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The DOL's Enron Brief: What It Means for 401(k) Investments

by Fred Reish, APM, and Debra A. Davis

WHILE THE ENRON CASE PRIMARILY INVOLVES PARTICIPANT INVESTMENTS IN EMPLOYER STOCK, THE FIDUCIARY PRINCIPLES RAISED IN THE CASE BROADLY APPLY TO THE SELECTION AND MONITORING OF ALL INVESTMENTS IN 401(k) PLANS. RATHER THAN FOCUS ON THE EMPLOYER STOCK ASPECTS, THIS ARTICLE HIGHLIGHTS HOW THE ISSUES RAISED IN THE ENRON LITIGATION GENERALLY APPLY TO FIDUCIARIES AND INVESTMENT OPTIONS FOR 401(k) PLANS.

The Department of Labor (DOL) filed a brief, as a "friend of the court" (*amicus curae*), in *Tittle v. Enron*. The case is a class action lawsuit by the participants in Enron's retirement plans. The defendants include Enron, former Enron CEO Kenneth Lay, members of the plans' Administrative Committee, and members of Enron's Compensation Committee. The DOL filed its brief in response to the defendants' attempt to have the case dismissed.[1] While the positions taken by the DOL in its brief are not new, they have not been well publicized and are not known by many sponsors of 401(k) plans.

People's Actions, as Well as Their Titles, Dictate Whether They Are Fiduciaries

Cindy Olson argued that she should not be liable because she was only acting on behalf of the corporation (Enron). Ms. Olson was both a member of

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Washington Update

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IRS Announces Its Interest in Curtailing 412(i) "Abuses"

by Brian H. Graff, Esq., and Danea M. Kehoe, Esq.

ON JANUARY 31, 2003, DURING THE LOS ANGELES BENEFITS CONFERENCE (CO-SPONSORED BY ASPA AND THE IRS), OFFICIALS FROM THE IRS AND THE TREASURY DEPARTMENT ISSUED STERN WARNINGS ABOUT THE GOVERNMENT'S INTENTION TO REGULATE AGGRESSIVE—SOME SAY ABUSIVE—USE OF FULLY INSURED §412(i) DEFINED BENEFIT PENSION PLANS.

The government "will not be gentle," said Richard J. Wickersham, Manager of IRS Tax Exempt/Government Entities (TE/GE) Division's Guidance and Quality Assurance. "No one should take comfort in the fact that there is no guidance yet," he added. And, he continued, "there is a criminal side" to abusive 412(i) schemes.

Treasury's Benefits Tax Counsel, William F. Sweetnam, Esq., warned that guidance on 412(i) plans is of "paramount importance." James E. Holland, of the IRS' Employee Plans Technical Unit, suggested the government may soon issue two types of guidance: a notice warning of the government's concern about these plans and then later, more substantive guidance laying out proposed rules aimed at shutting down abusive practices.

Continued on page 5

Due to an error in the printing and folding process, a correctly folded January/February 2003 "Summary Comparison of Qualified Plans, IRAs, and TSAs" supplement has been included with this issue.

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[1] Source: LIMRA (December 2001)

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From the Editor

It's Springtime in the Pension World! Rejoice!?!

by Chris L. Stroud, MSPA

AS A CHILD, I ALWAYS LOOKED FORWARD TO SPRING. IT MEANT BETTER WEATHER FOR PLAYING OUTSIDE, BASEBALL, BIRTHDAY PARTIES (MY BEST FRIEND'S BIRTHDAY WAS THE FIRST DAY OF SPRING), AND EASTER EGG HUNTS. WHEN I GOT A LITTLE OLDER, IT MEANT HELPING MY MOM WITH HER "SPRING" CLEANING, WHICH ALWAYS UNCOVERED INTERESTING BURIED TREASURES TO ENJOY. IN COLLEGE, SPRING MEANT "SPRING BREAK"—HOORAY! (OH, TO BE YOUNG AGAIN.) NOW, (SINCE I'M NO LONGER A "SPRING CHICKEN"), SPRING MEANS VALUATIONS, TESTING, INCREASED CLIENT CALLS, AND, OF COURSE, THAT DREADED INCOME TAX TIME. MOST OF US FIND OURSELVES "WOUND TIGHT AS A SPRING" DURING THIS TIME, AND THIS YEAR, WE CAN ALSO LOOK FORWARD TO A "SPRING TIDE" OF RESTATEMENT WORK TO ADD TO THE CHAOS.

