

## Are You Liable? Yes!

by Pat Byrnes

You are an architect with a thriving practice in a nice community. Interest rates are low and the residential building in that community is off the charts. You now have 12 employees, including your internal accounting person, Jane. Jane convinces you to set up a 401(k) plan and while you are the trustee, both of you are on the Plan Committee.

You have been good at understanding real estate value in your career, but to you the stock market is a little scary. The plan you set up has 25 mutual fund options with a local brokerage firm. And at the insistence of Jane, your plan also offers an individual brokerage account to each of the participants. Your personal net worth is \$2 million and while you don't know about Jane, you suspect that she is living from paycheck to paycheck.

As the vignette goes, Jane fancies herself an investment guru and pretty soon four of your plan participants have opened up their own brokerage accounts and are taking tips from Jane on how to invest their 401(k) money. You had no idea she was doing this and were only vaguely aware that anyone was using the brokerage accounts.

As it turns out, Jane's investment advice didn't work out too well and the four participants lost most of their money. They go to a local attorney and pretty soon the lawsuit is filed against you and Jane as the fiduciaries under the plan for the losses they incurred. To make matters worse, one of the participants files a complaint with the Department of Labor. The DOL sends you a terse letter asking that by this Friday you supply them with lots of papers.

The aftermath of this isn't pretty. Jane quits. None of your general liability policies provide coverage in this situation. And while you continue to insist that it was Jane that caused the problem, you soon learned that as fiduciaries, you and Jane were co-liable for the losses. Yikes! If you had known that, you would have paid more attention to what was going on.

While this little story may seem unrealistic, we are seeing a growing number of situations where client naïveté is creating potentially huge liability for plan sponsors and plan fiduciaries. Here are a few tips on how to manage and/or avoid personal liability when dealing with your company's retirement plan:

1. Understand your role as a fiduciary to your plan.
2. Make sure that any co-fiduciaries to the plan understand their roles. If they don't—remove them from the role.
3. Ask yourself the question, "Do I trust this person to be a cofiduciary with me on this plan?" If the answer is no, then don't have them serve as co-fiduciary.

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# IRS Issues Final Regulation on Participant Notification

by *Laura Mitchell, Consulting Actuary*

For employers who sponsor defined benefit, money purchase, and some other types of retirement plans, the rules for participant notification, 204(h) notices, have changed when benefits are being reduced.

## What types of plans are subject to the notice requirements?

Defined benefit plans and individual account plans that are subject to the minimum funding requirements under Internal Revenue Code Section 412. This generally means traditional defined benefit plans, cash balance plans, target benefit plans, and money purchase plans.

Government plans, certain church plans, and any plans with no employee participants and fewer than 100 participants (e.g. sole proprietorships and partnerships where no “employees” participate) are exempt from the notice requirement. In addition, Profit sharing plans, 401(k) plans, 403(b) plans and stock bonus plans are not subject to the notice requirements.

## What triggers the notice requirement?

If a plan subject to the notice requirement is being amended to “significantly” reduce, eliminate, or cease future benefit accruals, future benefit allocations, early retirement benefits or retirement-type subsidies, the notice requirement is triggered. For example, a money purchase plan being amended to change the allocation rate from 6% to 4% for plan years beginning after December 31, 2003 would trigger a notice requirement.

The word “significantly” must be viewed from the plan participants’ perspective. Most reductions to benefits will be viewed as significant by participants. If the plan is a money purchase plan and it is being converted to a profit sharing plan, the IRS has said this change is always significant.

Changing eligibility provisions for future plan participants, changing vesting schedules, and eliminating loan provisions are types of changes that do not trigger a participant notices.

## Who must receive the notice?

All participants, including QDRO alternate payees whose rate of future accrual will be reduced, must receive the notice. Also, any individual designated—in writing—to represent a participant, as well as employee organizations representing affected participants must receive the notice.

## When must the notice be given?

This depends on the size of the plan and other circumstances. If there are more than 100 participants in the plan and it is not a multi-employer plan, notice must be provided 45 days before

the amendment changing the plan benefit becomes effective. Multi-employer plans and plans with fewer than 100 participants must provide the notice 15 days before the amendment becomes effective.

