MID AMERICAN GROUP

"The Leading Edge"

A quarterly Newsletter to our valued friends and clients... *Fall, 2004*

Ask us about...

The Leading Edge

...a trend-setting employee benefits program from Mid American Group, including:

Administrative Services

- ⇨ COBRA Administration
- ⇨ Flex Administration
- ⇨ 5500 Form Preparation
- ⇨ Cafeteria Plan Administration
- ⇨ HIPAA Administration

Employee Benefits

- ⇨ EAP
- ⇨ Vision
- ⇨ Wellness Services
- ⇨ Internet Services

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The information contained in this publication is intended for the general information of our clients. It should not be construed as legal advice or legal opinion regarding any specific or factual situation.

DEFERRED COMPENSATION LAW ENACTED / PLAN REVIEW NECESSARY

Congress passed significant changes to deferred compensation plans, aimed at ending Enron-style abuses. **HR 4520, the American Jobs Creation Act of 2004 was signed into law by President Bush on October 22, 2004.**

The provisions were part of the tax bill passed in mid-October. Of particular importance is a new section to the tax code added by the Act, Section 409A. **This section provides a broad interpretation of what is considered a "nonqualified deferred compensation plan."**

The bill makes it more difficult to take deferred money early as well as requiring that decisions to defer money be made earlier. The new Act requires that almost all deferred compensation arrangements will have to be reviewed and amended. As important, changes will be required for plans that have not been viewed as deferred compensation.

The new rules apply to all amounts deferred or that become vested after December 31, 2004. There are "grandfather" provisions included in the Act. However, employers should be cautious because grandfather treatment will be lost if there are any material modifications made to covered plans after October 3, 2004.

The Act provides that a Plan may be considered a deferred compensation arrangement even if it includes only one person. Also, Plans are covered even if they apply to non-employees such as outside directors.

Plan sponsors are prohibited from funding nonqualified deferred compensation plans through a foreign trust. Assets in a foreign trust that are determined by the government as those to pay for such compensation will be treated as transferred property under section 83. If a plan violates the restrictions, affected participants will be required to pay interest and a 20 percent penalty on the amounts included in income.

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WHEN NQDC PARTICIPANTS CAN RECEIVE PAYMENTS:

- When they leave the company providing the plan;
- When they become disabled;
- On a date specified when the plan is set up;
- Upon a change of control of the company or in the ownership of a substantial portion of the assets of the company;
- The occurance of an unforeseeable emergency;
- Death

News Briefs

"Free" Long Term Care Insurance

One of the little remembered components of HIPAA, the Health Insurance Portability and Accountability Act of 1996 is the tax-preferential treatment provided for the purchase of long term care insurance (LTC). **HIPAA provided C-corporations with a 100% tax deduction for employer-sponsored LTC.**

Other types of business were able to deduct the premiums for LTC on the same basis that they were allowed to deduct the premiums for health insurance. Since the passage of HIPAA, the percentage of premiums that are deductible by other types of business has increased to 100% as well.

Another feature of the HIPAA provision allows the owner of a firm to select which individuals he/she wishes to cover under an LTC plan. Similarly, owners can determine any conditions relative to coverage by the policy. For example, the percentage of premiums paid by the owner may be higher for some employees.

Health Savings Accounts (HSAs) and EAPs

The new Health Savings Accounts (HSAs) are gaining the interest of employers and employees. But, growth has been slowed by outstanding questions regarding the requirements for the High Deductible Health Plans (HDHPs) that partner with the HSA. **One concern regarded Employee Assistance Plans (EAPs).** Employers wanted guidance on whether a HDHP that included an EAP would qualify for a HSA.

The IRS provided guidance that EAPs are not considered health plans if the EAP does not provide significant benefits in the "nature of medical care or treatment, screening and other preventive care services."

The guidance provides an example of an EAP that can co-exist with a HSA. An EAP that has benefits that consist "primarily of free or low-cost confidential short-term counseling to identify an employee's problem that may affect job performance and when appropriate, referrals to an outside organization, facility or program to assist the employee in resolving the problem" was not determined to provide significant benefits in the nature of medical care or treatment.

Life Insurance Rates Rising

The impact of new mortality tables that was expected to lower life insurance premiums is being blunted by higher reserve requirements due to insurance regulations according to a report by the *Wall Street Journal*. Insurers are responding by raising premiums and other underwriting methods.

Predictions are that term life insurance rates may increase by as much as 20% before the end of the year. Some insurers are taking other steps as well. Among the more novel is the use of an applicant's driving record. A poor driving record may result in higher premiums, assuming that the individual presents a greater risk to the insurer.

More stealthy actions are happening in the underwriting of new business. Risks that may have warranted preferred status only one year ago may only be rated as standard risks today. This trend toward tighter underwriting makes the role of the broker in the purchase of life insurance even more critical. Brokers gain an understanding of which carriers are competitive in different situations and can better guide the prospect to the carrier that will meet their needs.

