Action Items
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a newsletter for ACI's clients and their advisors

2005 Los Angeles Benefits Conference (LABC) Update

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IN THIS ISSUE

The 2005 Los Angeles Benefits Conference was held January 26th through 28th. At this conference the IRS and DOL meet with the benefits community to discuss current thinking about various topics, plans for issuing guidance and answer a variety of questions. Here are a few of the items we thought you might find interesting.

Mandatory Rollovers

On September 28, 2004, the Department of Labor published final regulations establishing a safe harbor, which satisfies the fiduciary duties under ERISA in connection with an automatic rollover of a mandatory distribution. The IRS recently released IRS Notice 2005-5 providing specific guidance on these automatic rollovers. The automatic rollover provision under section 401(a)(31)(B) becomes effective March 28, 2005. IRS Notice 2005-5 contains sample amendment language for plans that want to force distributions to terminated participants of amounts between $1,000 and $5,000 into IRAs. To satisfy fiduciary duties with the rollover IRS, the plan sponsor must have a written agreement with the IRA custodian and provide a notice regarding the automatic rollover to participants. Plans can still pay lump sums to those with lump sums under $1,000, but unless participant consent is received, distributions to participants with account balances or benefit amounts in excess of $1,000 but under $5,000, the distribution must be made to an IRA. Plans will need to be amended by the end of first the plan year ending on or after March 28, 2005.

Non Tradition Normal Retirement Age

In November the IRS issued proposed regulations on phased retirement. These regulations would generally outlaw provisions for Normal Retirement Age, where for example, the retirement age is the earlier of age 55 and 5 years of service. There is some question as to whether

See "LABC" on page 2

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"LABC" Continued from page 1

the Treasury and IRS have the authority to make this change. Many observers feel that if this provision makes it into the final regulations, it would be invalid. It is important for you to know that the IRS is looking at this issue and it may have implications for your Plans.

Meaningful Benefits

Those of you with defined benefit plans may be familiar with the term "meaningful benefit". It has to do with determining whether you are covering enough employees at high enough benefits in the defined benefit plan to have a qualified plan. The IRS has defined a benefit as meaningful if it provides an accrual of .5% of compensation per year of participation at the Plan's normal retirement age. Based on this definition, it is far more costly to provide a meaningful benefit at age 55 than it is at age 65. The following example was proposed to the IRS:

> *A plan provides a benefit of .5% of pay times years of service with a Normal Retirement Age of 65. Later the plan is amended to change the Normal Retirement Age to 55. This benefit improvement (earlier retirement age) would now make the plan fail to provide meaningful benefits.*

The IRS stated that they would look into the way they define meaningful benefits. We look at this as positive news for all who sponsor defined benefit plans.

Determination Letter Process

After the 2004 Los Angeles Benefit Conference, we reported that the IRS was examining a new approach for requesting and issuing determination letters on a staggered basis instead of the same deadline for everyone which leads to peaks and valleys in the volume of work that needs to be done by both the IRS and those submitting for determination letters. The IRS announced that they intend to unveil the new determination letter program in March which will require restatements for plans every six years. The EGTRRA provisions that plans adopted through model amendments in 2002 and 2003 will be the first test of this revolutionary new system.

The IRS's "softer approach"

The IRS is looking at the balance between service and examination. For the past several years fewer plans have been audited by the IRS. The IRS will be stepping up their examination process, planning to examine 11,000 plans in the current year (compared to the 7,500 last year). They expect to hire 71 employees (10 to 12 on the West Coast) with most of these employees focused on plan examinations. The good news is that the IRS is going to be doing more "focused" examinations, looking at key areas and deciding whether to proceed or close the case. As a result we can expect that cases would close more quickly.

Steve Miller, the new IRS Commissioner of Tax Exempt & Government Entities (TE/GE), pledged a strong response to abusive tax shelters in the retirement plan arena.

Working with the Employee Community to Make Change Work:

Part 2 of "Managing Transition from the Inside Out"

by Mark H. Fowler, CMC, CPA
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There are many things you can do to help initiate change within your business by building a closer rapport with your employees. The most important ingredient is to have someone or some department, the human resource people are usually the most appropriate, to champion this process of getting and staying closer to your most valuable asset. Second, you need to make a commitment that this is what you want and you will see it through. There is nothing worse than a start-stop scenario.

