

The Value of Change

by Pat Byrnes

Benjamin Franklin postulated life's two certainties as death and taxes. Mr. Franklin had it two-thirds right; he forgot about change.

We can choose to live with change, run from it, or make it work for our businesses. Whatever we decide will have increasing impact on our growth, and eventually our profits. From high-tech to low-tech to professional entities, all businesses and professional practices are challenged to keep up with a rapidly changing marketplace.

Now more than ever a growing number of our clients are coming to the conclusion that attracting, growing and retaining great people is rapidly becoming their most important job. For the last four and a half years, ACI has been building a broad range of services to help clients grow their businesses. Qualified retirement plans remain at the center of our work—we continue to provide creative solutions to our clients' retirement and cafeteria plan problems. We also have a unique executive benefits practice that allows us to find the right blend of qualified plans and non-qualified plans for executives. We have been performing compensation and benefits surveys for clients who want to make sure that a cohesive program is put in place to help attract and retain their people. Through partnering, we now offer our clients assistance in creating and "operationalizing" strategic and business plans.

Over the next year you will see both benefits and management-related articles in *Action Items* that may be helpful to you as you grow your businesses. As always, we value your feedback and welcome your suggestions for article topics. In a departure from the past, I would also like to invite you to submit articles for publication in *Action Items*. If you have expertise in a management or benefits field and believe a particular subject would be beneficial to our readers, please contact Jeff Wallace, editor of *Action Items* to discuss submitting an article.

Wishing you continued success,

Pat

IN THIS ISSUE

Deadline Extended for Y2000 Safe Harbor 401(k) Plans

Page 2

The Costs of Employee Turnover

Page 2

Is There a Defined Benefit Plan in Your Future?

Page 3

Keeping an Eye on Your Split Dollar Insurance

Page 3

Required Plan Restatement: The Silver Lining

Page 4

Treasury Department Announces Review of Cross-Testing

Page 5



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Deadline Extended for Year 2000 Safe Harbor 401(k) Plans

by Bob Eastwood

Do you sponsor a calendar year 401(k) plan and did you let the deadline get past you without deciding on using a nondiscrimination safe harbor for 2000? If you wish you had a second chance, you do! The Treasury Department just released Notice 2000-3, which gives 401(k) sponsors until May 1, 2000 to decide on using a safe harbor for 2000. As long as plan participants are told of your safe harbor intentions by May 1, the plan can avoid year 2000 discrimination testing by implementing a safe harbor employer contribution. What's more, you can prospectively discontinue any matching contribution and you need not commit to a non-matching contribution until late in the year.

Safe harbor 401(k) plans, first permitted in 1999, feature either specified employer matching contributions

or a 3% of compensation contribution to all eligible participants. Generally you must decide on whether you want to make these contributions before your plan year begins. Up until now, once you made a decision and announced it, you were locked in for the year. Not anymore. If you chose to match employee deferral contributions, you can change your mind mid-year, but the change must be prospective. Participants must be told 30 days in advance, and must be offered the opportunity to change their contribution rate after the match stops. If matching stops mid-year, the usual discrimination tests must be performed for the entire year.

Even more flexibility is offered to the sponsor considering the 3% of compensation safe harbor contribution. Participants must be informed

before the plan year begins (but no earlier than May 1, 2000) that the sponsor *may* make a decision to make the contribution later on in the year. If the sponsor does decide to make the contribution, you have until 30 days before year-end to notify participants of your decision. The process can be repeated each year, where some years the contribution is made, while in other years it's not. The only requirements are that participants be told before the year starts that you *may* make such a contribution, and then informed of the decision to actually make the contribution within 30 days of plan year end.

If you are considering using a safe harbor contribution in your 401(k) plan, there is still time for this year. Let an ACI representative help you with the details.

The Costs of Employee Turnover

by Jeff Wallace

Regardless of your business, you are probably concerned about employee retention and recruitment. With a tight labor market, finding talented employees is becoming increasingly difficult, and retaining your key staff members can be a challenge. Recently, several organizations have completed studies focusing on the costs associated with employee turnover. Here are a few of their findings:

- The average costs associated with replacing an employee range from 30% to 75% of annual sal-

ary, depending upon the skill level and seniority of the employee.

- It takes an average of 13 months for a new employee to reach the same level of productivity as his/her predecessor.
- The costs associated with replacing an executive-level employee average \$250,000.

