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## Bruce L. Ashton Elected ASPA President

by Troy L. Cornett



BRUCE L. ASHTON, APM, HAS BEEN ELECTED ASPA PRESIDENT FOR THE 2003-2004 TERM, WHICH BEGINS AT THE CLOSE OF THE 2003 ASPA ANNUAL CONFERENCE. BRUCE IS A PARTNER IN THE LOS ANGELES, CA, LAW FIRM OF REISH LUFTMAN & REICHER AND, WITH OVER THIRTY YEARS OF LEGAL EXPERIENCE, IS AN ASSOCIATED PROFESSIONAL MEMBER OF ASPA. BRUCE HAS BEEN AN ASPA MEMBER SINCE 1991 AND HAS SERVED ON THE EXECUTIVE COMMITTEE, AS A MEMBER OF THE BOARD OF DIRECTORS, AS CO-CHAIR OF THE GOVERNMENT AFFAIRS COMMITTEE, AND ON THE STEERING AND EXECUTIVE COMMITTEES OF THE LOS ANGELES BENEFITS CONFERENCE COMMITTEE. BRUCE WAS ALSO AN ORIGINAL MEMBER OF THE HEALTH AND WELFARE COMMITTEE OF E&E AND HAS BEEN INVOLVED IN MANY OTHER ASPA ACTIVITIES.

Bruce's law practice focuses on all aspects of employee benefits issues, including representing plans and their sponsors in controversies before the IRS and EBSA, negotiating the resolution of plan qualification issues under EPCRS, advising and defending fiduciaries on their obligations and liability under ERISA, and structuring qualified plans and non-qualified deferred compensation arrangements. Combining his employee benefits

and transactional expertise, Bruce is also active in the installation and funding of employee stock ownership plans.

Bruce received his BA degree from Rice University in 1967 and his JD from Southern Methodist University in 1970, where he was a member of the Order of the Coif, Phi Alpha Delta, and was a Roy R.

Continued on page 7

## WASHINGTON UPDATE

### Introducing the "RMBA"

by Brian H. Graff, Esq.



NO, IT IS NOT THE LATEST DANCE CRAZE IN WASHINGTON. RATHER, IT IS A LEGISLATIVE INITIATIVE SUPPORTED BY ASPA AND OTHER ORGANIZATIONS INTENDED TO MAKE QUALIFIED RETIREMENT PLANS MORE ATTRACTIVE RELATIVE TO NON-PLAN INVESTMENTS. AS YOU KNOW, PRESIDENT BUSH'S TAX BILL, ENACTED THIS PAST SPRING, PROVIDES FOR A 15 PERCENT TAX RATE ON DIVIDENDS AND CAPITAL GAINS ON INVESTMENTS HELD OUTSIDE A QUALIFIED RETIREMENT PLAN. ON A RELATIVE BASIS, THIS TAX RATE MAKES INVESTMENTS WITHIN A QUALIFIED RETIREMENT PLAN LESS ATTRACTIVE. GIVEN THE IMPORTANCE OF PROMOTING SAVINGS WITHIN QUALIFIED RETIREMENT PLANS FROM A SOCIETAL STANDPOINT, ASPA'S GOVERNMENT AFFAIRS COMMITTEE HAS BEEN THINKING ABOUT WAYS TO MAKE QUALIFIED RETIREMENT PLANS MORE ATTRACTIVE TO BOTH PLAN SPONSORS AND PARTICIPANTS. THE RMBA, WHICH APPEARS TO BE GARNERING SIGNIFICANT CONGRESSIONAL INTEREST, IS AN EXAMPLE OF THIS EFFORT.

So what is the RMBA? "RMBA" stands for Retiree Medical Benefit Accounts. The proposal arose in the context of the current congressional debate over Medicare and prescription drugs. Lawmakers are increasingly hearing concerns from constituents, particularly baby boomers, about having sufficient funds to pay for health care costs during retirement. Some experts predict that an

average baby boomer couple will need at least \$160,000 to cover retiree health care costs. Proposed Medicare reforms will likely add further economic burdens to retirees. Most working Americans are not sufficiently prepared to meet these requirements.

Continued on page 5



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**FROM THE EDITOR**

# What If Retirement Never Comes?

by Chris L. Stroud, MSPA

WE HAVE BEEN TRAINED TO PLAN FOR OUR RETIREMENT AND TAKE PRECAUTIONS TO PROTECT OUR HARD-EARNED RETIREMENT INVESTMENTS. AFTER ALL, MOST OF YOU READING THIS EDITORIAL ARE IN THE BUSINESS OF HELPING PEOPLE PLAN FOR THEIR OWN RETIREMENT. AS A RESULT, THESE THOUGHTS COME NATURALLY TO YOU AND ARE LIKELY OFTEN ON YOUR MINDS. I AM SURE MANY OF US ALSO SPEND TIME DREAMING ABOUT TAKING EXTENDED TRIPS WHEN WE RETIRE AND HAVING MORE TIME FOR HOBBIES. I WOULD GUESS THAT MOST OF US, HOWEVER, DO NOT SPEND ENOUGH TIME PONDERING THE QUESTION—WHAT IF RETIREMENT NEVER COMES?

In this issue, there is an excellent article on page eight, “Retirees Are Moving Your Cheese.” The article focuses on the need for planning beyond the simple accumulation of retirement assets. It addresses planning stages needed for various phases of life and for certain transitions in life. This type of “life” planning, as opposed to simple “retirement” planning, offers great value to an individual. It helps provide a “roadmap” to be used up to, and after, the big event—retirement. What if, however, life does not proceed as planned—and death arrives unexpectedly before retirement?

Much emphasis today is placed on the actual accumulation of assets, investment diversification, portfolio rebalancing, and market conditions, etc. While we typically pay close attention to these things, we sometimes lose focus of other issues that are equally important. Just as we make time personally for trips to the dentist or annual checkups with our doctors, we should also take the time to periodically ask ourselves: “What if retirement never comes?” “Is my will up to date?” “Do my beneficiary designations reflect my current circumstances?” “If I die, are my affairs in order and will someone have a relatively easy time determining where my assets are to help settle my estate?” Dealing with these questions now can provide additional roadmaps to help your loved ones in the future.

Sending reminders to participants to update beneficiary forms, especially when a marital status

change is reported, is one way to encourage others to revisit these questions.

As I write this article, I am saddened by the fact that this evening I will be attending the memorial service of a dear friend who died unexpectedly at the age of 53. Today, the above questions weigh heavy on my mind. My friend leaves behind a mother and a sister; he had no children. He leaves behind his loving girlfriend with whom he shared his home for the past six years. There is also an ex-wife from years past. Unfortunately, the one thing he did not leave behind is a will. He did not ask himself many of the above questions and now it is too late. He never updated his beneficiary designations after his divorce, and he never took the time to either add his girlfriend’s name to the deed for the house or to create a will that would take care of her upon his death, even though he often said those were his wishes. His estate will most likely not be settled in the manner he had really wanted, simply because he never took the time to make some simple changes to a few very important documents.

It is not uncommon for battles over money and property to devastate a family just as much as the death of a loved one does. We should never underestimate the importance of proper planning for *all* phases of our lives. Although planning for death is not particularly fun, it is necessary. Perhaps part of the legacy my friend leaves behind is an increased awareness of this importance. ▲

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The purpose of ASPA is to educate pension actuaries, consultants, administrators, and other benefits professionals, and to preserve and enhance the private pension system as part of the development of a cohesive and coherent national retirement income policy.

ASPA members are retirement plan professionals in a highly diversified, technical, and regulated industry. ASPA is made up of individuals who have chosen to be among the most dedicated practicing in the profession, and who view retirement plan work as a career.

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To submit comments or suggestions, send an e-mail to [theaspajournal@aspa.org](mailto:theaspajournal@aspa.org).

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### Mark Your Calendar Today!



## Washington Update

Working Americans typically save through employer-sponsored retirement savings vehicles [e.g., 401(k), 403(b), and governmental 457 plans]. More than any other savings device, these vehicles have been incredibly effective at getting middle-income Americans to save. Rather than create an entirely new tax-favored savings vehicle, which would be unfamiliar and likely confusing to the average American, the RMBA builds on the existing success of the employer-sponsored retirement plan system. Specifically, the RMBA is designed as an optional add-on account to existing salary reduction plans, giving working Americans an easy method to save for retiree health costs.

*So how does it work?* Following is a summary of the current proposal:

- Plan sponsors could, at their option, permit participants in employer-sponsored defined contribution plans to annually elect to have a portion of their employee pre-tax contributions (on a payroll deduction basis) and employer matching or profit sharing contributions allocated to a separate Retiree Medical Benefits Account (RMBA) within the retirement plan. Employee or employer contributions made to a RMBA would be subject to all existing contribution limits and nondiscrimination rules that apply to the underlying plan.
- An individual not covered by an employer-sponsored plan could elect to have a portion of his or her IRA contributions made to an IRA Retiree Medical Benefits Account (IRA RMBA). Contributions to the IRA RMBA would count against the individual's IRA contribution limit for the year. Any otherwise applicable Adjusted Gross Income (AGI) limits (e.g., the AGI limits that apply to an active participant in an employer-sponsored plan) would apply to an individual's ability to contribute to an IRA RMBA.
- Individuals age 50 and above could make additional pre-tax contributions to a RMBA or IRA RMBA. These additional contributions would be structured similar to "catch-up" contributions. For example, these individuals could contribute an additional \$2,000 per year.
- It is important to note that the current proposal only applies to prospective RMBA contributions, not to existing savings amounts. A chief

reason for this element of the proposal is revenue cost. Applying the proposal to prospective contributions greatly reduces the revenue cost in the 10-year budget window. A variation to the proposal might be considered, such as allowing a conversion of a limited amount of existing retirement savings amounts into a RMBA for participants above a certain age, like age 50. This variation would make the entire proposal much more attractive politically but would result in a much higher revenue cost.

- Distributions from a RMBA or IRA RMBA would be tax-free and penalty-free if they are: (1) made after age 65, and (2) used for "medical care" [as defined in the Sec. 213(d) of the Internal Revenue Code under itemized deduction rules]. Distributions before age 65, or for purposes other than "medical care," would be

The RMBA is designed as an optional add-on account to existing salary reduction plans, giving working Americans an easy method to save for retiree health costs.

includible in income (except to the extent of basis) and subject to an additional tax of 15%, except no penalty tax would apply to distributions made on account of death, disability, or financial hardship. The proposed definition of "medical care" is fairly broad and would include insurance premiums.

- RMBAs and IRA RMBAs would be completely portable. Individuals would be permitted to roll over RMBA balances to a RMBA in another employer's plan (provided it accepts such contributions) or to an IRA RMBA. Similarly, individuals could roll over IRA RMBA balances to another IRA RMBA or to a RMBA in an employer-sponsored plan.

- Upon death of a RMBA holder, a surviving spouse could roll over the RMBA balance to the spouse's own RMBA or treat an IRA RMBA as his or her own. Other beneficiaries could receive a taxable distribution equal to the value of the RMBA or IRA RMBA balance.

As of this Update, the current fate of the RMBA proposal is uncertain. The version of Medicare reform passed by the House prior to the August recess contains a significant expansion of Medical Savings Accounts (MSAs), which would now be called Health Savings Accounts (HSAs) and Health Savings Security Accounts (HSSAs). Generally, these new tax-favored accounts (separate from any existing savings vehicles) would be connected to high deductible health insurance plans, with deductibles ranging from \$500 to \$5,000, depending on the coverage. These proposals are fairly controversial, particularly in the Senate. (Remember the controversy surrounding the original MSA legislation in 1996?) Preliminary revenue estimates indicate they will cost \$175 billion over 10 years. Given the lack of appetite in the Senate for further tax cuts, particularly controversial ones, these proposals are unlikely to get very far. The RMBA proposal is being touted in the Senate, including by Senate Majority Leader Frist (R-TN), as a possible less controversial, lower cost alternative. Right now, it is hard to see how the House and Senate will resolve their very real differences over Medicare and prescription drugs, putting

aside the competing health care saving proposals. However, Medicare reform and prescription drug coverage remain a top priority for the President and he could force a deal this fall. Whether or not a deal is made, and whether or not it includes the RMBA, it would seem that the RMBA has enough legs to be considered in future years.