Health Costs Slowing

A recent analysis by Hewitt Associates finds that health care costs are slowing a bit. **Costs for next year are expected to rise by 11.3%.** The analysis is based on a survey of health plan increases that had been received by employers by the end of September.

401(k) Fees Under Microscope

One of the legacies of the last recession is reverberating in the workplace – increased scrutiny of investment firm fees. The recession found significant losses for employee portfolios but, fatter bottom lines for investment firms. They prospered, some said, at the expense of the small investors.

Employers across the country are bringing pressure to bear on fund managers to cut fees. They recognize that dollars that are used for fees and plan expenses ultimately may represent thousands of dollars that can't be used for retirement purposes. **An actuary calculated that expenses that are only 1% lower increased retirement funds by 28%.**

ERISA currently requires that employers take the responsibility of ensuring that the fees charged for retirement plans are reasonable. However, employers have found it difficult, if not impossible, to fully grasp what fees are being assessed. The fees that are documented on the ERISA Form 5500 are not necessarily the only fees that are built in to the retirement plan.

ERISA contains provisions that require disclosure of fees to plan participants. But, except for some general annual information, participants must file a request for more disclosure. Some employers, actuaries and money managers are now advocating that more information regarding the full extent of plan costs should be regularly disclosed.

The stockmarket climate has allowed employers to demand fee reductions from plan managers. And, when these demands have not been met, employers are showing a greater willingness to change to managers who will respond with lower fees.

Employers should immediately demand a full disclosure of any and all fees assessed against their plans. This disclosure should include direct and indirect costs. Indirect costs can include service fees, asset-based charges and recordkeeping fees.

Rabbi Trusts – protecting deferred compensation

Rabbi Trusts will continue to provide protection for employees that participate in Non-Qualified Deferred Compensation plans. Assets set aside to fund future deferred compensation payments to an employee must be subject to the claims of creditors in order to avoid current taxation to the employee.

Informally funded deferred compensation plans frequently hold the funding assets in a Grantor Trust (Rabbi Trust). Though they remain creditors, this still provides participants with protection from a change of heart or a change in control of the corporation**. The proposed limitations within the use of Rabbi Trusts include elimination of such items as provisions which formerly provided acceleration of distribution, a "seal off" from corporate creditors in bankruptcy proceedings and the so-called "haircut" provisions which allowed participants to obtain a full distribution on demand with a "haircut" penalty, typically 10%.** Other limitations include distribution triggers such as declines in company financial performance.

Deferred Compensation Law Enacted

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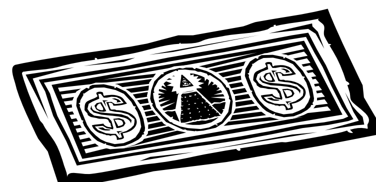
Employers should avoid taking immediate action as a result of the new Act. Actions taken before the first of the year may result in a loss of the "grandfather" provision.

Nonetheless, employers should take inventory of existing deferred compensation plans and those that appear to be covered due to the new law.

As a second step, employers may want to determine if they want to freeze existing plans and create new plans on a going forward basis. A freeze may be the best way to avoid unintended material modifications that would result in a loss of the grandfather protections.



MID AMERICAN GROUP
A quarterly Newsletter to our valued friends and clients...

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DOL Pension Rollover Safe Harbor Rules

Final regulations governing pension rollover rules for amounts between $1000 and $5000 go into effect on March 28, 2005. These rules implement changes made in the Economic Growth and Tax Relief Reconciliation Act of 2001. **This Act allows an employer to provide a default IRA rollover account when a participant has not provided instructions on what to do with a mandatory cash-out.**

The intention of the Act and the rules is to make it more likely that these relatively small sums will be maintained as retirement assets rather than cashed-out and spent. Even though there are tax consequences to taking the roll-over and spending it, this has been a common practice that public policy is now trying to discourage.

The final regulations have few differences from the interim regulations that were previously published. One notable difference is that the safe harbor can be used for accounts that have less that $1000.

Another important difference regards the fees charged for the roll-over plans. **Fees must be comparable among IRA roll-over products, but no limits have been established.** The concern: limiting the fees to those not exceeding the income earned by the IRA would restrict the number of providers willing to provide this service.

Employers utilizing this roll-over provision should note that a notice requirement was added by the rules. The rules require that the plan administrator notify the participant in writing that the participant may transfer the distribution to another individual retirement plan.

Information regarding automatic rollover procedures must also be included in a plan's Summary Plan Description (SPD) or Summary of Material Modification (SMM). These documents should also be provided to participants before a mandatory distribution is made. The views of the Department of Labor are that additional information and disclosures outweigh the costs and burdens associated with the disclosures.

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