

State of Retirement Plans

by Pat Byrnes, President
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Pension Legislation

In 1963 The Studebaker Corporation, which made those funny looking cars, went bankrupt in the United States and opened up in Canada to produce different types of products. Studebaker at the time had a defined benefit pension plan which was funded at approximately 26¢ on the dollar. Congress took umbrage at this and other similar occurrences at the time and deliberated for 11 years to produce ERISA. ERISA became law on September 2, 1974 when signed by President Ford. ERISA was a very complex and all-encompassing law which, among other things, created the Pension Benefit Guaranty Corporation (PBGC) that was designed to provide security for workers in the event of the termination or shut down of defined benefit pension plans.

It is ironic today, 32 years later, with United Airlines and others turning their plans over to the PBGC, and major sponsors of defined benefit plans such as IBM, electing to freeze or eliminate their plans, that the PBGC is in huge amounts of red ink. In response to this, our Legislature, after much deliberation, is about to pass a massive pension Bill that is likely to be presented to the President by Memorial Day.

At the moment, the Conference Committee charged to work out the differences between the House passed and the Senate passed Bills is hard at work and, yes, the lobbyists, special interest groups and the standard politicking are all at play. National news is very focused on Iraq, terrorism and now immigration, so the behemoth pension Bill has gotten very little press.

The Bill deals primarily with the funding levels of defined benefit pension plans. The provisions are complex and designed to increase funding in under funded plans as well as to encourage deductible "excess" funding in plans to create a cushion for the future.

There are also provisions to resolve key cash balance issues which include assurances that these plans do not prospectively violate age discrimination requirements if certain conditions are met. Congressman Rob Andrews who is on the Conference Committee is working to have the age discrimination clearance made retroactive to existing plans. Welcome relief is also anticipated by the elimination of the Whipsaw provisions of the current law. This has been a huge issue for all defined benefit plans but is much more visible in cash balance plans.

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There are also non defined benefit plan provisions—notably an issue of granting fiduciary relief in participant directed defined contribution plans. Some Conferees are arguing that so called “conflicted advice” should be sufficient to have the plan fiduciaries relieved of liability for participant choices. Others argue that the advice to participants should be “independent advice”. Conflicted advice is advice to participants by the company providing their own investments to the plan. This is a very hot issue and has already been aired in the general press.

Action Items will summarize the key elements of this legislation once the President has signed the Bill. However, the President has indicated that he will veto the Bill if it allows the airline industry a longer period of time to dig out of their under-funded pension liability hole than all other industries. Stay tuned.

Competing for Dollars

Retirement plans, of course, are not the only form of employee benefits that an employer utilizes to attract, grow and retain the right employees. In fact, there is more immediate concern among many employers regarding health care. Any company that provides medical coverage to their employees has witnessed skyrocketing costs and a variety of programs such as Health Savings Accounts (HSA), Health Reimbursement Accounts (HRA) and other devices geared to try and manage costs. In our experience, employers are now beginning to look at retirement plans and health expenditures as a common budget and are trying to figure out how to allocate monies between the two that allows their employees to have some security that their health expenditures will not bankrupt them, and that they will be able to accumulate retirement benefits in a manner that will give them the ability to have financial security once their working careers have ended. In an ever increasing global economy this is a huge challenge. These companies are beginning to develop unified strategies to deal with both the health and the retirement plan sides of their employee benefit programs.

Tax Reform

Over the last several years, the Bush Administration has been noodling around the concept of fundamental tax reform. The concept of a national sales tax has again re-emerged as one of the alternative ways of thinking. Under these models, the tax on income would be very little to non-existent, with the primary tax being raised through a “consumption model”. Deductions for mortgage interest, charitable contributions, medical insurance and retirement plan funding could be fundamentally changed. Part of this model could be the elimination of tax on investment earnings, which would have significant impact on the qualified retirement plans.

These discussions have appeared and re-appeared several times in my career, and the result generally is that the tax law becomes more complicated and the theoretical constructs never come close to being implemented. As we all know, the President has depleted political capital primarily based on world affairs. I do anticipate the pension bill passing this year; I do not anticipate any movement on the fundamental tax reform.

There are a number of matters pending, however, on the regulatory side that are more specific and possibly more immediate.