As Congress considers this proposal, now or in the future, its fine details will obviously change. However, its centerpiece—namely tax-free retirement plan distributions used for retiree health expenses—is unlikely to be modified measurably. This proposal is significant, given that it would clearly make investments in qualified defined contribution plans relatively more attractive. In fact, as baby boomers move ever closer to retirement age, I would not be surprised to see comparable proposals that relax the taxation of some qualified retirement plan benefits. For example, the most recent Portman-Cardin pension reform bill (H.R. 1776) reduces the tax rate on certain annuity distributions from qualified retirement plans. Naturally, the excessive revenue cost of any such proposals will be restrictive, but as the retiree population becomes a larger and larger critical voting block, the pressure to ease their tax burden will be intense. ▲

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*Brian H. Graff, Esq., is Executive Director of ASPA. Before joining ASPA, Brian was legislation counsel to the US Congress Joint Committee on Taxation.*

## AVAILABLE WEBCAST RECORDINGS

Missed a recent ASPA webcast? Need two extra ASPA CE credits? Check out the list of webcast recordings that are available on ASPA's Web site at <http://www.aspa.org/webcast/>. These archives are available for accessing at your convenience, any day, any time. Each webcast runs approximately 100 minutes in length. Visit the Web page identified above to find out more!

The following webcasts are currently available:

### Deemed IRAs

**Charles J. Close, FSPA, CPC**  
Available until August 30, 2004

### IRS Voluntary Correction—Easier, More Flexible, AND Lower Fees

**James C. Paul, APM**  
**Joyce Kahn**  
Available until July 30, 2004

### How Much is That Required Minimum This Year?

**Richard Hochman, APM**  
Available until July 30, 2004

### 401(k) Fiduciary Issues and Opportunities for Financial Consultants

**Fred Reish, APM**  
Available until June 30, 2004

### 2002 Form 5500 and Related Compliance Issues

**Valeri L. Stevens, APM**  
Available until April 30, 2004

### IRS/ASPA Washington Update

**Brian H. Graff, Esq., et al.**  
Available until March 31, 2004

### Participant Loans

**Jane E. Armstrong**  
Available until March 31, 2004

### Top 15 Pitfalls in Plan Administration

**Ilene H. Ferenczy, CPC**  
Available until November 30, 2003



**COST: \$125 FOR MEMBERS, \$225 FOR NON-MEMBERS**



## Bruce L. Ashton Elected ASPA President

Ray Scholar. He was a recipient of the Johnson, Bromberg, Leeds & Riggs Award, and the Arthur Stedley Hansen Consulting Actuaries of Dallas Award. He was a member (1968-1970), note and comment editor (1969-1970), and acting index editor (1970) of the *Journal of Air Law & Commerce*. Bruce was admitted to the California Bar in 1971.

Bruce is the author of numerous publications and articles. He co-authored (with his partner, Fred Reish, APM) the *Participant Directed Investments Answer Book, 3rd Edition* and the *Plan Correction Answer Book*, both published by Aspen Publishing. He also authored *Actuarial Audits: A Legal and Tactical Analysis*, published by ASPA, and has been a frequent speaker on employee benefits issues ranging from fiduciary responsibility to employee stock ownership plans (ESOPs). He speaks regularly at the ASPA Annual Conference, the Western Pension & Benefits Conference, and various other organizations' events. For those of you who attended ASPA's 1999 Summer Conference, you'll remember him as a rapper-extraordinaire.

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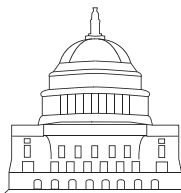
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*Troy L. Cornett is the Office Manager for ASPA and an Associate Editor of The ASPA Journal. Troy has been an ASPA employee since July 2000. In his time away from the National Office, Troy enjoys seeing the latest movie releases, driving his new VW bug, and sipping coffee lattes with his friends at Starbucks.*

## Save America's 401(k)



### Participate in ASPA's 2003 Visit to Capitol Hill

All members of Congress need to understand the detrimental effects the President's LSA/RSA/ERSA proposals would have on the retirement plan system. Help effectuate the power of ASPA's message. Participate in ASPA's Visit to Capitol Hill on Tuesday, October 28, during the Annual Conference.

ASPA will make all appointments and provide you with the information needed to discuss these important issues with your member of Congress.

Register online at:

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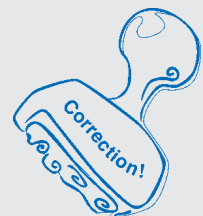
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### CORRECTION

On page 1 of the supplement entitled "Summary Comparison of Qualified Plans, IRAs, and TSAs," which was included with the January-February 2003 issue of *The ASPA Journal*, the explanation under the "SIMPLE 401(k)" plans column, "Contribution Limits—Employer" row, erroneously states "...nonelective contribution of 2% on first \$2000,000." It should read "...nonelective contribution of 2% on first \$200,000." We apologize for the error.





# Retirees Are Moving Your Cheese: Adapting to the New \$250 Billion Distribution Planning Market

by Delores R. Freitag

IN HIS BUSINESS BESTSELLER, *WHO MOVED MY CHEESE?*, SPENCER JOHNSON, MD, TELLS A FABLE ABOUT HOW TO DEAL WITH CHANGE. IN HIS STORY, TWO LITTLE PEOPLE, HEM AND HAW, SUFFER BECAUSE SOMEONE MOVED THE CHEESE IN THEIR MAZE. YET HEM AND HAW KEEP LOOKING IN ALL THE OLD PLACES. OUR HEROES, MICE NAMED SNIFF AND SCURRY, LEARN TO ADAPT AND FIND THE NEW LOCATION OF THEIR SUSTENANCE.



The situation is similar for today's retirement plan professionals: The location of much of the need for financial advice is moving.

For decades, many agents, advisors, enrollers, and TPAs made their living by locating and serving people who needed to accumulate wealth and invest wisely for retirement. Today there's less of that source of business, but there's a large and fast-growing location of "cheese" elsewhere for those willing to adapt to change.

As I write this article, I find myself reflecting on the messages repeated over and over by industry experts at recent conferences. "The industry is struggling." "It's all about relationships." "Education is the problem." "It's no longer about the plan sponsor—it's all about the employee." However, others will turn that last statement upside down and say "It is all about the plan sponsor, because *they* perceive no value added service to themselves *or* their employees!"

Most of the researchers do agree that the marketplace is changing and what is needed is a new approach to an old story. Yes, people need to save for retirement, but more importantly now is learning how to manage what they have saved so they can live the life they have envisioned. Smart investing during the accumulation years is only half the battle. What plan participants need to learn is how to retire comfortably, how to realize the lifestyle they envisioned when they were working, and how to enjoy life by making sure they never run out of money. This security is the added value that the retirement planning industry has often failed to deliver.

## SEEING THE OPPORTUNITY

Money is on the move. Each year, three to four million people become eligible for a lump-sum payment from employer-sponsored retirement plans as they change jobs, retire, or leave the workforce. Today, these assets equal approximately \$250 billion and are poised for record growth. Plan participants need to protect this money and the TPA,

insurance agent, and pension consultant are well positioned to serve these participants. In so doing, they better serve the plan sponsor as well.

Let me start by reminding you of the value of what you do. Many of you came into the business and built your success on helping people plan for a secure retirement by enrolling them in qualified plans. You taught the value of long-term investing and how to allocate assets to accumulate wealth. You taught the plan participant how to save, save, save. Indeed the baby boomer generation had, 10 years ago, just entered their peak savings years. They were well poised for this message!

But now, all of that has changed. Much of this market is moving rapidly toward the very thing we helped them save for—retirement—and we seemingly have lost our reason to educate them.

## A LONG AND WINDING ROAD

The road to retirement is long. Your wisdom, advice, and counsel to plan participants only begins with getting them into the plan. Consider the four stages that employees pass through as they plan for retirement. Each stage requires a greater level of planning expertise and a greater need for education. Each stage also creates many opportunities to deepen existing relationships.

1. During the first stage, *Developing Savers*, people get involved for the first time in defined contribution plans. Employers make a great deal of effort to encourage young workers to enroll in their plans early in order to accelerate the long-term benefits of saving. Additionally, individuals are encouraged, through the media and people they meet, to set up retirement accounts.

From the sales perspective, *Developing Savers* are primed for your counsel. They know that getting involved in the plan should be considered, but they are overwhelmed with the transition and in need of guidance. It is an easy approach.

2. In the next stage, *Becoming Investors*, plan participants generally take a more active role in



trying to understand the market and make some sense of what is contained in their plan. Our industry has done an excellent job of educating the public on investment selection, asset allocation, and time horizons through worksite education and printed materials.

From a sales perspective, *Becoming Investors* may become unnerved—particularly during uncertain markets. They know that long-term investing is the name of the game, but they see their balance dropping. Some of them feel the need to be proactive, to do something, and they need ongoing guidance to stay the course. *Becoming Investors* need to stay focused on the long-term goal of living on this money for an unknown time horizon that extends *beyond* the retirement date. They, too, need your educational services.

3. Once the retirement date draws closer, your participants will become increasingly focused, both financially and personally, on *Making the Transition* into retirement. This event turns attention away from accumulating assets and toward protecting those assets for an undetermined period of time.

The “transition” stage can also be triggered by other life events that cause separation from the employer, including termination or a voluntary job change.

Many questions come up at this time. What are my distribution options? What is the best option for me? How can I make this money last? What kind of lifestyle do I want to have? What about unforeseen circumstances that may arise? Plan participants face a whole new set of decisions and will need a new plan for distributing assets.

4. The last stage of retirement planning focuses on *Managing Retirement Assets* according to the new plan for distributing assets. It is characterized by creating ongoing income streams, continuing to grow assets through wise investing, and protecting assets through risk management.

From a sales perspective, there is enormous cross-selling opportunity at this stage—yet often the agent and advisor who initially signed on the participant have all but forgotten him or her by this time. Isn’t this the reason you sign participants up in the first place? So much of your wisdom, guidance, and advice are needed here once the employee begins living in retirement!

#### PROVIDE THE MISSING VALUE

While our industry has done a good job educating clients through the first two stages, information, guidance, and advice at payout time is scarce. There has been very little talk or material written about how to distribute portfolios effectively. According

to one institutional intermediary, the situation for departing plan participants, whether they are job changers or retirees, is “pretty much abandonment.” (Source: LIMRA International, “Pension Rollover: The Intermediaries View,” 2001). This trend signals a unique market opportunity for those who embrace new knowledge about retirement distribution planning and continually educate employees across stages. You can differentiate yourself from the competition by providing the value added service that is missing.

#### THE NEW ALLOCATION PLAN—DISTRIBUTION PLANNING

In some respects, retirement distribution planning is the next level of asset allocation for many representatives. In the 1980s, representatives learned portfolio theory and strategies to determine the most appropriate asset allocation to meet their clients’ accumulation goals. Today, they are learning a new approach to asset allocation that will help them meet their clients’ conservation goals.

What plan participants need to learn is how to retire comfortably, how to realize the lifestyle they envisioned when they were working, and how to enjoy life by making sure they never run out of money.

Distribution planning is not about accumulating large sums of money. It is about creating an income stream to make the mortgage and car payments, pay the insurance premiums, or pay the country club dues for an undetermined period of time, and, it is hoped, distributing the remainder of the money to loved ones. “Making it last” is retiring employees’ top concern. And so the distribution plan will allocate assets over three primary goals:

- Creating Income Streams
- Continued Asset Growth
- Risk Management

Continued on page 21

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# Issues with 412(i) Plans

by Lawrence Deutsch, MSPA, and Raymond G. Ankner, MSPA

WHAT IS NEW IS OLD AND WHAT IS OLD IS NEW. THIS STATEMENT IS AS TRUE OF THE EMPLOYEE BENEFIT PROFESSION AS IT IS WITH ANY ASPECT OF LIFE. ONE HOT, NEW TOPIC IN THE EMPLOYEE BENEFIT ARENA IS AN OLD SECTION OF THE INTERNAL REVENUE CODE—SECTION 412(i). THIS SECTION OF THE CODE SETS FORTH THE DESIGN AND OPERATION CRITERIA FOR A FULLY-INSURED, DEFINED BENEFIT PENSION PLAN THAT IS EXEMPT FROM THE NORMAL FUNDING REQUIREMENTS OF THE CODE. THIS EXEMPTION ALLOWS PLANS, IN CERTAIN INSTANCES, TO DO SOME THINGS THAT NON-412(i) PLANS CANNOT DO. HOWEVER, SOME PRACTITIONERS HAVE SUGGESTED DESIGNS THAT THE LAW DOES NOT ALLOW. THIS ARTICLE WILL DISCUSS THE DESIGN REQUIREMENTS OF A FULLY-INSURED, DEFINED BENEFIT PENSION PLAN UNDER SECTION 412(i) OF THE CODE, AS WELL AS SOME OF THE ABUSES EXISTING IN THE MARKETPLACE. THIS ARTICLE WILL NOT DISCUSS THE ISSUES INVOLVED IN WHY A PLAN SPONSOR MAY OR MAY NOT CONSIDER A 412(i) PLAN AS THE MEANS OF PROVIDING RETIREMENT BENEFITS TO ITS EMPLOYEES.

