

H. C. FOSTER & COMPANY

Retirement and Welfare Plan Actuaries

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Another Freedom Endangered – Fall 2014

U.S. Senate changes resulting from the 2014 midterm elections may mollify the requirements of the Affordable Care Act (ACA), but will not eliminate ACA unless the Obama Administration agrees. The threat of a “pension mandate” still looms under proposed legislation labeled as the USA Retirement Funds (USA Funds) similar in some ways to ACA requirements. Hopefully, the Republican Congress will halt USA Funds efforts, but that result favoring employers is not assured. Recall, it was Bush II who promoted an account balance replacement for the current Social Security defined benefit plan system, apparently unaware that a defined benefit system is the least-cost way to provide retirement benefits for each \$1 of retirement benefit actually delivered.

It appears no legislation beyond the proposal stage has evolved since Senator Tom Harkin introduced The USA Retirement Funds Act, S. 1979 to the Senate on January 30, 2014. This followed Obama’s “MyRA” proposal set forth in his 2014 State of the Union address as a cure-all for the private pension system. See a summary of *senate-bill/1979* on the Internet. Add */text* to see the whole bill that is 62 pages. We summarized the retirement plan provisions of the proposed USA Funds in our Summer 2013 Newsletter based on information at that time.

The USA Funds as currently proposed is similar to an employee-pay-all Section 401(k) Plan where eligible employees may elect voluntarily to deposit tax deferred employee elective contributions through payroll withholdings with no employer matching contributions. The administrative requirements for mandatory USA Funds coverage are as much or more than those of the existing private pension system under ERISA and the Pension Protection Act of 2006 (PPA '06). So, not only would the employer be saddled with salary withholding for employees who elect withholding, but would incur the expenses of another benefits program to meet disclosure, reporting, and other requirements currently proposed in S. 1979. Our experience is that only a small percentage of a typical employee group will voluntarily contribute to an employee-pay-all Section 401(k) Plan without employer matching contributions because most employees need their direct compensations to meet living expenses.

Employers sponsoring private pension plans under ERISA would be exempt from USA Funds coverage under the current proposal. Although cast as an expansion of the private pension system, the USA Funds is diametrically opposite any private system since it would be totally mandated under Federal regulations with employers bearing disclosure and administrative costs.

Employer-funded Section 401(k) Plans may not effectively avoid USA Funds coverage because the Obama Administration wants reduced contribution limits for defined contribution plans far below current levels. The proposed Section 401(k) contribution limitation is based on a maximum projected life annuity at age 65 of \$205,000 per year, reduced by existing account balances and the present value of defined benefit plan accruals. We calculate a maximum annual addition for a 35-year old male in the range of \$27,000 to \$43,000 under current assumptions and the reduced limitations. The annual limitation would decrease dramatically with increasing interest rates and increases in other benefits from year to year not offset by increases with age. Business owners and managers would not obtain an economic advantage under employer sponsored Section 401(k) Plans under reduced maximum benefit limitations. Privately sponsored defined benefit plans are the only means to rapidly accumulate pension benefits for older, longer-service employees, managers, and business owners.

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We see no positive implications of a USA Funds mandated retirement plan for reasons including the following:

1. The life insurance companies and the Federal Government would control asset management, benefit payments, and other plan functions traditionally under the control of the private pension system. A minimum life annuity is guaranteed at retirement that would ultimately be guaranteed by taxpayers.
2. The proposed USA Funds would continue to deplete employers' ability to control their compensation and benefits programs at a very high cost to both employers and their employees. Employers would be forced to adopt privately sponsored retirement plans to avoid USA Funds coverage in addition to Social Security retirement benefits to defend against another governmentally imposed mandate. Employers' ability to manage their compensation programs through discretionary choices must be preserved.
3. The private pension system in the United States thrives on the efficient management both private and public sector employers impose through self-administration of investment management and daily administrative functions. Some private pension plans are not cost effective because the employer's management ceded its investment and administrative responsibilities to Third Party Administrators and insurance companies that portend the inefficiencies of the proposed USA Funds.
4. Current proposals are that employees can elect to contribute 3.0% of their wages to the USA Funds through payroll withholding, increasing to 6.0% over the first three to four years of the pension mandate legislation. ACA already takes a meaningful portion of an average worker's spendable earnings through increased medical insurance premiums; and, both employers and employees will pay penalties under an increasing scale for non-participation if ACA is fully implemented. Every \$1 taken from spendable income reduces purchases of consumer goods and services. We believe the ultimate effect of a USA Funds would be a 3.0% to 6.0% increase in employers' direct compensation costs to maintain employee relationships. Once in place, Congress could easily make employer contributions to the USA Funds mandatory.

ERISA with its amendments through 2005 reduced employers' discretionary control over their privately sponsored pension plans. PPA '06 limited the available funding methods to one comparable to the Accrued Benefit Funding Method under ERISA, and limited actuaries' assumptions setting discretion to a narrow range of investment return and mortality options that may not represent a plan's past experience or the employer's funding policy. The Federal Reserve's forced low, fixed-rate interest rate policies since 2008 increased Lump Sum Distribution present values, when available from a plan, to twice or more their realistic values under long-term interest rates of 6% to 8% historically applied. The higher fixed-rate interest rates will return after the Federal Reserve loses control of the bond markets.

Obama may attempt to slip a USA Funds type mandate past an unwary U.S. Congress, remember Bush II. Any further hindrances to the private pension system in addition to the existing PPA '06 requirements will ultimately leave fewer employees with sufficient retirement income security at more cost to employers. Any defined contribution plan approach such as the USA Funds fails to direct pension savings to the older, longer-service employees who most need meaningful pension accumulations over their shorter remaining work-life expectancies.

Please e-mail any questions or comments.

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