There is a bright side! Spring also means that most of you can look forward to better weather (the kind of days that those of us lucky enough to live in Florida or California have been enjoying most of the winter)! With spring, we think of "spring forward" and that extra hour of daylight to enjoy that keeps us from driving home late from work in the dark. You can also exercise your sense of humor by "springing a joke" on someone for April Fool's Day.

It's actually quite interesting how the word "spring" itself can be used in so many ways. Someone can "spring something on you," as the President did with his 2003 budget proposal. People can "spring into action," as Brian Graff, GAC, and ASPA PAC did (to carry out ASPA's mission of preserving and protecting the private pension system) immediately after the President released his budget proposal. And, of course, you can "spring for a payment," as many ASPA members did, making recent contributions to strengthen ASPA PAC. You can also offer "spring training," as ASPA has, by educating Congress, industry segments, and the public on how the President's proposal, in its original form, could be devastating to the retirement income security of the public.

Yes, "springtime" in the pension world means many things to many people. Hopefully, when things slow down (and if you are like me, you find yourself often wondering if they ever will), you'll catch a little "spring fever!" Have a picnic somewhere by a calming, trickling "spring"—and sit back and relax. Until then, put a smile on your face and a "spring in your step"—and be thankful that you have a career in an industry that is anything but boring! ▲

The ASPA Journal is produced by The ASPA Journal Committee and the Executive Director of ASPA. Statements of fact and opinion in this publication, including editorials and letters to the editor, are the sole responsibility of the authors and do not necessarily represent the position of ASPA or the editors of *The ASPA Journal.*

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

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

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Letters to the Editor

Enron, *et al*! Never Again!

Thank you for keeping members informed about various Enron issues. Our industry has suffered because of the "bloodshed" resulting from the Enron debacle and other related incidents. Previously celebrated Fortune 100 companies and their leaders—once icons on the fruited plain—have been destroyed. A leader of the Big Five (now "final" four?), one of the largest and most renowned "independent" auditing firms in the world (its profession perennially viewed by many as the final investor protector), no longer exists. Most tragically of all, many hard earned retirements have been deferred, if not totally destroyed forever.

How could this happen? Could it be because:

(1) Professional investment advisors and their communication cohorts forgot to adequately emphasize and properly communicate effective and timely portfolio asset allocation and diversification;

(2) Of excess reliance on the portfolio management capabilities of plan participants—with modest investment backgrounds—to construct, monitor, and maintain retirement portfolios for the long-term financial needs of themselves and their families;

(3) Plan participants were naïve in believing the lies told to them by the executive management of their employers; or

(4) Plan participants did not have the option of participating in a traditional or modified defined benefit pension plan?

ASPA is all about protecting the private pension system in the United States. Brian Graff, the ASPA National Office, and the Pension Cavalry (GAC and ASPA PAC) will continue their rigorous and effective fight for the necessary ERISA legislation and regulation to strengthen, simplify, and make retirement plans more efficient, while providing "safe harbor" fiduciary support to give employers the ability to implement sound retirement benefit solutions for the employees who have made the success of their businesses possible. To support Brian and his team, ASPA members and the ASPA Benefits Councils must provide more help by directly and routinely contacting local US legislators, their staffs, and the leaders of their political parties to support our cavalry as it saves our clients' participants' pensions.

The benefits of a defined benefit plan must be better communicated to employers, plan participants, and beneficiaries (they are frequently not communicated at all), so that each participant and his or her family fully appreciates the financial and fiduciary commitments that are being made by their employer and their employer's plan fiduciaries on their behalf.

Especially now! How much longer can we allow our clients to say, "I think that I am going to terminate my defined benefit plan because it is so expensive, and my employees just do not understand, much less value it." "Our employees say they just want a 401(k) so that they can see their balances." And how many times are we going to allow unstated concerns by plan sponsors to steer them away from seriously considering an appropriately structured and effectively administered (for each unique circumstance) defined benefit plan. Not one moment longer, I hope. Let's give them the information they need to make their best decisions—today!

Remember the Alamo! Remember Enron! Remember the employees' pensions! Never again!

