

Are Social Security *and* Medicare both lost causes?

Greenspan warns of Social Security cutbacks & Medicare trustees cite enormous shortfall

by Jeff Wallace

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Because qualified retirement plans are heavily influenced by political, social and economic events, recent discussions regarding Social Security and Medicare warrant the attention of plan sponsors. Both programs are likely to impose severe cutbacks in benefits, making alternative savings vehicles, like qualified retirement plans, all the more important to American retirees.

Most Americans are aware that Social Security funding has been a source of great concern and considerable study. But what have gone largely unnoticed in recent years are the staggering figures surrounding Medicare. While unfunded liabilities related to Social Security are estimated to be \$10 trillion, two trustees of Medicare, John Palmer and Thomas Saving, have estimated that obligations to future retirees are unfunded by \$62 trillion.

In a world where we're buried in large numbers, it can be hard to fully appreciate the size of a \$62 trillion deficit. But to provide some sense of scope, Sen. Joe Lieberman pointed out in a recent editorial to the *Financial Times* that \$62 trillion exceeds the net worth of the entire population of the United States (so much for a tax-oriented solution). And for every year that passes without addressing the issue, the deficit increases by \$2 trillion.

It sounds alarmist, but it's also interesting to note that the two trustees, Palmer and Saving, are academics selected by different political parties: one by Democrats (Palmer) and one by Republicans (Saving). Their assumptions and mathematics have received some criticism, but the most common response to their conclusions isn't denial; it's disbelief. Even alternative calculations using more conservative assumptions yield dismaying results.

The message to all of us would seem to be, "Don't look to the government for retirement income or medical benefits." The government-sponsored safety net that we've all come to expect (to one degree or another) is unraveling. For sponsors of qualified retirement plans, this could actually have some favorable implications: heightened employee participation and appreciation, and a more favorable regulatory environment.

Small Problems First: Social Security

In late-February Alan Greenspan testified before the House Budget Committee, and controversy soon followed. During his presentation, he suggested that lawmakers consider reducing benefits to future retirees as a way of curbing future

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budget deficits. The deficits, he argued, would result in increased long-term interest rates, which would seriously harm the economy. Not surprisingly, groups representing retirees (and near-retirees) were quick to respond, mostly with demands for Greenspan’s resignation. Democratic presidential candidates were outraged that Greenspan didn’t call for the elimination of the Bush administration’s recent tax cuts, which have contributed to a projected \$521 billion deficit this year. Greenspan supports the idea of making these tax cuts permanent, at a projected cost of \$1 trillion over the next 10 years.

The government is faced with a limited array of options, none of which is politically appealing:

Cut Benefits.

Unfortunately Social Security is not considered to be a benefit program; it’s viewed as an entitlement program, meaning that most Americans view it as a right of citizenship, along with free speech, the pursuit of happiness, etc. Thus, reducing social security “benefits,” even if phased in over time so as to give people time to (theoretically) prepare, could be political suicide for anyone advocating it—poor Mr. Greenspan.

Increase Taxes.

Ignoring the aforementioned Medicare crisis, tax increases to support Social Security would themselves need to be significant, since there will be a larger group of people drawing benefits (the baby boomers) and a much smaller group of people to pay for them (anyone born after 1964).

Cut Government Spending.

Another alternative would be to significantly reduce spending in other areas. Hardest hit, though, would be the big-ticket items of defense and “other” social programs (like Medicare).

Realistically, any solution will likely be a mix of these options, along with a lot of other secondary measures aimed at keeping the Social Security system—in whatever form it takes—solvent. A growing number of observers suggest that anyone under age 50 will likely face reduced Social Security benefits and anyone under 40 will be lucky to receive anything remotely meaningful.

Implications to Businesses

What does this mean to a business owner? As awareness of the depth of the Social Security crisis becomes more common, employees will begin looking to employers to provide tax-advantaged savings plans. As an employee attraction and retention tool, the 401(k) plan will play an important role. These programs won’t simply be viewed as “desirable,” they’ll be essential. The question won’t be, “Do you have a 401(k) plan?” Employers are more likely to hear, “How much do you contribute to the 401(k) plan?” Employer matching contributions and profit sharing allocations may, in fact, become replacements to government-funded programs.