## DESIGN REQUIREMENTS

### 412(i) Plan Characteristics

Section 412 of the Code contains the funding requirements for pension plans that are qualified under Section 401(a) [profit sharing plans, including 401(k) plans, are not subject to these requirements]. Failure to comply with the funding requirements of Section 412 can lead to excise tax penalties. However, Code Section 412(h) provides several exemptions from these funding requirements. One of those exemptions is for plans funded exclusively with insurance contracts, which replace the general requirements of Code Section 412 with the requirements as described in Section 412(i).

In order to be a plan described in Code Section 412(i) [a “412(i) Plan”], the plan must have the following characteristics:

- 1) The plan must be funded solely with individual insurance or annuity contracts;
- 2) The contracts must have level premiums from the issue date of the policy to a date not later than the individual’s Normal Retirement;
- 3) Benefits under the plan must “equal” the guaranteed benefits under the policies (assuming all premiums paid to Normal Retirement);
- 4) All premiums must be paid promptly to avoid policy lapses;
- 5) No policy may be used as collateral to secure a loan; and
- 6) There can be no policy loans at any time.

There are minor exceptions to some of the above rules. For example, it is possible for a policy to lapse provided it is reinstated before year-end. Also, a loan is permitted provided it is for the purpose of paying a premium and it is repaid before the end of the year. In addition, a 412(i) Plan may be funded with group insurance or annuity

contracts, if the group contracts have the same characteristics as set forth above.

If a 412(i) Plan is top-heavy, as described in Code Section 416, it may be necessary to maintain an auxiliary fund to meet those top-heavy minimum benefits not met by the insurance or annuity contracts. This requirement is described at Treas. Reg. 1.416-1 Q&A M 17. If an auxiliary fund is required, a funding standard account must be maintained, and each Form 5500 filing must include a completed Schedule B.

## QUALIFICATION REQUIREMENTS

A 412(i) Plan is considered a defined benefit pension plan and, as such, must satisfy all the requirements of defined benefit pension plans to be a qualified plan under the Code. In order to constitute a qualified plan, a plan must comply with, among others, the requirements of Code Sections 401(a)(4), 401(a)(26), and 410(b). As will be seen below, a plan with only one employee who meets the age and service requirements of the plan will always satisfy these provisions. Therefore, much of this article is concerned primarily with plans of two or more participants.

### CODE SECTION 401(a)(26)—THE “50/40 TEST”

Code Section 401(a)(26) is the easiest of the three sections to deal with. Section 401(a)(26) imposes minimum participation requirements on a qualified defined benefit plan. Defined contribution plans are no longer subject to the requirements of Section 401(a)(26). It requires that a plan benefit the lesser of 50 employees or 40% of all employees who meet the plan’s age and service requirements (but no less than two employees, unless, as stated above, the employer only has one employee who meets the age and service requirement). Unlike Code Sections 401(a)(4) and 410(b), discussed



below, multiple plans of an employer may not be aggregated to satisfy the requirements of Section 401(a)(26).

*Example 1:* To illustrate the application of Section 401(a)(26), consider a company with five owners and 15 staff. Assume that all 20 employees meet the plan's age and service requirements. A plan covering only the owners would fail to comply with Section 401(a)(26). The plan covers five employees (which is less than 50) and the plan covers only 25% of the employees (which is less than 40%). In order to comply with Section 401(a)(26), the plan would have to cover, at a minimum, eight employees (40% of 20), requiring the inclusion of at least three non-owners in the plan. (Fractions should always be rounded up. In other words, if there are 21 employees, 8.4 should be rounded up to nine employees.)

### CODE SECTION 410(b)—MINIMUM COVERAGE REQUIREMENTS

Code Section 410(b) is the next easiest of the three aforementioned sections to deal with. Section 410(b) requires that a plan either satisfy the 70% Ratio Percentage Test or that the plan comply with the Nondiscriminatory Classification Test. (Definitions of the terms used in explaining the minimum coverage and non-discrimination requirements are contained in the Endnotes to this article.)

The 70% Ratio Percentage Test simply requires that the ratio percentage of the plan be at least 70%.

The Non-Discriminatory Classification Test requires that the plan satisfy three requirements:

- 1) The ABP must be at least 70%;
- 2) The ratio percentage must be at least as high as the amount from a table based on the concentration of HCEs in the organization (from a high of 50% required, to a low of 20%); and
- 3) The plan must cover a Reasonable Classification of employees.

### CODE SECTION 401(a)(4)—NON-DISCRIMINATION REQUIREMENTS

Code Section 401(a)(4) is the third section listed above and the most difficult to satisfy. Section 401(a)(4) contains the non-discrimination requirements for qualified plans. This section requires that benefits provided under a plan not discriminate in favor of HCEs. Treas. Reg. 1.401(a)(4)-1(b) provides two methods for a defined benefit plan to demonstrate compliance with Code Section 401(a)(4). The first is by use of a safe harbor [1.401(a)(4)-3(b)], and the second is by use of the so-called General Test [1.401(a)(4)-3(c)]. In addition, Treas. Reg. 1.401(a)(4)-4 requires that all

benefits, rights, and features of a plan be available on a non-discriminatory basis and Treas. Reg. 1.401(a)(4)-5 prohibits a plan amendment if the timing of such amendment has a discriminatory effect. [Generally, this last one is not an issue with a 412(i) Plan and will not be discussed.]

**Safe Harbors:** There is a special safe harbor for 412(i) Plans. This safe harbor requires, among other things, that the plan formula meet one of the requirements for a safe harbor formula using fractional accrual, assuming that benefits under the 412(i) Plan accrued fractionally over all years of participation in the plan, premium payments are level to normal retirement age, and all gains, including dividends and forfeitures, may only be used to reduce future premium payments [Treas. Reg. 1.401(a)(4)-3(b)(5)].

For a defined benefit plan to satisfy the safe harbor rules under 1.401(a)(4)-3(b) [other than the special safe harbor for 412(i) Plans], the plan would have to conform to an accrual rule provided in Code Section 411. These accrual rules are inconsistent with a fully insured plan. [While it is theoretically possible for a 412(i) Plan to comply with the accrual rules of Section 411, as a practical matter, it would require the cash values to be much higher in the earlier years than is typical in any insurance product used for 412(i) Plans.] [Treas. Reg. sections 1.401(a)(4)-2(b)(3)(i)(A) and 1.401(a)(4)-2(b)(4)(i)(A)]

**General Test:** If a 412(i) Plan does not satisfy the safe harbor rules, then it must demonstrate compliance with Code Section 401(a)(4) by using the General Test. The General Test requires that the plan's EBARS be determined. A defined benefit plan actually has two EBARS. The first is the normal EBAR, and the second is the most valuable EBAR [Treas. Reg. sections 1.401(a)(4)-3(d)(i) and 1.401(a)(4)-3(d)(ii)]. A plan's Normal EBAR is a function of the accrued benefit [Treas. Reg. 1.401(a)(4)-3(d)(i)]. The most valuable EBAR is a function of the benefit that would be paid in the form of a qualified joint and survivor annuity commencing at each age between the current age and the retirement age, based on no future service credited under the plan [Treas. Reg. 1.401(a)(4)-3(d)(ii)].

In a 412(i) Plan, the accrued benefit equals the cash value of the policies [Code Section 411(b)(1)(F)]. The accrued benefit must then be expressed in the form of a life only annuity commencing at the normal retirement age, determined using the terms of the plan (*i.e.*, the guaranteed terms of the policy) [Code Section 411(a)(7)(A)(i)]. It is only reasonable to assume that the determination is made with

Continued on page 22

# Embracing the Evolution of Defined Contribution Recordkeeping

by Robert Long, APM



SUCCESSFUL PENSION ADMINISTRATION FIRMS HAVE BUILT AND DEVELOPED ADMINISTRATION AND CONSULTING SERVICES BY BEING EDUCATED, REPUTABLE, AND COMPETITIVE, AND BY DELIVERING HIGH QUALITY SERVICES TO THEIR CLIENTS. THEY HAVE ALSO ENJOYED PROFITABILITY, AS WELL AS OPPORTUNITIES TO DEVELOP BUSINESS RELATIONSHIPS AND FURTHER THEIR BUSINESS GOALS. IN SHORT, THEIR BUSINESS MODEL HAS BEEN A SUCCESS.

Changes in the marketplace are inevitable, however, whether due to technology, legislation, or client expectations. Service expectations continue to evolve whereby plan sponsors and participants now expect faster service, quicker turnaround times, better access to their accounts, and more information. Deteriorating balances due to poor market conditions have raised awareness of the need for education and guidance, and have prompted many to question the merits of participant directed investments. At the same time, there is pressure to maintain or even reduce costs associated with administering plans, making efficient service delivery and execution paramount to staying competitive. In short, clients are demanding far more for less.

The key question for today's pension administration firm is "How do I meet my clients' increased quality and service expectations, improve the speed and manner of delivery, while continuing to add value to my relationships? And, at the same time, maintain or improve profitability?"

Within the context of existing business models, many will look for ways to improve productivity by streamlining existing processes and searching for ways to cut costs. Relationships with financial institutions and advisors will be examined, but many administration firms will continue to outsource the recordkeeping of larger plans due to the services they demand. Some will spend money on new technology. But will all of this be enough? Does the execution and delivery of services need to fundamentally change?

## NEW COMPETITION HAS ARRIVED

Here is a taste of the progressive services being offered to defined contribution plans today. Attributes include flexibility, real-time access to information, and a full range of enhanced services to meet comprehensive client needs. Thus, for purposes of this article, I will refer to the following as enhanced services:

- Instant plan sponsor and participant access to account information and investment education with sponsor update and download capabilities;
- Access to virtually any mutual fund available;
- Late day/same day trading for all contributions, transfers, rebalancing, and investment modeling in and between different fund families;
- Explicit participation in revenue sharing;
- Paperless loans and online statements with graphics;
- Self-directed and managed accounts;
- The ability to work through a broker of choice;
- Alternative funding via the most reputable financial institutions in the country;
- Complete distribution and rollover services; and
- Comprehensive plan design and compliance services.

All of these features are offered with local one-on-one service and at a cost lower than what many firms are charging today (including outsourcing partners).

Some firms already provide a portion or all of these enhanced services through a number of different avenues. Others may not have realized the need quite yet. But, as these services become more universal, administration firms must find ways to provide them while reducing unit costs, improving productivity, and increasing revenue and profitability if they expect to remain competitive. They must also continue to find ways to differentiate themselves from their competitors.

Before we explore various ways to provide enhanced services, there are two basic truths that need to be understood:

1. Enhanced services can only be provided if a plan is valued daily. Keep in mind that daily valuation is only a recordkeeping method—it is not an end in and of itself. Daily is the means by which these services are provided. Further, understand that traditional balance forward

recordkeeping is becoming somewhat antiquated.

2. Many administration firms will need to fundamentally change the way services are delivered. It may be a slow transition or possibly a radical transformation. But change is inevitable and is good, once it is accepted and embraced.

### OUTSOURCING OPTIONS

Let us start by examining the options available for outsourcing the delivery of enhanced services. In a recent ASPA survey on daily valuation trading practices, of those providing enhanced services, 57% primarily outsource to other entities. Further, 58% of those appear to be highly satisfied with their outsourced relationships. Thus, this well established approach remains popular as the status quo with many pension administration firms.

