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THE ASPPA Journal

ASPPA's Bi-monthly Journal for Actuaries, Consultants, Administrators and Other Retirement Plan Professionals

WASHINGTON UPDATE

Defined Benefit Funding Takes Center Stage

by Brian H. Graff, Esq., APM

In the last issue of *The ASPPA Journal,* the big picture policy issues likely to be addressed in the 109th Congress were discussed. However, while Congress may be considering such issues as Social Security and tax reform, it will also need to deal with defined benefit plan funding. The funding issue is important because the legislation passed last April, which dealt with the interest rate used for purposes of determining the deficit reduction contribution, only applied to the 2004 and 2005 plan years. Consequently, before 2006, Congress will once again need to face this issue.

Interest Rate Assumptions

As you recall, last year's legislation provided that the deficit reduction contribution would be determined using a 4-year

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FROM THE EDITOR

Happy New Year! So…What Else is New?

by Chris L. Stroud, MSPA

There is a certain element of excitement that accompanies anything new. We "ring in" each New Year with a celebration, and then we continue to enjoy experiencing the newness of other things throughout the year. Think about it—the sight of a newborn baby, the smell of a new car, the crispness of a new shirt, the sound of a new song or the taste of a special new recipe. If we travel back in time, we can also recall the feelings of other new adventures—like the first day of a new school year, the first date with a new love or the first day on a new job. People like new experiences and they enjoy hearing others talk about new experiences. Perhaps that's why the phrase "What's new?" is such a commonly used greeting.

This year will bring many new and exciting experiences to ASPPA and its members. For those of you who attended the ASPPA Business Meeting in October at the Annual Conference, you heard ASPPA President, Stephen H. Rosen, MSPA, CPC, offer his slogan for the year: "New Name, New Look—Same Expertise!" We have a new name, the American Society of Pension Professionals & Actuaries; a new acronym, ASPPA; and a new ASPPA logo. For the first time, we will also have a special new ASPPA Member logo that designated members will be able to use on their business cards, personal stationery, etc. We will all enjoy the benefits of the new ASPPA branding campaign and the new efforts to elevate the awareness of our credentials and our organization. And, if ASPPA members vote favorably, we may also add a new credential for sales professionals to our impressive list of offerings. We will all enjoy navigating the new ASPPA Web site, attending the new conference co-sponsored with the Department of Labor and shopping at the new ASPPA Marketplace to purchase ASPPA logo merchandise.

Following Steve Rosen's lead, we would like to give you this year's slogan for *The ASPPA Journal:* "New Name, New Look—Same Great Articles!" You have probably already noticed the new name (we added the extra "P" in ASPPA) and the new look. We listened to your comments over the past year. The added graphics, the increased readability and the ability to read more articles from beginning to end without "jumping" pages are just a few of the improvements that you will notice. We have also made a clearer distinction between the feature articles (the technical stuff) and the department articles (the ASPPA committees and organizational information). The cover now includes an "In This Issue" area, highlighting the topics of the main feature articles, and a more detailed Contents section is located inside. You will find new "department icons" to help you to identify the beginning of each ASPPA committee article. And, of course, some things haven't changed—you can still enjoy the popular Washington Update and the Fun-da-Mentals page in every issue!

2005 is off to a great start, packed full of exciting new experiences! And just think…the next time someone walks up to you and asks, "What's new?"—you should have lots of things to talk about! ▲

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WASHINGTON UPDATE

weighted average of rates of return on long-term corporate bonds conservatively invested. This new corporate bond rate was used instead of a rate based on the 4-year weighted average of 30-year Treasury bonds (which have not been issued since October 2001). Congress enacted this provision on a temporary basis (for just the 2004 and 2005 plan years) to give Congress more time to evaluate what would be a more appropriate permanent rate. Although there have been some interim hearings on the subject, it would be a stretch to suggest that Congress has been intensively examining the issue since the law was passed. Notwithstanding, Congress will have no choice but to start dealing with this matter in 2005.

During the debate last year, the Bush Administration proposed the use of a yield curve of long-term corporate bonds for purposes of determining the deficit reduction contribution interest rate assumption. This proposal was strongly opposed by various interest groups representing large plan sponsors. These interest groups were very concerned that such a proposal would lead to further freezes/terminations of larger corporate defined benefit plans by putting added pressure on funding requirements.

There is no reason to think that the Bush Administration, in its second term, is going to change its tune on this issue. The yield curve proposal was included as part of the President's proposal presented to Congress in January. As a result, there will likely, once again, be a battle between the Administration and groups representing larger plan sponsors over this matter.

Importantly, the Administration's yield curve proposal would also apply for purposes of calculating lump sum distributions. In other words, the IRC Section 417(e) rate (currently based on an approximated 30-year Treasury bond spot rate) would be a spot rate based on the long-term corporate bond yield curve. Last year's proposal did not address the lump sum distribution interest rate assumption. Many entities, including ASPPA's Government Affairs Committee, raised concerns about the legislation's failure to address the lump sum interest rate assumption. The required use of an artificially low interest rate assumption for

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the lump sum distribution calculation effectively subsidizes the lump sum, which can add significantly to the cost of operating the plan. The reason it was not addressed was largely a matter of politics. AARP strenuously opposed any change to IRC Section 417(e) since it would result in reduced benefits for retirees. AARP is likely to continue to maintain this position during the debate this year. It is quite possible, as the debate rages on, that Congress may decide to simply extend the current provision again (for two more plan years, for example) rather than deal with the politically difficult challenge of resolving the widely dissonant views on this subject.

On a related matter, it would be negligent not to mention the interest rate assumption to be used in calculating the lump sum IRC Section 415 defined benefit plan limitation. As part of a proposal supported by ASPPA's Government Affairs Committee, last year's bill provided that the limit is determined using a 5.5 percent interest rate assumption (again, for the 2004 and 2005 plan years, with some transition relief). It appears to be generally accepted by policymakers in Congress that the IRC Section 415 lump sum limitation should be determined using a fixed interest rate. We will be working to ensure that the provision in last year's bill is either made permanent or extended, depending on the course taken by Congress.

Other Funding Reforms

The funding status of defined benefit plans generally has garnered a significant amount of attention in the news media recently. There have been front page stories in many major newspapers regarding the solvency status of the PBGC. Further, there have been a number of stories about the impact of likely plan takeovers by the PBGC, particularly involving the airline industry. Some members of the media have been suggesting that the current "defined benefit plan funding crisis" could amount to a "mini Savings & Loan debacle." Others have questioned how the current rules could allow an airline, for example, to amass over six billion dollars in unfunded benefit liabilities while paying only approximately $400,000 in PBGC premiums.

Needless to say, all of this media focus has gotten Congress' attention. There will likely be several hearings early on in both the House and the Senate focusing on the funding rules and their impact on the current state of affairs. Congressman John Boehner (R-OH), chairman of the House Education and the Workforce Committee with jurisdiction over the law governing defined benefit plan funding, is likely to introduce legislation early in the Congressional session proposing comprehensive changes to the funding rules. Similarly, the President's proposal submitted to Congress in January contained major defined benefit plan funding reform proposals, in addition to addressing the interest rate assumptions discussed above.

These proposals will potentially cover issues such as:

- Creating a new pension funding system based on a plan's funding target and value according to two types of liabilities—called Ongoing or At-Risk Liability;

The yield curve proposal was included as part of the President's proposal presented to Congress in January.

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ASPPA, a national organization made up of more than 5,400 retirement plan professionals, is dedicated to the preservation and enhancement of the private retirement plan system in the United States. ASPPA is the only organization comprised exclusively of pension professionals that actively advocates for legislative and regulatory changes to expand and improve the private pension system. In addition, ASPPA offers an extensive credentialing program with a reputation for high quality training that is thorough and specialized. ASPPA credentials are bestowed on administrators, consultants, actuaries and other professionals associated with the retirement plan industry.

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2005 Harry T. Eidson Founders Award Nominations

Now Being Accepted

Harry T. Eidson Founders Award nominations for 2005 will be accepted until **June 1, 2005**. Nominations can be submitted directly from the Home Page or Membership Awards and Honors sections of ASPPA's Web site at **www.asppa.org/membership**, or you can complete and submit the nomination form insert in this edition of *The ASPPA Journal*.

In 1995, ASPPA established the Harry T. Eidson Founders Award to honor the memory of our founder, Harry T. Eidson, FSPA, CPC. Eidson was the initial inspiration behind the formation of ASPPA in 1966. Eidson 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. This award is presented to an individual who has made a significant contribution to ASPPA, the private pension system or both.

The following criteria are used to determine the nominee:

- The contribution must be consistent with the ASPPA mission statement and should have a lasting, positive influence on ASPPA or the private pension system.
- The contribution may be current, one that spanned many years or one made years ago that ASPPA or the private pension system benefit from today.
- The contribution should be a result of time devoted above and beyond reasonable expectations, not a result of time spent primarily for personal gain.
- The contribution may have been made and/or recognized on a national or regional level; however, publicity is not a criterion.

Any credentialed ASPPA member who knows someone who meets the award criteria can submit a nomination form. All nominations are reviewed by a special Eidson Award Subcommittee working with ASPPA's Membership Committee Chair. Please note that the recipient need not be an ASPPA member. If the Subcommittee determines that there is a deserving candidate, then such recommendation is made to the Board of Directors by the Membership Committee Chair. The Board makes the final determination at its July meeting.

The award is presented at the ASPPA Annual Conference, with the recipient receiving a personalized award memento. In addition, the recipient's name is engraved on a permanent plaque displayed in the ASPPA National Office.

Previous winners: C. Frederick Reish, APM, in 2004; Robert D. Lebenson, MSPA, in 2003; Curtis D. Hamilton, MSPA, CPC, in 2002; Ruth F. Frew, FSPA, CPC, in 2001; Leslie S. Shapiro, JD, 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.

We encourage you to take the time to nominate a worthy candidate for this prestigious award.