James A. Black
Wells Fargo Bank of Texas, NA
Houston, TX

I firmly agree that it is critical that ASPA members and the ASPA ABCs support ASPA's efforts in educating and advocating for effective legislation. Be sure to read the front-page article, "The DOL's Enron Brief: What it Means for 401(k) Investments," to learn more about recent Enron-related guidance.

—Chris

Correction to "Non Discrimination" Testing Article

Below is a correction to the table that appeared in the Non Discrimination Testing article on page 19 of the January/February 2003 issue of *The ASPA Journal*. The last two lines of the table should read as follows:

Safe Harbor and Unsafe Harbor Percentages Table

Non Highly Compensated Employee Concentration	Safe Harbor Percentage	Unsafe Harbor Percentage
98	21.50	20
99	20.75	20[31]

Continued from page 1

Washington Update

The government's concern stems from relatively new 412(i) marketing efforts born from the repeal of §415(e) dual plan limits. Insurance companies have developed new products, such as a product that combines one type of insurance policy that maximizes a small business owner's ability to contribute large amounts on a deductible basis for a few years—typically five years—with another type of policy that takes the inside build-up from the first policy and converts it into tax-free retirement income.

By the time you read this article, it is quite possible the notice outlining IRS's recent concerns respecting certain 412(i) plan designs—referred internally within the IRS as a "yellow-light" notice—will have already been issued. The IRS and Treasury have not signaled exactly what rules they intend to pursue to shut down these programs, but their interest seems to focus on the appropriate valuation of an insurance policy used in the 412(i) plan.

Fully insured pension plans are defined benefit plans exempt from qualified plan minimum funding rules under §412(i). Section 412(i) does not exempt plans from any other rules applicable to defined benefit pension plans. So, a 412(i) plan must comply with all other qualified plan rules.

ASPA's Government Affairs Committee (GAC) has met with the IRS and Treasury to discuss these issues and has emphasized that there are many 412(i) products in the marketplace that are perfectly consistent with current law and play an important role in providing defined benefits for employees. However, ASPA shares the legitimate concerns of both the IRS and Treasury respecting certain 412(i) programs essentially designed to get around the qualified plan rules.

412(i) Rules

The rules of IRC §412(i) require:

1. Funding exclusively by the purchase of individual insurance contracts. The definition of "life insurance contracts" includes life insurance policies or annuities. Group policies with the characteristics of individual policies, as determined by the Treasury, are treated as individual insurance contracts.
2. Funding by insurance contracts that are level-premium from the time a plan participant begins participation in the plan until that participant's normal retirement age.
3. Use of the contracts' guarantees in establishing contributions (premium price) levels. Earnings in excess of the level guaranteed must be used to reduce future contributions to fund plan benefits.
4. Contracts that provide benefits equal to the benefits provided by the qualified plan.
5. Premium payments that were paid prior to the lapse of the policy (or within a reinstatement period that occurs during the plan year).
6. Contracts against which no loans or security interests are taken.

Emerging Life Insurance Products for 412(i) Plans

The 412(i) programs of most current concern to the government use a life insurance product called a "sponge policy." It is typically an interest-sensitive life insurance policy that illustrates low cash values in the first five years and significantly increased cash value growth starting in year six. Generally, the life insurance policies are constructed to comply with the rules in Notice 89-25 (springing cash value policies), but nevertheless reflect low cash value accumulations in the first five years of the policy and then a marked increase in the growth of cash values in the policy's later years.

The mechanism involves the creation of approximately equal cash surrender values and interpolated terminal reserve amounts and also an accumulated value account. It is the accumulated value account, or its equivalent, that allows the later-year cash value growth. During the first five years there is typically a heavy surrender charge levied against the accumulation account.

Marketing

There has been a comparatively recent proliferation in the marketplace of 412(i) plans built on the above-described new insurance product designs. Generally, these programs and products share these characteristics:

1. They depend on an "exit strategy" that contemplates a pre-retirement distribution of the life insurance policy at a point in time where the taxable cash value is relatively low. After rollout, the insured can exercise a guaranteed right to exchange the 412(i) policy for a competitively performing, interest-sensitive life insurance policy. Retirement payouts are accomplished by tax-free borrowing against the exchanged-for policy's cash values.
2. They point out the tax consequences of pre-rollout death benefits. In such cases, to the extent the policy's death benefits exceed the level allowed

by the "incidental benefits" rule, the excess death benefits would be payable to the plan. To the extent those death benefits exceed the amount needed to fully fund the plan, they would constitute a reversion to the plan, which threatens qualification and causes taxation. Strategies to avoid this are discussed, and range from splitting off the amount of death benefit allowed under the incidental benefits rule into a separate life insurance policy to terminating the plan and/or transforming the 412(i) plan into a traditional defined benefit plan. Ultimately, these programs work best when the policy is distributed prior to the death of the insured.