Outsourcing, as the name implies, is an arrangement where another entity is actually providing trading platforms and day-to-day recordkeeping services. It is an easy way to provide enhanced services. Since firms are in effect paying someone else to do the work, the most important consideration is whether

the outsourcing entity can do it more cost-effectively than the administration firm and deliver quality service at a competitive price. There are a number of outsourcing opportunities that are viable and attractive.

### GROUP ANNUITY PRODUCTS

Many enhanced services are commonly provided through insurance company group annuity contracts. These options have existed for many years and are a great way to offer competitive services. Group annuity contracts will continue to be an effective tool to meet the needs of many plans. In particular, those that embrace and pursue NAV-type products should enjoy continued success.

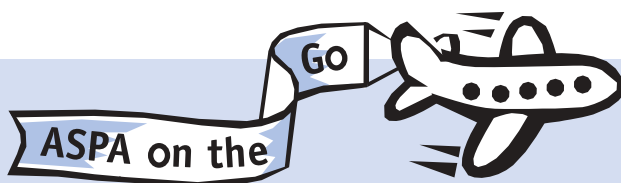
As plans grow in size and assets, and as sponsors grow in their knowledge and sophistication, sponsors may desire a fund selection not available within the annuity contract. Complex expense structures with implicit costs will be questioned by savvy plan administrators and trustees (thus the importance of NAV products). Continued control may also become an issue, as well as relationship changes with certain insurers that may create potential conflicts.

If annuity contracts are the only outsourcing option offered, can an administration firm compete against others offering enhanced services? Are these clients truly captive clients? Where do their loyalties genuinely lie?

### A NEW BREED OF VENDOR EMERGES

New technologies and Internet development have given rise to an array of outsourcing vendors, another popular method of delivering enhanced services. These vendors are similar to insurance companies in that they provide trading and recordkeeping services. (That is, they do a lot of the work for you). Their investment platforms typically offer a wider array of investment choices. Vendors vary considerably, differing in how they price their services, the extent to which firms participate in revenue sharing, the technologies employed, and how relationships with mutual clients are structured.

There are a number of strong, viable providers today that offer good, competitive options. Similar to working with insurance companies, this approach will work very well to satisfy client needs for a period of time. As this block of business grows, however, the same questions arise: How well can administration firms compete against others offering enhanced services if these are the only outsourcing options offered? Are these clients truly captive clients? Where do their loyalties genuinely lie?



As you may have already heard, ASPA has recently restructured its education program. Effective January 1, 2004, study material will be presented in smaller segments in a more logical, easier-to-understand way. The major changes occurred in the QKA and QPA programs, particularly the C-1 and C-2(DC) courses. These two courses have been combined, reorganized, and broken into three smaller segments: DC-1, DC-2, and DC-3.

What does this mean for those who are only part-way through the program? If you have passed C-1 or C-2(DC), you will get credit for DC-1 or DC-2 respectively. And, if you have passed both the C-1 and the C-2(DC) exams, you will get credit for DC-1, DC-2, AND DC-3.

If you have not already passed both the C-1 and C-2(DC), you get a one-time opportunity this fall exam cycle (November 1–December 15) to pass whichever exam you have not already passed and receive credit for all three new exams during the transition.

For more information on the restructured program and designation changes, visit <http://www.aspa.org/edu/restructure.htm>.

Continued on page 29





## CE Bargains Close To Home

by Cynthia A. Groszkiewicz, MSPA, QPA

ARE YOU LOOKING FOR A COST EFFECTIVE, CONVENIENT WAY FOR YOU AND YOUR EMPLOYEES TO EARN CONTINUING EDUCATION CREDITS? ASPA OFFERS NUMEROUS LIVE AND ON-DEMAND PRE-RECORDED WEBCAST PRESENTATIONS EACH YEAR THAT ALLOW YOU TO EARN CE WITHOUT EVER LEAVING THE OFFICE. WEBCASTS RUN APPROXIMATELY 100 MINUTES AND PARTICIPANTS EARN TWO ASPA CE CREDITS FOR EACH PRESENTATION.

That's just the beginning. You can also use the material from the webcasts for in-house training or study groups. Those who did not have an opportunity to participate in the webcast can still use the program to accumulate credits. It is a great opportunity to train your employees and allows them to earn CE credit at the same time!


How does it work? After listening to the webcast, set up a discussion group and designate someone who watched the webcast as the facilitator or trainer. Prepare an outline based on the information provided in the webcast and distribute this to the group of attendees. All program attendees can receive one credit per 50 minutes of group activity/discussion. Keep an outline with topic, date, and time information, as well as an attendance list as backup documentation. A credentialed ASPA member must be present at the program, and the employer or a credentialed ASPA member must sign the attendance form verifying attendance.

All that is needed to view the live webcasts are a phone and a modem connection for Internet access. The cost is usually \$125 for ASPA members and \$225 for nonmembers. For a schedule of

upcoming live webcasts, descriptions from our library of pre-recorded presentations, and webcast registration details, see page 6 or visit our Web site at [www.aspa.org/webcast/info.htm](http://www.aspa.org/webcast/info.htm) or contact the ASPA office at (703) 516-9300. To learn more about other ways you can meet ASPA's continuing education requirements, check out our CE Web page at [www.aspa.org/faq/conted.htm](http://www.aspa.org/faq/conted.htm), or contact the ASPA Membership Department.

Look for ASPA's new exam study Web courses beginning this fall. For more information visit: [www.aspa.org/edu](http://www.aspa.org/edu). ▲

*Cynthia A. Groszkiewicz, MSPA, QPA, is the director of Employee Benefits with Greenberg Traurig, LLP, in Atlanta, GA. Cynthia has over 30 years of experience in benefit plan administration, consulting, plan design, and IRS and DOL audit representation. She is also an Associate of the Society of Actuaries, a Member of the American Academy of Actuaries, and an actuary enrolled by the Joint Board. She currently serves on the ASPA Board of Directors, is a former Editor-in-Chief for The Pension Actuary, and was the founder of the ASPA Benefits Council of Atlanta.*



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## E&E Provides a Roadmap to Learning

by Michael L. Bain, MSPA

IT IS TIME TO START THINKING ABOUT 2004! YOU HAVE HEARD A LOT ABOUT CHANGES IN THE EDUCATION & EXAMINATION (E&E) PROGRAM AND OPPORTUNITIES TO MAXIMIZE YOUR TRANSITION CREDITS. NOW IT IS TIME TO LOOK AT THE MANY BENEFITS THAT THE NEW PROGRAM BRINGS TO THE TABLE. THE CHANGES ARE MUCH MORE SIGNIFICANT THAN SIMPLY REPLACING C1 AND C2-DC WITH A THREE PART SERIES.

We started from the beginning and built a program designed to significantly improve the education process and present the core material in a more manageable and logical manner.

After developing the logical training sequence, we began an analysis of the level of detail needed on each topic. While this task may sound easy, it was the most challenging part of the transition. The entire 35 member committee has spent a year developing learning objectives for all of our exams!

The E&E Committee holds a training session each year. In the past, the sessions have covered a variety of topics, such as training on writing clear and concise exam questions, writing ethics questions on professional exams, using statistics to review exam question quality, and other topics needed to ensure the excellence of ASPA's education program. This summer, the training session concentrated on learning objectives. Each of the committees revised their objectives based on what they learned during the session. Our thanks go to ASPA member, Nancy Michael, who provided a lively and excellent training session on this crucial topic.

Why is this effort important to ASPA's members and candidates in the education program? Learning objectives provide a framework and structure for the study guides, textbooks, Web and other courses (like the "cram sessions" offered at the summer and annual conferences), and the exams themselves. As opposed to a syllabus, which lists topics that will be covered, learning objectives detail what the candidate should know and be able to accomplish for successful completion of the exam.

Take a look for yourself. The learning objectives for each ASPA course can be found on the ASPA Web site at <http://www.aspa.org/edu>. These objectives are the framework for the newly restructured education program. (See *The ASPA Journal*, May-June 2003, Vol. 33, No. 3, or <http://www.aspa.org/edu/restructure.htm> for more information.)

Whether you have completed your designation requirements or are continuing your pursuit of additional professional education, here are a number of upcoming dates to keep in mind:

**October 31**—Final registration deadline for the fall exams for C-1, C-2(DB), C-2(DC), C-3, C-4, and A-4

**November 1–December 15**—Fall exam window for C-1, C-2(DB), and C-2(DC) exams

**December 3**—C-3, C-4, and A-4 exams

**December 15**—PA-1 (parts A and B) and Daily Valuation paper exams must be received by the ASPA office

**December 31**—PA-1A online course and online submissions for the PA-1 (parts A and B) and the Daily Valuation courses must be completed.

**January 1**—You've heard about it already! The newly restructured ASPA education program rolls out. For more information, visit the ASPA Web site at <http://www.aspa.org/edu>.

There are three exam windows in 2004.

**May 1–May 31: DC-1, DC-2, DB**

**Aug. 1–Aug. 31: DC-1, DC-2, DC-3, DB**

**Nov. 1–Dec. 15: DC-1, DC-2, DC-3, DB**

A complete calendar of all ASPA programs, events, and services, including up-to-the-minute and newly-developing information, can be found on the Web site at [www.aspa.org](http://www.aspa.org). ▲

*Michael L. Bain, MSPA, is president of CMC in Glendale, CA. Mike is General Chair of ASPA's Education and Examination Committee and a member of the Technology Committee. He is also a member of ASPA's Executive Committee and serves on the Board of Directors.*

*ASPA's newly restructured education program:*

# The More Things Change...

After two years of research, analysis, and planning, ASPA's Education Program has been newly restructured. Now, study material will be presented in smaller segments, in a more logical, easier-to-understand way.



# The More They Stay the Same.

ASPA's newly restructured education program debuts January 1, 2004. But the same high educational standards for which ASPA is known won't change.

**PA-1:** An introduction to qualified retirement plans and pension plan administration practices, with a focus on the annual administrative cycle

**PA-2:** An introduction to qualified retirement plans and pension plan administration practices, with a focus on event processing

**PA-3:** Daily Valuation terminology, concepts, and procedures

**DC-1:** Defined Contribution Basic Concepts

**DC-2:** Defined Contribution Compliance Issues

**DC-3:** Defined Contribution Advanced Topics

## REGISTER NOW!

**PA-1, PA-2, PA-3 take-home exams:**  
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**DC-1, DC-2, DC-3 computerized exams:**  
Offered in May, August, and November

For questions, contact ASPA at:  
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or email: [educaspa@aspa.org](mailto:educaspa@aspa.org)  
[www.aspa.org/edu](http://www.aspa.org/edu)





# ASPA Summer Conference 2003



*The 2003 ASPA Summer Conference attendees took time off from learning the latest news and trends in the retirement plan business to pay a visit to Mickey's California home.*



Thanks to ASPA's National Office staff for their help in making the conference run smoothly and efficiently. Staff members on site included: Brian Graff, Esq., Executive Director; Jane Grimm, Managing Director; Christy Bell, Data Services Assistant; Denise Calvert, Director of Membership; Chip Chabot, Webmaster/Multimedia Manager; Jolynne Flores, Government Affairs Manager; Blake Grimm, Data Services Coordinator; Joanne Lawrence Smith, CMP, Director of Meetings; Brian Lawrence; Janet McFadden, CMP, Meetings Coordinator; Jamie Pilot, CMP, Director of Education Services; and Jonathan Watson, Exhibit and Advertising Sales Manager.



