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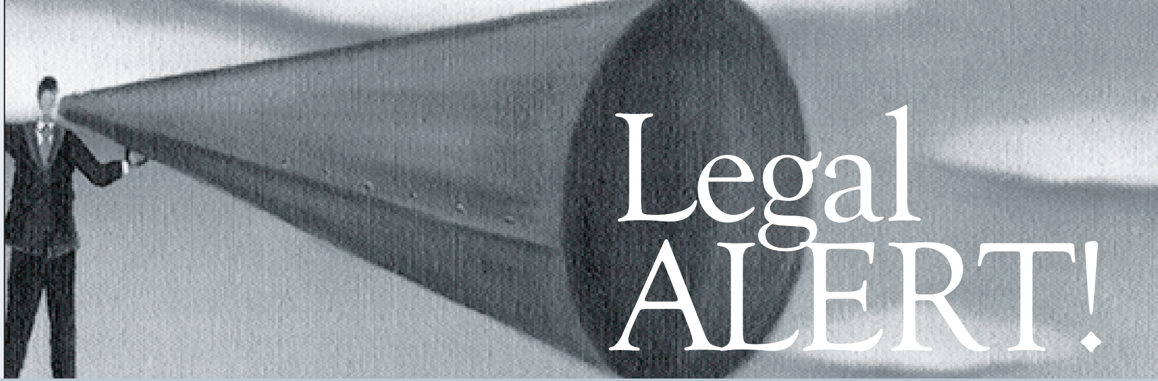

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Recent 401(k) Developments: IRS Sending 1,200 "Compliance Questionnaires"; Support Grows for Annuity Distributions from Defined Contributions Plans

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The IRS has mailed "401(k) Compliance Check Questionnaires" to a random sampling of 1,200 sponsors of 401(k) plans. The IRS announced that the questionnaires were mailed during the week of May 17. *Retirement News for Employers, Spring 2010; www.irs.gov.*

The questionnaire solicits information on a wide range of topics relating to the operation of 401(k) plans. The questionnaire seeks information regarding demographics, participation, employer and employee contributions, top-heavy and nondiscrimination testing, distributions and plan loans, automatic contribution arrangements, designated Roth features, use of IRS voluntary correction programs, and plan administration.

The IRS says that it developed the questionnaire because of the critical role 401(k) plans play in the private retirement system. IRS announcement states that there are nearly half a million 401(k) plans in the United States covering 50 million participants. According to the IRS, 401(k) plans are by far the most non-compliant type of retirement plan.

The IRS says that the 1,200 employers selected to participate were culled from a random sample of 401(k) plan sponsors that filed a Form 5500 for the 2007 plan year.

Although the IRS advises that the primary purpose of the questionnaire is to solicit general information about 401(k) Plans, the cover letter describes the questionnaire as a "compliance check." Speaking at the spring meeting of the Tax Section of the American Bar Association in May, IRS Director of Employee Plan Examinations, Monika Templeman, stated that the IRS may audit respondents if their responses to the questionnaire reveal non-compliance with the tax laws.

The full text of the questionnaire, instructions and related documents are available at the IRS website (http://www.irs.gov/retirement/article/0,,id=223440,00.html)

Support Builds for Use of Annuities in Defined Contribution Retirement Plans

In February 2010, the IRS and the Department of Labor released a "request for information" regarding whether the agencies "could or should ... facilitate access to, and use of, lifetime income or other arrangements designed to provide a lifetime stream of income after retirement." Two recent responses to the RFI add support to the lifetime income option.

The Government Accountability Office (GAO) released a report outlining the growing challenge that retirees will outlive their assets. "Retirement Income: Challenges for Ensuring Income throughout Retirement." The GAO study found that a couple both aged 62 face a 47% chance that at least one of them will live to their 90th birthday. According to the

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GAO, an investor with a well-managed and diversified investment portfolio, who withdrew 4% of his savings each year in retirement, runs 11% chance of exhausting his retirement savings at some point over 30 years, and a 23% chance over 35 years (assuming 3% annual inflation, and a 40/60 mix of stocks and bonds). The GAO noted that the chances of exhausting retirement savings are higher if the investor incurs substantial investment losses early in retirement.

Many retirees who participated in defined contribution plans during their working careers rely on social security retirement benefits as their primary source of lifetime income. The GAO study notes that the highest level of earnings covered by Social Security ($106,800 in 2010) replaces only 26% of pre-retirement income, and at the median level replaces an estimated 47% of pre-retirement income.

The GAO Report found that annuities offering lifetime income generally provide retirees more income than they would receive from conservative investments, such as bonds. For example, GAO's research found that in April 2010, a $100,000 annuity would provide $6,480 per year during the lives of the purchaser and the purchaser's spouse. The GAO contrasted this return against the annual interest generated from a highly rated $100,000 30-year AAA-rated corporate bond ($5,200), and concluded that annuity payout is 25% greater than the income generated by the bond. However, the GAO noted that the principal amount of the bond would typically be available in 30 years (absent a default), whether or not the purchaser or spouse is alive, whereas an annuity generally has no value after the death of the annuitants.

The American Council of Life Insurers ("ACLI") also released a report in response to the RFI. The ACLI report includes specific proposals to increase awareness of lifetime income options and provide incentives to participants to take retirement plan distributions in the form of life annuities. These proposals include:

1. allowing employers to provide education to plan participants regarding lifetime income and other distribution options;

2. changing the law to allow plan administrators to include on participant account statements, an illustration of participant account balances as monthly guaranteed lifetime income in retirement;

3. modifying the "safe harbor" tax notice given to participants with respect to plan distributions to include information on guaranteed lifetime income, including the availability of lifetime income plan distribution options and the importance of income protections; and

4. providing a limited tax incentive to encourage individuals to take all or a portion of their retirement savings as an annuity that guarantees lifetime income.

<u>Hiscock & Barclay, LLP Observation:</u> The IRS and DOL already possess the authority to permit employer education and to modify notice rules to include a description of lifetime income options. However, only Congress can require defined contribution plans to include a lifetime distribution option or provide tax incentives to encourage use of the this option.

If you have any questions or require our assistance in reviewing your policies or conducting management training, please contact the Hiscock & Barclay lawyer with whom you normally work or any attorney in our Labor & Employment practice area.