These are often viewed as the hard costs of employee turnover. There are also some soft costs that can take an even greater toll on an organiza-

tion. Employee turnover often impacts a company's relationships with clients, resulting in a decrease in customer satisfaction. Turnover may have a negative impact on the morale of those staff members who worked closely with the former employee. The new employee will also temporarily reduce the productivity of coworkers, as training and acclimation occur. In addition, turnover invariably creates added work for managers—they often find themselves filling in for the former employee while struggling to find an adequate replacement.

Continued on page 4

Is There a Defined Benefit Plan in Your Future?

by Bob Eastwood

Don't want the hassle of a defined benefit plan? Had one once before but had to terminate it? Don't be too hasty to write off the defined benefit plan as a tax-planning tool, especially in 2000 and beyond. If you own or control a small to medium-sized business, are age 45 or over, and fret over the \$30,000 annual limit on profit sharing or money purchase plan contributions, you had better take another look at the possibility of a defined benefit pension plan.

Two legal changes recently occurred which have a significant impact on defined benefit plans. To begin with, Congress repealed the 15% "success tax" imposed on distributions from tax-qualified retirement plans, so there is no longer a fear that your retirement nest egg will be too large. Furthermore, starting in 2000, there is no longer a special limit for individuals covered under both a defined benefit and a defined contribution plan. This means you can participate in both a defined benefit and a defined contribution plan with no worries that the benefits will be too large.

Before you start breaking down your local actuary's door, there are one or two things to consider. To begin with, while there is no longer a benefit limitation for those covered by both kinds of plans, businesses that sponsor both kinds are limited as to the deductible contribution which may be taken. If one or more individuals are covered under the same employer's defined benefit and defined contribution plan, deductions are

limited to the *greater* of: a) 25% of the covered participant's compensation; or b) the minimum needed to fund the defined benefit plan.

For example, let's say you are a sole proprietor earning well above \$200,000 and you have no employees (we want to keep this simple). A profit sharing plan will get you a maximum deductible contribution of \$25,500 (15% x \$170,000 maximum recognized compensation). If a money purchase plan is used, the figure goes up to a \$30,000 maximum deductible. However, if a defined benefit plan contribution was actuarially calculated to be \$32,500, you could also have \$10,000 put away in a profit sharing plan. This equals the maximum combined deduction of \$42,500 (25% x \$170,000). If you are older, you might be able to contribute as much as \$100,000 per year or more, with only a generously designed defined benefit plan and no profit sharing plan. The same principles apply for plans with employees.

There are still reasons why a defined benefit plan may not measure up. If you invest particularly well so that accumulated assets exceed the value of the (generous) pensions promised by the plan, excise taxes up to 50% may be assessed when the surplus reverts to the employer. Defined benefit plans are also more expensive to administer than their defined contribution sisters. They also may be required to pay premiums to a federal insurance agency: the Pension Benefit Guaranty Corporation.

While defined benefit plans have their drawbacks (e.g. does anybody but an actuary know how they work?), they represent the only way to rapidly accumulate the large sums necessary to fund meaningful lifetime pension amounts for an older individual. Fortunately, plan benefits need not be paid out exclusively as a lifetime pension. Instead, smaller defined benefit plans always permit the discounted value of the pension to be paid in a single sum, which can be rolled over into an IRA.

Might there be a defined benefit plan in your financial future? ACI professionals can help you find out.

Keeping an Eye on Your Split Dollar Insurance

by Trista Tyson

Split dollar insurance is one of the most popular executive benefits for closely held businesses. It is often used to provide retirement and death benefits for key employees.

Any type of whole or universal life insurance can be used as a split dol-

lar contract. At the time of purchase, the future value of the insurance contract is projected at reasonable rates of return, expense and mortality. The amount of insurance purchased is usually targeted to provide either a

Continued on page 5

Required Plan Restatement: The Silver Lining

If the impending GUST restatement is a gray cloud, the opportunity to improve your retirement plan design may be a silver lining.

During the next 18 months, every qualified retirement plan is going to be required to be restated in order to bring the plan into compliance with four laws which were passed during the last six years. These laws are often referred to as “GUST,” an acronym formed from the first word of each law: **G**eneral Agreement on Tariffs and Trade (GATT); **U**niform Services Employment and Reemployment Rights Act (USERRA); **S**mall Business Job Protection Act; and **T**axpayer Relief Act of 1997. While the IRS has not yet provided guidance for the restatement of all plans, they have provided the language necessary for most profit sharing and money purchase plans. ACI began restating plan documents late last year, and will continue restating plans throughout 2000.

