METRO NEWS – Report #60
August 5, 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.

401(k) Rules are Changing Fast:

There will be a new option available for plan sponsors, starting January 1, 2006. This is called the "Roth 401(k)" option. It is comparable to the (existing Roth IRA). It would allow employees to have the choice between having their own money go in either pre-tax (as is now the case) or else on a post-tax basis. There are certain opportunities and costs associated with this decision.

The benefit of contributing on an after-tax basis (Roth) is that the investment income on those funds is not taxable at all, either now or in the future. Since younger employees have many years during which to compound these (investment income) tax savings, this approach may work better for them. On the other hand, there will be a (small) one-time cost to amend the plan for this (Roth) provision, and the annual administration may become a little trickier and more expensive.

The increase in administrative cost/hassle will partly depend upon whether the investment company will be able to track this money separately. The other "hassle" factor will involve payouts, as the IRS 1099 Form will need to specify the pre-tax and post-tax payouts separately. A plan may take advantage of this new Roth option, but it need not do so. We'll be in touch with our clients in the Fall, to briefly describe this option (again) and to let you decide how you want to handle it, effective 1/1/06. Please let a Metro staff member know if you have any questions in the meantime.

We Try!

Since our livelihood depends upon providing strong service to our clients, we want to perform well in this regard. We've been including a "Report Card" for our clients to evaluate us for many years. (Since my son, Brian, then about 11, suggested it about 10 years ago.)

We ask our clients to rate us on factors like timeliness, accuracy, clarity, professionalism, value, etc. We have learned from these surveys. ("you don't know unless you ask!") For surveys that were returned to us in 2003, 2004 and (so far in) 2005, our clients have spoken clearly. Under "Overall Quality of Services", our ratings have been as follows:

- 177 surveys returned
- Poor/Fair rating = 0 (0%)
- Average rating = 1 (0.6%)
- Good rating = 21 (11.9%)
- Excellent rating = 155 (87.5%)

Please let us know how we can improve the service that we are providing to *you.*

Cafeteria Plans – "Use it or Lose it":

A section 125 ("cafeteria") plan allows an employee to pay for certain medical expenses on a "pre-tax" basis. Dependent Care costs can also be covered under this plan. By converting these expenses to a pre-tax basis, both employers and employees can recognize substantial cost savings. However, there are a few hurdles that the plan and its participants must navigate, if they want to achieve these tax savings:

1. The full annual amount of benefit must be available on every day of the year. For example, if an employee sets aside $100/mo. for medical benefits, that person can present the plan with a "reimbursement expense" for $1,200, the full annual amount, as early as January 2. The plan would have to reimburse this full amount, even though it has not yet been funded. If this employee were then to quit on January 31, the plan sponsor (employer) would be on the hook for the $1,100 that was never funded. While rare, this can occur. Employers who "hold back" on submitted claims until they are fully funded, are not in compliance with the law. Note that this issue only applies to the "medical reimbursement" part of the plan; not the dependent care portion. This is why most plans have a dollar limit on this coverage – to limit the employer's risk.

2. Assuming a calendar year plan, the employee must "use up" their entire account by December 31 of each year. Otherwise, the unused money is "forfeited", and reverts back to the employer. This is called the "use it or lose it" rule. In administering these arrangements, we typically remind plan participants near the end of the plan year how much they have left, so that they do not lose it.

Now, the IRS is offering to relax Rule #2 a bit. If the employer wants to amend its plan, we can now add a 2 ½ -month "grace period" for the use it or lose it rule. Thus, an employee could incur and submit the expense by March 15, 2006, and claim it against his remaining funds. This takes much of the employee risk away. However, the new rules add a layer of administrative complexity, and there may be other pitfalls relating to multiple plans, as well.

We'll be sending a more detailed explanation to our cafeteria plan clients, within the next month or two. The plan document will need to be amended by the end of the current plan year (12/31/05, for most) to take advantage of this new opportunity. Once you receive this letter, just let us know whether you'd like to use this new rule. Please let us know if we can help you learn more about Section 125 cafeteria plans.

Quick Further Update – Mandatory Payouts:

In our last Newsletter (#59), we discussed that the IRS has changed the rules for these "mandatory" payouts. If we are responsible for your plan document, then we will be providing you with a brief update and an "election form", so you can decide how to handle this issue. (Reminder – the option is to: (a) force out small balances for terminated employees using an IRA, or else (b) lower the limit for small balances to be forced out from $5,000 to $1,000.)

Would you like an apple or a pair?

This is the "actuary's corner", where we can all benefit from the types of statistical insights that we have come to expect from our favorite (i.e., my) profession. One game that actuaries enjoy is poker. In the most common version ("hold 'em"), each player is dealt two cards, face down. These then can be combined with several "up" cards to make your best hand. When you get a pair dealt to you face down, that is often a good start to making a strong hand.

Now, let's translate this to a blackjack game. Again, each player starts with two cards, one card face up and one down. Starting with a pair in this game is not necessarily a benefit, as it depends upon what that pair is (i.e., two tens = 20 is great, while two sevens = 14 is bad; pairs can also be split.)

The point is this – in playing blackjack recently, I noticed that you get a lot more pairs in this game than you do in poker, although you start out with 2 cards in each game. Is this possible? (I'll let you pause for a moment to consider your own answer now………….)

The answer is "YUP"!, not only is it possible, but it is probable. This is because there are many decks mixed together for blackjack, but only one single deck (hopefully) for poker. For example, if you are dealt an ace for your first card in poker, you have a 3/51 chance of hitting a second ace, i.e., there are 3 "companions" left for you.

This is not the case in blackjack. Assuming two decks (most casinos use 8), there are four new "companions" in the second deck (7/103 = 6.8% is much larger than 3/51 = 5.9%), so your chances of pairing are larger. I just didn't want you to be too surprised if this happens to you!

Unfortunately, my actuarial instincts have not (yet) rescued my poker game, so I may need to stay with my current job for a while longer.

Best Wishes (and good luck at the casino!), David M. Lipkin, F.S.A., Editor