- Determining a plan's funding target by using the yield curve and the unique status of an individual plan's financial health, including the risk of termination;
- Increasing the current law defined benefit plan deduction limit up to 130% of a plan's funding target (Ongoing or At-Risk Liability);
- Suggesting a "rolling" amortization period of seven years for underfunded contributions;
- Restricting the ability to use credit balances to reduce future minimum contributions and to smooth assets;
- Potentially freezing plan benefits and accruals and restrictions on lump sums depending on a plan's funding status and percentage of underfunding;
- Adjusting the current flat rate premium of $19 to an index-adjusted rate of $30;
- Reforming the variable rate premium to focus more on plan sponsor financial status and allowing the PBGC board to assess a periodic adjustment; and
- Greater and more timely disclosure to plan participants and to the government regarding the funding status of plans.

ASPPA will play a leading role as proposals such as those outlined are debated in the next Congress. ASPPA's Government Affairs Committee is, in fact, presently working on its own set of defined benefit plan funding reform proposals to be added to the mix. Look for more details on these proposals in a future issue of *The ASPPA Journal*.

As the debate over these issues develops, there is, unfortunately, a real danger that the government will overreact, particularly given all the recent negative media attention accorded defined benefit plans. It is critical that as these proposals are developed, the proper balance be struck between protecting the government's interest in healthier pension funding and proposals that could, perhaps, discourage the continued maintenance of defined benefit plans. For example, it would be entirely unfair to significantly raise the basic premium, as some commentators have recently said would be necessary. Raising the basic premium would in effect place the burden of impending PBGC plan takeovers squarely on those plans that have for the most part done a pretty good job with respect to funding. As more and more corporate sponsors are evaluating whether to continue to maintain their defined benefit plans, the last thing needed is overly strict rules that will end up "punishing" the many responsible plan sponsors providing valuable retirement benefits for their employees. ASPPA's Government Affairs Committee will do everything in its power to make sure that this does not happen and that the climate for establishing and maintaining defined benefit plans is as favorable as possible. ▲

ASPPA's Government Affairs Committee is, in fact, presently working on its own set of defined benefit plan funding reform proposals to be added to the mix.

Brian H. Graff, Esq., APM, is the Executive Director/CEO of ASPPA. Before joining ASPPA, he was pension and benefits counsel to the US Congress Joint Committee on Taxation. Brian is a nationally recognized leader in retirement policy, frequently speaking at pension conferences throughout the country. He has served as a delegate to the White House/Congressional Summit on Retirement Savings, and he serves on the employee benefits committee of the US Chamber of Commerce and the board of the Small Business Council of America.

Market Timing: The Fiduciary Duty to Protect Participants

by C. Frederick Reish, APM, and Bruce L. Ashton, APM

While market timing raises concerns about how mutual funds manage or mismanage the trading in their own shares, it also raises a significant concern for fiduciaries in participant-directed plans.

New York Attorney General Eliot Spitzer's investigations of the mutual fund industry during 2004 raised serious qualitative issues about the US securities markets. His investigations uncovered both criminal activity involving late trading and what can only be described, even in the most charitable light, as unethical conduct related to market timing. While market timing raises concerns about how mutual funds manage or mismanage the trading in their own shares, it also raises a significant concern for fiduciaries in participant-directed plans.

Background

Two investment practices in the mutual fund industry fell under the spotlight of public scrutiny during the past 12 months. The first, late trading, is illegal under the federal securities laws because it involves finalizing a buy or sell order for mutual fund shares after the market has closed for the day and the investor knows the final closing price of the security. In essence, the investor is cheating by using insider information to gain an advantage over all other investors who do not have access to the same information. The second practice is market timing, which is the focus of this article.

Historically, most mutual fund companies sought to limit market timing by stating in their fund prospectuses that they take steps to prohibit this type of trading. They have done so because they recognize that the practice is a device used by some to gain a personal advantage at the expense of others. It is the failure of the mutual funds to enforce this restriction uniformly that led to the investigations of the industry by Attorney General Spitzer and the Securities and Exchange Commission (SEC) and the recent implementation by some funds of trading restrictions discussed later in this article.[1]

Permitting market timing is contrary to the interests of a fund's long-term investors.

Here is how Attorney General Spitzer described the practice in testimony before Congress:

> "Market timing" permits a trader to take advantage of market information that develops during the lag between the last quoted price for securities held by the mutual fund and the time the fund's Net Asset Value is set. Permitting market timing is contrary to the interests of a fund's long-term investors. As the *Financial Analysts Journal* observed last summer: Because the gains [of market timers] are offset by losses to other investors in the fund, the funds clearly have a fiduciary duty to take some preventive action…[2]

Why is market timing bad? One court has described the impact of market timing in a 401(k) plan as follows:

> …market timing trading increased the cost of portfolio management, increased brokerage transaction costs and decreased investment performance for all individuals using the particular investment option being traded in this manner [other than the investor engaging in market timing trading].[3]

In essence, by engaging in rapid trades in certain securities, the market timer increases the costs of operating the entire plan, but only the market timer is able to profit from the trades. This type of trading reduces the return to all the other participants in the plan. (We note that market timers do not always profit, but that market timers engage in the activity for the purpose of

1 The failure to enforce the restriction stated in the prospectus is itself illegal under federal securities laws, so in this sense, market timing is more than merely unethical.

2 Testimony of Eliot Spitzer, New York Attorney General, before the US Senate Subcommittee on Financial Management, the Budget and Internal Security, Governmental Affairs Committee, November 3, 2003.

3 Borneman v Principal Life Insurance Company, 291 F Supp 2d 935, 941 (SD Iowa 2003) (referred to as the Borneman case).

profiting at the expense of the other shareholders.)

The response of mutual fund companies to the market timing scandal has been mixed. Some fund companies have sought to discourage market timing by imposing redemption fees (that often vary in amount and terms) on trades in and out of a given fund within a short time. The objective is to take away the profit that the market timer is trying to gain. Some fund companies are even applying these fees to trades in omnibus accounts, which creates significant problems for participant-directed plans.[4 5]

The SEC is also considering increasing the use of fair value pricing of their shares (*i.e.,* re-valuing the fund's shares, where appropriate, as a result of changes that have occurred since they were last valued rather than pricing the fund's shares solely at net asset value at the close of trading). For example, consider a mutual fund that invests in the securities of non-US companies that are traded on foreign securities exchanges (*i.e.,* international funds). If there is a development internationally that affects the value of those securities, arguably that new value should be taken into account in pricing the international mutual fund shares when the foreign securities exchanges close rather than waiting many hours until the US securities exchanges close. Some mutual funds now use this approach more regularly. Finally, some recordkeepers have imposed limitations on the number of trades a participant may make within a specified time period.

The objective of all of these steps is the same: to protect the vast majority of investors in a fund, or participants in a plan, by preventing a few investors from reaping financial gains at their expense.

The Fiduciary's Obligation

The Duty to Act

Under Section 404(a) of ERISA, fiduciaries have a duty to act in the best interest of their employees who participate in the retirement plan and for the exclusive purpose of providing retirement benefits. In speeches and statements, Ann L. Combs, Assistant Secretary, Employee Benefits Security Administration, US Department of Labor (DOL), has reminded fiduciaries of their obligation to examine the impact of market timing on their plans and what steps they should take to protect the interests of their participants.[6]

Acknowledging that this is true, does the obligation mean that fiduciaries must take affirmative steps to curtail the acts of a few participants that may be harmful to the participants as a group? The answer is "yes"—the duty of undivided loyalty to the interests of the participants requires a focus on providing retirement benefits to all participants as a group. In finding that the fiduciaries properly imposed trading restrictions, one court explained:

> As a fiduciary, [the plan sponsor] has a duty to act in the best interest of *all* plan participants and beneficiaries, not simply a duty to act in the best interest of each individual plan participant or beneficiary.[7] [Emphasis added]

The court also quoted from the opinion of the US Supreme Court in the case of *Varity Corp. v Howe,* 516 US 489 (1996), where the court noted that "The common law of trusts…requires a trustee to take impartial account of the interests of all the beneficiaries."

If the fiduciary's duty is to protect the interests of all participants, then it must establish procedures for administering the plan in such a way that the actions of some participants do not adversely impact the interests of others. In other words, the fiduciaries have a duty to restrict the rights of the few to protect the many. At the same time, the cost of the protection must be balanced against the degree of harm. That is, the fiduciaries should be cost effective in selecting and implementing the trading restrictions.

The DOL has explained that one of the obligations of fiduciaries is to know the facts and act on them. In its brief submitted in the Enron litigation, the DOL stated that ERISA:

> [Does] not permit fiduciaries to ignore grave risks to plan assets, stand idly by while participants' retirement security is destroyed and then blithely assert that they had no responsibility for the resulting harm.[8]

The DOL has made it clear that it views market timing as something that constitutes a potential "grave risk," requiring action on the part of the fiduciaries. In a speech to the Stable Value Investment Association National Forum in October 2003, Ann Combs said that "fiduciaries must investigate to determine the practices of the mutual funds and their management companies." She went on to say that:

> However, fiduciaries cannot "blindly" rely on the statements of the mutual fund management. Instead, they should verify those statements with their outside consultants, investment advisors and independent industry sources.

In a statement issued by Ann Combs in March 2004, she noted:

> The appropriate course of action will depend on the particular facts and circumstances relating to a plan's investment in a fund. Plan fiduciaries should follow prudent plan procedures relating to investment decisions and document their decisions. The guiding principle for fiduciaries should be to ensure that appropriate efforts are being made to act reasonably, prudently and solely in the interests of participants and beneficiaries.[9]

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4 The SEC has proposed a rule under the Investment Company Act requiring mutual fund companies to impose a 2% fee on the redemption of mutual fund shares purchased within the previous five days. It appears that this rule will not be implemented, but fund companies will be encouraged to institute their own redemption fee structure. See 69 Fed Reg 11,761 (March 11, 2004).

5 By "omnibus account," we are referring to the account held by an investment provider to aggregate the holdings of many plans; they are commonly used by plan providers and recordkeepers to facilitate transactions and reduce costs.

6 See Statement of Ann L. Combs, Assistant Secretary, Employee Benefits Security Administration, US Department of Labor, "Duties of Fiduciaries in Light of Recent Mutual Fund Investigations," February 17, 2004.