*Michelle Chabot, Chip's daughter, greeted attendees with a big smile and was the ASPA staff's tiniest ambassador of friendliness.*



*Jamie Pilot, CMP, ASPA's Director of Education Services, answered many questions about the education program's restructuring. For more information, visit the Web site at <http://www.aspa.org/edu/restructure.htm>.*



*Joanne Lawrence Smith, CMP, Director of Meetings, and Janet McFadden, CMP, Meetings Coordinator, share a rare quiet moment. The Summer Conference was Janet's last ASPA meeting. We will miss her and wish her the best of luck in her future endeavors.*



*Jonathan Watson, ASPA's Exhibit and Advertising Sales Manager, made sure the exhibit hall ran smoothly.*





*The exhibit hall was a very popular place where the attendees could see the latest products and services to keep their businesses on the cutting edge.*



*Brad Huss, APM, Member of the Executive Committee and GAC Co-Chair, updated the attendees on the Government Affairs Committee's activities and initiatives.*



*Attendees were able to access their e-mail and the Internet quickly and conveniently by taking advantage of the Cyber Cafe.*



*President-Elect Bruce Ashton, APM, caught up with old friends and met new ones at the opening reception.*



*Martin Heming, APM, told session attendees the Secrets of Successfully Managing an EBSA Investigation.*



*Former Educator's Award recipient, Chuck Klose, FSPA, CPC, taught one of the very popular ASPA exam "cram" sessions.*



*Ilene Ferenczy, CPC; Rajean Bosier, CPC, QPA, QKA; and Craig Hoffman, APM, served as contestants during the ERISA Game Show.*



*The southern California weather beckoned the attendees to enjoy the outdoors during the breaks between sessions.*

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Summer  
Conference  
Committee

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Alex M. Brucker,  
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Fallbrook, CA

Patricia L.  
Marquis, OPA,  
Antioch, CA

William J.  
Sheffler, MSPA,  
San Diego, CA

ASPA Summer Conference 2003

Thanks to ASPA's Summer Conference Speakers



*Neff McGhie, MSPA, well-known for his contributions to the ASPA ASAP, spoke about the ways different business entities affect compensation for qualified plans.*

Alane Allman  
Bruce L. Ashton, APM  
Michael L. Bain, MSPA  
Todd J. Berghuis, APM  
Avaneesh K. Bhagat  
Rajeane M. Bosier, CPC,  
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Marianne G. Davis  
Mark A. Davis  
Lawrence Deutsch, MSPA  
Michael Doran  
Lorraine Dorsa, MSPA  
Elizabeth Drigotas  
David B. Farber, MSPA  
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Norman Levinrad, FSPA, CPC  
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Kurt F. Piper, MSPA  
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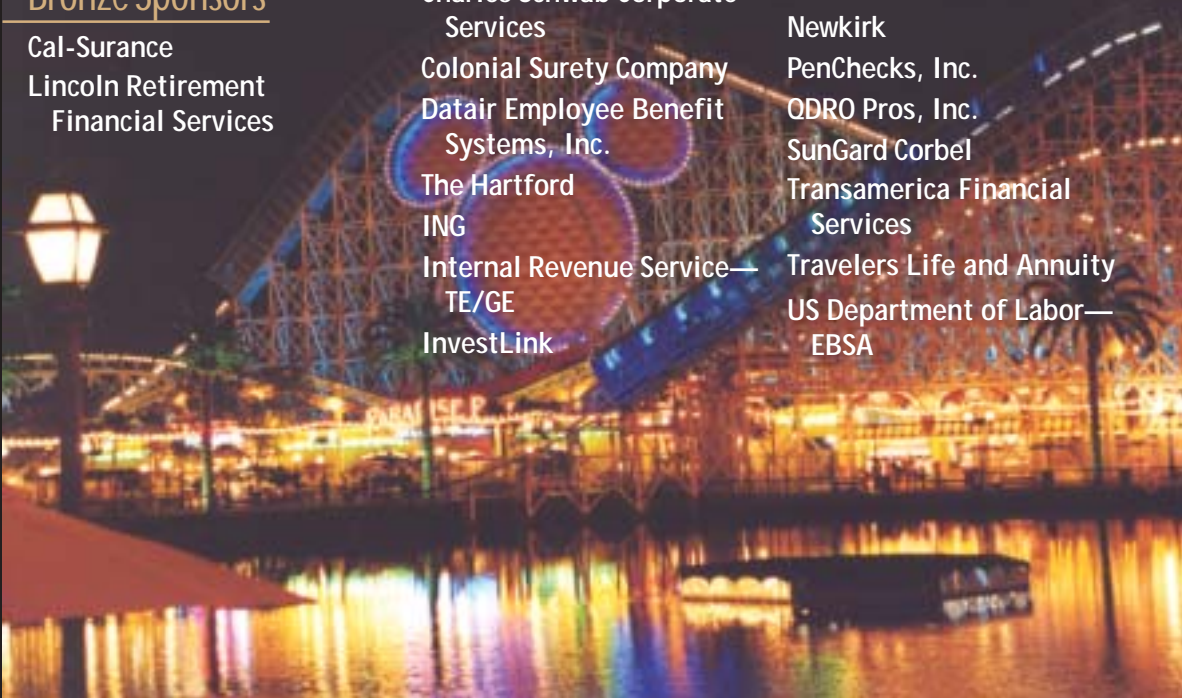
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## Issues with 412(i) Plans

future guaranteed interest accumulation but without any future death benefit charges under the policy and no future premium payments. This determination would cause the accrued benefits, relative to the formula, to be very low in the first year. This depressed accrued benefit would cause the formula for new rank and file employees to tend to be higher than a safe harbor formula, in order for a plan to pass nondiscrimination testing. Unlike a non-412(i) Plan, where accruals can be front-end loaded, the 412(i) Plan accrues benefits at an accelerating rate for the first several years, and then decreases somewhat in the later years (because of the level premium requirements). For this reason, reliance on general testing is almost never feasible in 412(i) Plans.

*Example 2:* To illustrate the problem with the General Test, consider a plan where the accrued benefit pattern might be 2%, 4.5%, 7.5%, 12% (or an average of 3% per year in the fourth year). Assume that in the fourth year of the plan, there is one HCE in his/her fourth year of participation and one NHCE in his/her first year of participation. The General Test would require that the NHCE have a policy with a formula equal to approximately 150% of the HCE's formula in order for the EBAR in the NHCE's first year to match up with the EBAR for the HCE. While this may be possible, it would generally seem to be counterproductive because the NHCE would have a higher benefit than in a safe harbor plan. The benefit for the NHCE could not be subsequently lowered without violating the level premium requirement [or alternatively, the 1.401(a)(4)-5 requirement].

### MISCONCEPTIONS IN THE MARKETPLACE

#### Aggregating Plans for Compliance Testing Does Not Work

When testing a plan for compliance with either Code Section 401(a)(4) or Section 410(b), the plan may be aggregated with other plans [Treas. Reg. sections 1.410(b)-7(d) and 1.401(a)(4)-13]. However, if a plan is aggregated with another plan to demonstrate compliance with one section, then it must also be aggregated with that plan to demonstrate compliance with the other section. For example, if two plans are aggregated to pass Section 410(b) of the Code, then the plans must be aggregated for purposes of determining whether the plans satisfy Section 401(a)(4) of the Code. There are certain restrictions on aggregations of plans [for example, the other plan cannot be a 401(k)

plan or an ESOP], which are not relevant to this article [Treas. Reg. 1.410(b)-7(c)].

*Example 3:* Assume that an employer has 20 employees, five of whom are HCEs. The plan sponsor has two plans, a defined benefit plan (DB) and a profit sharing plan (DC). The DB plan covers the five HCEs and five of the NHCEs. The DC plan covers the remaining 10 NHCEs. The DB plan satisfies Section 401(a)(26), because it covers 50% of the employees. However, the DB plan fails the 70% Ratio Percentage Test, because the Ratio Percentage is 33.33% [(5/15)/(5/5)]. In addition, assume the DB plan fails the Nondiscriminatory Classification Test. If the DB plan is combined with the DC plan, the aggregated plans now have a Ratio Percentage of 100% [(15/15)/(5/5)] and pass the 70% Ratio Percentage Test.

There are no restrictions in Code Section 410(b) that prohibit the aggregation of plans where one of the plans is a 412(i) Plan. Therefore, it is clear that a 412(i) Plan could be aggregated with a non-412(i) Plan, including a profit sharing plan, in order to demonstrate compliance with 410(b).

However, aggregating a 412(i) Plan with a non-412(i) Plan creates problems under Section 401(a)(4). In order for a plan to satisfy the 401(a)(4) safe harbor, the same formula must apply to all employees in the aggregated plans [Treas. Reg. 1.401(a)(4)-3(b)(2)]. But, where one plan is a 412(i) Plan and the other plan is a non-412(i) Plan, the plans will not share a common formula and, thus, cannot satisfy the safe harbor. Therefore, either a 412(i) Plan must be able to pass the Section 410(b) test without aggregation with another plan, or the aggregated plans must pass the General Test.

When a plan is tested for compliance with Section 401(a)(4), all of the plan's benefits, including ancillary benefits, such as life insurance, are subject to testing [Treas. Reg. 1.401(a)(4)-4(a)]. If an ancillary benefit is available on different terms to different employees, then each level of availability must be tested separately [Treas. Reg. 1.401(a)(4)-4(e)(2)]. This is taken so far that the actual policy series and other terms of the policy are considered a benefit, right, or feature [Treas. Reg. 1.401(a)(4)-3(b)(5)(vii)]. (In other words, the use of a different policy series could be a cause for discrimination.) If a 412(i) Plan is combined with a defined contribution plan, there is no way to provide the death benefit in the defined

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contribution plan on the same terms as in the 412(i) Plan. More specifically, in the 412(i) Plan, the death benefit is in addition to the benefit otherwise provided. In the defined contribution plan, the account would be reduced by the cost of the death benefit. This was the position stated by James Holland of the IRS at the 2003 Los Angeles Benefits Conference. Each level of benefit, right, and feature must be currently available to a group of employees that satisfies Section 410(b) [Treas. Reg. 1.401(a)(4)-4(b)] and must be effectively available to a group of employees that does not substantially favor HCEs [Treas. Reg. 1.401(a)(4)-4(c)]. In essence, the 412(i) portion of the aggregated plan would have to satisfy the rules on a stand-alone basis, because it is basically impossible to combine a 412(i) Plan with a non-412(i) Plan and satisfy Treas. Reg. 1.401(a)(4)-4. Ultimately this leads to the conclusion that, while a 412(i) plan could be aggregated with another plan to satisfy Section 410(b), that aggregation would cause the plan to fail Section 401(a)(4).

Another instance of violation of this rule would be purchasing whole life insurance (or some other, more favorable insurance contract) for one group of employees, which consists of primarily owners, and term insurance (or some other less favorable contract) for the balance of the employees. Even if this difference was justified based on a threshold level of insurance, or a service requirement such as five years of service to receive the whole life insurance, this policy difference would be subject to testing under 1.401(a)(4)-4. The concentration of owners in the better benefit would inevitably cause the plan to fail to be qualified.

#### A 412(i) PLAN CANNOT BE FUNDED SOLELY WITH LIFE INSURANCE

In addition to Code Sections 401(a)(4), 401(a)(26), and 410(b), there are other rules that all qualified plans, including 412(i) Plans, must satisfy. One such rule is that a qualified pension plan must exist *primarily for the payment of benefits after retirement* [Treas. Reg. 1.401-1(b)(1)(i)]. A qualified pension plan is not prohibited from providing certain other benefits, known as ancillary benefits, prior to retirement. However, the types and levels of ancillary benefits are limited. A pre-retirement death benefit is an ancillary benefit that can be provided by a qualified pension plan.

A typical 412(i) Plan is funded with a combination of life insurance and annuity contracts. In a series of revenue rulings, the IRS has provided rules for determining how much life insurance a

qualified pension plan can provide, with the life insurance benefit still being ancillary. This rule is sometimes called the “incidental death benefit rule.” The incidental death benefit rule is summarized in Revenue Ruling 74-307, which generally provides that no more than 25% of the total cost of the plan’s benefits for a participant can be used to purchase life insurance.

There are three ways in which Revenue Ruling 74-307 indicates that a defined benefit plan (where the only ancillary benefit is a pre-retirement death benefit) can comply with the incidental death benefit rule:

1. If the plan purchases term insurance, the cost of insurance can be up to  $\frac{1}{3}$  of the cost of the plan’s retirement benefit, without regard to the ancillary death benefit, because then the cost of the ancillary benefit would be less than 25% of the total cost;
2. The death benefit, provided by the insurance, can be equal to 100 times the anticipated monthly retirement benefit provided by the plan at retirement (even if insurance premiums for various participants exceed the 25% rule); or
3. If the plan purchases whole life insurance, the cost of insurance can be  $\frac{2}{3}$  of the cost of the plan’s retirement benefit, without regard to the ancillary benefit, and still be considered to be less than 25% of the total cost. This calculation is based upon the presumption that, during the period of funding the plan, one-half of the cost of the policy goes to building cash value to fund the retirement benefit and one-half goes to the cost of the death benefit. Since  $\frac{1}{2}$  of the total premium is the cost of the death benefit,  $\frac{1}{2}$  of  $\frac{2}{3}$  equals  $\frac{1}{3}$ , which, as stated in paragraph 1 above, satisfies the 25% rule. For this purpose, an interest sensitive policy, such as universal life, would not be considered to be a whole life insurance policy, and thus would be subject to 1 or 2 above.