Other favorable implications could be the simplification of the rules governing qualified retirement plans as an incentive for more employers to establish them, and additional tax credits for plan-related costs.

And now the real problem: Medicare

The good news is, compared to Medicare, the Social Security “crisis” is a piece of cake. Medicare’s shortfall, projected to be at least *six times* larger than the \$10 trillion Social Security shortfall, will require a radical re-conceptualization of government-subsidized healthcare, the ultimate sacred cow in the US.

Few people have dared to even suggest possible solutions to the Medicare problem; it’s probably too big to even chip away at right now. Most of the analysis has focused on whether it’s really a \$20 trillion, \$40 trillion, or \$60 trillion problem. Apparently, when you can’t agree on the scope of the problem (other than to agree that it’s really, really big), it’s hard to focus on solving it. But it appears that once a large enough group of baby boomers hits age 65, it’s highly improbable that the government will be able to do much more than pay for a small fraction of retirees’ medical expenses.

Implications to Businesses

For business owners, the Medicare situation further magnifies the importance of tax-advantaged savings plans. The paradigm shift related to qualified retirement plans is the likelihood that savings through these plans won’t only be used for cost-of-living basics like food, shelter and clothing; those savings will also be tapped to pay for most health care services, as well.

From a welfare benefit plan perspective, employees may look to employers for Health Savings or Health Reimbursement Accounts. By taking advantage of these new benefit programs, employers can reward employees who take a responsible approach to their health care plans. In a properly structured arrangement, the result can be lower health care premium costs to employers with no negative impact on employees. And depending upon utilization, employees may begin to accumulate tax-deferred savings for future health-related expenses.

Action Item

Review your employee benefit programs with an eye towards the future: Do your programs encourage your employees to save as much as possible *now*?

IRS Agrees with DOL on Distribution Fees

The IRS has agreed with a Department of Labor ruling from 2003, permitting plan sponsors to charge terminated participants for expenses associated with account distributions. Any expenses charged to a participant must be reasonable and cannot be categorized as “settlor” expenses, which must be borne by the employer. Another common example of an expense that may now be charged to participant accounts is a fee associated with a hardship withdrawal.

In order for these expenses to be deducted from participants’ accounts, plan documents will need to be amended. Please contact your plan administrator if you are interested in modifying your plan to take advantage of these new rules.

Best Practices for Growth: Sales Performance Enhancement

by Art Hobba, Managing Principal
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It is not often that you see ‘best practices’ and sales in the same sentence. The myth still lingers that salespeople/business developers and ‘Rainmaker’ professionals are ‘born’ with the gift of creating rapport and have the inherent fine skill of persuasion (or manipulation in some cases) to *make* clients and customers buy. Can salespeople and business developers performance be enhanced in a similar way that manufacturing process can be enhanced? Many Chief Executives and Sales Strategists think so. Today, with both new start-ups and company ‘makeovers’ business plans now have an executable go to market/sales action plan that can be systematic, measurable and efficient.

The backbone of any successful growth initiative is your CRM (Customer Relationship Management) software. In order to be effective, every player in the front office (sales, marketing and customer service) must utilize this ‘tool’ before, during and after the sales cycle. Some great CRM tools out there include Salesforce.com, a private, secure online database with minimal start-up costs; SalesLogix a more robust tool that is good for mid-to-larger professional service and distribution firms (www.saleslogix.com) and Goldmine (www.frontrange.com/goldmine) a more universal and popular, small-to-middle market company CRM.

After you have your CRM in place, you will want to begin tracking successful and unsuccessful activities such as:

- **Presales ‘touches’.** It takes an average of 7-9 prospect touches by your firm in order to deliver a sale. Some industries take much more (especially when your contact is a senior executive) and a few take less. *One client was surprised when the prospect called back in need of help out of the blue after their 35th recorded touch!*
- **Message.** Does your message involve satisfied current customers? Does it sound like your competition? Does it use benefits and ‘take-away’ differentiators or does it simply state your features? Is the message core clear and easily communicated by every person, from the receptionist to the service desk?
- **Telesales Dials.** How many phone calls does it take to reach a key decision-maker? Are the scripts effective? Would it be better to outsource this function?
- **Appointments.** How many customer *appointments* (executed) are generated from completed calls?
- **Follow-up recommendations.** How many competitive *proposals* (also called *opportunities*) does the salesperson create because of his appointments or meetings? Do you have a system to move these proposals along the ‘pipeline’? Are you given reminder desktop ‘ticklers’ by your CRM when and how to follow-up?