7 *Borneman v Principal, Id at 946.*

8 Brief of the US Department of Labor submitted in Tittle v Enron, *et al.*

9 See Remarks of Assistant Secretary Ann L. Combs To the Washington Forum of the US Institute, http://www.dol.gov/ebsa/newsroom/sp030804.html#.

Propriety of Acting

The federal courts have upheld the propriety of imposing limits on market timing and the obligation of fiduciaries to do so.[10] In the case of *Borneman v. Principal Life Insurance Co.*, a plan participant in Principal's 401(k) plan challenged the trading restrictions imposed on his trading activities. The participant, who had engaged in extensive market timing trading totaling hundreds of thousands of dollars for a seven- or eight-month period, filed suit claiming, among other things, that it was a breach of fiduciary duty for Principal to limit his direction of his own account. Principal, acting as both investment manager and plan administrator of its corporate plan, had imposed a trading restriction in June 2001 that limited participants to "round trip" trading of no more than $30,000 per day in the international funds they offered. The limitation was based in part on a provision of its plan document and also of its group annuity contract (which was the investment vehicle for the plan) that permitted the insurance company to defer or stop participant direction of their accounts where it believed it had to do so to fulfill its obligation to act prudently under ERISA.

The court said that Principal did not breach its duty. In so holding, the court relied on evidence presented by Principal showing that market timing trading had a detrimental effect on the plan and its participants. The court also pointed to decisions by other courts recognizing "the deleterious effects of market timing trading on a fund designed for long-term investment."[11] In the absence of any evidence that the insurance company was failing to act in the best interests of plan participants by imposing the trading limitation and in light of the evidence of the harm that unrestricted trading caused, the court ruled in favor of Principal.

The *Borneman* case emphasizes the duty of fiduciaries to protect the interests of participants by imposing reasonable restrictions on practices, such as market timing, that benefit a few participants but harm others. The court recognizes the detrimental impact of such activity in a retirement plan, the purpose of which is to accumulate assets over the long term, and the fact that the fiduciaries have to take action to protect the long-term investors, (*i.e.,* the participants in the plan).

Fiduciary Actions

So what do fiduciaries need to do? In addition to the requirement that fiduciaries act solely in the interests of the participants, they must also act prudently under ERISA Section 404(a)(1) (*i.e.,* the "prudent man" or "prudent expert" rule). The section states that the fiduciary must act:

> [W]ith the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

These 42 words implicate nearly a dozen steps the fiduciaries must take in the dealing with market timing. The fiduciaries must:

1. Understand the issues of market timing and the harm it may do to the plan participants;
2. Consider what steps can be taken to prevent that harm;
3. Analyze the cost of taking those steps;
4. Analyze the steps being taken by plan service or investment providers to restrict such trading and understand the cost of those steps;
5. Consider the impact of those steps on the participants that wish to trade frequently and

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10 Straus v Prudential Employee Savings Plan, 253 F Supp.2d 438 (EDNY 2003); Borneman v Principal, Id.

11 Borneman v Principal, Id. at 947, citing Windsor Securities, Inc. v Hartford Life Insurance Co., 986 F 2d 655 (3rd Cir 1993) and First Lincoln Holdings, Inc. v Equitable Life Assurance Society of the United States, 164 F Supp.2d 383 (SDNY 2001).

whether the steps will be unduly restrictive of their rights, as well as whether the steps will be effective in dealing with the issue;

6. Analyze the costs in the context of the harm being done to the majority of participants vs. the restrictions being imposed on the minority;
7. Consider the ability of participants to understand and work within the restrictions;
8. Communicate the restrictions to the participants and educate them on the meaning and impact of the restrictions (more on this issue later);
9. Review the plan document to ensure that it permits the types of restrictions being considered; and
10. Act on the conclusions reached in this evaluation by, for example, imposing trading restrictions and/or taking other steps.

Stated more simply, the fiduciaries must make sure they know what the harm of market timing is on the majority of participants and consider what to do about it. Among the factors they must consider is the impact on the participants who wish to use the strategy, the expense of restricting their activities and how well the whole process can be explained to the participants. The communication and education issue is perhaps the most difficult of all, because by implication, the prudence requirement of ERISA indicates that the fiduciaries need to make sure that any restrictions are explained in sufficient detail but in sufficiently straightforward terms so that the "innocent" participants will know how to effectively manage their investments without incurring penalties or redemption fees. [In fact, for a plan that intends to comply with ERISA Section 404(c), such disclosure is expressly required.[12]]

Market Place Restrictions

There are two approaches being implemented at this time to restrict abusive trading. One approach, which is used by mutual fund companies, is to impose redemption fees for trades made within certain time periods. Alternatively, other providers, such as recordkeepers, place limits on the number of trades that may be made within a given period, and after the limit has been reached, require that any further trades be submitted through the mail, rather than through Web sites or an 800 number. While trades received via the US mail are still processed in the ordinary course, there is no certainty that they will be

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12 DOL Regulation Section 2550.404c-1(b)(2)(i)(B)(1)(iv).

processed on any given day, so it is impossible for the participant to determine in advance the price at which the trade will be made. This second approach takes a significant element of control out of the hands of the participant who seeks to engage in market timing.

Redemption Fees

The SEC has proposed a rule for mutual fund companies (the adoption of which is by no means certain) under which market timing would be discouraged by requiring funds to impose a 2% redemption fee on all buys and sells in a given mutual fund within five days. Unfortunately, this rule would not be uniform; instead it would be a minimum rule that all funds would be required to comply with, and each fund company could adopt its own rules that go beyond that minimum. There would be no requirement that the mutual fund industry adopt common practices. Thus, it is possible or even likely that, even if the SEC rule is adopted, restrictions will vary widely and plan sponsors will have a duty to effectively communicate that information to participants.

In addition, some mutual fund companies will apply redemption fees to all transactions, including hardship withdrawals, participant loans, mapping of funds to replacement funds, severance distributions, retirement distributions, death distributions and so on. The application of redemption fees to these types of transactions, which are not motivated by market timing, could be detrimental to participants. Nonetheless, some fund companies will attempt to impose redemption fees on those transactions also, while others will not.

Fiduciaries have a duty to view these limitations in terms of their impact on participants. To do that, they need to review and understand the application of all of these fees on their participants and to determine whether to continue to hold funds that impose fees in a way that the fiduciaries consider inappropriate or harmful to their participants. As a part of that analysis, fiduciaries need to consider the application of redemption fees to a large array of transactions by some fund companies and to determine whether their plan should continue to offer funds that apply redemption fees to non-market timing transactions.

Fiduciaries also have a duty to communicate redemption fees and any other trading restrictions to the participants, in part to educate them on the benefits of market timing restrictions, and in part to enable them to avoid running afoul of the restrictions. Because of the difficulty in effectively communicating many different sets of trading restrictions to their participants—plans often offer ten, 20 or more funds from mutual fund families—the plan sponsors/fiduciaries, when selecting or monitoring funds in their investment line up, need to consider the trading restrictions being imposed by a mutual fund company. For example, if it turns out that most companies use a 30-day holding period for redemption fees, then plan fiduciaries would need to consider whether to limit their investment options to funds with those waiting periods or whether they want to include funds with other waiting periods—and to incur the additional education expense and effort (and the possibility that innocent participants will be hurt because of the complexity).

Trading Limits

Some recordkeepers are already imposing limits on the number of trades that may be made during a given period. For example, some limit the number of trades that can be made within a stated period, and if a participant's trading activity exceeds this number, the participant will be required to submit future trades via US mail. Alternatively (or in addition), there may be limits on the dollar value of trades within a stated period, which, if exceeded, will require the participant to give instructions through the mail.

Plan fiduciaries have, as noted, a duty to take steps to protect the participants from the adverse effects of market timing trading by others. Trading restrictions implemented by plan providers are designed to address the problem and may help the fiduciaries in fulfilling their obligations to the participants, but the fiduciaries must still engage in a prudent process of analysis. The fiduciaries must understand the provider's restrictions, the impact of not implementing effective restrictions or other actions to better manage market timing risks, how the restrictions will be communicated to the participants and assess whether they believe the restrictions will work to limit abuse and at the same time not adversely impact other participants. As a part of the process, the fiduciaries should document what they have considered and any decisions they make.

Conclusion

Under ERISA, fiduciaries have an obligation to act in the best interests of their participants to provide retirement benefits and to act prudently in carrying out their duties. This duty extends to all participants. The duty to act prudently requires that the fiduciaries engage in a diligent process to understand the issues of market timing, to understand the impact such trading has on other participants and to examine alternatives for preventing harm to participants. Once they have engaged in that process, the fiduciaries have a duty to take action to implement their decisions and to effectively communicate the restrictions to their participants.

The fiduciaries are not required to take these actions in a vacuum. Where the plan employs the services of a competent and knowledgeable provider, the fiduciaries may look to the provider to assist them in fulfilling their duties. The providers cannot act for the fiduciaries, but they can help by providing reasonable and cost effective trading restrictions.▲

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The TPA Value Proposition and Market Opportunity

by Christine Chaia

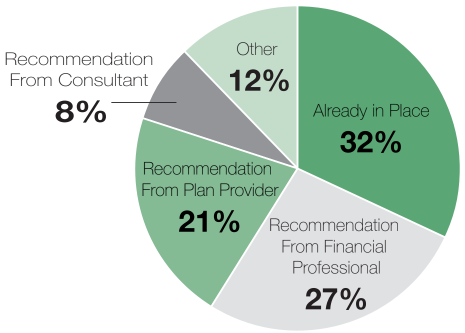
As a third party administrator (TPA), it is likely you spend a fair amount of time looking at the type of characteristics plan sponsors seek for in a TPA partner and how they usually find one. You may also wonder if some of the key issues and opportunities you see for your business are echoed or shared by your colleagues. Results from recent research conducted, as shown below, uncover valuable insights into these areas.

Without question, the events of the last 12 months within our industry have challenged us to all rethink how we deliver service, the qualities and needs instrumental to ensuring long-term growth and your value proposition to clients. It is clear that having blind faith in a company is not enough. In the end, both TPA firms and plan sponsors have very similar goals in mind: to create and maintain the most optimal retirement program for their employees, to encourage participation and to balance the needs of all parties to create lasting value to everyone.