There are special rules if the plan amendment is in connection with a business acquisition or disposition. If the plan amendment reduces the rate of future accruals, the notice must be provided 15 days before the amendment effective date. If the amendment does not reduce future accruals, but instead reduces early retirement-type subsidies, the notice may be issued no later than 30 days *after* the effective date of the amendment.

## How must the notice be given?

The notice may be a paper document that is hand-delivered or sent via first class mail to the participant’s last known address. Under certain circumstances, the document may be provided in electronic form. Posting the document in a common area is not an accepted method of delivery. Using hand delivery, the notice is deemed to be provided if it is delivered by the end of the day. When using first class mail, the notice is considered provided on the date of the US postmark.

## What information must the notice contain?

The notice must describe how the benefit or subsidy is calculated both before and after the amendment and when the change is effective. The participant should have sufficient information to determine the general magnitude of his or her reduction. When doing projections, if the plan uses a variable interest rate, the value of the rate at the time of the amendment must be used in the projections.

The notice must be designed to be understood by the average participant. This requirement is deemed satisfied if the notice contains illustrative examples showing magnitude of the change. If the change is not uniformly applicable to all participants, the notice must include sufficient information for the participant to determine which reductions apply to him/her. Alternatively, participants could receive individual statements projecting estimated future benefits at different dates. Traditional defined benefit plans converting to cash balance plans and plans that freeze a benefit until the new formula catches up to the old formula (known as a benefit wear-away) must provide illustrative examples.

## Is a Summary of Material Modifications (SMM) also required?

No, the Department of Labor has said the 204(h) notice will act as an SMM.

## What happens if the notice isn’t provided or isn’t provided timely?

The IRS has divided penalties for failure to provide the notice into two categories: Egregious failures and non-egregious failures. An egregious failure is defined as an intentional failure to provide the notice, or failure to provide most affected participants with most of the information to which they are entitled, whether intentional or not. Egregious failures also include a failure to promptly provide the notice after discovering an unin-

tentional failure. In the event of an egregious failure, all participants get the greater of the benefit they would have received before or after the amendment. There are also excise taxes associated with the failure (see below).

If a failure is not egregious, the amendment may still become effective. However, the employer may still be liable for civil enforcement penalties.

Whether the failure was egregious or not, an excise tax applies. The tax is \$100 per participant, per day. The tax begins on the date when the notice should have been provided and ends on the date the notice is actually provided. For example if there are 100 participants in a plan who should receive the notice on November 15, but 10 of the participants don't receive the notice until November 30, the excise tax is \$15,000 (\$100 times 10 participants times 15 days). The excise tax can quickly become more expensive than providing the better benefit.

The plan sponsor is responsible for paying the excise unless the plan is a multi-employer plan. For multi-employer plans, the plan is responsible for paying the excise tax.

A waiver of the excise tax may be obtained if the employer used reasonable diligence but did not know the failure existed or corrected the failure within 30 days of learning of the failure.

#### **Conclusion**

While the regulations have changed the timing and the content of what is to be provided to participants, the intent is to better inform them of changes to their pension plans. Failure to provide the appropriate notice can result in significant penalties. As a plan sponsor, when making changes to your plan, you will want to consult with your plan administrator in advance to ensure that you are able to provide notices on a timely basis.

#### **Are You Liable?** *continued from page 1*

4. Take an active interest in understanding how your plan works. Don't just leave it up to your accounting person to unilaterally interview vendors and service providers and make decisions.
5. Seek professional help (pension—not psychiatric) if you just don't have the time or energy to figure it out.
6. Consider declaring your plan to be compliant with ERISA Section 404(c) to avoid personal liability for participant investment losses.
7. Become procedurally prudent by documenting your decision-making.

ACI has been helping clients clarify the roles and responsibilities of fiduciaries and simplifying the procedurally prudent process to manage the liability. Please let us know if you would like to learn more about these services.

