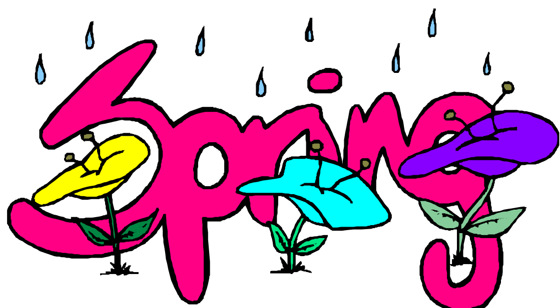
McCready and Keene, Inc. Actuaries and Employee Benefit Consultants for Over 70 Years

Employee Benefit News

March 31, 2004



REHIRED PARTICIPANTS

Do you frequently, or even occasionally, rehire former employees (including former employees of an affiliated employer)? It is important that your human resources staff distinguish between rehires and new employees. A rehire is generally eligible to participate immediately in a retirement plan and may be eligible for past service credit. Monthly plan payments from a defined benefit plan to a rehired participant may or may not have to stop, depending on the plan provisions. If the participant received a lump sum payment from a defined contribution plan or in some rare cases from a defined benefit plan, the participant may be entitled to a repayment option, sometimes referred to as a "buy-back."

The buy-back option and treatment of forfeited amounts depend on plan provisions. In most defined contribution plans, the forfeited account of a participant who quit with no vested interest and is rehired before incurring five consecutive one-year breaks-in-service must be restored. The forfeited account of a participant who quit with partial vesting, was paid the entire vested portion of his account balance, and is rehired before incurring five consecutive one-year breaks-in-service may need to be restored. Restoration for the partially vested participant is generally conditioned upon the participant repaying all or a portion of the amount that was previously distributed. The repayment must be made within the five-year period that begins on the participant's date of reemployment. If your plan document provides repayment rights, it is important that you notify rehires of this opportunity.

To assist you in the appropriate treatment of rehires, on the annual census we ask you to identify rehires and report all previous periods of employment with you or any affiliated employer. If you need more information or need help with a repayment rights notice, please contact your McCready and Keene consultant.

ARE 401(k) AND 403(b) PARTICIPANTS SAVING ENOUGH?

Many experts believe American workers are not saving enough for retirement, and there have been some studies to back up that generalization. However, the most helpful information for an individual participant is a retirement projection based on his or her financial profile. Participants in our daily accounting plans can log onto www.wt1.com/retirement for access to a retirement plan calculator. Click on "MasteryPOINT Analyzer" under "Planning and Advice" and then click on "Plan Ahead for Your Retirement." After some narrative information on savings and investments, the participant will come to a page entitled "Building Your Retirement Income Strategy." For our balance forward clients, there are a number of public websites that include retirement plan calculators. One example is www.usatoday.com/money/perfi/calculators/calculator.htm. MSN and Quicken are among other public sites that contain retirement planning calculators.

Participants may want to visit one of these websites to help evaluate their retirement planning. In addition, here are some reminders that may be helpful to participants:

- Compound interest provides great benefits. Over the long-term, the stock market has returned at least 10% annually. Assuming a 10% return, if a participant invests $500 a month, he or she would have $102,000 after 10 years, $380,000 after 20 years, and $1.1 million after 30 years.
- Beware of hardship withdrawals and loans. Because of the value of compound interest, taking a hardship withdrawal may deplete the participant's retirement savings more than anticipated. When returns are high, a participant who has a loan may be losing money. For example a participant may be paying himself or herself 6% interest on a plan loan. However, during a year such as 2003, the participant might have earned 20% or more if the money had remained in the plan.

DB BENEFITS CORNER

Questions Frequently Asked by Participants

Q: If I am fully vested and terminate employment before early retirement age, can I begin my benefit payments when I reach early retirement age?

A: It depends on what the service requirement is for early retirement in your plan. It is possible for the plan to have a longer service requirement for early retirement than for full vesting. If the participant has not satisfied the service requirement for early retirement, his or her benefit cannot commence until normal retirement age. For example, if the plan requires 5 years for full vesting and 10 years for early retirement and the participant terminates with less than 10 years of service, the participant will not be able to commence his or her benefit until normal retirement age.