The Employer Perspective: How They Find TPAs and What They Look For

Of those surveyed, the highest concentration (86%) of these plan sponsors had worked with their current TPA between one and five years. And the majority of those employers surveyed who did not already have a TPA in place found their TPA through a referral, either from a financial professional or a plan provider.

Survey Question:
How did you find this TPA?

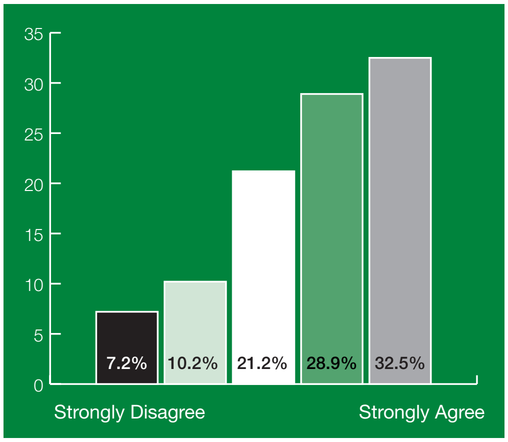


Key Point #1:
Referrals from outside parties continue to be a fertile source for new business opportunities for TPAs.

Interestingly, when it comes to paying the bills for TPA services, plan sponsors would seem to agree that "you get what you pay for" in terms of fees. If the service is there, the fees are viewed as almost secondary. The key is ensuring your clients understand the value your firm provides.

Survey Question:
On a scale of one (strongly disagree) to five (strongly agree), are you willing to pay higher fees for a higher level of product and service delivery?

Key Point #2:
While fees are becoming an increasingly hot topic, a majority of plan sponsors seem to agree that providing value is worth the cost when the bottom line is better service.



On the subject of service delivery, the survey pointed out several opportunities for improvement. Employers were asked to rank various services TPAs provide on a scale of one to five in terms of importance of the service and satisfaction with what is currently being provided. The largest discrepancies between perceived importance of the service and satisfaction by employers occurred in the following areas:

- Strong partnerships
- Ideas and steps related to keeping the plan compliant
- Proactive behavior in ensuring employees understand the plan

The Hartford recently commissioned *PLANSPONSOR* magazine to work with them to undertake a study designed to uncover key insights into the marketplace. This article includes excerpts from the complete survey article, which appeared in the November 2004 issue of *PLANSPONSOR* magazine. The survey was conducted with approximately 237 employers and 209 TPA firms from late September through mid-October 2004. It was designed to solicit viewpoints among TPAs on topics such as plan design, communication, administration and legal/regulatory developments. Plan sponsors who used TPAs received a similar questionnaire inquiring on trends and opportunities.

Survey Question:
Please rate the following qualities in terms of importance and satisfaction in working with a TPA firm.

1 = not at all important / not satisfied; 5 = extremely important / extremely satisfied	Plan sponsor's top expectations of a TPA	
	Importance	Satisfaction
Proactive in ensuring employees understand plan	4.68	3.22
Support steps related to keeping plan compliant	4.75	3.64
Strong partnership	4.81	3.74
Identify plan design concerns or issues	4.76	3.96
Communicate with participants	4.16	3.50
Provide quality, complete data	4.65	4.20
Provide timely data	4.73	4.39
Responsive to our firm's requests for information	3.98	4.10
Act as advocate to ensure compliance issues rectified	3.25	3.85

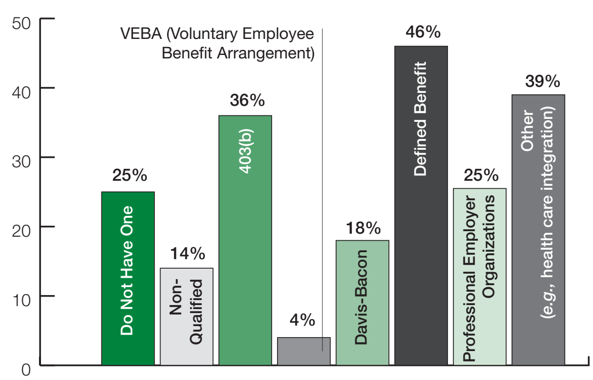
Key Point #3:
The largest discrepancy between what plan sponsors think are important and how satisfied they are with what their TPAs seem to occur in areas of service and partnership.

The TPA Perspective: Key Issues and Opportunities

The second half of the survey surfaced some interesting points on your business and how it is evolving. Out of all respondents, 100% of those surveyed see themselves as playing an important role in helping financial professionals through the sales process. Of this, 78% consider themselves a "non-producing" TPA. This result is in sharp contrast to those who are traditionally known as "producing TPAs," individuals who actively sell programs in addition to supporting them administratively.

Survey Question:
Besides the traditional 401(k) business, what are your "niche specialties?"

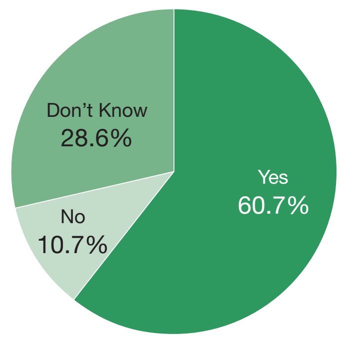
Key TPA Opportunity:
A majority of firms shared that business diversification is another way to carve out a firm's overall "value".



On the legislative front, 33% of the TPAs surveyed were unsure of the impact recent and proposed retirement legislation may have on their business while 15% felt the proposed legislation would have a negative impact. In various comments, TPAs cited uncertainty about which of the current proposals before Congress might become law and stressed that there are too many variables at play today in this area to truly predict any future impact.

Finally, we continue to see fiduciary responsibility as a key concern for TPAs as well as for the entire industry. Almost one third (32%) of TPAs believe that plan sponsors are not fully aware of what it means to be a fiduciary. Furthermore, TPAs opined that 61% of plan sponsors are not meeting their fiduciary obligations and 68% believe that lack of knowledge is the biggest challenge plan sponsors face in this area.

Survey Question:
Are any of your clients not fulfilling their fiduciary obligations?



In conclusion, we believe there is no better time to be a TPA and no better space to be in than the small- to mid-size retirement plan market. Because of the complexity of many plans at this end of the market, plan sponsors are willing to pay for the right expertise. And, as indicated by the research, there is a clear opportunity for the TPA to insert itself into the value chain of the plan sponsor through proactive outreach and partnership. And as the research among TPAs shows, this marketplace is evolving. Inside the industry, TPAs are evolving and some are taking a much more proactive sales approach. And, externally, through evolving legislation and ever growing concerns about fiduciary responsibility, there is no better time to be in this market as a "solutions provider" and a consultant to your plan sponsor clients.▲

Christine Chaia is a director of corporate marketing with The Hartford corporate retirement plans business. She is a prior Co-chair of The 401(k) SUMMIT and a current committee member. The Hartford supports small- to mid-sized corporate-sponsored retirement plans and works with plan sponsors, TPAs and financial advisors nationwide. For more information on The Hartford or for a reprint of the entire survey article appearing in the November issue of PLANSPONSOR, *contact Chris at Christine.Chaia@hartfordlife.com.*

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ABC Meetings Calendar

February 7
ABC of Central Florida
Topic: Legislative Update
Speaker: Brian H. Graff, Esq., APM, ASPPA Executive Director/CEO

March 10
ABC of Chicago
Topic: Issues Relating to Form 5500
Speaker: Janice M. Wegesin, CPC, QPA

April 19
ABC of Dallas/Ft. Worth
Topic: Legislative Update
Speaker: Brian H. Graff, Esq., APM, ASPPA Executive Director/CEO

April 22
ABC of South Florida
Topic: TBD (Full-Day Seminar)
Speaker: Sal L. Tripodi, APM

April 26
ABC of Central Florida
Topic: IRS Audits of Employee Benefit Plans
Speaker: Jeanette Whitten, IRS

May 5
ABC of New York
Topic: TBD (Full-Day Seminar)
Speaker: Sal L. Tripodi, APM

June 1
ABC of Northern Indiana
Topic: TBD
Speaker: Sal L. Tripodi, APM

June 9
ABC of Chicago
Topic: Plan Design
Speaker: Joan A. Gucciardi, MSPA, CPC

August 24
ABC of Dallas/Ft. Worth
Topic: Proven Marketing Methods to Build Your 401(k) Business
Speaker: Tom Foster

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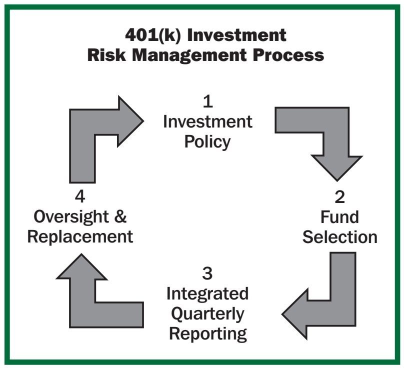
Managing Plan Sponsor Investment Risk in 401(k) Plans

by Ward M. Harris and Rhonda Evans

Every employer that sponsors a corporate retirement plan, including 401(k) arrangements, is responsible for doing and not doing certain things. The risks and responsibilities of plan sponsors in this regard are substantial but manageable.



A plan sponsor is a fiduciary, held to the highest standards of care and due diligence. Plan sponsors can manage related investment risks through a combination of good information, common sense and often with the support of third party professionals.

A plan sponsor is a fiduciary, held to the highest standards of care and due diligence.

Retirement professionals can play a valuable role in helping plan sponsors meet their fiduciary responsibility by providing informed judgment about the investment process, financial guidance in fund choice and knowledge of retirement and securities law. They can also play a valuable role in educating plan sponsors about the elements and limits of sponsors' obligations to plan participants. Since the ultimate fiduciary responsibility rests with the sponsor, a relationship built on trust and good communication is essential to successful professional assistance.

Whatever the source—self-fulfilled or professionally supported—there are efficient and effective best practices that can help plan sponsors manage investment risk. Plan fiduciaries can best manage their personal and organizational risks through the use of a four-part process that includes an investment policy, a decision system for fund selection, a monitoring process and an appropriate response for underperforming funds.

