




NATIONAL INSTITUTE *of* PENSION ADMINISTRATORS

2013 NAFE

Changes to Vesting Schedules or Service Crediting Methods Wednesday, May 1, 2013

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Take Aways

- Understand the administrative issues associated with various scenarios
- Be sensitive to these issues when drafting amendments to change vesting
- Have an outline that can be used a resource



VESTING SCHEDULES

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Statutory Maximum Schedules

- DC plans
 - 6-year graded
 - 2-20%; 3-40%; 4-60%; 5-80%; 6-100%
 - 3-year Cliff
 - 0 to 2 – 0%; 3 – 100%
- DB plans
 - 7-year graded
 - 3-20%; 4-40%; 5-60%; 6-80%; 7-100%
 - 5-year cliff
 - 0 to 4 – 0%; 5 – 100%

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Exceptions

- 5-year cliff or 7-year graded can still apply to:
 - Matching contributions made for PY beginning before 1/1/02
 - Nonelective contributions (e.g., profit sharing) made before 1/1/07
 - ESOPs with outstanding loans as of 9/26/05
 - Effective date of PPA change is first PY after earlier of:
 - Date of repayment of loan
 - Scheduled repayment date of loan as of 9/26/05

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Exceptions

- Governmental and church plans
- Hybrid (e.g., cash balance) DB plans
 - 3-year cliff
 - Delayed effective date for plans in existence on 6/29/05
- Top-heavy schedules: 6-year graded or 3-year cliff
- Full vesting at NRA
- Full vesting for those affected by partial termination

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AMENDMENTS TO VESTING SCHEDULES

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Amendments to Vesting Schedule

- Not as common in light of more restrictive schedules after EGTRRA and PPA
- 3 rules that may apply:
 - IRC § 411(a)(10) (3 YOS election)
 - IRC § 411(d)(6) anti-cutback Regulations
 - IRC § 401(a)(4) Regulations

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IRC § 411(a)(10)

- Each participant with at least 3 YOS has right to elect to stay under pre-amendment schedule
 - Election can be made within reasonable period of time of adoption of amendment
 - Election not needed if new schedule is more liberal in each year
- Applies to determine “nonforfeitable percentage”
 - Means it applies to entire account (old and new contributions)

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Election Period

- Begins no later than date the amendment adopted and ends on later of:
 - 60 days after adoption
 - 60 days after effective date
 - 60 days after written notice is provided
- 3 YOS is determined without regard to the permissible exclusions for vesting service (e.g., age 18 or effective date of plan)

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411(d)(6) Regulations

- Regulations modified to reflect *Heinz* decision applying anti-cutback rule of IRC § 411(d)(6)
- No amendment can reduce nonforfeitable *accrued benefit*
- This effectively means participants are entitled to the greater vesting percentage of old vs. new schedule based on account balance at time of amendment
 - Old schedule does not apply to future contributions
 - Complicates recordkeeping

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Example

- Plan is amended from 5-year graded schedule to 6-year graded schedule
 - Amendment can provide that Lauren is subject to new schedule only for future contributions
 - Amendment can provide that only new participants are subject to new schedule
- Assume for following examples that amendment applies to existing participants

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Example

- Lauren has 3 YOS
- Lauren elects to remain on old vesting schedule
 - Old schedule applies to *both* old and future contributions
- What is Lauren's vested % (based on 3 YOS)?

	OLD	NEW
1	20	
2	40	20
3	60	40
4	80	60
5	100	80
6		100

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Example

- Lauren has 1 YOS
 - What is Lauren's vested % based on 1 YOS?
 - What is Lauren's vested % based on 5 YOS?
 - Would answer change if Lauren had 3 YOS but did not elect to stay on old schedule?

	OLD	NEW
1	20	
2	40	20
3	60	40
4	80	60
5	100	80
6		100

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Example

- Schedule is amended as below
- Gary has 1 YOS as of amendment
 - What is Gary's vested % based on 1 YOS?
 - What is Gary's vested % based on 3 YOS?
 - What is Gary's vested % based on 4 YOS?

	OLD	NEW
1	20	40
2	20	40
3	50	40
4	75	80
5	100	100

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401(a)(4) Regulations

- Pattern of plan amendments must be nondiscriminatory
- Vesting schedule is an “other right or feature” subject to nondiscriminatory availability
 - Current and effective availability are generally facts and circumstances based test
- Statutory schedules are deemed equivalent
 - All HCEs on 6-year graded and all NHCEs on 3-year cliff is OK?
 - If employer reasonably believes there is a partial termination then full vesting for affected group is nondiscriminatory

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Example

- Bio Engineering, Co. shuts down research division in CA
- Bio reasonably determines there is a partial termination
 - Bio does not file a determination letter request on partial termination
- Those affected by partial termination are disproportionate group of HCEs
 - Since it is statutory requirement, full vesting is not discriminatory
- What if Bio believes there is no partial termination but wants to fully vest affected participants?