Roth 401(k)

EGTRRA brought in the Roth 401(k) Plan which, in 2006 began allowing adopting plans to offer their participants an election to defer into their 401(k) plan either a traditional, i.e., pre-tax, or Roth, which is after-tax. The new Roth deferrals and earnings thereon would ultimately be distributed income tax free. The plans are different in many respects from Roth IRAs. One notable exception is that there is no earned income limit on a participant for making a deferral into a Roth 401(k) while there is for a Roth IRA.

Mandatory Distributions and Maximum Benefit Rules

Considerable confusion and frustration continues with respect to the new rules affecting the ability of plan sponsors to automatically distribute monies to participants who refuse to take distributions and have account balances of under \$5,000. Regulations have been written and extended on a couple of occasions. This is primarily due to the implementation of the rule that requires electing employers to roll over into IRA accounts any amount up to \$5,000 with the limited exception for participants that have less than \$1,000. The struggle for many sponsors and vendors is to create a cost effective methodology for having small amounts of money invested in IRAs.

Employers would like to get rid of the small accounts or benefits owing terminated participants so that they no longer have to track these terminated employees. They would also like to avoid fiduciary responsibility for the investments as long as they were placed into the IRA in an account that could not lose principal. The rules, however, are complex and, if adopted by a plan, are required to be executed. Vendors are struggling to develop cost effective solutions.

Maximum Benefit Limits

The IRS and Treasury have indicated their desire to finalize the regulations under the Maximum Benefit Rules of the Internal Revenue Code (Section 415). These rules will affect defined benefit pension plans and are not viewed as favorable for smaller plans, including professional and entrepreneurial organizations. These regulations, when finalized, will bring about fundamental change in the way the calculation of maximum benefits is made, for example:

- When a new plan is established, the funding of the plan may have to be based on future compensation only and not on existing compensation history;
- If a participant was in a former defined benefit plan sponsored by his company that was terminated years ago and now the company wishes to establish a new one, he may experience a significant reduction in the maximum allowed benefit;
- A similar result would occur if a participant reaches the normal retirement age and rolls his/her benefit into an IRA account or a profit sharing account while continuing to accrue benefits for future years.

The government anticipates issuing these regulations by

the end of June.

Phased Retirement

The Treasury also has a set of regulations known as the Phased Retirement Plan Regulations, which are designed around the notion of encouraging the baby boomers to “partially retire” but in a phased fashion. Thus they may draw pension benefits while remaining employed albeit with less hours and, therefore, at a lower salary.

Buried in these regulations is the statement that a normal retirement age in the plan cannot be greater than what is traditional in that particular industry. This could have impact on some of the defined benefit plan designs that utilize non-traditional normal retirement ages (like the earlier of age 55 or 5 years of service) as a method of allowing participants to take defined benefit plan distributions annually and roll them into defined contribution plans.

The combination of the Maximum Benefit Regulations and the Phased Retirement Plan Regulations could have a significant impact on some existing retirement plan designs. It is not anticipated that any of this will be effective until 2007. As soon as these rules are finalized, we will let you know.

Relative Value Regs

Another complex issue dealing with retirement plans is the communication around a participant’s ability to take benefits from defined benefit pension plans in ways other than the normal form of benefit. In defined benefit plans, the normal form of benefit for married participants is a joint and survivor annuity and a life annuity for single participants. The participants are now required to understand the relative value of each optional form of benefit available under the plan. As with all things, this is not as simple as it appears and will in all likelihood be more confusing rather than less confusing to many retirees.

Plan Restatements

The restatement of plan documents to conform to the latest tax laws has been a constant thorn for the IRS and practitioners over the last 7 or 8 years. The government process of delaying compliance with four major and several minor tax bills which became known as GUST was a disaster for the IRS as well as the private sector. The IRS allowed for extension after extension to conform to each of the bills and, as a result, everything came down to the wire for literally all plans in 2003. In their venge not to allow this to occur in the future, the IRS has made a number of pronouncements:

1. In the future, anytime a new law passes a plan must be amended in the year in which it is effective.
2. If the plan is individually designed, it is placed on a 5-year cycle geared to the last digit of its employer identification number requiring that all those interim amendments be incorporated into a restatement every 5 years.
3. If the plan is a Volume Submitter or Prototype Plan, it is on a 6-year schedule that will require all the amendments be incorporated into a restatement on a 6-year schedule. The rules for the 6-year schedule are a lot less clear than the rules for the 5-year individually designed schedule.