Responsibility Under the Law

The principles at the heart of investing and related law are rooted in the concept of prudence and the obligations of one person investing on behalf of another in a "fiduciary" role. The "Prudent Man Rule" of fiduciary investing can be traced to a statement in 1830 by Judge Samuel Putnam, who maintained that "[t]hose with responsibility to invest money for others should act with prudence, discretion, intelligence and regard for the safety of capital as well as income."[1]

The 1974 Employee Retirement Income Security Act (ERISA) speaks directly to the issue of investment and funding policy. Some suggest that ERISA regulations require the application of a "prudent expert" to the fiduciary role. Regardless of one's view of that issue, it is clear that ERISA did introduce a "prudent person" requirement—that a plan fiduciary act on plan investments as "one familiar with such matters."[2] Loosely translated, this means that the party responsible for selecting and monitoring plan investments must know what they are doing, and must do it solely in the interest of the participants and beneficiaries.[3]

However, ERISA is concerned only with "the conduct of the fiduciary, not the success of the investment."[4] At issue, then, is the process that guides plan investment decisions, not the results. The process must demonstrate expertise, and actions must confirm it.

Right Conduct in Managing the Process

The four cornerstones of a sound investment compliance program, which can be termed as the "Four Ps," are:

1. **Policies—Written investment policy statement (IPS)** with fund selection and retention standards.
2. **Processes—Decision system** for analyzing and selecting plan investment managers.
3. **Procedures—Integrated quarterly reporting** for oversight of on-going plan investment performance that is based upon the standards set forth in the IPS.

1 Supreme Court of Massachusetts in *Harvard College v. Armory.*
2 ERISA Section 404(a)(1)(B).
3 ERISA Section 404(a)(1).
4 *GIW Industries, Inc. v. Trevor, Stewart, Burton & Jacobson, Inc.,* 895 F. 2d 729 (11th dr. 1990).

4. **Practices—Remediation** methods for management of funds whose performances represent exceptions to the stated objectives of the plan.

With its objectives, actions and results documented consistently, the plan sponsor can prove a good faith effort to discharge its fiduciary obligations. This attempt is likely to satisfy a reasonable third party that the sponsor has attempted to fulfill its fiduciary responsibility.

As a group, these elements represent a risk management system that helps protect the plan sponsor and its officers from criticism and shows that they have made a good faith effort to act in a reasonable manner to protect the participants' interests.

Such a system helps plan sponsors answer three key questions:

- How are we doing?
- What do we know?
- What should we do?

Retirement plan consultants and administrators have an opportunity (if not an obligation) to play a role in this process. Professionally, many clients are un-served or under-served by the investment industry and would benefit from the addition of a reporting service based upon formal plan investment objectives. Plan administration providers can also develop closer, more valued working relationships and even new revenue sources—with or without registration as an advisor or securities sales representative.

I. Policies

Most of us would not purchase a make and model of automobile that we knew to be poorly rated for reliability, safety or economy. Similarly, a 401(k) risk management system can help plan sponsors avoid mistakes of investment fund selection in the presence of reliable, historical information.

Performance measured by total return is only one of four key metrics for plan management. Other elements for consideration, measurement and analysis should include: investment risk taken, operating costs and management turnover. A risk management system need not be expensive, nor must it increase the client's risk. The opposite result is the real objective—to reduce risk through good information, common sense and a little help. Professional assistance can be particularly useful in specifying a plan sponsor's objectives and in setting realistic expectations. Regulatory expertise and sound financial judgment can help plan sponsors to establish appropriate criteria in this crucial first stage.

What is an Investment Policy Statement (IPS)?

An IPS is like a roadmap for how a 401(k) plan will accomplish certain tasks in its journey through the investment markets over time. At its core, an IPS provides a description of the *who, what, why, when, where* and *how* of properly creating an investment policy, selecting asset classes and choosing investment selection and monitoring criteria. It also includes a rational, comprehensive method for handling plan fund performance issues.

What is required of an IPS?

There is no ERISA requirement that a written investment policy be adopted by a plan, only that the "prudent expert" standard be followed. If a fiduciary adopts a formal investment policy, the regulators have made it clear that "statement(s) of investment policy issued by a named fiduciary… (are) part of the documents and instruments

governing the plan"[5] and must be adhered to in order to comply with the standard. When a plan fiduciary adopts an IPS, follows its guidelines and documents periodic plan investment reviews, the fiduciary has created a legal roadmap identifying what is to be done, how it is to be done and when it will be done.

An effective IPS will reduce the burden of following the policy by encouraging or, where possible, automating adherence and the monitoring process. Further, it will permit non-expert fiduciaries to easily integrate expert support for executing the duties that accompany the offering of a retirement plan.

The Department of Labor (DOL) permits discretion on what must be included in a plan's IPS. DOL officials note that a "statement may need to take into account factors such as the plan's funding policy and its liquidity needs as well as issues of prudence, diversification and other fiduciary requirements of ERISA."[6]

5 ERISA Section 404(a)(1)(D).
6 Department of Labor Interpretive Bulletin 94-2.

This open-ended policy is consistent with the freedom and responsibility given to plan sponsors in dealing with the unique and changing circumstances of their individual plans.

Who is responsible for creating/maintaining an IPS?

Ultimately, this job falls squarely upon the shoulders of plan sponsors. Independent, unbiased experts may be hired to provide services that accomplish many of these task elements, and many sophisticated employers use such professionals, but the final responsibility rests with employers.

II. Processes

A well-crafted Investment Policy Statement provides for both selection and monitoring criteria. Once plan objectives are in place through the IPS, a plan's fiduciaries and its advisor must seek a "best fit" of plan quality and performance standards with available investments. Here is where the rubber hits the road, as investment objectives and selection criteria are translated into fund choices that meet the plan sponsor's needs.

The advisor or plan administrator brings his/her judgment and expertise to the evaluation of a fund and its manager. A retirement plan professional also plays an important role at this stage by ensuring consistency in the evaluation method and by making sure that the charted processes are followed. At the plan participant level, the discharge of the sponsor's fiduciary obligations are best accomplished with three important building blocks and are as easy to remember as A B C.

A. Screening

The fund selection process should begin with a systematic screening process to identify the universe of funds that meet the plan sponsor's specific criteria. Beginning with preferential asset classes and style group, the plan sponsor and its advisor determine the universe of funds that both possess the specific attributes required and are generally reflective of quality management and a solid investment process. This stage is purely quantitative, as the plan's fiduciaries differentiate between what fits the IPS standards and what can easily be excluded.

B. Scoring

Once the general investment universe is known, a scoring system allows for a ranking of funds within an asset class. Here judgment comes into play as the pros and cons of fund characteristics are evaluated. The challenge is to identify investment alternatives that have high risk-adjusted performance and are reasonably weighted for acquisition and management costs. Scoring will produce a high-quality subset of funds with the desirable characteristics of tenured portfolio management, extensive performance histories, reasonable expense ratios and favorable risk characteristics.

C. Selecting

The selection stage is when the deal is closed. Any one of the top-scored funds would get the job done; funds are ultimately chosen by more subjective criteria based on management philosophy and comfort level. If a professional advisor is involved, the final selection of funds is essentially driven by the sponsor's preferences.

Funds in the selection stage may be included or eliminated based upon an assessment of the specifics of the portfolio management's investment approach and other noteworthy developments. Noteworthy items include: security holding or sector concentration; avoidance of certain sectors; growth or value overlays within an approach; changes in cash positions; and any updates on fund operations, portfolio manager(s) or the management company.

III. Procedures

Common sense suggests that an investment policy include regular oversight and a process for ensuring appropriate action if funds fall out of compliance. Knowledgeable plan sponsors conduct quarterly reviews of asset performance, and independent professionals using modern risk management systems can provide automated reports that integrate the IPS criteria with periodic plan investment performance metrics. This strategy allows plan sponsors to quickly spot any anomalies or deficiencies in fund performance.

Selected investment options are compared against appropriate benchmarks established in the IPS, such as performance of other comparable investments vehicles and/or relevant market indices. Quarterly reporting also allows a plan's fiduciaries and its advisor to regularly incorporate new investment information, including fund news and opinions about changes in the marketplace.

Active monitoring inevitably raises the question: What should be done with a fund that has failed to meet IPS standards? If a fund falls out of compliance, the first step is to do no damage, but instead to seek to understand the problem.

Is non-compliance the result of an unreasonable standard? It may be that it is simply difficult to find a mid-cap growth fund that is both a top performer and has expenses below the median—this may be a class where there are no high-performing bargains. If the problem stems from unrealistic expectations, the best solution is to amend the IPS.

If the standards seem appropriate, the fund itself must be scrutinized. Was it the right fund to begin with? If so, the next step is to determine whether the problem is short-term or long-term. Is it a temporary blip in an otherwise solid performer? Or is it the sign of a long-term problem that must be remedied? If it was the right fund, did something change structurally? Did returns decline, was there a management change, did expenses increase or did risk spike?

A sudden change in compliance is most likely the result of a management change or extra-market investment return anomalies.

Management Changes

Management turnover is often a clear-cut compliance issue—the very fact of a management change can cause a fund to fail the IPS standards. It is important to delve more deeply into what management turnover signals, and it is for just such a case that an IPS allows for flexibility. Is the new manager the person who has actually been running the fund the whole time? Does he or she have a successful track record with another fund? If so, management turnover may be a non-event. Otherwise, it may be prudent to place the fund on a watch list and adopt a wait-and-see response.

Underperformance of Returns

Decline in fund performance is not necessarily an actionable issue. The problem may be temporary and the result of poor stock picks in a particular investment period. Is the downturn the result of changes in a fund's general investment strategy? If the fund otherwise has a solid performance record and no major changes in investment approach have occurred, placing the fund on a watch list is a sensible response. This action allows the plan's fiduciaries and its advisor to further monitor the situation to determine how the fund's management adapts to performance concerns.

Expense increases and changes in risk profile are more likely to be long-term issues.

Expense Increases

Again, it is important to know what lies behind a fund slipping out of compliance on expenses. If it is a fund that had been on the outward edge and other funds in its class have dropped their fees, it may simply be a case of a ship being temporarily left out in deeper water. This scenario would suggest a wait-and-see attitude to determine if the fund adjusts to competitive changes.

