

# Action

# Items

August, 2006

a newsletter for ACI's clients and their advisors

## Breaking News on the Pension Bill

As this was going to Press, the House and Senate passed a new Pension bill as an alternative to the stalled pension bill discussed in articles of this issue of Action Items. The bill is being sent to the President who is expected to sign it. We will be sending out details of the bill once it is signed.

## The Interest Rate Dilemma

by *Laura Mitchell, Consulting Actuary*  
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Those of you with Defined Benefit Plans with over 100 participants may recall that depending on your funded status, you may be subject to what the IRS calls an Additional Funding Charge. That **Additional Funding Charge** depends on the funded current liability percentage. If you are less than 90% funded you may have additional funding charge depending on the funded status in prior years, but if the plan is below 80% funded, the Additional Funding Charge automatically applies. Until 2004, the Current Liability was calculated using an interest rate based on the 30-Year Treasury Bond Rate. In 2004 PFEA – the Pension Funding Equity Act became law and the 30-Year Treasury Bond Rate was temporarily replaced by the Corporate Bond Weighted Average Interest Rate for 2004 and 2005. The Corporate Bond Rate produced a higher interest rate for calculating the current liability and gave many plan sponsors a reprieve from Additional Funding Charges or significantly reduced them. This relief expired December 31, 2005.

PFEA also changed the interest rate that was used to calculate the liability for determining the PBGC variable rate premium. This reduced the variable rate premiums sponsors were required to make. This interest rate relief on this also expired on December 31, 2005, reverting back to lower interest rates and higher variable rate premiums.

To help resolve these issues, Congress is in the middle of reconciling pension bills that were passed by the House in December 2005 and the Senate in November 2005. These bills both replace the 30-Year Treasury Bond Rate with a rate based on “investment grade corporate bonds” and change the interest rate for calculating the PBGC variable rate premium.

*See “Interest Rate” on page 2*

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## "Interest Rate" Continued from page 1

When these bills first passed the House and Senate, it was envisioned that they would have a retroactive effective date of January 1, 2006. Because of this potential retroactivity, the pension community has been anxiously waiting for this bill becoming law so plan sponsors can determine their 2006 funding requirements and PBGC premiums.

The status of this bill has been the subject of many rumors, both with regards to content and timing. At first it was rumored that it would be reconciled before Memorial Day, then by July 4<sup>th</sup>. Some said that it wouldn't get done until after the election, if at all. The interesting thing about this bill is that it expires with this session of Congress. If it does not become law, the whole process starts over again. If it does become law there is conjecture about the effective date, some say 2007 others 2008. In the meantime Plan Sponsors are left wondering what to do with their plans.

As this was going to Press, the House and Senate had passed an alternate Pension Bill and are sending it to the President for signature. The President had reportedly threatened to veto the bill, but most expect him to sign it. We will keep you updated.

## Beyond Asset Allocation

by *Bambi Holzer, AIF, CEA, CPSG*  
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Throughout most of the 1990s, investing was all about asset allocation. This involved allocating assets in varying proportions to stocks, bonds, and cash based on the investor's risk tolerance, time horizon, spending requirements, and other individual objectives. A famous study by Gary Brinson and colleagues, published in the July/August 1986 issue of *Financial Analysts Journal*, showed that 93.6% of the variation in investment returns was due to asset class, not the selection of individual securities. So, investors and advisors everywhere took this to mean that getting the asset class right was the most important thing. Return projections were based on historical averages, about 10% for stocks, 5% for bonds, and 3-4% for cash.

In the late 1990s the system began to show a few cracks. For one, investors who had a portion of their portfolio in bonds wondered why in the world they were settling for mediocre returns there when stocks were going through the roof. I had such a hard time explaining to clients the concept of diversification and the rationale behind spreading your money among a variety of asset classes. It seemed obvious to them that they should have all their money in tech stocks. Then when the market topped in 2000, they understood the risks of having all their money in stocks. But now they wondered why they should have any money in stocks. In a year when stocks (as measured by the S&P 500) were down 7.5%, bonds and cash were looking pretty good.