These actions are just as valid in a major transition as in preventive maintenance:

1. Banish blame from the property. Blame doesn't work. In fact, most situations where something went wrong there is a variety cause not just one thing or one person. Seek to find out what happened and to understand, not to find out who did it. This is especially important in the crisis situation, where you don't want to shoot your most valuable people because they were trying to help.
2. Develop a communication system that works for the whole community, management and staff. By giving people simple and consistent day-to-day tools for communicating they are automatically open to work with each other.
3. Establish a platform for listening first, talking second. We all have something to say, but as managers and owners we have a duty to listen to those around us and to create an environment of appreciation of what is said.
4. Create an in-house newsletter that is about the company and the employees. People want to feel connected and the in-house newsletter can do that.
5. Solicit input from the employees. This can manifest itself in various formats: interviews, questionnaires, fo-

cus groups, special project committees or company-wide meetings. What is essential is that the information received is honored and respected. “There are no right or wrong perceptions or ideas”.

6. Establish an advisory board of employees, which may include outside resources. The objective of these advisory boards is to create a forum for ideas that can establish a feedback loop connecting management and employees.

7. Make a point of acknowledging and rewarding people for their efforts and accomplishments. It can be as simple as a note on the community board or a notice in the inhouse newsletter or a memo to all staff. Let people know that they are appreciated.

8. Trust people to do things. Allow others to take on projects and assignments that you believe only you or your select managers can handle. You may find that others, because of their different viewpoint, can often add as much or even more value to a situation than those closer to it.

9. Let people go who don’t belong. We have something we call the “one in twenty rule”. That rule says that it takes only one unhappy, or ill trained, or dysfunctional person to negatively affect the other nineteen people who work with and/or for them. Most people don’t do well in their job for two reasons: 1) they are not properly trained or suited for their duties and 2) they are not interested in the work. If you can’t help with number one, it is probably better if the person makes his or her own transition.

10. Create an “early warning system” for better overall communication. This can take many forms, some formal, some informal. It can mean a reward system for information. It can mean establishing key indicators where everyone benefits. It must, however, never become a vehicle for punishing others because we are talking about clearing up confusion, not creating it.

11. Support accountability. When people take on a task to accomplish something they become responsible and accountable. They are responsible for the work but they are also accountable to the company and all the people within the company. A team means everyone holds up their end. When you let people slide the company slides.

12. Reinforce the concept of empowerment. This means giving people the appropriate responsibility and authority to do their jobs. In addition, they have received or are receiving the training necessary to do their job correctly.

13. One of our favorite techniques is to create special project committees to help resolve specific operational issues. The team gets together and creates an outline of the issues they have discovered and a road map of how to resolve the situation. The most rewarding is when they do their presentations to the other team members. It creates a lot of goodwill and helps others better understand what is going on.

Where to Go From Here

First, look at the actions above as somewhat of a Chinese menu. There is a lot of information and all of it can work but you don’t need of all it to work. Rely on your own project management styles to effect change and include the above as you feel appropriate. This is essential because all situations and all people are different.

Some employee groups are more ready than others to assume responsibilities. Others have been, for various reasons, held down or skewed as to their perspectives and are not ready for additional duties. The managers also need to be considered. Managers can’t change over night what has become second nature. Things usually take time and patience and consideration are usually the watchwords.

On the other hand, it is amazing how little change is required to make major shifts in an organization. And, often these major shifts pay big dividends. The effort is always worth it and rarely, as long as you are on the positive side of the ledger, will you fail.

Mark Fowler specializes in transitioning companies from challenges to achievement with a focus on enhancing revenues and profits. For 25 years, he has been assisting companies move from problem to solution. A certified management consultant, he is a member of the Institute of Management Consultants (IMC) as well as a member of the AICPA, and California CPA Society.

Action Items is published quarterly.
If you would like to receive future publications of the newsletter, please contact Lace.Greene@acibenefits.com.

Visit our website at ***www.acibenefits.com****, or contact information@acibenefits.com for a brochure.*

The Role 401(k) Plans Play in Retirement Savings

by Lace Greene, Marketing Manager
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Most people recognize the need to save for retirement. However, in an instant-gratification world, it's the feeling that they can always start saving tomorrow that leads to endless procrastination. And procrastination is insidious; it can quickly become a habit that causes individuals to neglect all savings opportunities, no matter how good they may be.

Perhaps the most powerful savings tool available to most people is an employer-sponsored 401(k) plan. But procrastination takes a toll on participation in these plans, despite the many advantages to participation. A recent study by the National Institute on Aging found that more employees contribute to their 401(k) plans when faced with a firm deadline. Another study conducted by Hewitt Associates found that when a deadline is set, and employees are required to make a decision, contributions rose to 45% for people in their 20's, 66% for people in their 30's and 72% for people in their 50's. The lesson here would seem to be that employers can boost participation among employees by creating a sense of urgency.

How does procrastination impact 401(k) plans?

Consider this: During the first three months of employment, *even when offered an employer matching contribution*, only three out of ten new employees elect to contribute to a 401(k) plan. While it is unrealistic to think that everyone can afford to defer compensation into a retirement plan, it is certainly realistic to assume that more than 30% of employees can afford the deferral.