Risk Profile

The nature of fiduciary responsibility is such that it is more important to be sensitive to risk than to performance. Risk can more likely be extrapolated from past behavior than performance, since funds in general tend not to make dramatic changes in strategy. Risk can be planned for, and it is therefore easier to defend bad performance than an overly risky strategy. Non-compliance that results from a change in risk profile is a serious issue that must be addressed.

IV. Practices

Ultimately, standards and criteria are only as good as what you do with them. The law does not provide clear guidelines about when action on underperforming funds is necessary. However, if it has been determined over several quarters that a fund's structural problems have not been addressed, it is the fiduciaries' responsibility to take action. If the problem reflects a long-term structural issue that has not been remedied, plan fiduciaries can easily be criticized for not acting. Remember, action can always include acknowledging the exception to policy and keeping the fund on the plan's watch list of funds.

It should be emphasized that simply adding funds in response to a fund's underperformance is a questionable practice. If an underperforming fund is kept due to inertia or concerns about the cost and effort of replacement, fiduciaries open themselves up to criticism or other action. The best solution may be to educate participants about what happened, explain the need to

Retirement plans can benefit from the assistance of suitably equipped professionals in the creation and implementation of risk management strategies.

replace a fund and migrate balances to a more suitable and defensible investment option.

The Role of Professionals

Retirement plans can benefit from the assistance of suitably equipped professionals in the creation and implementation of risk management strategies. This support generally comes in one of two forms.

Investment Advisor

Many advisors provide access to products and services that assist in the oversight of retirement plan investments as a securities or insurance licensed representative and receive asset-based compensation. Others are registered as investment advisors and provide fee-based services to help accomplish plan sponsor objectives. In many cases, advisors are able to utilize both methods of compensation to support their delivery of services to plans.

Relationships can also be established with independent third party investment advice firms to create managed 401(k) account programs. Fees for this type of service can vary according to the use of technology and other factors.

Consultant/Administrator

In many cases, the plan sponsor has a relationship in place that provides counsel on design and administration issues. Such a plan administrator or consultant may prove valuable in the discharge of fiduciary investment obligations, even if he or she is not the source of such services.

The consultant or administrator is often well positioned to help the plan sponsor to interview and select an advisory professional to serve in that role. Such professionals know the plan, its sponsor and its participants quite well in most cases and, as a result, are uniquely equipped to help fill out the team supporting the retirement plan.

The selection of a retirement plan investment advisor is often a subjective and personal decision on the part of key plan decision makers. Traditional benchmarks in such decisions include answers to questions such as, "Are they competent, are they trustworthy and can we communicate clearly and consistently?"

Also of value are references from other satisfied clients; demonstration of specific service elements and deliverables; and proven expertise and experience in support of qualified retirement plans similar to the plan in question.

One valuable benchmark is a professional designation salient to the delivery of a systemic risk management service. Many professional designations (CFP, CFA, ChFC and CEBS) exist that might bear upon these issues. One in particular is the Accredited Investment Fiduciary™ professional designation, introduced by the Center for Fiduciary Studies in October of 2002. It is the first and only designation that illustrates knowledge and competency in the area of fiduciary responsibility. Holders of the AIF® mark must successfully complete a specialized program on investment fiduciary standards of care and subsequently pass a comprehensive examination.

Congratulations

IRS Selects Janice M. Wegesin, CPC, QPA, for Information Reporting Program Advisory Committee

The Internal Revenue Service announced the selection of nine new members for its Information Reporting Program Advisory Committee (IRPAC) for a three-year term. ASPPA congratulates member Janice M. Wegesin, CPC, QPA, president of JMW Consulting, Inc., Palatine, IL, as one of the IRS's selections. The appointees will join eight returning members.

The IRPAC was established in 1991 to focus on information reporting issues. The committee's purpose is to provide an organized public forum for discussion of relevant tax administration issues between IRS officials and representatives of the public. Committee members provide recommendations and suggestions on a broad range of issues intended to improve the information reporting program and achieve equitable treatment of all taxpayers.

Additional information on IRPAC can be found at ***www.irs.gov/taxpros.article/0,,id=158,00.html.***

[Editor's note: ASPPA is considering the addition of an educational program and credential for sales and investment professionals. The proposed program, which will be presented for membership vote in the first quarter of 2005, includes extensive coverage of fiduciary issues.]

Designees must be able to understand and articulate the legal and regulatory environment surrounding the fiduciary, be able to develop and implement an effective investment management process applying the principles of Modern Portfolio Theory, document all due diligence and, above all, treat their clients with the utmost prudence and care.

Whatever the educational, professional or personal attributes brought to the relationship, the plan sponsor must, once again, make decisions about the selection of such professionals with the skill and care of a prudent professional.

Conclusion

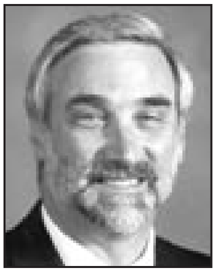
Simply stated, the regulations suggest that we avoid "bad" funds, not pursue the "best" funds. Managing plan sponsor risk is less about optimizing performance than it is about meeting standards for reasonable and appropriate action. These goals can be effectively accomplished by developing suitable policy, creating implementation processes and monitoring procedures and establishing correct practices to handle change.

The ultimate objective is to select those investment vehicles that can reasonably be expected to reproduce similar results under similar market and economic circumstances. No one can predict the future or predetermine the outcome of any investment activity, but we can avoid certain known risks based upon prior experience.

Any system has its limitations—there is no certainty that high-ranked funds will perform well in the future. However, the fiduciary can ensure that a prudent process has been followed in analyzing available funds for use by the plan by adhering to the "Four Ps."▲

Ward M. Harris is founder and CEO of McHenry Consulting and its PlanTools™ affiliate, which are based in Emeryville, CA. These organizations have been delivering fiduciary tools and support services since 1998. Ward was formerly national sales development director with Charles Schwab & Co., supporting advisory and retirement lines of business. He also served with The Bank of California, First Interstate Bank and Dean Witter. In his hometown of Seattle, Ward was a partner in a registered investment advisory firm.

Rhonda Evans, PhD, is the director of research at McHenry Consulting. In that role, she helps clients to understand their working environment and how to best approach market risks and opportunities. Her considerable skills were honed in both academic and business environments. Rhonda is also a research associate at UC Berkeley's Institute of Industrial Relations.



FROM THE PRESIDENT

ASPPA's Commitment to Actuaries

by Stephen H. Rosen, MSPA, CPC

Although our name has changed to reflect the diversity of our membership, the commitment of ASPPA's current leadership to our actuarial membership has not wavered. This commitment in no way diminishes the commitment to all of ASPPA's members, but the commitment that the leadership has made to our actuarial membership is a critical component of our organization.

As ASPPA begins its rebranding initiative, our organization, and all of our members, will become even more recognized and respected. This increased exposure for ASPPA will provide our membership with an even stronger forum for making a difference. To achieve maximum impact in actuarial issues, it is important that members of our actuarial component help ASPPA to identify and achieve the initiatives that are most important to pension actuaries.

To this end, we have undertaken initiatives—some of which are brand new but others of which are ongoing—affecting all aspects of our organization to better serve our actuarial membership. These initiatives are outlined below. A number of these initiatives were discussed at a special actuaries' breakfast held at the 2004 ASPPA Annual Conference.

Membership Initiatives

- Development of an outreach program focused on attracting all pension actuaries to become members of ASPPA. A newly-formed subcommittee is already actively working on this project.
- Development of a pool of actuarial volunteers that will be used as an on-going resource by all of the other committees. This pool will ensure strong representation by our actuarial membership on all of our key committees. Again, the Membership Committee is actively working on creating this resource, and we encourage you to volunteer your time and talents.

Education and Examination Initiatives

- Development of a basic training program for candidates leading up to the Enrolled Actuaries exam. This project is already underway, using the results of the recently completed membership survey.
- Revitalization and enhancement of all of our current actuarial exams. The E&E Committee is actively studying the current exams.
- Development of a direct relationship with the actuarial science program with the University of Michigan to provide better actuarial science content for our exams.
- Identifying and putting together a contract to hire a professor at a major university.

Government Affairs Initiatives

- Appointment of a pension actuary, George J. Taylor, MSPA, ASPPA Past President, as a co-chair with the primary charge of developing and recruiting actuarial members to the Government Affairs Committee.
- Creation of a Defined Benefit Sub-committee that is a resource for all of the other committees for actuarial input and direction. All related legislative and regulatory projects will pass through this subcommittee for guidance. This subcommittee is in operation, chaired by David Lipkin, MSPA.
- Greater emphasis on upcoming actuarial issues, including proactive development of proposals to address the current issues facing defined benefit plans. GAC is currently working on finalizing proposals that were discussed at a brainstorming session during the meeting at the 2004 ASPPA Annual Conference. We anticipate that this initiative will be an ongoing project.

Conferences Initiatives

- All conferences will consider an actuarial track as a part of their programming. Such a track has been created for the "Meeting Midway" conference to be held in July 2005, and the Annual Conference Committee is in the process of putting this track together for the 2005 Annual Conference.

- Actuarial volunteers are included on all non-specialized conference committees. These volunteers are in place at this time. [The specialized conferences are The 401(k) SUMMIT and the DOL Conference.]
- Development of a stand-alone, high level, two-day actuarial conference, possibly in cooperation with one of our sister actuarial organizations. This conference is scheduled for early 2006.

Actuarial Issues Committee

- Establishment of an Actuarial Issues Committee that will enhance focus on actuarial issues that cross committee lines as well as affecting relations with our sister actuarial organizations. The purpose of this committee will be to take responsibility for all actuarial issues that do not have immediate legislative or regulatory implications (because those issues are under the purview of GAC and its actuarial sub-committee). The details of this Committee are being finalized by our Executive Committee, and will be brought to our Board for approval within the next 60 days.