Then some of the leading analysts and advisors began talking about

a statistical concept called *reversion to the mean*. This meant, quite simply, that after the high-return years of the late 1990s, stocks were due for several years of low-return years in order to average out to the roughly 10% that stocks had earned since 1926. Bond returns have also started to sink, returning to their pre-1980s yields of 2-4% after inflation with slim hopes for capital gains. The term "low-return environment" is being used rather frequently by investment committees who are scratching their heads and wondering how they are going to meet their return objectives.

Endowments and foundations were one of the first groups to abandon the traditional concept of asset allocation. These organizations do not have the luxury of earning negative returns. Spending policies averaging around 5% per year require that they earn net returns of 8% or more to keep from going in the hole after inflation. The answer for some of them was to switch out of traditional asset classes into alternative investments. According to the 2005 annual report by the National Association of College and University Business Officers, endowments over \$1 billion had an average of 31% invested in alternative investments, up from 22.5% in 2004. The strategy paid off. Endowments greater than \$1 billion earned an average of 13.8% in 2005, compared with 6.3% for the S&P 500.

Alternative investments typically include things like hedge funds, real estate, private equity, venture capital, managed futures, and other investment options that do not fit neatly into the stock-bond-cash categories. They can be somewhat complex and more challenging to evaluate. Often, it is the people and the strategy, not the asset class itself, that determines the success of the investment. Some of them are quite risky, while others use hedging or other strategies in a deliberate attempt to reduce risk. Due diligence is mandatory.

What the asset allocation experience has taught us is that a static strategy of any kind may have its limitations. Markets are dynamic and constantly changing. To keep up with them, we must periodically evaluate our investment strategy and determine whether or not it's still working. If not, it may be time for a change.

Here are some things to consider:

- Asset classes vs. individual investments. Is it necessarily better to go from the top down instead of the bottom up?
- Which asset classes should you use? The Brinson study considered only stocks, long-term government bonds, and T-bills. But many asset allocation plans break these down into many subcategories. How many—and which— asset categories are appropriate?
- Strategic vs. tactical. How long should an asset allocation plan be left in place? What criteria should you use to change it?
- Historical returns vs. forecast modeling. Should you look to the past or the future when considering risk-adjusted returns of the various assets?
- Diversification vs. concentration. Is it always better to diversify? Why? Should your diversification/concentration policy be static or should it vary based on economic and market conditions?

Bambi Holzer, president of Bambi Holzer Financial Group, is a registered representative with Brookstreet Securities Corporation. She is the author of three books on personal finance and has appeared on the Today Show, CNN, CNBC, Bloomberg, and been quoted in national publications such as U.S. News and World Report, Business Week, Money Magazine, and the New York Times. She can be reached at 877-905-3100 or [bholzer@brookstreet.com](mailto:bholzer@brookstreet.com). Visit her web site at [www.bambiholzer.com](http://www.bambiholzer.com).

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Note from the Editor:

The opinions expressed are solely those of the author and are presented for the benefit of plan sponsors who are constantly challenged to stay abreast of current thinking around investment decisions. You are encouraged to refer to <http://www.dol.gov/dol/topic/health-plans/fiduciaryresp.htm> for the DOL's explanation of fiduciary responsibilities under ERISA.

## Why A Plan Should Have More Than One Trustee

by Tobi Cogswell, Director, Client Services  
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Virtually all retirement plans have their assets invested in a Trust. The exception is an "annuity plan" where all the assets are held in the general account of an insurance company. Every Trust has a trustee(s).

At a minimum the Trust holds title to the assets. There are two general kinds of trustees.

**Institutional Trustees** are banks and other corporate organizations that specialize in being trustees. They can either operate in a full trust capacity (make investment decisions), or they can operate in "passive" or "directed" capacities where they operate more like custodians. A directed trustee is the most common institutional Trustee in a 401(k) plan where participants are choosing their own investments. The powers of institutional trustees are set by the plan/trust document that is adopted by a Board resolution.