It's not easy to view a required restatement in a positive light; nobody is excited by the prospect of spending money on a retirement plan document. However, you may want to take advantage of this restatement by combining it with additional modifications to improve your plan. For example, by adding a cross-testing feature to an existing *pro-rata* profit sharing plan, the plan sponsor may be able to direct significantly higher profit sharing allocations to selected employees. Or by adding a safe harbor feature to an existing 401(k) plan, a plan sponsor can avoid refunds to highly compensated employees, and increase profit sharing allocations!

If the goals for your retirement plan have changed, or if you are contemplating any changes to the design of your plan, the GUST restatement provides you with a rare opportunity. You will eliminate the costs associated with plan amendments by combining these changes with the restatement. If you would like an ACI consultant to review your plan and discuss design alternatives with you, please call your plan administrator.

Costs of Turnover

Continued from page 2

Improving Retention

Improving employee retention begins by determining the causes of turnover. Rarely does an employee leave a company for just one reason. Often, many factors contribute to the decision to leave. The most-commonly cited factors include:

Values, Vision & Culture

Some employees leave because they simply don't fit in with an organization's

culture. A company's values and their vision of the future are the cornerstones of their culture, and finding employees who buy into the culture is crucial to improving retention. Unfortunately, organizations often hire primarily based upon technical skills, and only later realize that they have hired someone whose personal value system is in direct conflict with the organization's. If, for example, the company values personal and professional growth, they may find themselves with a brilliant technician who is only willing to do things the way he's done them for the last ten years, and is totally resistant to change. No matter how technically proficient the employee may be, he will almost certainly be a drain on the organization. Whether the employee eventually resigns or is terminated, the consequences of the hiring decision can be significant.

Training

Some employees may leave because they feel that they were inadequately trained or supported and, consequently, were unable to meet expectations. The real issue here is one of planning and communication. When the expectations were established, did the employee have an opportunity to provide feedback? Did he express concerns about training? Did his supervisor address the concerns by developing a training plan, or providing adequate supervision to increase the odds of success? If not, the employee's decision to depart should come as no surprise.

Compensation & Benefits

One of the most commonly cited reasons for leaving a company is dissatisfaction with compensation and

Continued on page 5

Costs of Turnover (continued)

benefits. Companies obviously need to maintain competitive compensation levels to retain people. How they structure compensation varies significantly from industry to industry. Base salary with some form of incentive compensation is rapidly becoming the standard for most businesses. How to determine a fair level of base compensation, and how to establish and monitor objective performance criteria for incentive compensation are the major challenges facing employers. Determining how much to offer in incentive compensation, and how to structure the payout (taking taxes into consideration) are also concerns.

In terms of benefits, the world has changed dramatically. In the past, a 401(k) plan was viewed as a nice perk. Today, most employees assume that companies competing for their services will offer a 401(k) plan (usually with a generous match). Medi-

cal, dental, and vision coverage are often regarded as “must have” benefits, as well. Non-qualified plans are becoming a standard demand among executives. The need to defer current compensation beyond qualified plan limits is very real to many of these key employees. The proliferation of stock options has had a major impact on how many companies structure both base compensation, as well as other benefit plans.

Identifying Issues

What do your employees think about your company’s culture? Its values? Your compensation and benefit programs? Once you answer these questions, you’ll be prepared to begin addressing issues that may contribute to turnover. ACI has developed and evaluated surveys addressing a variety of issues for our clients. When conducting employee surveys, we offer employers an objective, expert third-party opinion. We offer

employees complete confidentiality, thereby ensuring candid feedback. If you would like more information about our employee survey services, please contact Jeff Wallace at extension 138.

Treasury Department Announces Review of Cross-Testing

On February 24, 2000, the Treasury Department and IRS released Notice 2000-14 announcing that they are reviewing nondiscrimination regulations relating to cross-tested plan designs. They are seeking to determine whether this type of plan design is appropriate in all cases.

