



4245 North Fairfax Drive, Suite 750
Arlington, VA 22203
P 703.516.9300 F 703.516.9308
www.asppa.org

Comments on Mid-Year Changes to a Safe Harbor §401(k) Plan

Submitted to the
Internal Revenue Service

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The American Society of Pension Professionals & Actuaries (ASPPA) appreciates this opportunity to comment on mid-year modifications of the provisions of a safe harbor plan under Internal Revenue Code (Code) §§401(k) and 401(m), as requested by the Internal Revenue Service (IRS) and Treasury in Announcement 2007-59.

ASPPA is a national organization of over 6,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, investment professionals, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA unique insight into current practical applications of ERISA and qualified retirement plans, with a particular focus on the issues faced by small- to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-sponsored retirement plan system.

Summary of Recommendations

- A. ASPPA recommends that the IRS provide a list of plan modifications that may be made mid-year without affecting a plan's safe harbor status under Code §§ 401(k)(12) and 401(m)(11). In addition, ASPPA recommends that the IRS provide a list of those provisions that may NOT be modified mid-year without affecting a plan's safe harbor status.
- B. ASPPA recommends that the Service clarify which provisions may be amended mid-year but would require that the plan sponsor provide a supplemental notice to participants. To the extent a supplemental notice is required; ASPPA recommends that plan sponsors be permitted to provide the updated notice within 60 days of the effective date of the modified provision.

Discussion of Issues

Background

To qualify for the Actual Deferral Percentage (ADP) test safe harbor of Code §401(k)(12), plans must satisfy specific contribution and notice requirements of Code §401(k)(12)(D). Similar requirements appear in Code §401(m)(11) to qualify for the Actual Contribution Percentage (ACP)

test safe harbor. In general, plan sponsors must provide notices to participants, and include safe harbor provisions in their plans, prior to the beginning of the plan year for which the safe harbor provisions will apply. Sponsors of safe harbor plans, and their advisors, are concerned about whether certain mid-year changes to a plan may be made without jeopardizing the plan's safe harbor status and whether permissible mid-year changes may require that an updated notice be provided to participants.

In Announcement 2007-59, the IRS provided welcome relief to plan sponsors and practitioners by stating that safe harbor plans may add Roth contribution programs and expand hardship withdrawal provisions in accordance with Part III of Notice 2007-7 after the start of a plan year (*i.e.*, mid-year) without causing the plan to fail the requirements of Code §401(k)(12) or §401(m)(11).

A. Expanding the List of Permissible Plan Design Changes That Will Not Affect Safe Harbor Status

One of the key principles of Code §§401(k)(12) and 401(m)(11) is that a plan is exempt from ADP and ACP (if applicable) tests because employees are adequately informed, prior to the beginning of a plan year, of the advantages and consequences of electing to make deferrals to the plan. Thus, an employer should not be permitted to make a mid-year change to a safe harbor plan if the change would have a significant impact on an individual's decision to participate in the plan. Many plan design changes are beneficial to all participants and may positively affect employees' participation in a safe harbor plan. Other changes will have little or no impact on employees' participation in the plan and these changes should be permitted at any time during a plan year without jeopardizing the safe harbor status of the plan. Two examples of such changes are described in Announcement 2007-59 (adding a provision permitting designated Roth contributions or expanding hardship provisions).

ASPPA recommends that the following list of plan design changes, which will not have a significant impact on an individual's decision to defer, be allowed during a plan year without affecting the safe harbor status of the plan:

1. The addition of hardship provisions to a plan that does not currently contain any such provisions;
2. Adding a nonelective contribution source to a plan (which is separate and distinct from the plan's safe harbor contributions);
3. Altering the allocation method for nonelective contributions other than the safe harbor contributions (while protecting benefits already accrued);
4. Altering allocation accrual requirements for nonelective contributions other than safe harbor contributions;
5. Adding a participant loan provision;
6. Amending the definition of compensation for allocations of nonelective contributions other than the safe harbor contributions;
7. Changing the eligibility terms of the plan (*e.g.*, adding a new division or group of participants);
8. Amending the vesting schedule for accounts subject to a vesting schedule;
9. Adding an automatic enrollment feature to the plan;

10. Modifying distribution provisions (*i.e.*, timing or form of distributions) with respect to accounts attributable to contributions other than elective deferrals and safe harbor contributions; and
11. Modifying investment provisions (*e.g.*, participant directed investment provisions).