- **Sales.** Do you have an agreed upon proposal ‘sub-process’? What is the number of winning proposals versus losers? How can you improve that ratio year after year?
- **Sales training.** Do you have an established sales process that takes your business developers from the first phone call or meeting through to close and handoff to the implementation team? Has the process been universally adapted? A reproducible sales process has been shown to increase sales dollar volume by over 45%
- **Sales dollars.** Do you have a forecast able, updated pipeline? How much revenue is produced by sales?
- **Compensation plans.** Without a plan that directs and incentives your people toward your growth and profit goals, you will get mixed, at best, results. Make your Business Developers ‘stakeholders’ via creating a plan that is entrepreneurial and provides a seemingly unlimited income to those who work smart and hard.
- **Recognition system.** Many people (including marketing professionals) don’t understand that good salespeople are *driven by economic stimuli*. Secondly, and barely so, recognizing an outstanding effort creates a healthy admiration and competition among co-sellers...they want to be the one rewarded net time.
- **Review System.** Do you have a systematic review system in place? Morale increases not only when people succeed, but also when they know where they stand and how they can improve as a professional seller.

Accsellerate, LLC recommends installing a reproducible sales system at your organization and then recording these above activities weekly, or at least, monthly. What you see in activity today will create new business 3-9 months later. Most CRM’s will provide an activity report at the push of a button. This does not replace ‘ride-alongs’ between the manager and the sales professional. The goal is reaching a point where you know, on the average, what every call is worth, what every appointment and every presentation is worth, and, finally, what every sale is worth. These measurements can then be plotted versus the cost of creating these calls and presentations to determine Sales ROI. Now you not only have made your sales predictable, but you can budget more accurately and clearly articulate to stakeholders and future and present sales candidates, what’s needed to succeed.

Art has established a career as a “Rainmaker” and business leader in Southern California for over 30 years. As the Managing Principal of Accsellerate, he helps business owners accelerate growth.

In addition to helping companies achieve their growth potential, Art is an accomplished public speaker, writer and sales trainer. His senior management experience includes General Manager, Executive Vice President and Vice President of Sales and Marketing roles for several successful public and private technology and professional service companies. You can reach Art at ahobba@accsellerate.com

Fiduciary Liability 101: Three Common Errors

by Jeff Wallace

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In the last issue of *Action Items*, we answered the question of how to limit a retirement plan fiduciary's liability. In this issue, we'll explore the most common errors made by fiduciaries.

Error #1: No Investment Policy

Many retirement plan fiduciaries are not aware that they are responsible for developing and maintaining an investment course of action, commonly referred to as an investment policy. The investment policy aids in the process of properly selecting, monitoring, removing and replacing a diversified selection of investment alternatives.

Error #2: Investments Not Appropriate to Participants

It is not uncommon to find retirement plans that offer over 75 investment options to participants, despite the fact that the workforce is composed primarily of unsophisticated investors. In some instances, each participant, regardless of his level of sophistication, is provided with an individual brokerage account, from which he may invest his retirement savings in individual stocks or bonds, or select from over 2,500 mutual funds.

While both of these approaches may be appropriate to a group of

sophisticated investors, retirement plan fiduciaries are responsible for ensuring that the investment line-up is appropriate to the entire workforce. It would not be a prudent decision to offer a group of unsophisticated investors brokerage accounts or dozens of investment options, some of which are redundant to one another, long-term underperformers, or funds focused on highly aggressive niches. We believe that the conservative interpretation of this requirement is that the investments offered in a 401(k) plan should be diverse enough to cover the entire risk-reward continuum, but not so broad as to bewilder a typical employee.

Error #3: No Investment Due-Diligence Process

While the investment policy describes the criteria used to select and monitor investment options, fiduciaries are also responsible for implementing a due-diligence process to ensure that investment options are, in fact, monitored. It is important for fiduciaries to meet at least annually to review investment performance relative to benchmarks contained in the investment policy, and to document the due-diligence meetings.

