

Pension act loaded in favor of 401(k)s

401(k) ADVISOR

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What may be the most significant piece of retirement plan legislation in 30 years, the Pension Protection Act of 2006, was signed into law last month and is expected to meaningfully change the way companies offer retirement benefits.

While the goal is to make traditional defined benefit pension plans more secure, experts predict their eventual disappearance because the new law will make the plans more expensive to maintain.

Recognizing that traditional pension plans are likely going the way of the dinosaur, legislators loaded the Pension Protection Act with new rules that make 401(k) plans and IRAs more attractive. Here are some highlights of the new law:

• Expect 401(k) participation to be automated.

Perhaps the most profound impact of the Pension Protection Act will be on how employees enroll in their 401(k) plans in the future.

The new law offers incentives to employers to switch to an automatic enrollment, automatic deferral arrangement - a plan design that requires employees to proactively "opt out" of their 401(k) plan if they do not want to participate. Currently, most plans require employees to proactively sign up or "opt in" if they wish to participate.

• Higher limits and Roth 401(k) made permanent

The last time meaningful rule changes were made to 401(k) plans was 2001. Maximum 401(k) contributions limits were raised, "catch up" contributions for those 50 and older were introduced, tax credits for lower-income savers were offered, and the Roth 401(k) established.

All of these provisions were set to expire by the end of 2010, but the Pension Protection Act makes these enhancements permanent. In doing so, the new law ensures that maximum contribution levels

will not only remain at \$15,000 for those under 50, but continue to rise with inflation in \$500 increments.

• Expect more help

The new law encourages employers to offer their employees something they've been begging for: advice.

Some companies had been hesitant to offer advice, fearing lawsuits if the advice didn't prove to be successful. Under the new law, employers are offered a significant amount of legal protection to encourage them to provide employees with unbiased asset allocation and retirement planning advice.

So expect to hear more about new services designed to help you with your individual plan decisions.

• Check your beneficiary

The new law allows non-spousal beneficiaries to roll inherited 401(k)s and IRAs into a specially designated "Inherited IRA."

Under the old rules, only a spouse was afforded this preferential tax treatment. Everyone else had a maximum of five years to withdraw inherited money from its tax sheltered account and pay the tax.

Now, any named beneficiary can roll an inherited 401(k) or IRA into their own IRA and make prescribed annual withdrawals based on their life expectancy, greatly increasing the amount of time for valuable tax deferred compounding.

Now is a good time to investigate who you've named as your 401(k) and IRA beneficiary. Consider naming your children, or a trust, as contingent beneficiary to your account in case your spouse dies first. If you die without a living beneficiary, your 401(k) and IRA become part of your estate and the tax deferral could be limited to five years after your death.

• Direct IRA deposits and distributions simplified

The new law allows you to direct deposit your federal tax refund into an IRA, up to the applicable annual contribution limit.

It also allows those over 70 1/2, who are required to take a minimum distribution from their tax-sheltered accounts, to donate up to \$100,000 of their required minimum distribution each year directly to a qualified charity and not have the distribution affect their adjusted gross income.

• Company contributions freed up

The Pension Protection Act also makes it easier for participants to access the money their employer may put into their 401(k) account.

Starting next year, for publicly traded companies that contribute shares of company stock to employee accounts, employees can no longer be required to hold the stock.

For stock that may have already been contributed, your employer has three years to release all sale restrictions on the stock. This new rule will allow participants to better diversify their plan assets, and protect themselves against a sudden drop in the value of their employer's stock.

Overall, the Pension Protection Act clearly places more emphasis on employee-funded retirement plans. Now more than ever, you need to become familiar with your retirement planning alternatives and take personal responsibility for your own financial security at retirement.

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