The above are some key examples of the progress made for our actuarial membership, but the Executive Committee is also working on new initiatives for other sectors of our membership. Watch this column for announcements of more initiatives that will enhance your ASPPA membership.▲

Stephen H. Rosen, MSPA, CPC, is an independent consulting actuary specializing in the design and implementation of employee benefit plans. He is president of Stephen H. Rosen & Associates, Inc., an employee benefits consulting firm in Haddonfield, NJ. Steve is President of ASPPA, an Enrolled Actuary and a Member of the American Academy of Actuaries. He has served as President and Chairman of the Board of the ASPPA Benefits Council of the Delaware Valley and is the former Chair of ASPPA's ABC Committee. Steve has lectured at several actuarial conferences, including the Enrolled Actuaries Meeting and ASPPA's Annual Conference.

Latest Additions to the Board of Directors

by Troy L. Cornett

David A. Pratt, APM

Sheldon H. Smith, APM

Donald A. Barnes, FSPA

Charles N. McLeod, FSPA, CPC

David A. Pratt, APM, and Sheldon H. Smith, APM, have been elected to ASPPA's Board of Directors and will each serve his first term until 2007. Donald A. Barnes, FSPA, and Charles N. McLeod, FSPA, CPC, have also been elected to the Board to fill a partial term for 2005.

David A. Pratt, APM, is a professor of law at Albany Law School, Albany, New York. He is also of counsel to Hodgson, Russ LLP, in Albany, and Downs, Rachlin Martin PLLC in Burlington, Vermont. David received his law degree from Oxford University and is licensed to practice law in England and in New York.

For almost 30 years, David has specialized in the design and implementation of retirement plans and other employee benefit programs for a wide range of private and public sector clients. He has written numerous articles on benefits topics and is a senior editor of the *Journal of Pension Benefits*. He is co-author of *The Social Security and Medicare Answer Book* and *Taxation of Distributions from Qualified Plans.* Additionally, he is a frequent lecturer. In 2001, he was elected a fellow of the American College of Employee Benefits Counsel. He is also a director of the New York Employee Benefits Conference, Chair of the Legislative Relations Committee of ASPPA's Government Affairs Committee and former Co-chair of its Tax Exempt and Governmental Plans Subcommittee.

Sheldon H. Smith, APM, is a partner in Holland & Hart LLP's employee benefits group in Denver, Colorado. He is a long-time member of the adjunct and visiting faculties of the Graduate Tax Program of the University of Denver College of Law. Sheldon received his undergraduate BA degree from Washington University in St. Louis and both of his law degrees [JD and LLM (taxation)] from the University of Denver.

Sheldon has over 30 years of litigation experience and defends clients in ERISA and benefits litigation matters in both state and federal courts. He advises clients on ERISA, employee benefits, executive compensation, equity compensation, fiduciary dutiesand qualified retirement plans, as well as representing clients before the IRS, DOL and the PBGC. Sheldon has presented seminars and given speeches to many diverse types of professional groups including the American Institute of Certified Public Accountants, more than 30 different state societies of CPAs and the Golden Gate chapter of the California Society of Enrolled Agents, just to name a few. He has also written numerous articles and course materials in his area of expertise. Sheldon is a member of the Western Pension & Benefits Conference, serves as Vice-chair for ASPPA's IRS Conferences and has been the Co-chair of the Central and Mountain States Benefits Conference for the past two years.

Donald A. Barnes, FSPA, serves as the vice president for the Pension Board—United Church of Christ, based in New York City. The Pension Board provides self-insured and administered pension, annuity, life, disability and health benefits for over 15,000 individuals nationwide. These plans represent $2.8 billion in assets reserved for benefit and annuity payments.

Don has worked in the employee benefits field for more than 30 years, serving as a benefits administrator, pension actuary, plan consultant and manager. Within ASPPA, Don has served on the Actuarial Resource Group of the Government Affairs Committee. In past years, he has served on regional and national conference planning committees, including Chair of the ASPPA Annual Conference. Don has also had articles published in a national accounting magazine, has given radio interviews on benefits issues and has been quoted in *Money* magazine. Don is a Fellow of ASPPA, an Enrolled Actuary and a Member of the American Academy of Actuaries.

Charles N. McLeod, FSPA, CPC, is the president and CEO of National Actuarial Pension Services, Inc. (NAPS), a Houston-based pension consulting firm that Chuck and his wife, Mary, formed in 1980. Chuck graduated with a BA in Mathematics from Washburn University and did advanced pension actuarial studies at the University of Iowa.

NAPS provides administrative and actuarial services to approximately 650 retirement plans. In addition to his duties at NAPS, Chuck provides qualified plan seminars for programs sponsored by the Texas Society of Certified Public Accountants, the Houston CPA Society and various financial planning, accounting, attorney, insurance and actuarial groups in the Houston area. Chuck has also served as a Moderator for the Charles D. Spencer & Associates Annual Pension Consultants Conference for over 20 years. He has been a member of ASPPA for over 30 years, is an Enrolled Actuary, a Member of the American Academy of Actuaries and a Fellow of the Conference of Consulting Actuaries.▲

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

Actuarial Profession Tackles Image Problem with Program to Promote Unique Value

by Joel Albizo

Every actuary has the potential to help shape the image of the entire profession.

It is no secret that the actuarial profession has an image problem. Anecdotal experience suggests it and quantitative research conducted by the Society of Actuaries (SOA) confirms it. That's why ASPPA has joined with other North American actuarial organizations to conduct a long-term campaign to enhance the profession's image.

Why an image campaign?

Because opportunity is at risk.

Two rounds of SOA-sponsored research has concluded that employers perceive actuaries as one-dimensional technicians, and they do not understand the full value of the actuarial skill set. A more dynamic and relevant image for the profession will set the stage for significant and measurable gains in opportunities for actuaries in both traditional (*e.g.*, pensions, consulting, insurance and re-insurance) and broader financial services sectors (*e.g.*, banking, investment and mutual funds).

Given the trends toward mergers, acquisitions, consolidation and cost-cutting, doing nothing risks losing relevance in traditional sectors and potentially being locked-out of challenging and lucrative opportunities in the broader financial services sector.

How do we reshape this image?

The Image Advisory Group, made up of members from each of the North American actuarial organizations, including ASPPA, have developed a four-part strategy:

1. Involve the profession at the outset by seeking actuaries' input on our campaign theme. Thanks to the leadership of ASPPA's President Stephen H. Rosen, MSPA, CPC, and Image Advisory Group member and ASPPA Past President Michael E. Callahan, FSPA, CPC, ASPPA's actuarial membership was well represented at a breakfast presentation and theme straw poll at the ASPPA Annual Conference this past October in Washington, DC.
2. Focus resources on reaching out to those audiences who have the ability to influence many others. This approach is often called "influencing the influencers," and decision makers like CEOs and CFOs will be a key early audience.
3. Promote our profession's recognized strengths: strong ethics, ability to solve difficult problems and thought leadership. These are strengths that were identified by actuarial employers!
4. Present the profession as both dynamic and relevant to today's business challenges. Actuaries are the premier managers of financial risk—from pension plans to insurance and investment firms.

The Actuarial Advantage

According to the SOA employer and member survey, employers rate actuaries as stronger than competing professionals on the following attributes:

- Ethics
- Thought leadership
- Ability to solve complex problems
- Quantitative modeling abilities
- Financial assessment and reporting skills

What can the profession expect from the campaign's efforts?

While a new "brand" for the profession is a long-term prospect that may take ten years or more, the profession can take positive, meaningful steps in that direction now. These steps include identifying, activating and celebrating our pioneers; becoming the authority on risk; being the voice of enterprise risk management and building a new image *within* the profession, one actuary at a time.

How will the image campaign benefit pension actuaries?

An enhanced image will benefit pension actuaries in several ways. First, greater awareness and understanding of your unique skills and abilities will contribute to greater credibility for your recommendations and counsel. Second, when customers and the media have a better understanding of what pension actuaries do, they will be more receptive to your messages in a stressful situation—when the "heat" is on.

Third, a more dynamic image will help open doors if and when you seek to expand into a different practice focus or, like an increasing number of pension actuaries, if you branch out into individual practice.

And finally, every actuary has the potential to help shape the image of the entire profession. As Barbara Lautzenheizer, past president of the American Academy of Actuaries and the SOA has correctly observed, "Each one of us speaks for all of us."

Does the pension community have input to the image campaign?

Yes. ASPPA is well represented on the Image Advisory Group by Mike Callahan and Executive Director/CEO, Brian H. Graff, Esq., APM. Your representatives ensure that your perspectives are shared and considered in the planning process.

When will the campaign be launched and how can I provide input?

The image advisory group welcomes the input and participation of every actuary. Please feel free to e-mail your comments to me at **jalbizo@soa.org.**

Joel Albizo is the managing director of marketing and communications for the Society of Actuaries, where he leads the effort to enhance communication with members, candidates, media, employers and other actuarial organizations. He also provides leadership to the image campaign for the actuarial profession, an initiative that is joined by all six North American actuarial organizations. Joel has over 19 years of experience in marketing and public relations in the association and for-profit worlds.

Nominations Open *for* Educator's Award

The Education and Examination (E&E) Committee is seeking nominations for ASPPA's Educator's Award to recognize and honor outstanding educators.

If you know an ASPPA member who has made a significant contribution to pension education (*e.g.,* through instruction, conferences, ASPPA Benefit Councils, promotion of ASPPA's education program or preparation of education materials), please visit **www.asppa.org** and submit your nomination by July 1, 2005. Please include a few paragraphs in support of your nomination, including nominee background information.

The recipient of the award will receive a plaque in recognition of his or her achievement, complimentary registration to the 2005 ASPPA Annual Conference to attend the award presentation, one night's accommodation and feature articles in *The ASPPA Journal* and *The Candidate Connection.*

ASPPA Examinations Awarded College Credit Recommendations

by Jamie S. Pilot

ASPPA is pleased to announce that all ASPPA examinations have been awarded college credit recommendations by the American Council on Education (ACE). Founded in 1918, ACE is the major coordinating body for all of the nation's higher education institutions representing 1,800 accredited, degree-granting colleges/universities and higher education-related associations, organizations and corporations.

An extensive two-day, on-site review of all ASPPA examinations occurred at the ASPPA National Office in November 2004. A team of six subject-matter experts consisting of college/university faculty members and psychometricians met with key ASPPA volunteer leaders and staff. The ACE team thoroughly examined the materials and procedures for developing, administering and evaluating ASPPA examinations and found that the skill sets measured by the examinations were equivalent to those found in college courses.