This also raises the issue of investment option flexibility. If your vendor does not allow you to add or remove investment options, your fiduciaries may face the possibility of having to accept responsibility for keeping a fund in the plan that they feel is not an appropriate option.

Action Item

The first step to managing fiduciary liability is to understand it. Identify your plan's fiduciaries and provide them with a clear understanding of their responsibilities and liability.

Has Your Plan's Trust ID Number Been Deactivated?

Unknown to many plan sponsors or retirement plan consultants, the IRS began to deactivate "unused" trust ID numbers. While this might seem like a minor issue, the IRS' definition of "unused" is probably not appropriate to retirement plans.

The IRS may have designated your plan's trust ID number as "unused" if the plan did not make any distributions that were subject to withholding for more than a year (or possibly two, the details are still sketchy). Here's the problem: Not all retirement plans make distributions every year, or even every other year. These are generally small plans with five or fewer employees, but we suspect they represent a significant portion of the overall retirement plan population.

If your plan's trust ID number was deactivated, you will find out when you next process a distribution and attempt to deposit any withholding with the IRS. When the IRS receives the withholding payment, they will attempt to match it to the plan's trust ID number.

If the number has been deactivated, they will credit the payment to the employer's ID number and earmark the payment as late, since they assume the payment is part of standard payroll tax (and payment due dates are obviously different). The IRS will then assess penalties. Somewhere in this process—probably at the penalty notification stage—you'll discover that something is amiss.

The good news is the IRS is now aware of this problem, and should be very accommodating in helping to resolve it. Trust ID numbers are no longer being deactivated, but the process as described above was in place for at least one year.

Action Item

If you've not made a distribution from your retirement plan that was subject to withholding in the last couple of years, watch for correspondence related to late payments or incorrect trust ID numbers.

New Rules on Minimum Distributions

by Edward E. Burrows
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Qualified retirement plans enjoy significant tax advantages. As a matter of policy, Congress believes these advantages should focus on the provision of retirement benefits for participants. They should not apply to accumulations that might remain in a plan and continue to enjoy tax favors long after a participant retires or passes away. This belief has led to statutory rules spelling out how rapidly plans must pay benefits following retirement, death, or attainment of a certain age.

These statutory rules have spawned regulations that are long, complex, and the subject of frequent revision. Last month, the regulators published yet one more revision. One aspect of these revisions could be important with defined benefit plans covering any participant who owns more than 5% of the firm sponsoring the plan. In general, benefit payments to a 5% owner must commence when the owner reaches age 70½ whether or not retirement has occurred. (Other participants who continue working beyond 70½ can postpone commencement until actual retirement.) In dealing with this 5% owner requirement, owners usually have three objectives:

1. To minimize distributions until actual retirement,
2. To provide a lump sum settlement of remaining benefits upon actual retirement, and
3. To provide a death benefit of remaining benefits if death should occur before actual retirement.

The set of regulations issued just before the current set made it practically impossible to satisfy these three requirements with defined benefit plans. Satisfying them was (and still is) feasible with defined contribution plans, but not with defined benefits. It had begun to appear that the best solution was to have the owner take a lump sum distribution at age 70½, and roll it over to an IRA. Then, the IRA could satisfy the minimum distribution requirements applicable to defined contribution plans.

The latest set of regulations does provide ways for at least some plans to accommodate their owner participants without resorting to an IRA rollout. This is how one such approach would work:

1. Upon reaching age 70½, the owner would begin receiving an annuity. It would be payable not for life but for a fixed number of years. The regulations prescribe the maximum fixed number – generally about 27 years.
2. Upon actual retirement, the owner would “convert” this annuity to a lump sum equal in value to the remaining yearly installments.

3. If the owner should die before actual retirement, the beneficiary would continue receiving yearly installments. The beneficiary could elect to receive the value of these unpaid installments in a lump sum.

In some cases, an approach of this type will be a good solution. But, more often, it could present problems.

Unfortunately, these problems and uncertainties are likely to prompt most sponsors to continue providing their owners who reach age 70½ with IRA rollouts. Then, it will be possible to use the familiar and workable defined contribution rules.

The new regulations offer other, relatively minor, improvements. These apply, principally, to a very small number of plans.

On balance, this latest regulatory package offers incremental improvements that will offer slightly improved flexibility for most sponsors.

