

# American Academy of Actuaries

---

## **Pensions 201: Understanding Pension Reform- and Estimating Your Own Retirement Benefits**

Lawrence A. Johansen, President

James E. Turpin, Vice-President (Pension)

M. Todd Tuten, Director of Public Policy

Bridget R. Flynn, Pension Policy Analyst

August 3, 2001



# Major Pension Legislation

## **The Employee Retirement Income Security Act of 1974**

**(ERISA):** This is the basic law covering qualified plans and incorporates both the pertinent Internal Revenue Code provisions and labor law provisions. ERISA is the basic law designed to protect the rights of beneficiaries of employee benefit plans offered by employers, unions, and the like. ERISA imposes various coverage, participation and benefit standards and fiduciary responsibilities on both welfare benefit and retirement plans, and provides enforcement procedures as well. In the retirement area, it also provides the basic standards incorporated into the tax qualification requirements.



# Pension Regulation by Government Agencies

**Department of Labor (DOL):** The non-tax, regulatory and administrative provisions of ERISA are administered by the Department of Labor. The Department issues opinion letters and other pronouncements, and requires certain information forms to be filed.

**Internal Revenue Service (IRS):** The IRS is charged with primary responsibility for administering, interpreting, and enforcing the Internal Revenue Code. Most retirement plan issues are handled by the Employee Plans group of Tax Exempt and Governmental Entities division of the IRS.



# Pension Regulation

## (continued)

**Pension Benefit Guaranty Corporation (PBGC):** A nonprofit corporation, functioning under the jurisdiction of the Department of Labor, that is responsible for insuring pension benefits.

**Department of Treasury:** The tax, regulatory and administrative provisions of ERISA are administered by the Department of Treasury. The Department issues regulations and other pronouncements, and requires certain information forms to be filed through the IRS. Note that the Secretary of the Treasury, and not IRS, issues regulations under the Internal Revenue Code.



# Academy Mission Statement

---

- ◆ Academy serves the public and the profession by:
  - Establishing, maintaining and enforcing high standards of conduct, qualification and practice.
  - Assisting in the formulation of public policy by providing independent and objective information, analysis and education.



# Academy Mission Statement (continued)

---

- Representing and advancing the profession and increasing the public's recognition of the profession's value.



# Pensions 201: Retirement Plan Changes

---

**James E. Turpin**  
**Vice President (Pension)**  
**American Academy of Actuaries**



# Economic Growth and Tax Relief Reconciliation Act of 2001

---

## Limited Summary of Changes for Retirement



# Individual Retirement Accounts

<u>Year</u>	<u>Contribution</u>	<u>Catch-Up</u>
2001	\$2,000	\$ 0
2002	3,000	500
2003	3,000	500
2004	3,000	500
2005	4,000	500
2006	4,000	1,000
2007	4,000	1,000
2008+	5,000*	1,000

**\* Subject to Cost of Living Adjustments**



# IRA Restrictions

If the taxpayer is an active participant in a pension plan, deductible contributions to an IRA phase out.

<u>Year</u>	<u>Single Taxpayer</u>	<u>Joint Taxpayers</u>
2001	\$33,000-\$43,000	\$53,000-\$63,000
2002	34,000 - 44,000	54,000 - 64,000
2003	40,000 - 50,000	60,000 - 70,000
2004	45,000 - 55,000	65,000 - 75,000
2005	50,000 - 60,000	70,000 - 80,000
2006	50,000 - 60,000	75,000 - 85,000
2007+	50,000 - 60,000	80,000 - 90,000



# New Compensation Limit

---

- Current Limit for 2001 - \$170,000
- Current Expected Limit for 2002 - \$180,000
- New Law Limit for 2002 - \$200,000



# Salary Deferral Limits

IRC §402(g) - Applies to §401(k), §403(b), §408(k)(6) and §457

<u>Year</u>	<u>Limitation</u>
2001	\$10,500
2002	11,000
2003	12,000
2004	13,000
2005	14,000
2006+	15,000



# SIMPLE Salary Deferral Limit

<u>Year</u>	<u>Limitation</u>
2001	\$ 6,000
2002	7,000
2003	8,000
2004	9,000
2005+	10,000



# Defined Contribution Plan Limitations

---

## 2001 Current Law Limits

Lesser of 25% of Compensation or  
\$35,000

## 2002 New Law Limits

Lesser of 100% of Compensation or  
\$40,000



# Defined Benefit Plan Limitations

---

2001 Current Law Limits

Lesser of

100% of Highest 3-Year Average Compensation  
or \$140,000

**payable as a life annuity at**

**Social Security Normal Retirement Age (65 to 67)**



# Defined Benefit Plan Limitations

(continued)

