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Comments of ADP/ACP Safe Harbor Notices and Final 401(k)/401(m) Regulations

Submitted to the
Internal Revenue Service

September 26, 2006

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates this opportunity to comment on the modification of the safe harbor notice requirements in the final regulations under Internal Revenue Code (Code) sections 401(k) and 401(m), as issued by the IRS and Treasury on December 29, 2004 (Final Regulations; TD 9169, 69 Fed Reg 78144).

ASPPA is a national society of retirement plan professionals. ASPPA's mission is to educate pension professionals and to preserve and enhance the private pension system. Its membership consists of over 6,000 actuaries, plan administrators, attorneys, CPAs and other retirement plan experts who design, implement and maintain qualified retirement plans covering tens of millions of American workers.

Background

To qualify for the Actual Deferral Percentage (ADP) test safe harbor of Code §401(k)(12)(A)(ii), plans must satisfy the notice requirements of subparagraph (D). A similar requirement appears in Code §401(m)(11)(A)(ii) to qualify for the Actual Contribution Percentage (ACP) test safe harbor.

Prior to the issuance of the Final Regulations, IRS Notice 2000-3, Q & A 8(vii), permitted the safe harbor notice to cross-reference the plan's Summary Plan Description (SPD) for a description of the plan's withdrawal and vesting provisions. The Final Regulations [Treas. Reg. §1.401(k)-3(d)(2)(iii)] have eliminated the ability to cross-reference the SPD for the withdrawal and vesting provisions of the plan.

In Notice 2005-95, the IRS provided welcome relief to practitioners by delaying this change in the safe harbor notice content requirement until plan years beginning in 2007. ASPPA recommends that this relief be expanded by modifying the Final Regulations as suggested below.

Concerns Regarding Extensive Safe Harbor Notice

Adverse Impact on Plan Participants

The purpose of the safe harbor notice is to encourage participants to make elective deferrals to the plan. Conveying information about the plan is an essential component of this process, especially where the plan provides for a matching contribution. However, there needs to be a reasonable limit in the amount of information contained in the notice in order to efficiently convey the information. For example, duplicating information that is readily available in the SPD, as required in the Final Regulations, makes the notice longer than it needs to be, and potentially intimidates participants who would otherwise be enthusiastic about making salary deferrals to the plan.

Many employee communication experts recognize that the longer the communication material, the less likely it will be read. More specifically, a lengthy plan communication tends to obfuscate its key provisions that might impact a participant's decision to defer. The added length of a safe harbor notice that conforms to the Final Regulations requires participants to distill the

considerations relevant to a deferral election. It is likely to deter many participants from reading the notice at all. The result is that such participants are uninformed and frustrated, and thereby opt not to participate in the plan. This is contrary to the policy behind ADP safe harbor provisions and retirement plan policy in general.

Adverse Impact on Plan Sponsors and Practitioners

The new notice content requirements will provide plan participants with very specific information on vesting and in-service withdrawals, even on amounts unrelated to deferrals or safe harbor contributions. Many ASPPA members, however, are concerned that the change in the content requirement imposes a significant burden on plan providers (which would translate into more expenses for plan sponsors; expenses that are often passed on to plan participants).

The change in the content requirement will significantly increase the size of the notice (*e.g.,* in some situations, the notice would expand from two pages to six or more). A longer notice is more costly to produce and replicate, increasing plan expenses.

In addition, to satisfy the new content requirement, a well-advised practitioner might copy word-for-word the relevant sections of the SPD (which are ostensibly written in a manner calculated to be understood by the average plan participant) directly into the safe harbor notice. If so, then the new content is no different in effect from a simple cross-reference to the SPD and does not provide any additional information to the participants. Again, duplicative information will likely discourage participation.

Alternatively, some practitioners may draft new language for the notice to minimize the length of the notice. In doing so, the practitioner runs the risk of inadvertently creating inconsistencies with the SPD (as well as with the plan document). Such inconsistencies may raise questions concerning plan administration and could give rise to liability.

Some practitioners have suggested that rather than going through a labor-intensive process of creating new safe harbor notices, it would be easier, and potentially safer, to merely put a cover page on an existing SPD stating that it also serves as the safe harbor notice. This would alleviate the burden to the practitioner and employer and would resolve some of the concerns practitioners have in conforming to the Final Regulations' requirements. By merely adding a cover page to the SPD, the goal of having the safe harbor notice to be a condensed description of the safe harbor provisions is not achieved.

Given the burden the new requirement will impose on practitioners, the risk of frustrating and alienating participants, the risk of inadvertent inconsistencies with the SPD, and the potential ERISA and qualification issues that could thereby arise, the approach of using the SPD as the safe harbor notice seems to be the most prudent. This approach may also be sound from a compliance perspective because the Final Regulations do not clarify the extent to which the distribution and vesting provisions must be explained in the safe harbor notice. For example, the vesting provisions could require an explanation of multiple schedules (*e.g.,* a schedule for matching contributions and a schedule for discretionary non-elective contributions) and the definition of service used to determine vesting, including any break in service and leave of absence service crediting rules. The distribution provisions could include similar service conditions, provisions relating to the normal retirement age, disability, the timing of distributions over and under $5,000, the form of payment, etc. Practitioners would want to provide an all-inclusive SPD that would ensure that the safe harbor notice contains all required content.

Nonetheless, as stated above, using the SPD as the safe harbor notice does not fulfill the ostensible goal of the notice, which is to annually give participants sufficient information in a succinct manner to make an informed decision about making salary deferrals.

Recommendations and Conclusions

Conforming to the new content requirement will require extensive time and

resources by the practitioner. Furthermore, increasing the length and complexity of the notice defeats the underlying principle of encouraging participation in safe harbor plans.

IRS Notice 2000-3 provides a thorough, concise explanation of the safe harbor provisions without the drawbacks described above. ASPPA believes that participants would benefit more from a concise and efficient safe harbor notice than from a lengthy, duplicative safe harbor notice.

The Final Regulations' new requirements will likely hinder plan participation while at the same time consuming practitioner and plan sponsor resources. Perhaps most importantly, contrary to the Final Regulations' goal, it will do nothing to improve participants' knowledge and understanding of their plan.

ASPPA recommends that the Treasury and IRS revise the Final Regulations to permit safe harbor notices to incorporate by reference the distributions and vesting provisions of the SPD. From both practical and policy points of view, allowing the safe harbor notice to cross-reference the SPD for the plan's withdrawal and vesting provisions would benefit both plan participants and plan sponsors in having important plan information clearly communicated.

ASPPA also recommends that, in recognition of the fact that a modification of a regulation is a lengthy process, the IRS extend the relief provided in Notice 2005-95 until the effective date of the amended regulation. Such relief should be announced as soon as possible since within the next several months practitioners will need to begin the process of preparing new safe harbor notices for plan years beginning in 2007.

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These comments were prepared by ASPPA's 401(k) Subcommittee of the Government Affairs Committee, Robert M. Kaplan, CPC, QPA, Vice-chair and primary author. Please contact us if you have any comments or questions regarding the matters discussed above. Thank you for your consideration.

Sincerely,

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