On a number of occasions, the IRS has stated that a plan funded solely with life insurance is not a qualified plan, because the death benefit will exceed the incidental death benefit rule (see, in particular, Rev. Rul. 81-162). In addition, Section 401(a)(2) of the Code requires that the assets of a qualified plan be held for the exclusive benefit of the employees. However, a 412(i) Plan funded exclusively with life insurance could easily have assets, on the death of a participant, in excess of the amount required to provide the Plan’s retirement benefits for the remaining participants (particularly if there are no other participants). Since excess assets would be for other than providing the



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benefits under the plan (for example, they may revert to the employer or be transferred to another plan) a 412(i) Plan funded exclusively with life insurance will violate the exclusive benefit rule.

Notwithstanding the foregoing, some have argued that there are circumstances under which a plan can justify the purchase of excess life insurance and still qualify under Code Section 401(a). However, the plan must have a legitimate reason for purchasing such excess insurance. For example, if the plan realized a savings (because of banding rules), or, if the plan had a legitimate insurable risk, it might be able to justify the purchase of additional insurance.

However, it does not seem likely that a one-person plan could justify that excess insurance is needed to provide benefits to participants. Insurance on the life of the lone participant in the plan would provide funds in excess of the participant's benefit under the plan. Since there are no other participants to receive the funds, the additional death benefit would not be related to providing retirement benefits under the plan.

If there is more than one participant in the plan, it might be possible to make an argument that, upon the death of a principal, there is a risk that the benefits of other participants will not be funded. In such a case, it would seem that at an absolute outside, the maximum amount at risk is the cost of funding the benefits for the remaining participants. More likely, the limit is the amount of the unfunded accrued benefits. Of course, in a 412(i) Plan, by definition there are no unfunded accrued benefits because, under Section 411(b)(1)(F) of the Code, the accrued benefits in a 412(i) Plan are the cash value of the contracts.

To take the issue one step further, assume that the purchase of additional insurance could be justified in a plan with multiple participants. What happens if the insured participant does not die? If the intent is to allow the participant to take the policy from the plan, in any form, then that right to convert is a benefit, right, and feature of the plan under Treas. Reg. 1.401(a)(4)-4(b)(1). As pointed out above, that regulation requires that any benefit, right, or feature of a qualified plan be provided to a group of employees that satisfies, among other requirements, Code Section 410(b). Therefore, the same right (*i.e.*, the conversion of a policy in excess of the maximum allowable death benefit) must be provided to a sufficient number of rank and file employees. In order to provide that right, the plan must also purchase excess insurance for the rank and file employees. But, a plan probably cannot justify the purchase of excess insurance on the rank and file. Therefore, while a plan with NHCEs

may justify the purchase of excess insurance on a particular participant, it would not be possible for that participant to receive any of the death benefit or to take (directly or indirectly) the policy from the plan.

## SPRINGING CASH VALUES AND OTHER SIMILAR POLICIES

Now assume that a plan purchases life insurance with the intent to distribute the policy to a participant after five years. Assume further that the cash value of the policy significantly increases shortly after the participant takes the policy from the plan. The purpose of this transaction is to transfer value from the plan to the participant, with a large portion of the value of the policy escaping taxation. Understanding this transaction requires the discussion of two issues. The first is the value of the policy and the second is the transfer of an asset from a qualified plan to a participant.

Under Code Section 402(a) [Treas. Reg. 1.402(a)-1(a)(iii)], the transfer of a policy from a qualified plan to a participant is a taxable event and the value of the transaction should reflect the market value of the policy. For years, it was assumed that the cash value of the policy represented the value of the transaction to the participant. But, in Notice 89-25 (Q&A 10), the IRS questioned whether the true value of a policy might be something other than the cash value of the policy. In Notice 89-25, the IRS described, as an example, a policy where the *reserves* of the policy exceeded the policy's cash value at the point of distribution. The IRS said that as a result, the *reserves* should be used as the value of that policy rather than the cash value.

Notice 89-25 gave rise to the term "springing cash value." The example in Notice 89-25 was not meant to be exhaustive. The IRS reserved the right to use other measures of the value of a life insurance policy. The IRS has suggested that the value, in some instances, should reflect the cost of a single premium policy similar to the distributed policy, which should be about equal to the sum of the premiums paid. [See IRS examination guideline 355(3)(e) as published in IRS Announcement 94-101.] The important point is that it is no longer safe to rely on cash value as a measure of fair value just because cash values happen to parallel "reserves." "Springing reserves" are just as suspect as "springing cash values."

*Example 4:* In a more pure sense, consider a policy with a premium of \$100,000 for each of the first five years of the plan. Further assume that, in year five, the policy's reserve is \$150,000. Finally, assume that in year eight, the policy (with no additional premiums after the fifth year) has a cash value of \$400,000. While the question of the

value of the policy may be complicated, it is difficult to argue in today's investment environment that a policy guaranteed to have a value in year eight of \$400,000 could have a value in year five of less than \$350,000. This scenario would mean a guaranteed rate of return of 4.55%. Yet, in this example, the year-five value is not \$350,000, but a mere \$150,000.

#### DISTRIBUTING A LIFE INSURANCE POLICY FROM A PENSION PLAN

Another issue, in addition to the proper valuation of the policy, is simply the distribution of a life insurance policy from a qualified plan. Distributions may occur either while the participation is ongoing or after a "distributable event," such as termination of service, termination of the plan, or attainment of retirement age. If the plan is ongoing, the transfer of a policy for less than an accurate "market value" creates serious problems. Prohibited Transaction Exemption 92-6, issued by the Department of Labor, provides the rules for the sale of certain plan assets to a participant. PTE 92-6 one line requires that the plan be in the same cash position after the sale as it was before the sale. In addition, it says that the ERISA fiduciary standards apply. If a plan sells an asset, guaranteed to be worth \$400,000 in three years, for \$150,000, the plan is not in the same cash position after the transaction as before. In addition, this transaction would be a clear violation of ERISA's fiduciary rules. ERISA's fiduciary rules require that transactions between a plan and a party-in-interest, such as the shareholder/employee of the plan sponsor, be at "arms length"—in other words, in a similar manner as if the transaction were with an unrelated party. However, it is unlikely that an unrelated party

could purchase an asset guaranteed to be worth \$400,000 in three years, for only \$150,000. Furthermore, one of the conditions of PTE 92-6 is that the contract would, but for the sale, have been surrendered by the plan. It seems ludicrous to suggest that it would be prudent to surrender, for \$150,000, a contract scheduled to increase in value to \$400,000 in just three years without further premium payment.

If a policy is "purchased" from a 412(i) Plan, the plan may no longer qualify under Section 412(i). This raises the issue of the conversion of a 412(i) Plan into a non-412(i) Plan. Such a conversion is treated as a plan amendment subject to Code Section 411(d)(6). Under Section 411(d)(6), benefits may not be reduced as a result of a plan amendment. The IRS has made it clear that a participant's accrued benefit includes all future benefit payments that the participant would be entitled to, if the participant were credited with no additional service other than vesting service. Prior to the amendment, the participant was entitled to the policy's cash value of \$400,000 in three years. Thus, the accrued benefit after the amendment would have to account for this amount, plus all other guaranteed benefits in the combination of policies prior to the amendment. To avoid "backloading" in the accruals, the accrued benefit after the conversion may have to be raised. In turn, this rise in accrued benefit may cause issues under 401(a)(4), in particular 1.401(a)(4)-5.

In Notice 89-25, the IRS stated that if the market value of a distributed policy exceeds the consideration paid for the policy, the excess would be treated as a distribution. If there was no distributable event, any amount of excess could cause plan

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disqualification. In addition, if the sum of the benefit after the conversion, plus the value of the distribution (*i.e.*, the excess of the true value over the value used) exceeded the limits of Code Section 415, this circumstance could also trigger plan disqualification.

If there is a “distributable event,” such as plan termination, then distribution of a policy can be put in a completely different light. First, the conversion issue is moot since there is no conversion. The fiduciary issues also appear to be moot, because the “value” of the benefit to be paid from the plan would equal the “value” of the policy. An argument could be made that the law simply indicates that the accrued benefit is the “cash value” of the policy, and, by distributing a policy with a current “value” exceeding the current “cash value,” the distribution was too high. But the counter argument that was apparently the congressional intent was that whatever the policy provided would be what the participant was entitled to—and the IRS position on the definition of accrued benefit—and that the accrued benefit would include the future higher cash value, seems more persuasive.

Therefore, in the case of a “distributable event,” the issues seem to be narrowed to those in Notice 89-25. In particular, how much should the participant include as income and does the distribution exceed the 415 limits? The issue of the amount taken into income is basically the correct value of the policy, and this issue has already been examined. The issue of the 415 limits can be very fact dependent. Consider the situation where the participant is at retirement when the policy is distributed. In this event, an argument could be made that, since the value of the policy at distribution is exactly equal to (or less than) the amount necessary to provide the 415 limit, the participant is free and clear after the distribution. But, under Treas. Reg. 1.415-3(a), if the policy, at any time, could (directly, or indirectly) provide a benefit in excess of the 415 limit, then the distribution of the policy would exceed such limits. Therefore, in order to distribute the policy, the policy must prohibit the payment of any amounts in excess of the 415 limit, which in turn would prohibit the participant from receiving (directly or indirectly) the benefit of the jump in cash value (assuming the value before the jump was at the 415 limit). It is also important to remember that the 415 limit is reduced for years of participation less than 10 and for payments prior to age 62. In addition, all of the plan sponsor’s defined benefit plans (including, most notably, prior payments under prior plans) are aggregated for purposes of determining the benefit for 415 purposes.

Of course, installing a plan with the intent of terminating in five years can have its own set of problems. Under Treas. Reg. 1.401-1(b)(2), a plan must be intended to be permanent in nature. Under Treas. Reg. 1.401-1(b)(3), a plan that was intended to last only five years could be at risk of retroactive disqualification for violation of this rule.

## FLOOR OFFSET PLANS

Another topic of interest is whether a 412(i) Plan can be part of a “floor offset” plan. In a floor offset plan, the benefits provided by the combination of a defined benefit plan and a defined contribution plan are the better of the defined benefit plan formula and the defined contribution plan benefits. To accomplish this, the benefits in the defined benefit plan are reduced by the actuarial equivalent of the defined contribution account balance.

*Example 5:* Assume a defined benefit plan provides a benefit of 2% of pay per year of service and a defined contribution plan provides an allocation of 5% of pay. When the benefit from the defined benefit plan is paid, the benefit is the 2% of pay benefit reduced by the actuarial equivalent of the defined contribution account balance. Thus, if the defined contribution benefits are larger, then the participant will receive only those benefits. If the defined benefit benefits are larger, then the defined benefit plan will provide the additional benefit, so that the sum of the benefits under the defined contribution plan and the defined benefit plan equals the defined benefit formula, prior to the offset.

In a 412(i) Plan, this becomes very problematic. The accrued benefit before the offset is the cash balance of the policy. But what policy? What would have to be done is that a hypothetical policy is issued. The cash value of this hypothetical policy is determined. The accrued benefit is then the difference between the hypothetical policy and the account balance. An actual policy would then have to be found that has a level premium, but a cash value that follows the correct pattern. An argument could be made (but it is probably not a good one) that the premiums could be adjusted to reflect the ups and downs of the investment earnings in the defined contribution account. If the participant chooses not to take a distribution upon termination, this would require continued adjustments in the policy after termination.