## **Cash Balance Regs Shelved**

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In April, the IRS withdrew one portion of their proposed cash balance regulations and held a public hearing on the remainder, and various members of Congress introduced legislation to abolish the regulations entirely and establish new guidelines. The proposed age discrimination regulations have stirred a great deal of debate, with organizations like AARP maintaining that the plans discriminate unfairly against older employees, and industry groups pointing out that cash balance designs actually result in the establishment of many new plans in organizations that would not otherwise sponsor pension plans.

The IRS continues to solicit feedback and will eventually issue revised regulations. We'll let you know when these new regulations are issued.

## **GUST Restatement Deadline Approaching**

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Just a reminder: All qualified plan documents must be restated to comply with GUST prior to September 30, 2003. If your document has not already been restated, contact your plan administrator to discuss the timing of this project. If you've been considering any changes to your plan (eligibility requirements, profit sharing tiers, trustees, etc.), we would encourage you to make these changes now. By combining these changes with the GUST restatement, you will avoid additional amendment costs.

## **Improved IRA Protection**

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The US House of Representatives recently passed the Bankruptcy Reform Bill. This bill provides that an employer-sponsored retirement plan which received a favorable determination letter has creditor protection. This creditor protection is extended to IRAs and Roth IRAs with a cap of \$1 million in IRAs.

Employers who currently sponsor "frozen" plans may now consider terminating their plans since IRAs will be afforded the same protection as a qualified retirement plan. Keep in mind that the bankruptcy protection is limited to \$1 million.

It's also important to note that this bill has not yet passed through the Senate, though it is likely to be approved when considered. We will keep you posted.

# Hiring To Your Culture

by John Wentworth  
The Wentworth Company, Inc.

You have been successful. Now you want to step back a little and let others play a more significant role.

You need to add some people. You have hired employees who are great so long as you lead, but most were not potential leaders themselves. Hiring leaders is scary: How will you and they fit with each other? Will they share your values? Will you be able to trust them? How can you tell? How can you find them?

You can address these questions through a four-step process:

1. Identify your values.
2. Identify what you want done. Determine how to tell if a candidate CAN do what you want done, and whether he/she WANTS to do it.
3. Find candidates who have the skills and desires you need and who have "values compatibility" with you and your organization.
4. Determine how you will know whether the person you hired is doing what you want done on the job, within your values structure.

Contrary to popular wisdom, good employee selection is mostly science and only a little art. Anybody who says, "I can tell," is probably hiring at about 50% accuracy (the equivalent of flipping a coin). Here are some evaluation tools categorized by Wendell Williams, Ph.D. ([www.scientificselection.com](http://www.scientificselection.com)) by their accuracy of predicting:

## **Least Accurate**

Handwriting Analysis, Age, Education, GPA, Self-Assessment, Projective Tests, Traditional Interviews, Expert Recommendations

## **Marginal**

Personality Tests, Motivation, Reference Checks, Biographical Data

## **Better**

Situational Interviews, Behavioral Event Interviews

## **Most Accurate**

Mental Ability Tests, Content Valid Simulations

If you want to hire the right people, you have to put some real effort into it. Recruiting and selection are frequently viewed as irritating obstacles. Done wrong, that's just what they are. Done right, they add measurable value: You'll have the luxury of choosing between several people who are just what you want and need and who will do very well on the job. Good recruiting starts with your commitment to doing it correctly.

## **1. Identify Your Values**

Begin by describing your personal values. Those are probably the same values you have instilled in your business. If they're not the same, develop a list of your business' values. Be careful to avoid simple cliches like "Excellence," or "Integrity." These are not values: They are meaningless platitudes (ask Enron). *Real* values are unambiguous. They are situationally blind; they don't change depending upon circumstances. They are also rationally blind; they aren't different for different employees. And they are touchstones for difficult decisions. Try to develop a short list of simple phrases that identify how you really expect people to behave as employees of your business.

How can you tell if someone shares your values? Asking them is the least effective way. A better way is to find out what they did in situations that would test their commitment to the values.