**Individual Trustee(s)** could either be the plan sponsor or an individual(s) appointed by the employer. Again the roles are set forth in the Trust agreement (often embodied in the retirement plan document). The roles can include the selection and monitoring of the investment alternatives that will be available to the participants, and also include the authorization of steps taken by custodians with regard to loans, distributions and so forth. While this latter authority may be delegated to an "authorized signer", all plans must have a trustee(s) (exception on annuity plans).

Very often the trustees will be one or more owners in a privately held business. If there is only one designated trustee, and something

happens to that trustee, the plan will be in a position where it is unable to function. Even if there someone who can sign documents on behalf of the plan, for example to terminate the plan, there will not be a trustee to authorize the distributions to the participants.

### What should you do?

If your plan has only one trustee, consider adding another trustee immediately. Alternatively, consider documenting your plan to name a successor trustee in the event one is needed.

Your ACI plan administrator can help prepare the documentation needed so that your plan is safe in this regard.

## ASPPA / WPBC Conference

by Skylar Smith, Retirement Plans Consultant  
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Nearly 1,000 people attended the **American Society of Pension Professionals and Actuaries/Western Pension & Benefits Conference** held in Las Vegas on July 16-19. Speakers included representatives from the Internal Revenue Service, Department of Labor and the Department of Treasury, attorneys and accountants specializing in retirement plans, as well as plan sponsors. The topics covered in the seminars ranged from the technical to the cultural. Hot topics included discussions about fees; who gets paid what for doing what with regard to retirement plans, and, of course the pending pension legislation.

Rumors continued about the possible time-frame for passage of the pension bill. There was much discussion and speculation about which initiatives will be included in the final bill. IRS representatives made it clear that regardless of the timing of passage, they will be issuing guidance this year with regard to several key initiatives in the bill that are currently written as effective for this plan year.

Heavy rains in June flooded the IRS Headquarters building in Washington, D.C. The IRS building on Constitution Avenue has moats that flooded, breaking windows in the lower level and sending water into the basements while rising ground water compounded the problem. The building will remain closed for repairs at least until year end.

This means that IRS headquarters staff is working from off-site locations – 2,400 of them from home – others from various other US Government buildings in the Washington, D.C. area. This is feasible because the agency's IT systems, which are located in suburban Maryland, were not affected. Voicemail for headquarters staff however, had not been restored by last week.

We will keep you up to date on the pension bill legislation.

# Cash Balance & Other Individually Designed Plans

by *Laura Mitchell, Consulting Actuary*  
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In previous *Action Items* articles, we have discussed the IRS determination letter process changing to a 5 to 6 year cycle. On February 1, 2006, the IRS opened the determination cycle for plan sponsors of individually designed plans with EINs ending in 1 or 6. This cycle closes on January 31, 2007, and the cycle for EINs ending in 2 and 7 begins on February 1, 2007.

**What is an individually designed plan?** An individually designed plan is one that has not been pre-approved by the IRS, such as cash balance plans and ESOPs. Another common type of individually designed plan is a plan that is on a prototype document that has had an amendment added to it that takes it out of prototype status.

**What does this mean?** If you sponsor a cash balance or other individually designed plan and your EIN ends in 1 or 6, your plan document will need to be restated by January 31, 2007. ACI will be

contacting you in the fall to discuss the restatement and submission process and any changes you might want to make to the plan.

**What if I sponsor an individually designed plan and my EIN ends in a number other than 1 or 6?** Individually designed plans are on a 5 year cycle. The date on which your cycle begins depends on the number your EIN ends in. The cycles are as follows:

<u>EIN ending in</u>	<u>Restatement/Submission Deadline</u>
1 or 6	January 31, 2007
2 or 7	January 31, 2008
3 or 8	January 31, 2009
4 or 9	January 31, 2010
5 or 0	January 31, 2011

**What if I sponsor a plan that is not individually designed?** If you sponsor a plan that is not individually designed, your plan is on a 6 year cycle that depends on the type of plan you sponsor. The IRS is expected to open the cycle for defined contribution plans in February 1, 2008 with a restatement and submission deadline of January 31, 2010. The cycle for defined benefit plans is expected to start sometime after the defined contribution plan cycle ends. We will be notifying you of the details as they are released.

