

# CLASH OF THE TITANS

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My office received a worried phone call last Friday from a new client who recently hired our ERPA services to review his “fully insured cash balance plan” implemented in late 2010. The Maryland broker who sold him the plan, and all its underlying insurance products, had been in town twice already demanding the next year’s (2011) premium payment and he was about to arrive again on Tuesday. The client wanted me to be there as this broker was both forceful and controlling. I eagerly agreed. I wanted to know more about this insurance principal from Maryland and his involvement in the development and sale of this unproven product. After all, the “fully insured split funded cash balance 412(e)(3) plan” came marketed with the full faith and backing of the life insurance company providing the underlying products. Recent conversations with this insurance company, however, indicated they were NOT willing to endorse or support this plan at all. In fact, they stated they required disclaimers from the TPA, broker AND plan sponsor acknowledging they were not liable for anything in relation to this type of plan. So the 412(e)(3) fully insured split funded cash balance plan marketed so adamantly by the TPA and its’ brokers is probably not a 412(e)(3) plan at all but a split funded plan which should have an Enrolled Actuary involved. INTERESTING! As I am sure there is not an Enrolled Actuary worth his or her grain of salt that would be caught “DEAD” certifying this type of plan.

Prior to today’s meeting, I already had sent out inquiries into the “pension” email network looking to see if anyone else had seen or heard of this new “creature” in the defined benefit world and to my disappointment, most people, except for Steve Sansone, Esq. of Payden-Kravitz, remained unusually quiet. I did manage to get the owner of the software system used by this supposed TPA selling these plans to acknowledge that the “fully insured split funded cash balance plans”, as marketed by this TPA, were probably not viable. Subsequent conversations with a well known actuary at the home office of the American Society of Pension Professionals and Actuaries, (ASPPA), definitely indicated she thought this was the “let’s give the insurance guys rich but also not viable cash balance plan”.

So what’s the problem? It is simple here, folks. The cash balance plan is a hybrid defined benefit plan where the participant’s benefit is equal to the hypothetical account balance under the plan. The IRS liked this concept so well it actually ALLOWS these plans an exclusion from the 417(e) rules which would make the payouts vastly different. Introduce insurance products like “whole life policies” that take a huge portion of this account balance to buy a death benefit but produces a low cash surrender value in the early years and guess what goes haywire. The hypothetical account balance no longer is the contribution plus the IRS stated interest rate but some small account balance, a smaller cash surrender value and a HUGE insurance policy that goes BACK to the plan.

I was amused to see the broker had used the insurance company’s portfolios and other marketing pieces when distributing the original individual whole life policies to the participants to add credibility and implied “backing” by the insurance company itself. In addition, the participants’ received a Certificate of Participation that showed the contribution being made, a small balance in the annuity portion of the plan and a large premium going out as an expense to buy the insurance policy. Unfortunately for the plan sponsor, copies of these policies were NOT provided to them nor valuation reports showing how the costs were generated. The 2010 Form 5500 was not any better. There was a huge employer

contribution shown followed by a large “expense” equal to the premium payment ending in an asset value equal only to the value in the annuity portion of the plan. AMAZING!!

So the meeting time was set for Tuesday, today, ...1:30pm sharp! I arrived promptly and eagerly awaited the broker’s arrival..... then it was 2:00pm, 2:30pm, 3:00pm, finally around 3:20pm, the man came through the door and sat down. The plan sponsor introduced me as the new TPA, not really a correct title at this point but ok to move forward on and, to put it bluntly, the rest of the meeting went downhill from there. This bully of man immediately tried to take over stating my main purpose for being there was “for the money” and that my concerns for this program were unfounded and I was basically unworthy of consideration. I immediately told him that my concerns were for the client AND HIM as a broker. My initial thought process was that he was merely a pawn having been sold a bill of goods by the “unscrupulous” TPA who had developed this “fully insured cash balance plan with split funding” program. NOT TO BE THE CASE! It was obvious he was up to his EYE BALLS in this and probably has been spreading his venom nationally for awhile. The argument commenced.

He had the full faith and backing of the insurance company, he screamed. Not only that but the principal/owner of the TPA firm involved also back this program. FINE, I replied, then you won’t have a problem calling the insurance company right now as the VP of the Retirement Services providing the product had told me they would NOT back the program. He angrily replied, I just talked to her and she is willing to take over the administration of this plan. OK, I replied, get her on the phone. NO WAY, he snorted back, I will not talk to her with you in the room, only with MY clients. Ok, I said then let’s agree on getting the IRS’s input into the plan. No one (including the insurance company by the way) has actually ASKED the IRS for an opinion on this type of plan. The TPA’s website marketing this program references a lawyer. Well, we all know how much weight those “lawyer” opinion letters had when all the old 412(i) got audited (or should I say are still being audited). Toilet paper. The bantering and posturing went on for around an hour when he yelled “That’s ridiculous” “So what if the IRS says these plans are not acceptable, as long as the insurance company says they are ok and the TPA says they are ok”. At that point, I stood up, looked him in the eye and said “you and I are at a moral impasse so I will leave you to your “conversation” “alone” with the insurance company” got up, took the plan sponsor with me and called Richard E. Burke, Esq. of Gray Robinson, ERISA attorney to set up an appointment for early next week.

Later today, I did call that VP of Retirement Services at the insurance company and told her about my delightful meeting with her broker. I also found out he also call but all he asked her was do they administer fully insured cash balance plans...and they do but not the cross tested split funded with huge whole life insurance policies like the TPA in the Mid-west was pushing. She repeated to me that they asked for waivers of liability. I hope they have them. I told her that I had warned Pacific Life many years about the pitfalls of having huge whole life policies only for owners and annuities for the rank and file under the old 412(i), they dismissed my concerns. (Interesting enough, they hired Larry Starr a year later for a nice to tell them the same thing I told them for “free” earlier.) We know what happened to them. I asked her not to do the same. She agreed and indicated they might consider a “moratorium” until this is vetted out. SO, I will let everyone know more later as the saga continues.....