The illustration on page 27 is based upon a policy with no loads, no death benefit (other than the cash value), and an internal rate of return of 3%. The problem mathematically is that since the pattern of the growth on the real and the hypothetical policy must be the same, then so must the increase in the account balance. Since this will not occur, the plan



## The Mathematics of the Policy

Year	Hypothetical Premium	Hypothetical Cash Value	Defined Contribution Allocation	Defined Contribution Account	Required Cash Value	Required Premium	Real Cash Value
1	2,879	2,879	1,200	1,200	1,679	1,562	1,562
2	2,879	5,844	1,200	2,460	3,384	1,562	3,171
3	2,879	8,897	1,200	3,783	5,114	1,562	4,828
4	2,879	12,043	1,200	5,172	6,871	1,562	6,535
5	2,879	15,283	1,200	6,631	8,652	1,562	8,293
6	2,879	18,620	1,200	8,162	10,458	1,562	10,104
7	2,879	22,057	1,200	9,770	12,287	1,562	11,969
8	2,879	25,598	1,200	11,459	14,139	1,562	13,890
9	2,879	29,244	1,200	13,232	16,012	1,562	15,868
10	2,879	33,000	1,200	15,093	17,907	1,562	17,907

either will not conform to the requirement for the accrued benefit to equal the cash value, or it will not conform to the requirement for the premium to be level. This problem gets much worse when death benefit charges and policy loads are added to the policy. This scenario would also still have the benefits, rights, and features problem discussed earlier.

### CONCLUSION

The requirements for qualification under Section 412(i) are strict, and failure to adhere to these requirements can have adverse consequences for both the professional and his or her client. There are promoters in the marketplace who aggressively stretch the limits of Code Section 412(i) to the breaking point. The prudent advisor will design plans that conform to the Internal Revenue Code and the regulations thereunder.

Representatives of the Internal Revenue Service have indicated, informally, that they are aware of the egregious practices currently taking place. They state that they plan to take action to bring these practices to an end. Further guidance should be available soon, possibly even available already as you are reading this article. Practitioners need to be aware of the issues and advise their clients accordingly.

### ENDNOTES

**Excludable Employee:** An Excludable Employee is defined in Treas. Reg. 1.410-b(6) generally as either an employee who does not meet the plan's age and service requirements, who terminated with less than 500 hours (and didn't benefit from the plan), or is a union employee.

**Non-excludable Employee:** An employee who is not an Excludable Employee.

**EBAR:** Benefit Rates (EBAR) are used in various calculations [Treas. Regs. 1.401(a)(4)-2(c), 1.401(a)(4)-3(d), 1.401(a)(4)-8(b), 1.401(a)(4)-8(c), 1.401(a)(4)-9(b), and 1.410(b)-5]. The EBAR is generally the employee's benefit, expressed as a percentage of pay, determined on either a benefit or allocation basis.

**Ratio Percentage:** Ratio Percentage is the ratio (as a percentage) of the percentage of non-excludable NHCEs benefiting under the plan to the percentage of non-excludable HCEs benefiting under the plan [Treas. Reg. 1.410(b)-9].

**ABP:** The Average Benefit Percentage (ABP) is the ratio (as a percentage) of the average of the EBARs for all non-excludable NHCEs to the average of the EBARs for all non-excludable HCEs. ▲

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# Embracing the Evolution of Defined Contribution Recordkeeping

## IN-HOUSE SERVICE DELIVERY

Another alternative in offering enhanced services is to maintain the recordkeeping and investment trading platform in-house rather than, or in addition to, outsourcing (e.g., providing daily valuation services in-house). Interestingly, in ASPA's recent survey on daily valuation practices, there was not a clear single reason as to why many service providers avoid in-house daily valuation. Most cited complexity, cost, and potential trading liability as their primary reason, as well as satisfaction with outsourcing vendor relationships.

In the not too distant past, in-house daily recordkeeping was in fact expensive and labor intensive. Premises-based solutions were the only ones available, and it was difficult to make money. Thankfully, this has changed dramatically!

Today's technology now allows providers to offer the same daily services as larger market players, but at an affordable cost. Automation developments make daily trading an easy proposition with tools to minimize trading liability. There are a number of good daily software products available that offer a wide variety of automated trading platforms.

An administration firm can typically begin offering daily services with premises-based software for as little as \$50,000. Full first-year costs will be more in the \$70,000 and up range, but that should include training, implementation, and maintenance. Costs will vary considerably depending upon the software employed, existing infrastructure and/or hardware needs, the implementation approach used, staffing needs, and, of course, each individual situation.

## ASP—REINVENTING TIMESHARE

Delivering enhanced services in-house no longer requires maintaining premises-based software. As a result of new technology and the Internet, ASP (Application Service Provider) options are now available. ASP is basically an updated version of the old time-sharing model. This approach enables a user to access and operate software via the Internet that resides on a server somewhere else, without requiring the end user to maintain it. The ASP approach could be used for all applications or just some (e.g., plan sponsor and participant access may be provided via an ASP with the recordkeeping software maintained in-house).

Today, the ASP model is attractive to those who are in the process of changing their service delivery (i.e., getting their feet wet) or those who do

not expect much growth. Costs are generally lower as a result of the absence of up-front fixed costs and variable costs that are based on volume. As with time-sharing, costs will increase with volume. As a certain critical mass is attained, scalable premises-based solutions may offer greater control and cost effectiveness to support growth.

The most important aspect of in-house delivery is reaching critical mass with regard to assets and plans—the break-even point, where amortized set-up costs and ongoing costs are being covered. Past that point, leveraging the technology will enable a recordkeeping firm to increase plans and assets while improving profitability by reducing unit costs and increasing revenue. In-house delivery also gives the provider the intangible benefit of being perceived as a bona fide administration firm who has the ability to perform and deliver enhanced services. The real challenge is identifying what critical mass means, as it will differ from firm to firm.

## THE NEW BUSINESS MODEL

For a moment, think about this: What if it was easy to efficiently and cost-effectively provide enhanced services in-house? A typical business model might look like this:

- Focus on the most important valued-added service provided: relationships with clients and keeping their plans in compliance.
- Create a highly automated technological and processing infrastructure that enables efficient execution and delivery of services to plan sponsors and participants.
- Offer multiple trading partners, all of whom provide same day trading, access to virtually all mutual funds, revenue sharing, and competitive pricing.
- Diversify by offering outsourcing options to complement the in-house delivery system. Outsourcing options are important to round out product and service offerings and will be more appropriate in certain circumstances.
- Develop and maintain relationships with financial advisors and brokers, further adding value to the services offered.

A critical aspect of this model is capturing available revenue on the assets of all plans from fund companies that are more than willing to do so. This



logic holds true whether the assets are participant or trustee directed, and applies regardless of the plan type. For example, on a simple trustee directed profit sharing plan that has little activity: why not capture revenue sharing on the assets? This additional revenue is commonly used to cover trading costs and help reduce client fees.

In ASPA's survey on daily valuation trading practices, only 24% said they are trading trustee directed plans through their daily trading platform. However, there was a clear correlation in that all 24% were high asset respondents. This draws one to conclude that higher asset administration firms have figured out the value in receiving revenue on assets from all plans.

In a 2000 McHenry Consulting Group survey labeled "A Survey of Third Party Retirement Administrators," 36% of respondents indicated that small case revenue sharing has had an extremely positive impact on their business activities, 31% reported a somewhat positive impact, and 30% reported a neutral impact (only 3% reported any type of negative impact). Why miss out on this opportunity?

Services will vary, but in a different manner than they do today. Some examples include:

- Online statements, on-demand, periodic paper statements, or a combination, which may vary participant-to-participant, plan-by-plan. Methods of delivery will vary as well.
- The degree of investment education that is available may vary, and may include individual participant consulting.

- Investment education may not be emphasized when assets are trustee directed, but some level of participant access is still provided, and all trustee investment direction and changes are performed by the trustee via the Internet.
- All transactional activity is automated—no paper requests.
- Coordination with other services your firm may provide (additional plans, documents, rollover services, etc.) as well as services from financial advisors.
- And yes, balance-forward recordkeeping has been completely phased out. Daily valuation recordkeeping supports all of your services and enhances the timeliness of compliance testing results.

"Ah...so the point of this article is to promote daily valuation, right?" No, not at all. All assets under this new business model will be valued daily, regardless of trustee/participant direction. As referenced earlier, 'daily' is nothing more than a recordkeeping method, just one small component leading to a much broader strategic goal. The concept is far beyond daily valuation. It is adapting current business models by:

- Implementing and leveraging technology to fully automate day-to-day recordkeeping tasks—the routine aspects of what happens every day. And, having one way of performing those tasks for all DC plans. Separate daily and balance forward units are counterproductive and inefficient;
- Diversifying product and service offerings to best meet client needs, offering in-house and

## Gwen S. O'Connell, CPC, QPA, Named as the Recipient of the 2003 Educator's Award

The ASPA Education and Examination (E&E) Committee's divisional chairs selected Gwen S. O'Connell, CPC, QPA, as the recipient of the 2003 Educator's Award. Gwen has been a consultant and administrator of qualified plans for over 24 years. She was a member of ASPA's E&E Committee for many years, most recently serving four years as General Chair. She is currently on the ASPA Conference and Membership Committees. Gwen is a member of the National Association of Actuaries and Consultants, Inc. She is a frequent speaker on pension topics and is an authorized instructor for ASPA and the American College.



On the basis of her dedication to education, ASPA is proud to honor and present Gwen with the 2003 Educator's Award. Gwen will receive her award on Sunday, October 26, during the Business Meeting at the 2003 ASPA Annual Conference.

Past recipients of the Educator's Award include Charles J. Klose, FSPA, CPC; Janice Wegesin, CPC, QPA; David B. Farber, MSPA; Cheryl Morgan, CPC; Sal L. Tripodi, APM; and Joan Gucciardi, MSPA, CPC. ▲

outsourced DC options (let us not forget DB options as well!);

- Maintaining the potential to receive available revenue sharing on an entire asset base and working with financial advisors and brokers; and
- Focusing on the quality of client relationships and the expertise brought to the table to keep their plans in compliance.

The result of this new model is improved productivity, cost effectiveness, increased revenue, and emphasizing high quality personalized service, which ultimately leads to client retention and satisfaction. Quite simply, doing more for less, which is exactly what clients are looking for. A win-win proposition any way you look at it.

Many firms are moving towards this new model. They are choosing to answer the question, “How do we deliver—and do it profitably?” rather than “Can it be done?” However, many larger companies (e.g., insurance companies) have encountered a fundamental problem they have yet to overcome: the cost of their infrastructure and layers of management. So far, many remain competitive, but many are dropping out, unable to break through their cost structure. This dilemma gives smart, smaller, and nimble companies an incredible advantage—if they are willing to change and embrace a different business model.

#### SUMMARY

Progressive, forward-thinking pension administration firms have already embraced the new evolution of defined contribution recordkeeping—a new business model that supports enhanced services through in-house delivery, complimented by outsourcing options. Not surprisingly, they are experiencing success and profitability, albeit not without a learning curve and some growing pains. Yet, they are demonstrating technological prowess, flexibility, the ability to competitively adapt and meet client needs, and the wisdom to focus on what they do best—service their client relationships. Never abandon the values and integrity that business success is built on. Fundamentally changing the way services are delivered, however, can assure continued success. ▲

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*Robert Long, APM, CLU, ChFC, is currently a product manager for ASC. With over 25 years in the industry, Bob's expertise in the daily valuation area includes software systems, support, training, and implementation. Bob is a member of ASPA's E&E Committee (Daily Val/PA-3 committee), a member of ASPA's Marketing Committee, and he has spoken at ASPA's Summer Conference.*

## Robert D. Levenson, MSPA, Selected as the 2003 Henry T. Eidson Founders Award Recipient

Robert D. Levenson, MSPA, was recently selected as this year's recipient of the Eidson Award. Bob was selected for this prestigious award based on the significant role he has played in advancing ASPA's interests and those of the private pension system.

Please join us in recognizing this exceptional individual at the awards presentation being held on Sunday, October 26, at 3:15 p.m., at the Washington Hilton & Towers. The awards ceremony is held in conjunction with the 2003 ASPA Annual Conference.

In 1995, ASPA established the Harry T. Eidson Founders Award to honor the memory of ASPA founder Harry T. Eidson, FSPA, CPC. Eidson was the initial inspiration behind the formation of ASPA in 1966. He firmly believed in the importance of a private pension system for the United States and was committed to building an organization dedicated to preserving and enhancing such a system. The Harry T. Eidson Founders Award recognizes exceptional accomplishments that contribute to ASPA, the private pension system, or both.