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## End of Year Planning

by *Tobi Cogswell, Director, Client Services*  
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If you have a calendar year profit sharing or 401(k) plan, now is not too early to start thinking about end of year planning. Some considerations you may wish to address are:

**Have your ADP tests been passing?** If not, have you been correcting them by making refunds to certain Highly Compensated employees (HCE's) or by making a contribution to certain Non Highly Compensated employees (NHCE's)?

### **New Rules for 2006:**

The method of determining who receives a contribution in order to correct a failed test, and the amount allowed to be contributed, are changing for the 2006 plan year. This correction method may be more costly than in the past.

### **Options for Correction:**

If you are using the "prior year" testing method, you should already know who the HCE's will be for 2006, and you should already know the maximum percentage they can defer. You can look at your year-to-date compensation versus deferrals for your HCE's to see if anyone is exceeding this percentage. Note that this is an average, not an individual maximum. This means if one HCE is deferring zero, another HCE can defer more so that the average does not exceed the maximum percentage for 2006.

If you are using the "current year" testing method, you may wish to consider doing an interim ADP test. This is a "snapshot" of how the test looks currently which will give you time to reduce the deferrals for the HCE's before the end of the year.

Your ACI plan administrator is available to assist you with both of these options.

### **Consider Being a Safe Harbor 401(k) Plan for 2007:**

Adding safe harbor provisions for 2007 so that you don't need to satisfy the ADP or ACP tests at all. Safe harbor plans have notice requirements. Unless you currently have a profit sharing plan and are adding 401(k) provisions for the very first time, it's too late to do this for 2006.

### **Two Ways to be a Safe Harbor Plan:**

There are two ways to make safe harbor contributions; as a match or as a profit sharing contribution. Both must be 100% vested. Neither may require employment on the last day of the year. Both may be limited only to NHCE's who are older than age 21 with greater than one year of service.

Generally the safe harbor match will be 100% of the first 3% of compensation deferred, plus 50% of the next 2% of compensation deferred. If you have low participation and if your plan is not top heavy, this may be the most cost effective method of satisfying the safe harbor requirements.

A safe harbor profit sharing contribution is 3% of compensation. This not only buys you out of the ADP/ACP testing, it also satisfies the top heavy minimum if your plan is top heavy. If you have what

is known as a “tiered” or “cross-tested” profit sharing allocation, the 3% safe harbor will also satisfy the minimum required Gateway contribution.

Your ACI plan administrator is available to assist you with exploring, and implementing, either of these safe harbor options.

**Additional Considerations:**

*Is the plan still meeting the needs of your company?*

*Have your demographics changed?*

*Have you had an acquisition or a portion of your company sold?*

*Have new family members become eligible?*

*Have you changed payroll systems?*

*Has your internal HR or payroll staff changed?*

*What is, or isn't working?*

All of these questions and more can be better addressed before the end of your plan year. We are happy to work with you and your advisors to ensure that the plan continues to meet your goals and expectations. Please give yourself the maximum amount of flexibility available by starting your planning early.

## The ERISA Filing Acceptance System (EFAST)

*by Lace Greene, Marketing Manager  
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The U.S. Department of Labor’s Employee Benefits Security Administration (EBSA) announced the final regulation required plans to file Form 5500 annual reports electronically. This will be effective for plan years starting on or after January 1, 2008. EBSA along with the IRS and Pension Benefit Guaranty Corporation (PBGC) proposed changes to the Form 5500 that will be processed under the new electronic system. This automated document processing system is called the ERISA Filing Acceptance System (EFAST).

According to EBSA, the filing system will be more streamlined, cost-effective and more efficient for plans. With over one million pension and other employee benefit plans filed each year, EFAST will increase the accuracy rate on information used by the public and the government. EFAST is designed to simplify and expedite the receipt and processing of the Form 5500 by the use of computer scanable forms.

This regulation affects employee pension and welfare benefit plans, plan sponsors, administrators, and service providers to plans subject to Title I of ERISA. This rule was effective September 19, 2006.