**Value:** Treat everyone with respect

**Behavioral Interview Question:** An employee irresponsibly botched a small and easy task. A customer was so enraged that he cancelled a large order. What did you do insofar as that employee was concerned?

**Value:** Only do good work

**Value:** Nurture relationships

**Behavioral Interview Question:** A client offers you a lot of money to manufacture your product from less durable material as a way of getting the price down. How do you respond to the client?

Role playing is even better. You can observe an applicant's actual behavior, rather than have her tell you what she will do (she's trying to make a good impression, after all). This is often done with customer service reps. Rather than asking them how they handle difficult customers, some companies put them in a room with a telephone and have someone call and pretend to be an irate customer in order to see how the applicant handles the situation (the applicant, of course, knows this is a test, not a real customer.)

## **2. Identifying what the candidate Can Do and Wants to Do.**

Hiring people as contractors, consultants or interns is like an extended role play, and is highly accurate (the ultimate content valid simulation). If this is not possible, you can ask candidates behavioral questions about what they have done in the past (Was it what you will want them to do?) and ask them to describe how they did it.

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

The “Wants to Do” is harder to get from an interview. Candidates want your job and may, for that moment, really believe that they want to do your job when, in a more sober moment, they realize they really don’t. Tests exist, however, that can help you understand enough about how somebody ticks to determine whether they really want to do what you need done. You can test, for instance, for wanting to follow rules and procedures. A manufacturing manager in an ISO environment who scores low on this dimension may not be the right fit.

### 3. Finding the Right People

It’s impossible to summarize how to find good people into quick sound bites, but suffice it to say that they are not found by just running ads in newspapers or on the internet. Here are some guidelines, though:

**Be precise:** Advertise in a trade journal that is read by the people you want, not in the newspaper or on the Internet. Not only will you reach a higher concentration of good candidates, you present yourself better by advertising smarter.

**Be personal:** Ask your suppliers, consultants, employees, etc. for referrals. They know you and they know the sort of person who might work well in your company. Their referral means a lot to the candidate, too, in terms of how they are predisposed to see you.

**Think sideways:** If you want someone with a certain set of values, you might compliment searching down professional paths with searching through churches, synagogues, or other places where you will find a high concentration of people with your values.

**Have a compelling answer to this question:** “Why would I leave my perfectly good job for yours?”

### 4. Measure Performance

Whatever criteria you establish for selection can become the criteria by which you assess performance. Measured performance is always better than performance that isn’t measured. After measuring, spend time training, coaching and mentoring the person in order to improve performance. Reward achievements with money, praise, public recognition and involvement in decisions.

Recruiting and selection should add measurable value to your organization. One measure might be how many days you lay on the beach in the Caribbean knowing that your company is in good hands!

*John Wentworth owns, and on some days is allowed to run, The Wentworth Company, Inc. The Wentworth Company provides national turn-key employment department management, on-site project recruiting, executive search and recruiting consulting and training about recruiting. They have helped 300+ client companies hire more 20,000 new employees.*

# Leased Employees & Your Retirement Plans: Many Decisions, Little Time

*by Jack Cross, Chief Operating Officer*

For many years employers have been utilizing leasing organizations, sometimes referred to as Professional Employer Organizations (PEO’s), as a way to deal with human resource issues, benefit delivery systems and general administrative practices. The leasing organization assumed the responsibility for all the administrative aspects of an employee, while the client company managed and directed the work activities of the employee.

This seemed an efficient way for a business to focus on business issues and not be distracted by many of the time-consuming and costly human resource problems that sometimes distract from core business activities. Leasing organizations have proliferated and the number of businesses using these services has expanded greatly over the last 20 years.

Unfortunately, things are not always as simple as they seem. ERISA, the major piece of legislation governing retirement plans, defines, among other things, who may be covered by retirement plans and who may not. That definition conflicted with the practices of the leasing organizations. The basic conflict was that ERISA generally does not allow a plan to cover employees that are not employed by the sponsoring entity.

This clearly raised the question of who actually employed workers provided by a PEO to a client company. Rulings have consistently indicated that the employees in these arrangements were common law employees of the client company—not the PEO—and therefore, should not be covered by a PEO plan.