Previous recipients include: Curtis D. Hamilton, MSPA, CPC, in 2002; Ruth F. Frew, FSPA, CPC, in 2001; Leslie S. Shapiro, J.D., in 2000; Howard J. Johnson, MSPA, in 1999; Andrew J. Fair, APM, in 1998; Chester J. Salkind in 1997; John N. Erlenborn in 1996; and Edward E. Burrows, MSPA, in 1995. ▲



## New York ABC is Active and Growing

by Cathy G. Waxenberg, APM

THE ASPA BENEFITS COUNCIL OF NEW YORK HAD AN EXCITING START THIS YEAR WITH A FILLED-TO-CAPACITY ROUNDTABLE MEETING IN FEBRUARY. THE TOPIC WAS FULLY INSURED [SECTION 412(i)] DEFINED BENEFIT PENSION PLANS. WE HAD TWO INDUSTRY EXPERTS LEADING THE DISCUSSION, BUT THE EXPERIENCED ACTUARIES AND ADMINISTRATORS AROUND THE TABLE ADDED ALL THE FIREWORKS! WE ARE HOPING TO REPRISÉ THIS TOPIC ONCE THE IRS ISSUES ITS PROMISED REGULATIONS.

At our half-day regular seminar meeting in April, we were fortunate to have Brian Graff, Esq., Executive Director of ASPA, address the group. The topics included proposed pension legislation, as well as new laws and regulations currently taking effect. Considering some of the changes being promoted by the Bush administration, we all realized how important it is for everyone at ASPA to get involved with government affairs and support the great lobbying efforts that Brian spearheads.

Our next half-day meeting took place on September 23, 2003. Seymour Goldberg, Esq. (noted author and lecturer on retirement distributions) and Leonard Whitman, Esq. (frequent and popular ASPA lecturer on estate planning and post-death distributions) headed the panel. As always, there will be

ample time set aside for questions from the attendees.

The Board of the ABC of New York has been successful in recruiting new members recently. While many of the Board members have been loyally serving since the chapter began several years ago, it is refreshing to have some new insights into our planning strategies. The current board members are:

### Chair

Harvey M. Katz

### Meeting Chair/President

Cathy G. Waxenberg, APM

### Co-Membership Chair

Steven Greenbaum

### Co-Membership Chair

Steven Halpern

### Co-Continuing Education Chair

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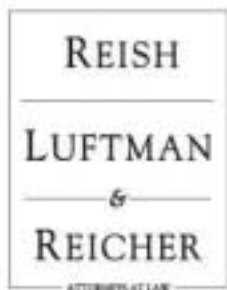
Rachael Salsano-Mazza, CPC

### Treasurer

Judy A. Lynch, QPA

### Events Coordinator

Adam Cantor



*We congratulate our partner*

**Bruce L. Ashton**

*on becoming  
President of ASPA*

**October 29, 2003**

11755 Wilshire Blvd., 10<sup>th</sup> Floor Los Angeles, California 90025  
Phone 310-478-5656 Fax 310-478-5831 www.reish.com

For more information about the ASPA Benefits Council of New York, membership registration, and upcoming events, contact Board Chair Harvey M. Katz at (212) 704-0100. ▲

*Cathy G. Waxenberg, APM, is on the Board of Directors of the ASPA Benefits Council of New York. She is an attorney and co-owner/president of Laiken Associates, Inc. in New York City, an employee benefits and actuarial consulting firm. She has practiced in the employee benefits field as an attorney and consultant for more than 20 years, specializing in plan design, compliance, and administration.*



# Northern Indiana ABC Reaches Out

by Robert J. Toth, Jr.

THE NORTHERN INDIANA ABC WAS FORMED BY A COLLECTION OF FORT WAYNE, INDIANA-BASED BENEFIT PROFESSIONALS WHO HAD, TWO DECADES AGO, FORMED THEIR OWN LOCAL GROUP CALLED THE ERISA DISCUSSION GROUP. NOW IN OUR THIRD YEAR OF OPERATION AS AN ABC, WE HAVE HAD TWO SUCCESSFUL SAL TRIPODI SEMINARS, SUPPORTED AND PROVIDED SPEAKERS FOR TWO OF THE INDIANAPOLIS BEST OF GREAT LAKES, HELD TWO REGIONAL TWO-DAY CE TRAINING SEMINARS BASED ON THE ANNUAL MEETING TAPES, CONVENED TWO ANNUAL DINNERS/MEETINGS, AND HELD A NUMBER OF SMALLER EDUCATIONAL GET-TOGETHERS WHERE OUR MEMBERS PRODUCED PAPERS FOR ONE ANOTHER ON HOT TOPICS. OUR TRIPODI SEMINARS HAVE BEEN PARTICULARLY SUCCESSFUL, EACH DRAWING OVER 100 PARTICIPANTS FROM INDIANA, ILLINOIS, MICHIGAN, OHIO, AND KENTUCKY.

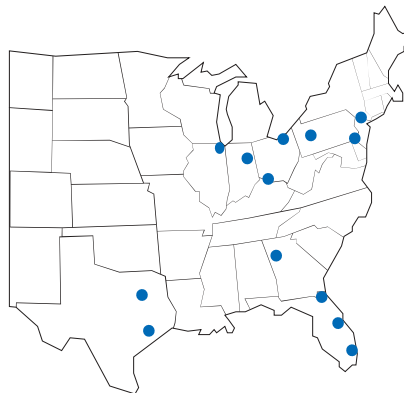
We are now seeking to expand our participation further. In an effort to encourage membership beyond our Fort Wayne roots, we will be holding our next educational lunch approximately 75 miles down the road in Warsaw, Indiana. Those sessions will be presented by professionals from the northeast Indiana area. Our members also continue to actively participate in ASPA committees.

The ABC system has been a boon to the benefit professionals in this area, who utilize us as a cost effective way to keep up their ASPA CE requirements, and as a fun, local way to keep abreast of happenings at the national level. We look forward to years of fruitful association with ASPA. ▲

*Robert Toth is the current president of the Northern Indiana ABC. He is associate general counsel of Lincoln National Life in Fort Wayne, Indiana; a member of ASPA's 403(b) and Great Lakes committees; the Pension Committee of the American Council of Life Insurers; the Committee of Annuity Insurers; the American Bar Association's Tax Section; and the Michigan and Indiana Bar Associations.*

## A Special Invitation ABC Cocktail Party

Have you ever wondered what the ABCs are? Have you thought about the role they play in ASPA? Have you ever thought about becoming involved in an ABC or perhaps even starting one in your own area? The Annual ABC Cocktail Party Reception being held on Monday evening, October 27, during the 2003 ASPA Annual



Conference in Washington, DC, is a wonderful opportunity to meet and mingle with active ABC leaders and members to learn the many benefits reaped from the ABCs. The ABCs serve as an excellent resource for local networking, continuing education, and professional development. Come join us to find out how you can become involved!

### ASPA BENEFITS COUNCILS CALENDAR OF EVENTS

Date	Location	Event	Speakers
November 11	Texas Gulf Coast	Washington Update	Brian H. Graff, Esq.
November 12	Dallas/Ft. Worth	Full Day ERISA Workshop	Charles Lockwood
November 13	Dallas/Ft. Worth	Keeping Current	Sal Tripodi, APM

# FUN-da-MENTALs

## Quotable Quotes

- To do is to be. — Descartes
- To be is to do. — Voltaire
- Do be do be do. — Frank Sinatra



If pro is the opposite of con, then what is the opposite of progress? Congress!

—Author Unknown

SIDE FUN



"Do you think this is what they meant by the 'blackout period'?"

## Emoticons

In this day and age of email, people with too much time on their hands have created "emoticons" to express emotions or to represent events or people. Here are a few that we thought, given the nature of our industry, you might be able to use!

- =:-) = Bad hair day
- C=-) = Chez Actuarie
- ?:-) = Confused
- <:-) = Dunce hat
- ?-( = Sorry, I don't know what went wrong
- %-) = Stared too long at the monitor
- =[:-)= = Uncle Sam
- X:-) = Unconscious

## WORD SCRAMBLE

Unscramble these four puzzles—one letter to each space—to reveal four pension-related words. Answers will be posted on ASPA's Web site at <https://router.aspa.org>. Once you have logged in, place your cursor over the Membership tab in the navigation dropdown menu. Move to Membership Benefits, then click on *The ASPA Journal*. The answers are located near the bottom of the page.

- PER ALE    \_\_○\_\_○○○
- GET TINS    \_\_○○○\_\_○
- GAVE CORE    ○○○○\_\_\_\_\_
- TAN IN FOIL    ○○\_\_\_\_\_○○○

BONUS: Arrange the circled letters to form the Mystery Answer as suggested by the cartoon.

Mystery Answer:

To avoid "○○○○○○○○○○ ○○○○○○○○○"



Why Florida is replacing its voting machines

# WHEN YOU THINK OF ING

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<sup>1</sup> Source: LIMRA (December 2001)

[www.ing-usa.com](http://www.ing-usa.com) [www.ingretirementplans.com](http://www.ingretirementplans.com)

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2003

Oct 26–29	Annual Conference Washington, DC	20
Oct 31	Final Registration Deadline for Fall Examinations	
Nov 1	Registration Deadline for Fall Weekend Courses	
Nov 1–Dec 15	C-1, C-2(DB), and C-2(DC) Fall Examination Window	
Nov 8–9	C Exam Weekend Courses Chicago, IL	15
Nov 21	C-3, C-4, A-4 Postponement Deadline for Fall Exams	
Dec 1	C-1, C-2(DB), C-2(DC) Postponement Deadline for Fall Exams	
Dec 1	Deadline for 2003 Edition Paper Examinations for PA-1 (Parts A and B) and Daily Valuation (\$80 grading fee)	
Dec 3	C-3, C-4, and A-4 Examinations	
Dec 15	Deadline for 2003 Edition Paper Examinations for PA-1 (Parts A and B) and Daily Valuation (\$100 grading fee)	
Dec 31	Deadline for 2003 PA-1A Online Course and Online Examination Submission for PA-1 and Daily Valuation	

2004

Jan 29–30	Los Angeles Benefits Conference Los Angeles, CA	16
Feb 22–24	401(k) Sales Summit Orlando, FL	15

**Bulletin Board**

**Education**

*October 31  
Final Registration  
Deadline for Fall  
Examinations*

*November 1–December 15  
C-1, C-2(DB)  
and C-2(DC)  
Fall Examination Window*

*December 3  
C-3, C-4, and A-4  
Examinations*

*December 31  
Deadline for 2003 PA-1A  
Online Course and Online  
Examination Submission for  
PA-1 and Daily Valuation*

**Conferences**

*Jan 29–30, 2004  
Los Angeles Benefits  
Conference  
Los Angeles, CA*

*February 22–24, 2004  
401(k) Sales Summit  
Orlando, FL*

**INVESTMENT ADVISOR  
SOUGHT**

ASPA is considering changing investment advisors to invest ASPA's reserves according to the Investment Policy Statement adopted by ASPA's Board of Directors.

If you or your company is interested in responding to a Request for Proposal, visit the Web site at [www.aspa.org](http://www.aspa.org) or contact Marc Raffel, Controller, at [mraffel@aspa.org](mailto:mraffel@aspa.org).

**INSTRUCTORS NEEDED**

ASPA is looking for instructors who have taught ASPA courses and actively use PowerPoint in their presentations. The E&E Committee is developing recorded Web courses as an educational training tool. It is anticipated that there will be five to eight 100-minute recorded sessions for each exam that will be available at any time on the Internet. The instructor will use an E&E PowerPoint template and work with the exam committee to ensure that course follows the exam topics.

Remuneration will be a 15% royalty based on the fees collected for Web courses DC-1–DC-3 and \$1,300 per 100-minute recording for DB, C-3 and C-4 exams.

For more information, visit the Web site at [www.aspa.org/edu](http://www.aspa.org/edu) or contact [jpilot@aspa.org](mailto:jpilot@aspa.org).

**DID YOU KNOW?**

Did you know that the IRS announced tax relief on August 15, 2003, for those hit by the power blackout in the Northeastern United States? The IRS will consider as timely any tax returns or payments due from Friday, August 15, through Friday, August 22, if they were completed by August 22, 2003. The law does not, however, allow the agency to abate interest on any overdue taxes during this period.

While the IRS cannot extend the time for making employment and excise tax deposits, it will waive penalties on such deposits due during this period for affected taxpayers due to reasonable cause, if the deposits were made by August 22, 2003. To qualify for this relief, affected taxpayers should put "NORTHEAST BLACKOUT" in red ink at the top of the return relying on this relief.

The full IRS notice is located on ASPA's Web site at <http://www.aspa.org/archivepages/gac/2003/081503-blackout.htm>.