investment options under the plan and when these options should be replaced. An IPS is extremely important for participant directed plans because the use of an IPS is one of the most important components to minimize liability under an ERISA §404(c) participant directed plan. Helping a plan sponsor develop and maintain an IPS is one of the important roles of a retirement plan financial advisor. For a free sample, please contact me.

Form 5500. The annual reporting return to be filed electronically for all plans subjects to ERISA. Forms 5500 must generally be filed by the last day of the seventh month following the end of the plan year, unless an extension has been granted (July 31 for a calendar year plan). Retirement plans with more than 100 participants (except for those that fall under the 80/120 rules) must also include an audit performed by an independent auditing/accounting firm. Failure to file a Form 5500 can result in huge penalties unless the plan sponsor corrects the problem thorough the DOL's voluntary compliance program. If you have a current or potential client that has failed to make at least one timely Form 5500 have them contact an ERISA attorney to quickly avoid a penalty from the DOL.

The effective date of the Section 408(b)(2) Regulations: The Department of Labor regulation that was supposed to be implemented in April 2012, requiring plan providers to reveal to the plan sponsor direct and indirect compensation that they receive from a plan has now been pushed back to July 1, 2012. So you will have three more months to procrastinate and then panic again. Again, I draft client service agreements for service providers to comply for $1,000 (cheap plug).

Section 404(a)(5) Regulations: Plan sponsors are not the only ones who will finally get the costs of plan administration. Under this new DOL regulation, participants will finally get a disclosure of fees charges against their 401(k) account by September 1, 2012. The total cost in dollars being assessed to plan participants every quarter will be listed clearly on the participant's quarterly account statement. So while plan sponsors will be on the hook for providing this information, plan sponsors will rely on their financial advisors to assist them in providing the information for them to fill out this

disclosure as well as helping make sure the third party administrator helps as well.

Profit sharing contributions: A discretionary contribution made to a participant in a profit sharing or 401(k) plan that is tied to the participant's compensation. In a 401(k) plan, a participant who does not defer would still be entitled to a contribution if the employer makes one. It can take the form as a uniform percentage of compensation (comp to comp), giving a greater benefit to those who earn more than the Social Security Wage Base (integration), an age weighted allocation, an allocation using a points system, or a new comparability/cross tested method that gives bigger benefits to highly compensated employees.

Matching contributions: They are what they say they are, they are an employer contribution that is used to match salary deferrals a participant makes in a 401(k) plan. While plans may have stated matching formulas in their plan document, it is often advisable to have a discretionary formula to make sure in the event an employer can't afford to make a matching contribution.

Vesting: Vesting measures the non-forfeitable right a participant has in the employer contribution portion of his/her account balance. An employee is always fully vested in their own salary deferral contributions. Employer contributions that are not fully vested in the employee are forfeited upon termination of service and payment of the vested account balance to the former participant. A vesting schedule must be at least as liberal as one that provides 100% vesting after 3 years of service or a 6-year graded vesting schedule (increasing 20% a year and beginning in the second year) by law. In addition, a participant becomes fully vested upon attaining normal retirement age.

Hardship Distribution: A 401(k) plan may (but is not required to) allow participants to receive hardship distributions. A distribution from a participant's elective deferral account can only be made if the distribution is: because of an immediate and heavy financial need, and limited to the amount necessary to satisfy that financial need. What governs of what is a hardship is either the plan using its own set criteria or using the safe harbor standards set forth by the Internal Revenue Code. With 401(k) plans that have loans, participants would have to exhaust all loans under the plan in order to receive a hardship. It should be noted that participants receiving hardship distributions prior to attaining age 59 ½ will pay a 10% excise tax.

In-Service Distribution: The option in a plan that allows a participant to receive a distribution of their benefit while still employed by their employer. While defined benefit plans could not offer pre-retirement distributions, a law change now allows plans to offer an in-service distribution at age 62. For 401(k) plans, it should be noted that allowing an in-service distribution from a participant's salary deferrals (other than a hardship distribution) prior to the participant attaining age 59 ½ is a disqualifying plan provision that threatens the tax exempt status of the plan.

Discrimination testing: In order to preserve the tax qualification of a retirement plan, they need to undergo discrimination testing to make sure that the plan does not discriminate in favor of highly compensated employees.

All plans must pass coverage (making sure participation is skewed to benefit highly compensated employees) and a top heavy test (to make sure 60% or more of the benefits in the plan don't benefit key employees). Plans may also have to pass a test regarding benefits (if employer contributions are made), as well as an ADP test (for deferrals in a 401(k)) and ACP test (for matching). If the plan offers a benefit, right, or feature that is limited to some participation, a test has to be done for that as well. While safe harbor 401(k) plans are deemed to have passed top heavy, ACP, and ADP, they still may fail the other discrimination tests if the plan is not designed correctly.

These are just some more of the basic concepts of retirement plan that financial advisors in the retirement plan industry should get a grasp of. If you have any further questions on these concepts or any other questions on how you can grow or maintain your retirement plan book business, considering asking your local TPA or contacts yours truly. As I always state, I never charge an advisor for a phone call because helping financial advisors is one important way in improving retirement plans.

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