Alternatively, or in addition to the list of permissible mid-year modifications, **ASPPA recommends** that the Service provide a list of items that may NOT be modified once the plan year has begun without jeopardizing the plan's safe harbor status.

ASPPA also recommends that in issuing guidance regarding impermissible mid-year amendments, the Service provide exceptions for certain amendments that are made early in a plan year. For example, §2.02(1)(a)(ii)(F) of Appendix B to Rev. Proc. 2006-27 (the Employee Plans Compliance Resolution System or EPCRS) provides a special rule for the brief exclusion (up to three months) from the plan of an eligible employee. Under such an exception, an otherwise impermissible mid-year modification would be permitted if (1) such modification is made within the first three months of the plan year, (2) participants are notified of the modification, (3) participants have an opportunity to modify their deferral elections for a reasonable period of time after the amendment.

B. Clarifying Whether an Updated Participant Notice is Required for Permissible Mid-Year Changes

Some permissible mid-year plan amendments that do not affect safe harbor status may nevertheless impact participant behavior in the plan. For example, the mid-year addition of a designated Roth deferral program will not impact the safe harbor status of a plan, but some employees may want to modify the type of deferrals being made to the plan. IRS Announcement 2007-7, however, does not address whether the employer has an obligation to provide employees with an updated ADP test safe harbor notice when the plan is amended mid-year.

ASPPA recommends that the IRS provide a framework for sponsors to determine (1) which permissible mid-year changes will require an updated notice, (2) the timing standards for any such notice, and (3) whether participants must be provided with an opportunity to modify existing deferral elections. In this regard, ASPPA recommends that the IRS develop guidelines under which a new, mid-year notice will be required only for an amendment that could materially impact a participant's decision to participate in the plan. Under such guidelines, the distribution of a mid-year safe harbor notice would not be necessary in cases where a plan design change has no impact on the deferral decision of participants. In these cases, where there is no urgency to provide an immediate notice of the plan amendment, we suggest that the IRS permit the plan sponsor to communicate the amendment via other legally required disclosure methods, such as an updated Summary Plan Description or Summary of Material Modifications. Examples of such plan amendments that would follow this protocol include:

1. The addition of hardship withdrawal provisions for a plan that does not have them;
2. Altering allocation accrual requirements for non-elective contribution sources;
3. Adding (or altering) a participant loan program;
4. Changing the eligibility terms of the plan (*e.g.*, if adding a new division or group of participants, the new group of eligible participants would receive the notice, but not the otherwise eligible groups who would have previously received the notice); and

5. Changes to the vesting schedule for amounts that are subject to a vesting schedule.

ASPPA also recommends that, to the extent a mid-year notice must be provided to participants, the IRS permit employers to provide the notice within 60 days after the effective date of the modified plan provision. ASPPA considers the 60-day time frame appropriate because it balances the need for participants to be provided with relevant information and at the same time it will allow the plan sponsor adequate time to update enrollment materials and educational material for the plan, as well as conduct employee meetings when appropriate.

Conclusion

Safe harbor plans have become very popular, and sponsors of such plans commonly desire to make mid-year changes to their plans. ASPPA therefore appreciates the IRS's willingness to provide additional guidance on how various mid-year plan design changes may be treated under the safe harbor rules.



These comments were prepared by ASPPA's 401(k) Subcommittee of the Government Affairs Committee, Robert M. Kaplan, CPC, QPA, 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,

/s/

Brian H. Graff, Esq., APM
Executive Director/CEO

/s/

Teresa T. Bloom, Esq., APM
Chief of Government Affairs

/s/

David M. Lipkin, MSPA, Co-chair
Gov't Affairs Committee

/s/

Robert M. Richter, Esq., APM, Co-chair
Gov't Affairs Committee

/s/

Mark L. Lofgren, Esq., APM, Co-chair
Administrative Relations Committee

/s/

Debra A. Davis, Esq., APM, Co-chair
Administrative Relations Committee