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COUNTING VESTING SERVICE

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Year of Service

- 12-month Computation Period (CP) in which EE has at least 1,000 Hours of Service
- No requirement to be employed on a particular day
- Have YOS even if not employed at beginning or end of CP
 - No requirement to work 12 months
 - It is a 12 month computation period during which 1,000 hours of service are completed

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Vesting Computation Period

- May be any 12 month period specified in plan
- Most plans use the plan year as the computation period for vesting purposes

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What is an “Hour of Service”?

1. An hour for which an EE is paid for performance of duties
2. An hour for which an EE is paid for non-performance of duties (e.g., vacation pay, sick pay)
3. An hour for which an EE receives an award for back pay

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Credit for Nonperformance

- Some reasons for pay for nonperformance of duty:
 - vacations
 - holidays
 - illness or incapacity, including disability
 - layoff
 - jury duty
 - military duty
 - leave of absence
- It does not matter whether the employment relationship has terminated at the time of the payment

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Limits on Nonperformance Credit

- Don't have to credit more than 501 HOS for any given computation period for nonperformance
- No need for credits for payments under a plan to comply with:
 - workers compensation
 - unemployment compensation
 - disability insurance laws
- These are credited hours and differ from maternity and paternity absences (hours credited just to avoid a break in service)

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Credit for Nonperformance

- David works 900 hours of service
- David goes on short term disability leave for 4 weeks (160 hours)
 - Insurance company pays David while on leave and disability benefits are reportable on W-2 (i.e., it is employer provided coverage)
- David has 1060 hours of service for vesting

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Counting HOS

- Two options for counting HOS
 - Count actual hours
 - Easy to do for workers paid by the hour
 - Nearly impossible for salaried professional
 - Use equivalency
- Plan document must specify method being used

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Available Equivalencies

- Working hours
 - Disregard nonperformance hours
 - 870 working hours = 1 YOS
- Regular hours
 - Disregard nonperformance & overtime
 - 750 regular hours = 1 YOS
- Earnings method
 - Divide compensation by lowest hourly pay rate
- Employment period method (next slide)

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Employment Period Method

- 1 day = 10 HOS
- 1 week = 45 HOS
- ½ month = 95 HOS
- 1 month = 190 HOS
- 1 shift = Entire length of shift

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Change in Computation Period

- DOL Reg. § 2530.203-2(c)
- Applies where using hours of service method
- Vested percentage can be no less on *any date* after the change than it would be absent the change
- Deemed satisfied if first computation period under amendment begins before last day of preceding computation period

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Examples

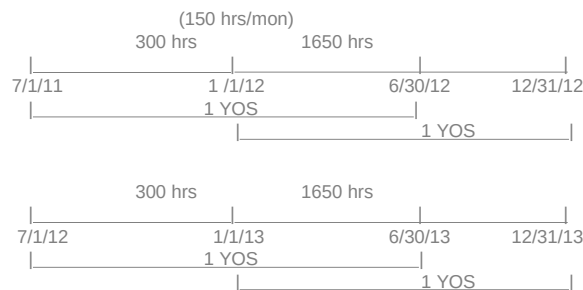
- Computation period is PY
- PY is 7/1 to 12/31
- Amendment to change PY to CY effective 1/1/13
- Determination of YOS – method 1
 - 7/1/12 – 6/30/13
 - 1/1/13 – 12/31/13
- Determination of YOS – method 2
 - 1/1/12 – 12/31/12
 - 1/1/13 – 12/31/13

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Computation Period Example

- Amendment effective 1/1/13 to change from 7/1 to CY PY
- 2 Methods to determine vesting



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A Change in Computation Period?

- New CY plan with initial short plan year of 7/1/12 – 12/31/12
- Plan provides that vesting computation period is the PY
- No authority to have a computation period of less than 1 YOS

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Elapsed Time Method

- Based on period of time that elapses while EE is employed
- Period of Service
 - Starts on Date of Hire
 - Ends on “severance from service” date = the earlier of date of severance (e.g., quit) or one year after a leave of absence
- Period of Severance
 - Starts on the “severance from service” date
 - Ends when employee returns to service

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Elapsed Time (cont'd)

- Service spanning rule
 - If employee returns to work within 1 year, then must be credited with that year
 - Period of Severance can also be Period of Service
- 1-Year Period of Service for vesting is number of whole years
 - 12 months (30 days equals month) OR 365 days
 - Fractional periods are added up
- Break in Service (BIS) = a period of severance that isn't counted as a period of service

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Elapsed Time Example

- Michele has following employment history:
 - Hired March 1, 2011
 - Quits October 2011
 - Rehired January 2012
 - Quits February 2012
 - Rehired December 2012
- Michele has 2 Periods of Service on March 1, 2013
 - Did not have 1-year break

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Included Service

- If ER is maintaining a predecessor ER's plan, the plan must count service with the predecessor ER
- If the ER is not maintaining a predecessor ER's plan, the plan may credit predecessor service on a nondiscriminatory basis
- Service with related employers (e.g., controlled groups or affiliated service groups)
- Service with all employers who have adopted a multi-employer or multiple employer plan