Sponsors of defined contribution Volume Submitter and Prototype Plans had to submit their Master Document to the IRS for approval by January 31, 2006 and have until January 31, 2007 for defined benefit plans. Once these approvals have been received, the taxpayer would be given a period of time to actually sign onto those Master Documents.

From a practical perspective, the critical item at the moment is that sponsors of individually designed plans (including all cash balance plans) may need to be submitted to the IRS for an individual approval by January 31, 2007 if the last digit in their employer identification number is either a 1 or a 6.

Who Gets Paid What for Doing What?

For several years pressure has been heating up on fee disclosure and the responsibility of the fiduciaries to know what plan advisors, consultants, attorneys and administrators are being paid for their services. The DOL issued check lists and competitive forces are now at play resulting in better capture of various forms of revenue sharing.

Plan Fiduciaries will continue to press for a better understanding of the “value” received in exchange for the compensation being paid directly or indirectly to plan service providers. This does not mean that the lowest cost is the sole focus. Plan sponsors want value added services and are willing to pay for them.

Participants are becoming more aware of the fees and costs as is illustrated by an expose article in the Los Angeles Times on Sunday, April 23, 2006 entitled “Fees Eat Away at Employees’ 401(k) Nest Eggs.”

These issues will not go away and will in fact heighten. Reasonable fees and cost can not be determined until all forms of cost and compensation are known by plan sponsors.

Government Missions

The primary mission of the Internal Revenue Service is to enforce the tax laws. The primary mission of the Department of Labor/under its Employee Benefit Security Association (EBSA), is to protect the plan participants.

The IRS historically over the last 7 or 8 years has audited significantly less than 1% of the plan universe annually. Their primary attention has been wrapped up in the GUST Restatement process. Their intent now is to audit approximately 1% of plans and to do so by mining the data from completed 5500 Forms and other IRS filings so they can audit the plans that will give them the highest yield. They will continue to increase the amount of “field” audits and will begin a new process of “correspondence” audits where they will mail questions to plan sponsors and ask for written responses.

On the other hand, the EBSA generally does not do audits but, rather, conducts investigations. Investigations are generally triggered by participant complaints, referrals from other governmental agencies, including the IRS and other undisclosed sources.

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Say No to Financial Education and Information

by Marc Robinson, JD, RIA
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The retirement planning industry is beginning to notice the secret that's been right before its eyes for several decades: Smart money management doesn't come from more education and information; it comes from more understanding and inspiration. The goal is successful saving and investing; acting more than learning.

We recognize the value of learning from experience all the time. "It's not the same in books as in practice," and "Just do it," are two examples. Yet, year after year, financial education programs overwhelm people with more information and more ways of receiving information, rather than focusing on the basic rules of comprehension and behavioral change—learn from experience, and less is more.

So what can we do? Top salespeople know that "people buy on emotion and justify with fact." In other words, we have to sell—not simply teach—the things we want people to learn. This doesn't mean "make it fun." It means Intrigue, Engage, Inform, and Enlighten.

Make It Real

We would help people simply by discussing that how you think about money is less important than how you feel about money. Money is about life itself. For example, investing is about hopes, dreams, and fear; credit is about promises, discipline, and trust. Our money management says a lot about how we feel about ourselves and our friends and acquaintances. Sure, compounding and risk tolerance are valuable concepts, but they're abstract and disconnected from our lives.

We can help enormously if we give people a new way to approach money. We can deemphasize "finances" and emphasize how money affects the life of a person, a family, a community, and a society. For example, we can explain how borrowing money means making a promise that other people rely upon for their own lives. If you don't keep your promise, those others have to change their plans and maybe their own promises, possibly forcing others to adjust their plans and promises, too. Break a promise, and you can start a domino effect. Your decisions and actions have consequences you can't always see.

Does knowledge predict proficiency?