3. The insurance contracts used to fund these plans use a very low guaranteed interest rate. Of course, the lower the guaranteed rate, the larger the deduction for a contribution calculated using the guaranteed rate.
4. Many of these programs purchase life insurance (death benefit) amounts far in excess of what would be allowed under the "incidental benefits" rules. However, the plan itself specifies that death benefits will be payable only to the extent that the incidental benefits rules allow.

The government is aware of many products and 412(i) plan vendors and sponsors that comply with both the letter and spirit of the law governing fully insured plans. Government personnel have indicated to ASPA that they intend to distinguish between what they see as abusive plans and more traditional conservative plans and products.

Finally, government personnel believe they have—even in the absence of a formal notice—put the industry on notice of their intention to curtail the use of abusive 412(i) plans. Consequently, in addition to expecting tight new rules from IRS and Treasury, it is also possible that such rules may be applied retroactively to existing plans and policies that they perceive to be particularly abusive. ▲

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

Danea M. Kehoe, Esq., is outside counsel to ASPA and assists with our lobbying efforts. Previously, she was a lobbyist for the National Association of Insurance and Financial Advisors (formerly NALU).

Focus on ASPA PAC

Help ASPA PAC Grow Even Stronger!

by Stephen L. Dobrow, CPC, QPA, QKA

CAPITOL HILL IS SWIRLING WITH LEGISLATIVE PROPOSALS TO REVITALIZE OUR ECONOMY. IN ADDITION, THE BILLS THAT WERE REACTIONS TO ENRON AND OTHER 401(K) DEBACLES LAST FALL ARE RESURFACING HERE IN THE 108TH CONGRESS. ALL OF THESE PROPOSALS WILL IMPACT OUR INDUSTRY IN EITHER A POSITIVE OR NEGATIVE WAY.

In late January, the President submitted a budget proposal to Congress that would make investments outside of an employer-sponsored plan significantly more attractive than saving in a plan. If the Administration's proposals are enacted, they will most likely result in fewer employer-sponsored retirement plans, particularly among small employers. It is up to us to educate members of Congress about pension issues and, through ASPA PAC, we are able to "open the door" and deliver our message.

Given the breadth of the President's plan, numerous interest groups are fiercely lobbying to protect their interests. Contributions made by ASPA PAC are needed to help ASPA "open the door" to members of Congress who will be pivotal during this legislative process. ASPA PAC is pivotal to ensuring our message—that any changes cannot harm the private retirement system—will be heard loud and clear.

Given the stakes, we need to work harder than ever to make sure that our voice is heard. If you have not yet done so, please consider joining ASPA PAC for 2003! Thank you to the many who have already joined and made their direct commitment to strengthening ASPA's voice. All amounts are welcome and will make a difference.

Only ASPA members may contribute to ASPA PAC and we can only accept personal contributions, not corporate funds. We accept personal checks and can process personal credit cards. You can read more about ASPA PAC in the Government Affairs and Members Only sections of the ASPA Web site. ▲

Stephen L. Dobrow, CPC, QPA, QKA, APA, is chair of the Committee for Political Action and serves on ASPA's Board of Directors. Stephen is President of Primark Benefits, Burlingame, CA. He formerly served as a chapter officer for NIPA and is active in the Western Pension & Benefits Conference.

Tinker, Tailor, Soldier, Sailor…Employee?

by James C. Paul, APM

PROPERLY CLASSIFYING WORKERS IS VITAL. INDIVIDUALS WORKING FOR YOUR COMPANY MAY BE EMPLOYEES, INDEPENDENT CONTRACTORS, LEASED EMPLOYEES, OR SHARED EMPLOYEES. DEPENDING ON HOW THEY ARE CLASSIFIED INITIALLY, WORKERS ARE TREATED DIFFERENTLY FOR RETIREMENT PLAN PURPOSES, STATE AND FEDERAL INCOME AND EMPLOYMENT TAX WITHHOLDING AND REPORTING. THEY MAY ALSO BE TREATED DIFFERENTLY UNDER YOUR COMPANY'S HEALTH AND WELFARE PLANS.