Over the last several years, the leasing organizations and the government have been in discussions on how to resolve these conflicts and finally, in 2002, the government issued Revenue Procedure 2002-21, which offered PEO’s and client company’s “safe-harbor” choices.

Essentially, Rev Proc 2002-21, forgives the past, erroneous practices on the part of PEO’s if they conform to the procedures as outlined. They essentially have two choices: 1) terminate their single employer retirement plan arrangements; or 2) create a multiple employer plan of which each sponsoring client company, that intended to provide benefits at the PEO level, must be a co-adopter.

Most of the PEO organizations have selected the latter course of action.

Once the PEO determined that they would establish a multiple employer plan, then they were required to contact all of their client company organizations by May 2, 2003 to advise them of their decision. Subsequently, the PEO must now give the

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*See “Leased Employees” on page 6*

# DOL Offers Opinion on Distribution Expenses: But Wait...The IRS May Have a Different Opinion!

On May 19, the Department of Labor issued guidance (FAB 2003-03) on the subject of distribution expenses. Specifically, the DOL guidance permits plans to charge participants for the costs associated with termination distributions, hardship distributions, and QDROs.

Unfortunately, the IRS may have a different view on this matter. And this particular issue may fall within the dominion of the IRS (the DOL acknowledged in their guidance that ERISA doesn't really focus on how plan expenses may be handled). The IRS' advice to plan sponsors who are considering implementing the approach noted in the DOL guidance: *Wait!* The Service hopes to issue their own guidance on this subject within the next twelve months.

ACI suggests that plan sponsors heed the IRS' advice and hold off on making any changes to plan operation based upon the DOL guidance. We'll let you know if/when IRS guidance is issued.

## Client Referrals

*Our primary source of new business is referrals from our existing clientele. If you know someone who could benefit from our services, please let your plan administrator know.*

## Leased Employees *continued from page 5*

client company three choices: 1) become a co-adopter of the multiple employer plan; 2) transfer the account balances of the employees from the PEO plan to a plan sponsored by the client company; or 3) terminate all retirement benefits to leased employees of the client company.

But what do these choices mean to a client company? What, if anything, is the consequence of being a co-adopter of a multiple-employer plan? What does this mean for plans currently sponsored at the client company level? If the sponsoring entity is delivering benefits to certain employees through a plan at the client company level and providing benefits to other employees through the PEO, is that still OK? Was it ever OK?

What about liability? If I am a co-adopter of a multiple-employer plan, have I accepted a different level of liability than if I sponsored my own plan? If another co-adopter does something that adversely impacts the plan, what is the consequence to me? What is my liability?

How about control? What decisions can I make that impact vesting, eligibility, contribution expectations or allocations?

There are a great many questions raised by the attempt to reconcile this Revenue Procedure with PEO practices that have been in operation for, in some cases, many years. But unfortunately, there is not a great deal of time to accomplish this task. The PEO plans must be in compliance by the first day of the plan year beginning in 2004 and this means that many are insisting that their clients respond to them with a selected course of action in the immediate future. That means that if you are the owner of a client company, you have very little time to consider, understand and elect a course of action that will have a major impact on you and your employees.

If you have leased employees in your business and would like help sorting these issues out, please call your plan administrator or an ACI consultant.

## ACI In the News

### ACI is Moving

In late August, ACI is scheduled to move into a new facility. Our new office won't be far from our current location. We'll provide you with the new address and phone number in the coming weeks.

### 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 2003 Presentation Topics, contact Lace Greene at (310) 316-1334, ext. 120, or at [lace.greene@acibenefits.com](mailto:lace.greene@acibenefits.com).

### ACI Client Education Schedule

Only two dates left for the **401(k) Basic Training: An Introduction to 401(k) Plan Operation** Seminar. These are held at ACI's office in Torrance from 9:00 AM to 12:00 PM. There is no cost to attend this seminar. Please RSVP by contacting Lace Greene. Indicate which seminar date you would like to attend.

**Wednesday, July 16      Thursday, September 18**