The content of the Form 5500 is in draft for an update to ensure

compatibility with the electronic system. The following are the proposed revisions to the Form 5500:

- Creation of a new short form for small plans whose assets are held in easy to value investments with regulated financial institutions
- Increased transparency of plan-related fees and expenses
- Improved information on the funding of defined benefit plans
- Realignment of the reporting rules of 403(b) plans (subject to Title 1) to be compatible with those of 401(k) plans
- Customize information required to be filed to the type of plan involved in each filing

To find out more information on EFAST go to <http://www.efast.dol.gov/>

## ACI Welcomes Pamela E. Jordan, Compliance Consultant

ACI is proud to announce the addition of Pamela E. Jordan to our team as Compliance Consultant. She will be responsible for our client’s plan documents and fiduciary compliance.

Pamela began her career in Los Angeles with William M. Mercer, a national benefits consulting firm. Thereafter, she worked at National Associates, a company that specializes in small to medium size retirement plans. Prior to joining ACI, Pamela managed the document and compliance department of NRS, Inc. in Seal Beach, as well as being a key member of their technical resource team.

Pamela is a graduate of the University of Southern California in Los Angeles. Subsequently, she received a Paralegal Certificate from the Institute of Paralegal Training in Philadelphia.

We welcome Pamela and hope you are as pleased as we are to have her compliment our team.

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

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and request a brochure.*

# Reminders

- December 31, 2005 plan year ends that did not file their 5500's by July 31, 2006 were put on IRS Form 5558 extension until October 15, 2006. If you are waiting until September 15<sup>th</sup> to make your contribution please let your ACI plan administrator know as soon as the contribution has been made so we can prepare signature ready tax forms for you in a timely manner.
- October 31, 2005 plan years that are on corporate extension must have their contribution deposited by August 15, 2006.
- May 31, 2006 plan years have contributions due August 15, 2006 unless they go on corporate extension.
- January 31, 2006 plan years have their 5500 due August 31, 2006 unless they go on extension by filing IRS Form 5558.
- If you do not currently have 401(k) provisions in your plan and you are thinking of adding them for 2006, note that if you would like to have a safe harbor plan, i.e., one that allows Highly Compensated participants to defer the maximum of \$15,000 in 2006 (plus an additional \$5,000 if they are 50 or over) without threat of test failures, the provisions must be in effect for at least 3 months. Therefore, October 1, 2006 is the last date you can amend your plan to add safe harbor provisions.
- If you want to do an interim ADP test please contact your ACI administrator.
- The new limits (maximum compensation, deferrals, catch-up, etc.) for 2007 should be published in late October – we will send you this information as soon as we get it.

# ACI Client Education Seminars

## *Basic Training Seminars:*

### *An Introduction to 401(k) Plan Operation*

### *Understanding Annual Plan Administration*

The *Introduction to 401(k) Plan Operation* is an educational presentation that covers items such as non discrimination testing, employee deferrals and employer contributions, loans and distributions and payroll issues.

This year we have added an additional seminar to help members of your staff understand the process of plan administration in general called *Understanding Annual Plan Administration*. This seminar will cover issues such as employee communication, distribution requirements, tax reporting (945, DE6, DE7 & 1096), year-end data packages, setting up timeline and expectations and changes in company structure.

The seminars are open to anyone who would like a better understanding of their plan(s). The seminars will be held at our Torrance location. There is a \$25 fee for each seminar. **This fee is waived for all ACI clients.**

SEATING IS EXTREMELY LIMITED

You can contact Lace Greene, Marketing Manager, to reserve a seat at lace.greene@acibenefits.com; or call (310) 212-2600, ext. 204.

There are only two more sessions left this year.

### **Plan Administration**

Wednesday	August 23rd	9:00 AM to 12:00 PM <b>FULL</b>
Thursday	November 16th	9:00 AM to 12:00 PM

### **401(k) Basic Training**

Wednesday	August 23rd	1:00 PM to 4:00 PM <b>FULL</b>
Thursday	November 16th	1:00 PM to 4:00 PM