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Intelligent Money

Current thinking from Haven Financial Advisors

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Special Notes of Interest:

The *Wall Street Journal* reported that in 2000 "nine out of every 10 dollars raised by foreign companies through new stock offerings were done in New York....But by 2005, the reverse was true: Nine of every 10 dollars were raised through new company listings in London or Luxembourg.

Based on earnings guidance effective November 13th, the total income for the S&P 500 is expected to grow 9.7% in calendar 2007

Pension Protection Act of 2006

On August 17th of the this year, President Bush signed into law the Pension Protection Act of 2006 (PPA). The stated intent of the legislation is to streamline retirement savings. Most provisions of the PPA are designed to force employers to shore up their pension plans. However, there is great deal of change affecting the individual employee. This article will review some of the salient features of the (PPA) as they affect the employee and small business owner.

Beginning in 2008, plan sponsors will be able to phase in the use of corporate bond yields to calculate lump sum payouts for defined benefit plans. Currently, sponsors use the treasury yield curve which has lower interest rates. This shift, complete by 2012, will reduce lump sum payouts by 2 to 3% holding all other variables constant. Employees may want to accelerate lump sum elections to the extent possible as the PPA will gradually impose higher discount rates on the future pension cash flows used to calculate these lump sums.

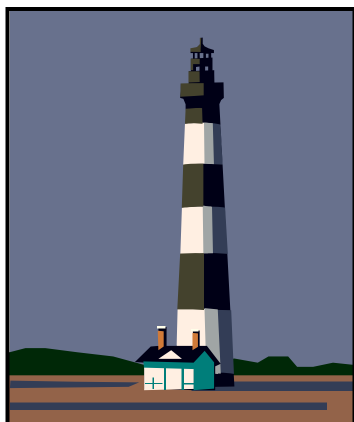
The PPA facilitates the adoption of automatic enrollment 401(k) plans by preempting state laws affecting them and providing additional nondiscrimination safe harbor protections. For example, a plan is deemed to satisfy the nondiscrimination rules for elective deferrals and matching contributions if it provides a minimum match of 100 percent of elective deferrals up to 1 percent of compensation, and 50 percent of elective deferrals between 1 percent and 6 percent of compensation. Many large employers already do this. An employee who is automatically enrolled may be given a 90-day window to elect out of the plan and withdraw the contributions. The distribution will be taxed in the year of receipt and is not subject to the 10 percent penalty tax.

Cash balance and hybrid defined benefit plans will now have some safe harbor protections. In a nutshell, these plans allow for earlier accrual of pension benefits as opposed to a traditional plan that generally backloads benefits. Thus, they are beneficial to the growing body of workers that change careers. In the 1990s, cash balance and hybrid plans were subject to litigation, based on allegations that the reduction in benefits for older workers was tantamount to age discrimination. The PPA immunizes hybrid and cash balance plans against challenges under age discrimination rules so long as their vesting schedules and interest crediting rates meet specified standards.

After December 31st, defined benefit pension plans can provide for in-service distributions to participants who are age 62 or older. Under current law, in service withdrawals are prohibited until age 65. The intent here is to enable older workers to become part-time employees while maintaining their current earnings level by drawing down pension resources.

In the aftermath of the Enron scandal, congress took measures to reduce plan participant investment in company stock. Yet it remains common for plan sponsors to match elective deferrals with company stock. The PPA grants employees complete control over investing their elective deferrals and allows them to diversify employer-contributed company stock after holding it for three years. Plan providers must provide at least 3 meaningfully different investment options in their 401k plans. This latter is not a binding constraint as most plans have far more options.

The PPA also provides guidelines for the



provision of third party advice to plan participants. A fiduciary that is a registered investment company, bank, insurance company or registered broker-dealer will be allowed to give investment advice to participants without engaging in a prohibited transaction if either (1) its fee does not vary depending on the investment choices or (2) its recommendations are based on a computer model certified by an independent third party. This rule becomes operative after December 31, 2006.

The PPA makes permanent the current maximum amounts that an individual may contribute to an IRA and defer to a 401(k) or 403(b) plan. These amounts had been scheduled for a major downward revision in 2011 due to sunset provisions in previous legislation. Such a development would have been adverse to both qualified plan sponsors and individual savers. The table below, prepared by Deloitte & Touche, contrasts contribution and benefit limitations under the PPA against the limits that would have prevailed had the sunset provisions kicked in.

The tax-exempt status of distributions from 529 plans was extended permanently by the PPA. This too had been scheduled to expire in 2011. Families planning to use this tax shelter for their young children's college fund will gain some measure of certainty.

There are also some specific changes to inherited assets. The new law allows non-spouse beneficiaries to roll over assets inherited from a qualified retirement plan into an IRA. Those assets can then be distributed over the beneficiary's lifetime. This will mean more flexible retirement and estate planning for non-spouse beneficiaries, such as domestic partners.

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Type of Contribution	Limit in 2006	Limit in 2011 Under the PPA	Limit in 2011 w/o extension
IRA	$4,000	$5,000	$2,000
IRA Catch-Up (Age 50+)	$1,000	$1,000	$0
401(k)/403(b) Deferral	$15,000	$16,500	$13,500
401(k) Catch-Up (Age 50+)	$5,000	$5,500	$0
SIMPLE IRA/SIMPLE 401(k)	$10,000	$11,500	$8,000
SIMPLE Catch-Up (Age 50+)	$2,500	$2,500	$0
Defined Contribution Plan Limit	$44,000	$49,000	$45,000
Defined Benefit Limit	$175,000	$195,000	$175,000
Compensation Limit	$220,000	$245,000	$220,000

Fallout from the 2006 Mid Term Election

The Democrats will take nominal control over both chambers of congress this January. Their takeover of the Senate counts as somewhat of a surprise. Political futures contracts at www.tradesports.com on the eve of the election assigned an 80% chance of a democratic takeover of the House and a 30% chance of shift in the Senate.

Equity markets reacted smoothly to the results. – even while control in the senate remained in doubt. There was no spike in volatility and, overall, stocks were up during the 3 trading days that followed the election. While voters expressed dissatisfaction with the status quo, the congressional majorities will not be large enough to override a presidential veto.

There may be some legislative fallout from last Tuesday. Democratic leaders have promised a vote on a hike in the federal minimum wage. They are likely to succeed with some moderate republican support. Pharmaceutical companies may suffer as Congress may seek price concessions for drugs used in government programs like Medicare part D. Indeed, the stocks of key drug makers like Merck and Pfizer fell more than 5% after the election.

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On the upside, companies involved in the production of alternative energy solutions may receive a boost. Congress may enhance tax credits or subsidies to stimulate production and demand in this area. Property and casualty insurers could benefit from an extension of the Terrorism Risk Insurance Act.