Perhaps the greatest tools employers can use to overcome the procrastination problem is to implement a 401(k) plan, offer a matching contribution, aggressively communicate the benefits of the program, and then require employees to make a decision to participate in the plan within a few days.

Is it too late to start saving for retirement?

It's never too late and most people know this. After all, most would agree that it's better to have something than nothing. But there are inevitably some people who think, "I've gotten this far in life without planning. I'll be able to manage once I hit retirement." These poor souls actually need to win the lottery. No joke! If they don't, there's almost no way they can maintain their current lifestyle—no matter how modest—during their retirement years. There is no combination of government-sponsored entitlement programs that are going to permit people to continue to live anything other than the most austere of lifestyles.

Maximizing Savings

How can an employee maximize the value of their retirement savings?

- Take personal responsibility for saving for retirement. Recognize the high likelihood that nobody else is going to take care of you during the golden years.
- SPEND LESS MONEY! Experts suggest that each of us should be saving at least 10% to 15% of our pay. Most people who are not saving, or saving less than average, know they have a problem, yet they still are not doing anything to correct it. There is a wealth of resources online or in bookstores to help people establish a budget and live within it. Changing spending habits is the most fundamental step to increasing retirement savings. Earmark a large portion of the budget savings for your 401(k) plan and let pre-tax savings work their magic!
- If you change jobs, avoid an automatic distribution or cash-out from your prior employer's 401(k) plan. Instead, if you don't want to leave money in your prior employer's 401(k) plan, roll it into your new employer's pension plan or an IRA. Make sure your retirement savings retain their "pre-tax" status as you transition them from one vehicle to another, or you'll lose twice: First, you'll pay taxes (and penalties if you are under 59½) on the amount of the distribution. Second, since you'll probably spend whatever's left over after the IRS gets their cut, you'll have fewer savings for retirement.
- Review your retirement plan statements. Learn how your plan operates and manage your investment portfolio. This doesn't require you to become an investment guru. It simply means that you should take advantage of the educational resources available to you through your employer's retirement plan or through other public resources. There are some retirement plan investments that are actively managed for you based upon your projected retirement date or your risk tolerance. If you prefer the "pick once and forget about it" approach to investment selection, you may want to investigate one of these options.

If you are an employer:

- Allow early enrollment in the plan—maybe immediately upon hire if you do not have unusually high turnover and stress deadlines. Encourage everyone to begin saving immediately.
- Consider "automatic enrollment." In this type of arrangement, each employee automatically begins participating in the plan once they meet eligibility requirements (which

See "Savings" on page 6

Retirement Plan Basics:

Actual Deferral Percentage (ADP) Tests

Following is an excerpt from Retirement Plan Basics: An Administrator's Guide to Key Issues, a publication of ACI that addresses many of the complex issues associated with the maintenance of retirement plans. This article focuses on participant loans.

Actual Deferral Percentage (ADP) Test

The ADP test compares the actual deferral percentage of highly compensated employees (HCEs) for the current year to the actual deferral percentage of non-highly compensated employees (NHCEs) for the prior plan year (Prior Year testing method). Prior to 1997, the ADPs of both the HCEs and the NHCEs for the current plan year were required. This method may continue to be used if elected by the plan sponsor (Current Year testing method).

To perform an ADP test, the actual deferral ratio (ADR) for each employee is determined by dividing his/her salary deferral by his/her compensation. The ADR for an employee who does not elect to make a deferral is zero. The ADRs are divided into HCE and NHCE groups, totaled, and divided by the total number of employees in each group to arrive at the ADP for the group.

The ADP test is satisfied if the current year ADP for HCEs does not exceed the greater of:

1) 1.25 x the prior year ADP for NHCEs; or
2) The lesser of:
    a) 2 x the prior year ADP for NHCEs; or
    b) the prior year ADP for NHCEs plus 2%

Actual Contribution Percentage (ACP) Test

The ACP test applies to any plan which makes matching contributions, most frequently 401(k) plans. The ACP test is calculated in the same manners as the ADP test. The actual contribution ratio (ACR) for each employee is determined by adding his matching contributions and any other after-tax contributions (if permitted) and dividing the result by his compensation. The ACRs for all HCEs are totaled and divided by the number of HCEs. The same computation is then done for the NHCE group.

The ACP test is satisfied in the same manner as the ADP test described above.

Test Failures

Any failure in the non-discrimination tests may be corrected without penalty if completed within two and one-half (2½) months after the close of the plan year-end.

If tests repeatedly fail, maybe it's time to reconsider the plan design. There are standard and unique forms of matcing contributions that may help tests to pass by encouraging employees to save more (see related article on page 4, *"The Role 401(k) Plans Play in Retirement Savings"*).