As a result of the on-site review and effective immediately, a total of 15 semester hours in the upper division baccalaureate degree category and three semester hours in the lower division baccalaureate/associate degree category have been recommended for ASPPA examinations.

More than 17,000 ASPPA examination candidates may be able to receive academic credit for successful completion of these examinations retroactively for ten years. Periodic reviews by ACE will occur to ensure that college credits will be available for future ASPPA exam candidates.

Below are the specific college credit recommendations for each ASPPA examination. These recommendations appear in the *Guide to Educational Credit by Examinations*, published annually by ACE.

C-1: Upper division baccalaureate degree category, two semester hours in Administrative and Qualification Issues of Retirement Plans.

C-2(DC): Upper division baccalaureate degree category, one semester hour in Administrative Issues of Defined Contribution Plans.

PA-1: Lower division baccalaureate/associate degree category, one semester hour in Pension Plan Terminology.

PA-2: Lower division baccalaureate/associate degree category, one semester hour in Pension Plan Records and Processing.

PA-3: Lower division baccalaureate/associate degree category, one semester hour in Pension Plan Evaluation.

DC-1: Upper division baccalaureate degree category, one semester hour in Defined Contribution Pension Plans.

DC-2: Upper division baccalaureate degree category, one semester hour in Defined Contribution Pension Plans.

DC-3: Upper division baccalaureate degree category, one semester hour in Defined Contribution Pension Plans.

DB: Upper division baccalaureate degree category, two semester hours in Defined Benefit Plan Administration.

C-3: Upper division baccalaureate degree category, two semester hours in Financial and Fiduciary Aspects of Qualified Plans.

C-4: Upper division baccalaureate degree category, two semester hours in Retirement Planning and Consulting.

A-4: Upper division baccalaureate degree category, three semester hours in Advanced Actuarial Methods.

The credits listed above are recommended credits. Institutions are not required to grant a student the credit recommended by ACE, nor are they limited to granting only the stated credit recommendations. For more information, contact Jamie S. Pilot, Director of Education Services, at **jpilot@asppa.org**.▲

Jamie S. Pilot, CMP, Director of Education Services, joined ASPPA in July 2000. She has more than 11 years experience in the association field. In Jamie's quiet time, she enjoys running, spending time with her husband, eating M&Ms and collecting M&Ms memorabilia.

What Do You Think of Your New THE ASPPA Journal

As we created the new look for ***The ASPPA Journal,*** we took many of your suggestions into consideration. For example, we added graphics and the ability to read more articles from beginning to end without "jumping" pages. We have also made a clearer distinction between the technical articles and the department articles, where you will find new "department icons" to help you to identify the beginning of each article.

We'd like to hear from you. So tell us, what do you think of your new *The ASPPA Journal*? **theasppajournal@asppa.org**

Calendar of Events

Date	Description	CE Credits
Mar 17-19	The 401(k) SUMMIT • San Diego, CA	15
Mar 31	Early Registration Deadline for Spring Examinations	
Apr 25-26	DOL Speaks: The 2005 Employee Benefits Conference • Washington, DC	TBA
Apr 30	Final Registration Deadline for Spring Examinations	
May 1-31	Spring 2005 Examination Window	
May 5-6	Great Lakes Benefits Conference • Chicago, IL	15
May 13	Postponement Deadline for All Spring Examinations	
May 18	C-3 Examinations	
May 19	C-4 Examinations	
May 23-24	Mid-Atlantic Benefits Conference • Philadelphia, PA	15
Jun 1	Eidson Founders Award Nominations Due	
Jun 9 & 10	Northeast Area Benefits Conference Natick, MA • White Plains, NY	15
Jul 24-27	Meeting Midway • San Diego, CA	15
Sep 13-15	Central and Mountain States Benefits Conference • Denver, CO	TBA
Sep 30	Early Registration Deadline for Fall Examinations	
Oct 31	Final Registration Deadline for Fall Examinations	
Nov 1-Dec 15	Fall 2005 Examination Window	
Nov 6-9	Annual Conference • Washington, DC	15
Nov 11	C-3, C-4 and A-4 Postponement Deadline	
Nov 16	C-3/A-4 Examination	
Nov 17	C-4 Examination	
Dec 1	DC-1, DC-2, DC-3 and DB Postponement	

Renew Your Membership Online!

ASPPA's new online membership renewal system is fast, easy and a secure way to renew instantly and receive immediate payment confirmation. The multi-member discount for businesses with more than one ASPPA credentialed member is automatically calculated based on the company's current renewal status. To use the system, simply log on to the ASPPA Web site at **www.asppa.org/membership/member_renew.htm** and follow the renewal prompts. The online system accepts Visa, MasterCard and American Express payments.

Correction

In the November-December 2004 issue of *The ASPPA Journal*, in the center photo spread, we incorrectly spelled the name of "Envisage" of Envisage Information Systems, LLC. We apologize for the error.

Fun-da-Mentals

Equation of Earnings

—Author Unknown

In today's environment, most people recognize that the amount of work they can get accomplished is dependent upon the amount of power and influence they have and the amount of time they have. Therefore, consider this equation:

Postulate 1: Knowledge is Power

Postulate 2: Time is Money

Work = Power * Time

Since Knowledge = Power and Time = Money,

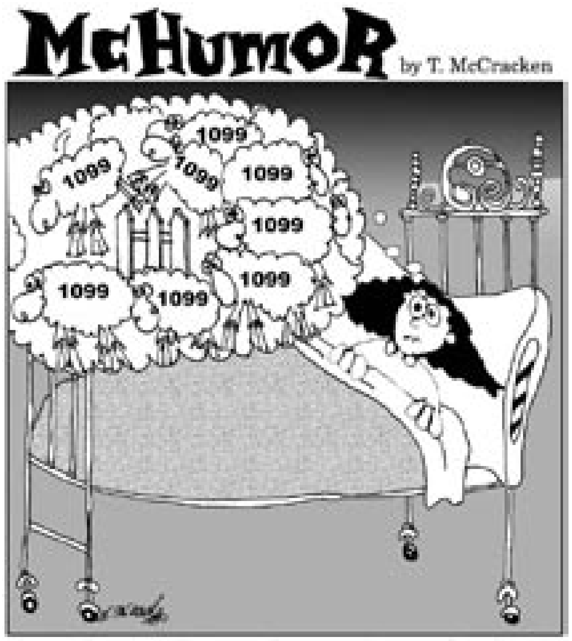
then Work = Knowledge * Money.

Solving for Money, we get:

Money = Work/Knowledge.

Thus, it is easy to see that as Knowledge decreases, Money increases, regardless of how much Work is done.

Conclusion: The Less you Know, the More Money you Earn! ☺



Annual sleep disorder for pension professionals

Word Scramble

Unscramble these four puzzles—one letter to each space—to reveal four pension-related words. Answers will be posted on ASPPA's Web site at https://router.asppa.org. Login, scroll down to "Check out the last issue of The ASPPA Journal" and click on the latest issue. Scroll down to "Answers to Fun-da-mentals".

Y RENT □ □ __ □ __

CAD VIE __ __ □ □ □ __

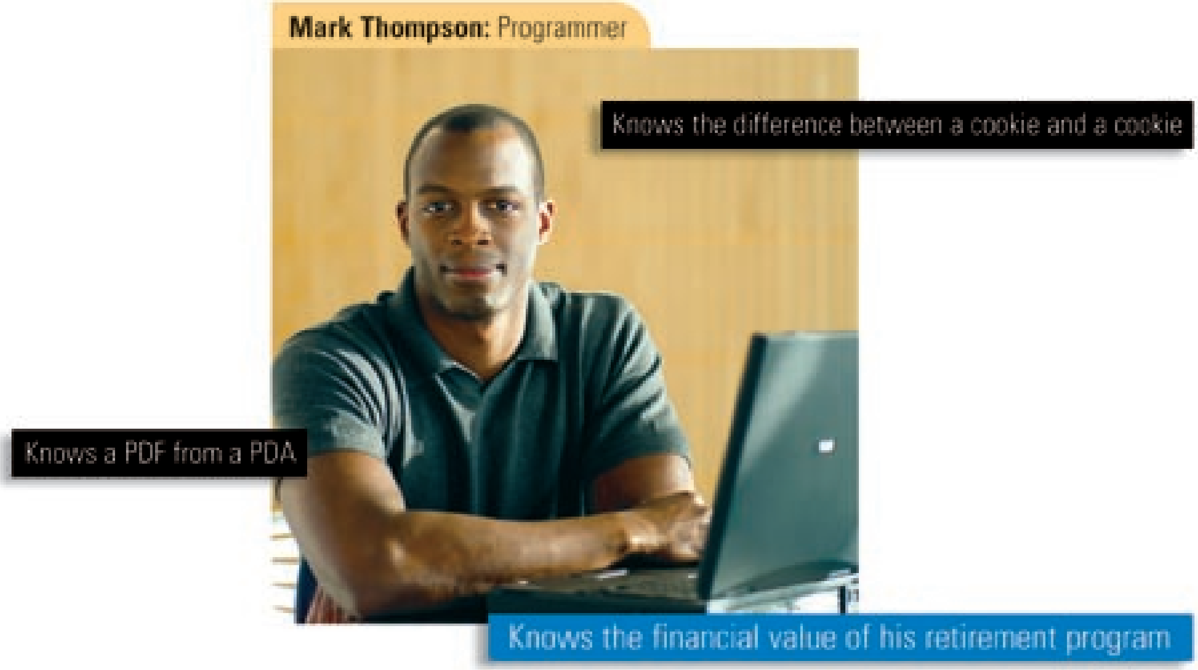
MET ARK __ □ □ □ □ __

FEET BINS □ __ __ □ __ □ __ □

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

Mystery Answer: A "_ _ _ _ _ - _ _" _ _ _ _ _ _ _

What the thief advertised in the Yellow Pages.



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* *Compares contribution rates of MassMutual's total retirement services clients with MassMutual's defined-contribution only clients. As of December 31, 2003.*
** *As of April 1, 2004. Ratings subject to change.*