Edward E. Burrows is a pension actuary practicing independently in Boston, MA. He is also the manager of the Benefit Consultants' Consortium of which ACI is a member.

More Information on 401(k) Deferral Timing

Amounts withheld from an employee's paycheck must be deposited into the 401(k) plan *as soon as they can be segregated from the employer's general assets*. The IRS, in a 2003 Bulletin, provided some clarity as to what exactly this means. In the Bulletin, they note that “You must contribute deferrals to the plan as soon as the funds are available to be contributed. If the deferrals are withheld from the participant's check on Friday and are available to be paid to the plan on Monday, then the money should be in the plan by close of business on Monday.” The IRS further notes that they have been forgiving of short delays, but that their counterparts at the Department of Labor have been “very active and very strict about the timing of payments.”

In the era of electronic fund transfers, it would be nearly impossible to justify anything more than a delay of a day or two. If it's determined that you have failed to deposit deferrals timely, you will be required to calculate lost earnings to each participant for each delayed deposit and pay penalties to both the IRS and DOL. The penalties will likely appear to be mild compared to the time and expense you will invest in calculating lost earnings for participants.

If you are concerned about late deposits of deferrals, contact an ACI plan administrator or a consultant to discuss your situation.

Reminder: Tax Credits Available for Small Plans

As part of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA), small employers with no more than 100 employees are eligible to receive a tax credit for some of the costs associated with the establishment of new retirement plans.

Tax credit specifics:

- The credit equals 50% of the start-up costs incurred to create or maintain a new plan.
- The credit is limited to \$500 in any tax year.
- The credit may be claimed for qualified costs incurred in each of the first three tax years during which the plan operates.
- Eligible plans include defined benefit plans, defined contribution plans, SIMPLE plans, and SEPs.
- The plan must cover at least one non-highly compensated employee in order for the employer to receive the tax credit.
- Prior plans covering essentially the same group of employees may preclude use of the credit.

There are some catches associated with this tax credit. We suggest you contact your accountant or tax adviser to find out whether your plan qualifies for the credit.

Proposed Cash Balance Regulations Shelved

The Treasury Department, realizing their proposed Cash Balance regulations were not going to be supported by Congress, withdrew the regulations on June 15th, instead handing the issue to Congress to resolve via legislation. As a result, sponsors of cash balance plans remain in limbo, waiting for the government to formalize what many in the industry consider to be a fait accompli: confirming that cash balance plans are not in violation of federal age discrimination laws.

Acknowledging that cash balance plans are an important component of the private retirement system, Rep. John Boehner, Chairman of the House Education & Workforce Committee, stated that “the ongoing uncertainty about cash balance plan conversions is undermining the retirement security of American workers and jeopardizing employers’ willingness to continue offering defined benefit plans.”

We will keep you posted as this issue continues to evolve.

Visit our website at www.acibenefits.com

For an ACI brochure, contact Lace Greene at lace.greene@acibenefits.com

ACI In the News

Speeches

Pat Byrnes, along with Marc Robinson of MoneyTours, spoke on the subject of increasing employee productivity and managing fiduciary liability on July 20th at UCLA. On August 17th, Pat will be speaking to Lincoln Financial Group in San Francisco. His subject is “*The Cash Balance Sweet Spot: Who, What, When & Why*”.

Articles

Pat co-authored an article with Fred Reish of Reish Luftman Reicher & Cohen in the September issue of the *Journal of Financial Service Professionals* entitled “Retirement Plan Fiduciary Liability and Its Abatement under ERISA Sec. 404(c).”

Continuing Education Presentations

Each year, ACI prepares a number of presentations related to employee benefits and compensation issues. Many of the presenta-

tions are eligible for continuing education credit and have been presented at various professional conferences. For a complete list of ACI’s 2004 presentation topics, go to our website at www.acibenefits.com.

401(k) Basic Training in August

The last 401(k) Basic Training Seminar of 2004 will be held on Thursday, August 19th from 9:00 AM to 12:00 PM. This presentation covers the fundamentals of 401(k) plan operation: 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 day-to-day administration of 401(k) plans. To attend this seminar, contact Lace Greene, ACI’s Marketing Manager, at Lace.Greene@acibenefits.com to reserve a seat.

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