The answer seems to be no. For example, Freddie Mac surveys revealed that specific and detailed knowledge did not predict successful behavior. In fact, many studies seem to show a wide gap between

people's perceived understanding of financial topics and their actual knowledge. Self-assessments tend to be overconfident. A 2004 Bankrate.com/ RoperASW study claims people are likely to provide dishonest answers, often overstating their abilities. If we consider how money can impact our sense of self, it's not hard to see why people may be less than honest—with themselves as well as with others.

Motivation predicts proficiency

Studies have revealed a closer connection between one's financial proficiency and one's confidence and broad understanding. What's more, the key connection to financial proficiency seems to be motivation (how much one is drawn to move toward a goal).

Which One: Learn and Do, or Do and Learn?

When we don't have an opportunity to quickly try out what we've just learned, we tend to lose the lesson. We start to forget some of it, question the accuracy of what we remember, lose confidence, and let our motivation slip away. It's no wonder that once-a-year participant workshops (often taught by salespeople who'd rather be selling than teaching) barely cause a blip in behavioral change.

The big question today is about whether we should take action for participants (automatic enrollment, contributions, allocations) or find better ways to instill real learning that can last a lifetime. It's the critical question, but it's also simply just another venue for a question that's been around for years: Is it better to give people fish or teach them how to fish?

It's Both

In my opinion, there is no dilemma. We can give people some fish so they know how good it is and want more, and we can do it in a way that begins the learning process. Said another way: Start by reeling in the fish so they can see the result and be motivated to replicate it; then show them how to do it for themselves. Start the process for people—but make it just that; the start of a process, not the end in itself.

Learning is a Building Process

We all learn a little at a time. We all build gradually on what we've learned and retained. We all need little bursts of motivation to keep us going. We all need to learn and do; and do and learn. In that light, "instant gratification" isn't a dirty phrase; it's a fact of life, and a clue to human nature and how we learn.

How Can You Change Plan Education Today?

Talk to your financial education provider about designing a program that gets people started, and integrates learning with doing, so that participants can quickly see the results of their effort to learn. Ask about designing a program for learning, acting, and reinforcing...again and again and again. Think about simplifying people's investment choices to reflect the way the average per-

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son—rather than the expert—thinks and feels about saving and investing. Reinforce workshops with better online tools accessible 24/7 (if it's not quick and simple it's probably useless) and regularly "push" quick tidbits to participants. Consider automating some of the plan decision processes, at least for a year, so people can see the rod reeling in the fish and experience how the fish tastes when cooked. The time to offer participants a little more learning is while you have their attention and while they believe they can repeat the process themselves. Money, after all, is a belief system. And confidence breeds more confidence.

Marc Robinson, JD, RIA, is a Director at Sageview Advisory Group. He is a consultant/advisor to plan sponsors. He's created plan communications for Fortune 500 companies, written more than 20 personal finance books for The Wall Street Journal, Time-Life, and others, and was a pioneer in simplified financial forms and statements. In 2005, he created AARP's financial planning website and was appointed as a member of The White House Conference on Aging, Financial Services Subcommittee, charged with recommending policies to the President.

Changes in IRS User Fees

by Glenda McAfee, Consulting Administrator
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Effective July 1, 2006, the fees for filing a plan with the IRS for a letter of determination will be increasing. The new fee structure will more accurately reflect the costs of processing various applications.

The fee for a Volume Submitter or Master/Prototype Plan that has adopted only the options permitted by the plan is increasing from \$125 to \$300.

The fee for a plan that has adopted options outside those permitted by a Volume Submitter or Master/Prototype Plan is considered to be individually-designed. The fee for an individually designed plan is increasing from \$1,250 to \$1,800.

An employer with less than 100 employees can have the user fees waived for a period that extends to the later of the last day of the fifth plan year or the last day of what is known as the Remedial Amendment Period (RAP), which begins during the first 5 years.

This program is only available if the plan contains at least one new highly compensated employee (HCE).

As you can see, the availability of the waiver is quite confusing. However, for many plan sponsors, the above increase in fees will extend through the upcoming required restatements under EGTRRA.

For those plans that do not fit into the waiver program, we encourage clients to submit their data to their administrator in a timely fashion to ensure that their plan is submitted to the IRS at the earliest date possible.

