

METRO NEWS – Report #58

November 10, 2004

To our clients and friends:

This is another in a series of newsletters designed to keep you clearly informed of current events in the area of employee benefit plans.

Here is my Homework Problem:

While most of us work with 401(k) and similar types of plans, there are many “Defined Benefit” (“DB”) plans that still exist. These used to be really popular, but probably 80% of them have terminated in the past 20 years. The main reasons that Employers shy (or “run”) away from them are (a) financial risk, and (b) “baggage/hassle”.

DB plans promise to pay employees a specified monthly benefit when they retire, for their lifetime. These were the “traditional” types of pension plans. Actuaries (the cool guys) would regulate their funding, by measuring their liabilities and recommending funding levels. This is where the “risk” for the Employer came in, since the contributions could become unpredictable, especially if investments went down. Congress messed things up, too, by capping tax-deductible contributions, so in good years, Employers could not put away extra funding to provide a cushion for bad years. (Congress did this in the ‘80’s to enhance revenue).

The “baggage” issue results because there is a lot of paperwork, PBGC premiums, harsh employee notices if the plan’s funding diminished, etc.

Congress is trying to fix the system before it becomes even more of a mess. Through the American Society of Pension Professionals and Actuaries, I am working on a task force to organize and present these DB “fixes”. Some of the issues include:

- How to calculate lump sum payouts – the current system overstates the “true” lump sum, making funding worse and giving participants an unfair advantage
- Fixing tax problems – allow Employers to set aside more in good years
- Tighten funding rules – The “minimum funding standards” contained in ERISA are obviously broken, as a plan could comply with them and still run out of money.

- Fix the PBGC's priority – It is too easy (still) for Employers to dump unfunded liabilities on the PBGC. (Note – USairways just did this quite easily.) This government agency needs higher standing in the bankruptcy line.
- Allow Employers to put their hand in the cookie jar – if Employers do improve the funding, they should be able to get some money back out if they need it, subject to a reasonable tax (not the current 50%). This will allow Employers to become more comfortable in putting more money in during good times
- Explain it to the employees – It is important that employees understand where their plan's funding is. Current disclosures are confusing and inadequate.

As you can see, this is (at least) a multi-faceted problem. Feel free to share your ideas to help me out with my homework!

New Regulations Out:

The DOL recently issued regulations on what to do if you want to force a terminated employee to take out his money from a 401(k) plan. You can do this if the payout is less than \$5,000. Until now, you simply mailed them a check for 80% of the payout amount, with the other 20% going to the IRS as an advance on their taxes due. These payouts might occur if an Employer just wanted to clean up his plan, or if the plan were being terminated so “everything must go”.

For payouts of over \$5,000, the employee must first agree to take a distribution. For payouts of less than \$1,000, the old rules can still be applied (80%/cash.)

Congress (there they go again!) felt that the “retirement assets” would be better “preserved” if people didn't “waste” (i.e., spend) their money too quickly, and this is why they changed the rules to the “IRA rollover method”. How motherly.

Anyway, the problem is that very few financial institutions will accept these rollovers. Reasons: (a) small dollars = low profit, and (b) generally an IRA can not be set up without a participant's signature, and in this case there is no cooperative participant. (or else we wouldn't be forcing their money out in the first place.)

The new rules take effect for mandatory payouts made after 3/28/05. This will also require a plan amendment. Apparently, the IRS will be issuing a “model amendment” for this purpose. (One last opinion – we just got done restating all plan documents – it seems like 5 minutes ago. Why not “save up” all of these newer amendments and do them all at once in a few years – to limit paperwork? Feel free to chime in on this with your Congressperson.)

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Here's some good news!

You can put more away in your Plan next year. The IRS announced that the overall limits for 401(k) and profit sharing plans will increase from \$41,000 to \$42,000, in 2005. Any 401(k) participant over the age of 50 can put away an extra \$4,000. The 401(k) annual limit (part of the \$42K) has increased from \$13,000 to \$14,000.

If these limits are not high enough, note that a DB plan (the one with all the problems, described above) can produce an annual contribution of over \$200,000 per year. Let us know if this fits your needs better.

When to Merge?

You're driving along, bopping to the music, and here come the orange signs – traffic merging ahead! Being the obedient soul that you are, you promptly move into the continuing lane (using your turn signal, unless you are from Western PA.) Other drivers do not. They go straight to the end and then try to barge their way in past you. (I am typing faster now.) You are right (as always) and they are lazy, ..., &@*^%\$'s, etc.

But wait. Where does it say when to merge? Most of the time, no one knows. Maybe they were right? There are no rules. If there were, then everyone would have the same expectations. Feel free to recommend a solution to this world problem. (I heard nothing on this from the candidates, either.)

Little progress to report:

In Metro News #6 (like 15 years ago), I ranted about non-zero based graphs. This problem will not be getting better soon.

Pick up today's newspaper or any magazine, and see what the graphs look like. The vast majority of these graphs do not start at zero on the bottom. For example, if the chart is illustrating values from 100 to 135, then it is likely that the bottom of the graph will start at 90 or 100. By using a non-zero starting point, the graph-maker can make the shape of the curve look however they want it to. This is cheating!! It defeats the purpose of the graph. It also allows the graph-maker the ability to twist the message being presented, by introducing inappropriate "visual drama". (I'm not sure that even Congress can fix this one.)

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Congratulations:

Red Sox fans, and I never thought I would say that. You've earned it.

2005 Safe Harbor Notices:

If you want to take advantage of certain "401(k) safe harbors", then you need to act fast. These "safe harbors" allow you to ignore the 2005 401(k) discrimination testing. This would allow owners to put away the (maximum) \$14,000, plus the extra \$4,000 if they are old. (just kidding – I'll be eligible for this, too!)

In order to make this work, the Employer needs to:

- Make a fully vested matching or profit sharing contribution for each member
- Provide an employee notice by 11/30/04.

Let us know if we can help.

Oops/Errata: "Don't let transportation costs drive you crazy!"

In our previous MetroNews (#57, July 7, 2004), we inadvertently gave you incorrect 2004 limits for Section 132(f) Transportation Plans. The correct limits are as follows:

- For taxable years beginning in 2004, the monthly limit for transportation in a commuter highway vehicle (e.g. "Vanpool") or any transit pass remains at \$100. This is also the monthly limit for a combined Vanpool/transit expense reimbursement.
- For taxable years beginning in 2004, the monthly limit for qualified parking expenses is \$195.

We apologize for the error. We will let you know the 2005 limits once they become available.

Best Wishes, David M. Lipkin, F.S.A., Editor

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