At this point, sponsors of plans utilizing cross-testing should not panic. To begin with, the Notice points out that any changes in these regulations would be applied on a *prospective* basis only. In 1994, the Treasury proposed similar changes to regulations, which ultimately were rejected. Representatives of the American Society of Pension Actuaries (ASPA), along with the US Chamber of Commerce and the Small Business Council of America are mobilizing to address this most-recent rethinking of cross-testing. Depending upon how serious this review becomes, ASPA may organize a grassroots campaign among plan sponsors to voice opposition to changes in these regulations.

We’ll keep a watchful eye on Washington, and keep you posted as this matter continues to evolve.

Split Dollar Insurance

Continued from page 3

specified amount of death benefit or a specific amount of cash value at retirement age that can be withdrawn to provide retirement benefits.

If you have split dollar insurance policies that have been in effect for more than a couple of years, it is a good idea to have the death benefits and cash values reprojected based on the existing policy values and interest, mortality and expense rates that are reasonable today. You may be pleasantly surprised to find that the values in your policies are greater than expected, or you may find that you need to make some adjustments to meet your original goals.

If your policy was purchased to target a particular percentage of income as either a death benefit or retirement benefit, you may want to adjust the insurance benefits to reflect any increases in compensation.

You may also want to consider issuing annual “benefit statements” to employees who have split dollar policies as a reminder of the value of this benefit.

ACI can work with you and your insurance agent to set up a regular program to review your split dollar policies and provide benefit statements to plan participants.

Changes at ACI

Plan Administration

ACI recently reorganized our plan administration department in order to better meet the evolving needs of our clients. We are pleased to announce that four of our most experienced staff members, **Sandy Crawford, Glenda McAfee, Tobi Cogswell, and Gerri Wheeler**, were promoted to the position of Consulting Administrator.

In their new role, each Consulting Administrator will lead a team of Senior Plan Administrators and Administrator Assistants, while continuing to work with a selected group of clients. Sandy, Glenda, Tobi, and Gerri will share their experience and expertise with their teams, while continuing to provide ongoing consulting support.

We believe this reorganization will further improve our ability to provide each of our clients with the level of

administrative support that is most appropriate to their retirement plan.

Management Team

On January 1, **Jack Cross** was promoted to the position of Chief Operations Officer of ACI. In his new role, Jack will oversee all aspects of ACI's day-to-day operations, including the Firm's Plan Administration, MIS, and Accounting departments. Despite his expanded responsibilities, Jack will continue to share his 20 years of experience with clients as he consults on pension-related matters.

Accounting

On January 1, **Colette Laurent** was promoted to the position of Controller. Previously ACI's Accounting Manager, Colette led ACI's Accounting department through recent transitions and has been an invaluable resource to ACI's management team.

Laura Mitchell-Vela Joins ACI

We are pleased to announce the addition of Laura Mitchell – Vela to the ACI team as an Associate Actuary. Laura is an Enrolled Actuary and will assume substantial roles in the areas of valuations, technical training, and consulting. Laura will assume many of the responsibilities formerly held by Bob Eastwood, as Bob spends more of his time in consulting and marketing activities.

Prior to joining ACI, Laura worked as a pension plan consultant for William M. Mercer Inc. for more than 11 years. She spent this time helping large corporations grapple with their pension, non-qualified deferred compensation, and retiree medical plan issues.

Laura has also spent a significant amount of time training non-actuaries in the technical side of their duties, including the organization of a complete course program concerning actuarial valuation basics.

Laura earned her bachelor's degree in Mathematics and Applied Science from the University of California, Los Angeles.

We welcome Laura and expect that many of you will be meeting and working with her as she assumes a widening technical role. We hope you are as pleased as we are to have her compliment our technical staff.

Have an Idea for an Article?

We produce *Action Items* in order to provide our clients and their advisors with articles that address relevant, timely issues. If you have a particular topic that you would like us to address, a question you would like answered, or if you would like to submit an article for publication, please let us know! We welcome your feedback and input.

If you have any comments or suggestions regarding *Action Items*, please contact Jeff Wallace, ACI's marketing manager, at ext. 138, or by e-mail at jeff@actuarial-consultants.com.

We Want Your E-Mail Address!

ACI is constantly updating our database with current e-mail addresses. Many clients and advisors have expressed a preference to receive materials via e-mail. Let us know your e-mail address by either calling your plan administrator, or by sending an e-mail from your return address to Jeff Wallace at jeff@actuarial-consultants.com. Please include your name, along with your organization's name in the e-mail message.

Action Items will be available via e-mail in the near future!