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The IRS has developed a very elaborate Voluntary Compliance Resolution program which has many different elements. These programs went into effect in 1991 and are now ingrained in their methodology of doing business. Voluntary compliance is encouraged since the penalties for corrections if a plan sponsor comes forth to correct mistakes is far less than the sanctions that might be imposed if the IRS discovers the matter on audit. The Department of Labor has been evolving its own voluntary compliance program, mostly to do with failure to timely file forms and plans on expanding their program in the future.

Both organizations have outreach programs designed to educate plan sponsors and professionals as to their roles and responsibilities. It is generally observed that if either the IRS or EBSA contact a plan sponsor, the sponsor should consider not responding to them until they have spoken with either their administrator, actuary or in some cases ERISA counsel. Very often, issues can be resolved in a much more straightforward fashion if advisors are involved in the process early.

ACI Outreach

ACI provides newsletters like this, classes for finance and HR personnel and seminars for professionals. If you have any questions concerning any of these ACI outreach programs, please contact Lace Greene at lace.greene@acibenefits.com.

ACI Welcomes Skylar E. Smith, Retirement Plans Consultant

We at ACI are proud to announce the addition of Skylar E. Smith to our team as a Retirement Plans Consultant. She will assume a substantial role in bringing dynamic solutions to the evolving retirement plan needs of ACI's clients and their advisors.

Skylar began her consulting career as a program director with Booz Allen Hamilton, a global technology and strategy consulting firm. She then ran her own consulting practice in Washington DC, followed by a position with American Express as a financial advisor.

Skylar is an organizing member of the Light the Night Walk of the Leukemia and Lymphoma Society and sits on the Board of The Living Success Center.

We welcome Skylar and know you will be as pleased as we are to have her on our team.

PBGC Filers Notice:

Increase in Flat-Rate Premiums

by Gerri Howell, Consulting Administrator
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A new law was enacted on February 8, 2006 entitled the "Deficit Reduction Act of 2005" (DRA '05). The affect of this new law is threefold:

1. Increased PBGC premiums flat rate for both single-employer and multiemployer plans effective for plan years beginning on or after January 1, 2006:
 - \$19 to \$30 for single-employer plans
 - \$2.60 to \$8 for multiemployer plans
2. Automatic increases to the PBGC premium flat rates for future years effective for the plan years beginning on or after January 1, 2007. This adjustment is annual and is tied to the national average wage index used for Social Security indexing.
3. Introduction of an "Exit Fee" for an employer with an ongoing business who terminates an under funded plan in a distress or involuntary plan termination:
 - \$1,250 per participant per year for 3 years
 - For example: A plan with 400 lives that terminates an under funded plan can expect to pay \$1.5 million dollars as an "Exit Fee"

ACI's Electronic Newsletter

For those of you who are new to ACI, we have been distributing a free email based newsletter on a bi-weekly basis to our clients and their advisors. The bi-weekly e-newsletters are tailored to each individual's interests and cover a broad range of employee benefits and tax-related issues. You'll find topics such as:

- 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, these articles are very short and unobtrusive. This value-added service to you is at no cost. We wanted to provide you with short, well-written articles on timely subjects.

The bi-weekly e-newsletter does not take place of our quarterly *Action Items* newsletter (which is what you are reading right now). Although, some articles you see in the *Action Items* newsletter may appear in some of the bi-weekly e-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 bi-weekly electronic newsletters.

If you would like to subscribe to ACI's bi-weekly e-newsletter, please email your NAME, TITLE, COMPANY NAME and EMAIL ADDRESS to [lace.greene@acibenefits.com](mailto:lance.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.

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 Lance Greene, Marketing Manager, to reserve a seat at [lace.greene@acibenefits.com](mailto:lance.greene@acibenefits.com) or (310) 212-2600, ext. 204.

The following is the 2006 schedule:

Plan Administration

Tuesday, May 23rd from 9:00 AM to 12:00 PM

Wednesday, August 23rd from 9:00 AM to 12:00 PM

Thursday, November 16th from 9:00 AM to 12:00 PM

401(k) Basic Training

Tuesday, May 23rd from 1:00 PM to 4:00 PM

Wednesday, August 23rd from 1:00 PM to 4:00 PM

Thursday, November 16th from 1:00 PM to 4:00 PM

Action Items is published quarterly.

If you would like to receive future publications of the newsletter, please contact Lance.Greene@acibenefits.com.