---

## 2002 New Law Limits

Lesser of  
100% of Highest 3-Year Average Compensation  
or \$160,000

**payable as a life annuity at  
ages 62 to 65**



# Defined Benefit Limitations

<u>Age</u>	<u>Current Law</u>	<u>New Law</u>
45	30,425	49,675
50	42,027	68,616
55	58,919	96,194
60	84,310	137,650
62	98,000	160,000
65	123,200	160,000



# §401(m) Matching Contributions New Vesting Schedule

	<u>Current Law</u>	<u>New Law</u>
» Less than 2 years	-- 0%	0%
» 2 years	-- 0%	20%
» 3 years	-- 20%	40%
» 4 years	-- 40%	60%
» 5 years	-- 60%	80%
» 6 years	-- 80%	100%
» 7 or more years	-- 100%	100%



# Matching Vesting

(continued)

» Or		<u>Current Law</u>	<u>New Law</u>
» Less than 3 years	--	0%	0%
» 3 years	--	0%	100%
» 4 years	--	0%	100%
» 5 or more years	--	100%	100%



# 401(k)/401(m) Testing

Under current law, when a plan offers both salary deferrals under §401(k) and matching contributions under §401(m), both salary deferrals and matching contributions are tested for nondiscrimination (ADP and ACP tests). In addition, salary deferrals and matching contributions have to be tested on a combined basis.



# 401(k)/401(m) Testing (continued)

Under the current multiple limit test, when salary deferrals for highly compensated employees is maximized, matching contributions to HCE may have to be reduced even though matching contributions pass the ACP test. The new law eliminates the multiple use test, reducing the administrative burden for 401(k) plans.



# Other Changes for Defined Contribution Plans

Under current law, the maximum amount of deductible employer contributions was based on participant compensation that did not include employee salary deferrals. So, if total employee compensation was \$100,000 and employees contributed \$10,000 in salary deferrals, the maximum total contribution would be \$13,500 (15% of \$90,000), ...



# Other Changes for DC Plans

## (continued)

**... not \$15,000 (15% of \$100,000). The maximum employer contribution includes the salary deferrals.**

**Under new law, the full \$100,000 can be used to determine the maximum employer contribution. Plus, the salary deferrals are not part of the maximum contribution.**



# Other Changes for DC Plans

## (continued)

---

Under current law, profit sharing plans, including 401(k) salary deferrals, are limited to a total contribution of 15%.

Under new law, the limit is increased from 15% to 25%.



# Other Changes for Defined Benefit Plans

Under current law, when an employer sponsors both a defined benefit plan and a defined contribution plan, the total contribution to both plans is limited to the greater of 25% of compensation or the required contribution for the defined benefit plan.



# Changes for DB Plans

## (continued)

---

Under the new law, this combined plan limit does not change. However, 401(k) salary deferrals are no part of the employer contribution for deduction purposes. Thus, now an employer with a DB plan with a contribution of more than 25% of compensation can more easily offer another plan with 401(k) salary deferrals.



# Changes for DB Plans

## (continued)

---

Under current law, there are several full funding limitations that apply to minimum and maximum contributions for DB Plans. The new law expands the definition of certain funding limitations and gradually phases out the current liability full funding limitation.



# Other Changes for Pension Plans

---

Currently, when a pension plan changes the rate of future benefit accruals such as the termination of a plan, a notice has to be given to all affected participants. The new law expands the notice requirement when changes in benefits are made to pension plans and imposes excise taxes when there is a failure to provide timely notice.



# Other Retirement Changes

---

- 401(k) Salary Deferrals can be treated as Roth contributions
- Tax credits for low income participants
- Tax credits for small employers with new plans
- Elimination of determination letter fees for small employers



# Other Retirement Changes

## (continued)

---

- Top-heavy rules are simplified
- Expanded rollovers between various types of plans and IRAs
- Revised treatment for optional forms of distributions including automatic rollovers for small benefit amounts
- Plan loans available to proprietors, partners and S-corp shareholders



# CSRS Congressional Employees

## 2.5% x Service x High 3 Pay

- » High 3 average pay (continuous service)
- » To get 2.5% formula
  - Must have at least 5 years of Congressional service
  - Last 5 years before retirement must be covered service
- » Other federal service generally gets 2%/Year
- » Military service up to 5 years gets 2.5%/Year
- » Maximum = 80% of High 3



# FERS Congressional Employees

**1.7 % x (Congressional Service < 20 years)  
x High 3 Pay +  
1 % x All Other Service x High 3 Pay**

**High 3 average pay (continuous service)**

**Plus Social Security Supplement until age 62**



# American Academy of Actuaries

---

## Questions?

Bridget Flynn, Pension Policy Analyst

[Flynn@actuary.org](mailto:Flynn@actuary.org)

202-223-8196

[www.actuary.org](http://www.actuary.org)

