

METRO NEWS – Report #59

March 4, 2005

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.

Update – Mandatory Payouts:

In our last Newsletter (#58), we discussed that the IRS has changed the rules for these “mandatory” payouts. Normally, when someone terminates their employment, they are paid out their account balance. However, sometimes, the terminated members do not respond when asked if they want their money. If the payout is less than \$5,000, then the plan can “force” their money out to them, via a mandatory cash-out. The new rules require that the payout occur in the form of an IRA rollover, and not in cash. (The parental thinking is that the IRA assets will remain inside the “retirement system”, i.e., the payee is probably too helpless to save the money on their own for retirement, so we’d better help steer them into an IRA.)

The IRS recently provided an extension of when the new rules will start. They are effective for all mandatory payouts after 3/28/05. The plan document will need a short amendment to reflect these new rules. The amendment need not be adopted until the earlier of 12/31/05, or the date that the first mandatory payout is done. (These dates are for plans with calendar year anniversaries; other plans may have a sooner amendment deadline.)

We’ll be in touch with our clients to arrange for this amendment.

New 401(k) Regulations...:

... have been issued by the IRS. They provide a lot of technical information in boring areas like compliance testing.

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For example, if a 401(k) discrimination test is failed, one option is to refund “excess” contributions to the “Highly Compensated Employees”. As of 1/1/06, this refund needs to include more interest. (This may not seem like a big deal but it is to people like us.)

Another option to correct a failed 401(k) test is for the Employer to make an extra profit sharing contribution, that is allocated only to the non-owners. The new regulations prohibit certain abusive practices whereby this extra allocation was given only to the lowest-paid employees. (This is called a “bottoms-up QNEC”.)

However, note that the new rules have enlarged the grounds for a “hardship” withdrawal to include funeral expenses and certain repairs to the principal residence.

If you need a Break Today...

... then “Hershey’s” spells relief! (at least it does to me.) This is definitely an idea (i.e., a chocolate snack) that can make the day go quicker or a client meeting more productive. Anyway, if one were to dial 717-534-4942, this would allow you to order from the “Hershey’s Chocolate World” mail order line. (You usually have to leave your name and number but they will get back to you.) Just take this as a quick business hint for the sophisticated businessperson.

We are Growing....

.... as several Metro employees have recently passed their professional exams, for “ASPPA”, which is our professional 401(k)/pension organization. Please join me in congratulating Kelly Pucciarelli on achieving her “QKA” status (“Qualified 401(k) Administrator”).

As if that wasn’t enough good news, Mike Steve also passed his “C-3” exam. Mike had already earned his “QPA” designations (“Qualified Pension Administrator”), and with one more exam will reach the ultimate ASPPA goal of “CPC” (“Certified Pension Consultant”).

Finally, please join me in congratulating Russell Smith on his new title of Associate Vice President. Russ has been with us for eight years, and he keeps a substantial number of our clients happy. Hopefully, he’ll get over his Eagles’ Super Bowl loss OK.

We at Metro are proud of these accomplishments – every one of our Pension Analysts and Consultants is either traveling on or has already completed their examination path. All of our Administrative Assistants have also completed an introductory pension study course, as well. We believe that this contributes to professionalism and allows us to provide services to you more effectively.

Everyone is Talking about Social Security Reform...

... so why can't I? One would expect an actuary to have a perspective on this discussion, and mine is that many of the ideas make sense, but they haven't been presented openly yet.

Specifically:

- The retirement age should be indexed. Obviously, if people are living longer now than they used to (and we are!!), then the age at which full benefits start needs to be adjusted. This was already done once, in the 1983 Reform Act. Rather than simply re-adjusting now to a revised age, they should just put an indexing mechanism in the law, so we don't have to bicker about this again every 20 years. While this wouldn't appear that controversial – it is. This is because minority segments of the population do not have the same life expectancy as others, and so increasing the retirement age seems like it would be making the system even more unfair against them. This is being used as an argument – on their behalf – in favor of private investment of retirement accounts, i.e., at least they'll get their money out before they die. Note that this undercurrent is not really being talked about too much.
- There is a problem with the price-indexing mechanism. Currently, benefits are adjusted annually for inflation, based upon the increase in prices. Some people believe that this is unfair to active workers, whose real wages may not go up that fast. The alternative would be to index the retirees' benefits based upon the increase in average wages.
- The two "tweaks" discussed above would go a long way towards fixing the actuarial problems in the system. It is unfortunate that these discussions are lost in the debate over personal investment accounts.
- The idea of investment accounts is a good one. It is optional, so that people who wish to retain the current system can do so – why would people argue with that? (Other than the "people are too stupid" argument.) One missing piece that I have not yet grasped is why there would be a \$ 1 trillion start up cost to do this. It seems to me that if you coordinated the reduction in the promised monthly benefit with the cost of the new accounts, it could be done at little or no expense.

Pension Funding Reform:

I just spent 3 days in Washington, D.C. discussing reform of ERISA's minimum funding rules for pension plans. (This is about "defined benefit plans", where the Employer promises a monthly benefit at retirement age; 401(k) plan sponsors need not worry about this, and it won't be on the test.)

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The problem is that the current funding rules – designed over 30 years ago – no longer work. (This is a serious problem.) As a result, some very large companies with underfunded plans are “dumping” these unfunded liabilities on the government, by terminating the plans through the PBGC. The PBGC is like a government-run insurance company that pays off on the promised benefits, even though the assets are insufficient. The PBGC’s deficit is now in the billions, and growing. There is a need to tighten funding rules to avoid future such deficits. (The other need is to tighten bankruptcy law, so that it is not so easy for companies to dump these liabilities on to the PBGC.)

My concern is that the Bush administration’s proposals to fix the problems are too inflexible – their proposed new rules designate what assumptions and methods the actuary shall use. This is in contrast with the current system, where the actuary gets to select the actuarial assumptions that “fit” a plan, as well as the particular “actuarial funding method”, which is a formula that spreads out the costs over time. There are better fixes available, which we lobbied for this week.

Specifically, we (“The American Society of Pension Professionals and Actuaries”) argued that the actuary should be allowed some (but not total) discretion in the assumptions and methods used to fund the plan. Further, we believe that the amortization periods should be shortened, so that unfunded liabilities would be paid off quicker. Let me know if you’d like to discuss this further, especially if you are a Congressperson.

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

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