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Excluded Service

- Rule of parity (5 1-year breaks)
- 1-year holdout rule
- Service prior to age 18
- Service when employee declined to make mandatory contributions
- Service during which plan, or "predecessor plan," is not maintained
 - Plan deemed adopted as of first day of PY even if not actually adopted until mid-year
 - Merger based on component plans

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Merger

- Plan A established 1/1/2000
- Plan B established 1/1/2010
- Employer A and B not related
- Plans merge 1/1/2013
- For A EEs may exclude service prior to 1/1/2000
- For B EEs may exclude service prior to 1/1/2010

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Predecessor Plan

- “Predecessor plan” if new plan established within 5 years of termination of any other plan
 - No distinction as to type of plan
- GR: If EE covered by “predecessor plan,” service while covered under predecessor counts
- Exception: Can exclude EE’s service under prior plan if number of 1-year breaks between establishment of plans equals or exceeds service while covered under prior plan

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Example of Predecessor Plan Covered Service

- Employer XYZ terminates Plan A 12/31/97
- Employer XYZ establishes new Plan B 1/1/2001
 - Old plan is “predecessor plan” because less than 5 years
- Joe not covered by Plan A so can exclude service prior to 1/1/2001 because prior plan not maintained for Joe
- Moe was covered by Plan and had 3 YOS as of 12/31/97
 - If Moe had 3 or more BIS from 12/31/97 to 1/1/2001 then Plan B not maintained until 1/1/2001
 - If Moe had less than 3 BIS then Plan B is maintained as of Plan A’s establishment

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Excluded Service for Vesting

- After 5 BIS, future service is excluded in determining vesting of prior contributions
 - This is why plans provide for a forfeiture after 5 BIS – vested % of the existing account will not be increased
 - This rule does not affect vesting of future contributions

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Distribution of Partially Vested Account

- If distribution is made and vesting percentage can increase (e.g., in-service distribution of partially vested account)
- Two methods to determine vested amount (X)
 - $X = P(AB + D) - D$
 - Maintain separate account and $X = (P(AB + (R \times D)) - (R \times D))$
- P = Vested % at relevant time
- AB = Account Balance at relevant time
- D = Amount of distribution
- R = Ratio of AB to AB after distribution
- Relevant time = Time of determination of vesting

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Examples

- Jennifer has vested interest of \$100K and is 60% vested
- She withdraws \$60,000 as in-service distribution
- Jennifer is now 80% vested
- Her total account balance is \$42K (\$40K + 2K earnings)
- What is Jennifer's vested account balance under each of the 2 methods?

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Easy Method

- $X = P(AB + D) - D$
- Vested amount = $[80\% (\$42K + \$60K)] - \$60K$
- Vested amount = \$21,600
 - 80% vested in \$2,000 earnings

Withdrew	\$60,000
Current AB	\$42,000
Vested %	80%

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Harder Method

- $X = (P(AB + (R \times D)) - (R \times D))$
- Vested amount = $[80\% (\$42K + ((42/40) \times \$60K)) - (42/40 \times \$60K)]$
- Vested amount = \$21,000
 - 50% vested in \$2,000 earnings
- Requires separate accounting for old vs. new contributions

Withdrew	\$60,000
AB after withdrawal	\$40,000
Current AB	\$42,000
Vested %	80%

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Amendment to Service Method

- Treas. Reg. § 1.401(a)-7(f)
- Hour of Service to Elapsed Time – Service equals:
 - YOS before the computation period in which amendment is made, plus
 - Greater of:
 - Service for computation period as of date of amendment
 - Period of Service for entire computation period using Elapsed Time (treat as new hire)

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HOS to Elapsed

- Calendar plan year
- YOS for vesting purposes is 1,000 hours of service
- Amendment to elapsed time method adopted and effective 6/1/12
- EE hired May 1, 2009
- Worked 1,000 hours of service in 2009, 2010 and 2011
- What is his vested percentage in years as of 6/1/12?
 - 3 + 1 for 2012 if EE ends up working 1000 hours OR does not have period of severance for 2012

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Change to Service Method

- Elapsed Time to Hours of Service – Service equals:
 - YOS for each Period of Service before the computation period in which amendment is made, plus
 - For computation period when amendment is made, YOS based on equivalency method for any period prior to the date of the amendment
 - Only relevant if amendment is effective during a computation period
 - Change from elapsed time to hour of service method effective April 2013 for CY plan
 - For period from January 2013 – April 2013 use HOS equivalency method stated in plan

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Elapsed to HOS

- Calendar plan year
- YOS for vesting purposes is 1,000 hours of service
- Amendment to hour of service method adopted and effective 6/1/12
- Hired May 1, 2009
- What is his vested percentage in years as of 6/1/12?
 - 3 periods of service for 12 months ending May 2010, 2011 and 2012
 - 1 YOS for 2012 if 1000 hours in CY
 - Period from 1/1/12 to 6/1/12 use an HOS equivalency method set forth in plan

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Best Practices

- Know why the employer wants to make a change to vesting
- Review the different options and impact on administration
- Draft the amendment paying close attention to:
 - The effective date of the amendment
 - Try to avoid changes in the middle of a computation period
 - The participant subject to the amendment

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