Q: If I transfer from one job classification to another, such as from hourly to salaried, can I receive the benefits that I have earned even though I have not terminated employment?

A: Generally speaking, benefits cannot be paid while a participant is still employed, even if there has been a change in job classification.

However, a plan may allow a participant to elect commencement of benefits after normal retirement age, even if the participant continues to work. This exception may apply to all participants, not just those who have experienced a change in job classification. In addition, most plans require all participants to commence benefits by April 1 following the year the participant reaches age 70½.

AVOID TOP-HEAVY SURPRISES IN DC PLANS

By now, most employers are aware that if 60% or more of a plan's assets are in the accounts of top executives (defined as "key employees"), the plan is top-heavy. The consequences of top-heavy status are a minimum employer contribution (usually 3%) to non-key employees participating in the plan and a vesting schedule that is at least as generous as a 3 year cliff or a 2-6 year graded schedule.

Armed with this understanding, some employers have designed their defined contribution plans with a 3% employer contribution and a top-heavy vesting schedule thinking they have now avoided all of the top-heavy issues. However, there are some additional plan provisions that can provide unwanted surprises! Here are some provisions to watch:

- If the plan requires full year compensation for the top-heavy minimum (as opposed to compensation after the participation date), be sure the 3% profit sharing contribution is also based on full year compensation.
- The top-heavy minimum contribution must be paid to every non-key employee participating in the plan who is employed on the last day of the plan year. Therefore, if the plan requires a minimum number of hours to receive the 3% profit sharing contribution (for example, 1,000 hours), any participant who did not satisfy the hours requirement but was employed on the last day will still be entitled to a top-heavy minimum.
- If the plan has earlier eligibility requirements for 401(k) deferrals than for the profit sharing contribution, participants who were eligible to make deferrals but not yet eligible to share in the profit sharing contribution will be entitled to a top-heavy minimum.
- A safe harbor 401(k) plan that consists solely of contributions that satisfy the ADP and ACP tests is exempt from the top-heavy rules. However, if the employer makes an additional profit sharing contribution, reallocates forfeitures, or has different eligibility requirements for 401(k) deferrals and the safe harbor contribution, the exemption does not apply.

PROPOSED REGULATIONS ISSUED ON AUTOMATIC ROLLOVERS

The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") provides a solution when participants entitled to a small benefit cannot be located or do not respond to distribution options. If a participant's lump sum benefit is between $1,000 and $5,000 and the participant does not direct how the distribution will be paid (cash or rollover), the employer may roll the distribution into an IRA.

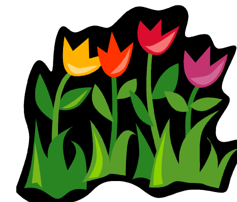
The new EGTRRA provision will be effective some period of time after the Department of Labor ("DOL") issues final regulations. Earlier this month the DOL issued proposed regulations.

The proposed regulations provide that the IRA must be designed to preserve principal, have a reasonable rate of return and be reasonably liquid. Fees (other than fees related to the establishment of the IRA) may only be charged against income earned by the IRA.

We will let you know when final regulations are published. At that time, employers will need to select an IRA provider, amend their retirement plan, and give participants a revised summary plan description or a summary of material modifications.

2004 VALUATION REPORTS

For 2002 and 2003 defined benefit valuation reports, Congress provided relief with regard to the current liability interest rate corridor. The relief has not been extended for 2004. Without the relief, contributions could significantly increase over the 2003 levels. It is possible that Congress may extend the relief to 2004 or beyond. It is also possible that Congress will act on one of the proposals that has been suggested to replace the 30-year treasury rate with a corporate bond based rate. The bill is currently in Conference Committee. Either of these actions by Congress would be helpful to employers. We are proceeding with the 2004 valuations using current law. However, the valuations may need to be revised, if Congress acts on one or both of these items.



Happy Spring!

If you have questions or would like additional information about the items presented in this newsletter, call your McCready and Keene consultant.

Employee Benefit News is not intended as legal advice. Readers should seek legal advice before acting on any of these subjects.