ACI's Electronic Newsletter

We mentioned on the last newsletter that ACI recently began distributing a free e-mail based newsletter on a bi-weekly basis to our clients and their advisors. The newsletters are tailored to each individual's interests and cover a broad range of employee benefits and tax-related issues. Topics that you will find in the e-newsletter are:

- Medical Insurance
- Health Care
- Benefits Administration
- Motivating Perks
- Ancillary Benefits
- Business & Employee Insurance Protection
- Retirement Plans
- Benefit Plan Tax Issues
- Business Tax Issues
- Estate Planning.

Unlike other electronic newsletters, it's very short and unobtrusive. We wanted to extend this value-added service to you at no cost and provide you with short, well-written articles on timely subjects.

The electronic newsletter does not take place of our quarterly ***Action Items*** newsletter. Although, some articles you see in the ***Action Items*** newsletter may appear in some of the electronic newsletters, you'll find that most of the articles in ***Action Items*** have a more in depth coverage than the articles you may find in the electronic newsletters.

If you would like to subscribe to ACI's bi-weekly electronic newsletter, please email your NAME , TITLE, COMPANY NAME and EMAIL ADDRESS to lace.greene@acibenefits.com. You will receive the newsletter every other week with the subject heading, ***"Actuarial Consultants, Inc. Newsletter for (Date Released)."*** You may unsubscribe at any time. Please note that e-mail addresses remain confidential.

"Savings" Continued from page 4

should be immediate participation at date of hire for maximum effectiveness). In order to opt-out of this arrangement, employees must complete a discontinuance form. What makes these approaches effective is that if a small default contribution rate is selected (maybe 2% to 3% of compensation, or $10 to $20 per paycheck), the participant barely notices a change in their take-home pay. Inertia is also powerful: If people have to complete paperwork to opt-out, they often times won't go to the effort. They'll simply allow things to go on as-is indefinitely.

- Select the default investment(s) carefully. It used to be that the money market account was considered (by default) to be the default account in nearly all 401(k) plans. But times have changed. Employers are charged with having to balance the need to protect savings with the need to grow accounts at a reasonable rate. Employers now tend to select some sort of asset-allocation model as a default account, or they determine default accounts based upon participants' ages. For example, younger participants might be invested in a growth-oriented fund, while older participants would be invested in a more conservative fund. Consult with your plan's financial advisor when selecting your default option.

- If it is economically feasible, offer a matching contribution. Research shows that matching contributions inevitably increase contribution rates.

- Educate your employees by conducting retirement plan seminars. Studies have shown that the more educated participants are regarding their retirement plan, the more likely they are to participate.

When it comes to retirement savings, the main objective for all of us is to not outlive our money. Both employees and employers have roles in achieving this goal. But for individuals, it's most important to remember to periodically check to make sure they're saving enough. If not, they need to take immediate action to increasing savings.

DID YOU KNOW

(research based on Hewitt Associates study)

- One out of every five employees participating in their company's 401(k) plan has an account balance of less than $5000.
- More than one-third of employees use "Lifestyle" funds when they are available in 401(k) plans, but few understand or accept the role of this type of fund (only 13% of employees have all of their non-corporate stock account balances in a single Lifestyle fund).
- The average 401(k) plan participant is 43 years old, has 10 years of tenure and earns an annual salary of approx $59,000.
- The average employee who does not participate is younger (average 39), has an annual salary of $36,000, and shorter tenure with the employer (average 5.5 years).

ACI In the News

SPEECHES

Pat Byrnes participated in the IRS Q&A Session at the **Los Angeles Benefits Conference** in Universal City on January 26th -28th, 2004. The session featured key IRS officials answering questions about IRS positions on a wide range of qualified plan issues.

ACI CLIENT EDUCATION SEMINARS

2005 401(k) Basic Training: An Introduction to 401(k) Plan Operation.

This educational presentation covers items such as non discrimination testing, employee deferrals and employer contributions, loans and distributions and payroll issues. This seminar is open to anyone who would like a better understanding of the administration of 401(k) plans. The following is the 2005 schedule. Please contact Lace.Greene@acibenefits.com to reserve a seat.

Tuesday, April 19th from 9:00 AM to 12:00 PM
Wednesday, July 20th from 9:00 AM to 12:00 PM
Thursday, October 20th from 9:00 AM to 12:00 PM

Continuing Education Presentations

Each year, ACI prepares a number of presentations related to employee benefits and compensation issues. Many of the presentations are eligible for continuing education credit and have been presented at various professional conferences. For a complete list of ACI's 2005 presentation topics, go to our website at **www.acibenefits.com**.