The distinction between an "employee" and an "independent contractor" dates back to decisions of the courts under the old English common law of "master and servant." Under the common law, a company generally will be liable for the tortious acts of its employees committed in the course and scope of their employment. In contrast, a company generally is not liable for tortious acts of independent contractors.

Today, properly classifying workers is more important than ever. Not only can a company be liable for the tortious acts of its employees, but it must properly report and pay various state and federal employment taxes for employees and must properly report and withhold state and federal income taxes. In addition, employees generally must be covered in a company's qualified retirement plans, while independent contractors generally may not be covered. Misclassifying workers, or guessing wrong about whether they are employees, can be costly and can have devastating effects on the qualified retirement plans, as can be seen from the experiences of a hypothetical Internet retailer, Nozama.com.

Nozama sells products to consumers via its Web site. Nozama was established in 1997 by three computer techies. With the help of an investment banker, Nozama went public and before the three original owners knew what was happening, their business took off. They had more orders than they could possibly fill and only two employees besides themselves. To meet the instant demand for their products and to avoid a drastic plunge in their high flying stock price, the company officers knew they had to act quickly. They rented warehouse space so they could stock sufficient inventory to meet demand. Now, they just needed workers—about 20 to 25—right away. None of the Nozama officers had any real experience in hiring and managing workers, let alone doing payroll, taxes, and reporting for that number of employees. They knew they needed help.

Nozama retained Temps-R-Us to provide workers and payroll services. Temps-R-Us provided 25 workers who immediately began working in Nozama's warehouse. Temps-R-Us kept payroll records and did all of the accounting and reporting for Nozama's warehouse workers, including all reporting for state and federal employment taxes and income tax withholding. Although the workers were treated as employees of Temps-R-Us, they worked at Nozama under the supervision of Nozama employees and Nozama supplied all tools and supplies needed for their work. Nozama set the working hours and schedules for these workers. Nozama paid Temps-R-Us all amounts necessary to pay the workers and cover employment taxes and income tax withholding, along with a fee for the services provided.

Nozama had also established a profit sharing plan and made substantial contributions, which were allocated to its employees from 1997–2002. Since the warehouse workers were paid by Temps-R-Us and were not treated as Nozama employees for tax reporting purposes, Nozama had always assumed that the workers were independent contractors and did not include them in the profit sharing plan.

Early in 2003, an IRS auditor came to visit Nozama. The auditor quickly concluded that the warehouse workers were employees of Nozama. When Nozama argued that the workers were independent contractors, the auditor explained that whether workers performing services for a company are its employees is determined using a twenty-factor test established by the IRS. Even though Nozama's workers were paid by Temps-R-Us and treated as employees of Temps-R-Us, under the twenty-factor test they were clearly employees of Nozama and not independent contractors. See the table on page 23 for a list of the twenty factors used by the IRS and a detailed analysis of why the Temps-R-Us workers were employees of Nozama.

The auditor informed Nozama's management that not only had they failed to properly report and pay employment taxes and withhold income taxes, but these workers should have been included in Nozama's profit sharing plan because, as "employees," the workers were eligible and should have participated under the terms of the plan. Nozama now faced disqualification of its profit sharing plan. Nozama could request a closing agreement and take steps to correct the failure to include eligible workers, but that would be very costly. At a minimum, Nozama would

have to make contributions for these 25 workers for the years from 1997–2002. Nozama was stunned by these developments.

Nozama next argued that the workers were leased employees. Since the Nozama profit sharing plan excluded leased employees, at least Nozama should not be required to cover the workers under the plan. Unfortunately, Nozama learned that a company must first determine whether workers are its employees under the twenty-factor test. If a worker is an employee, that worker cannot be a leased employee. Accordingly, since the workers used by Nozama were deemed as its employees, they could not be excluded from the plan as leased employees.

How Do You Know If Workers Are Employees?

If you are unsure whether individuals working for your company should be classified as employees, independent contractors, or leased employees, use the twenty factors in the accompanying table on page 23 as a checklist. If you are unsure how to apply the factors or if it is still unclear whether your workers should be classified as employees, seek advice from a qualified tax or labor attorney.

Classifying Workers As Employees When They Are Not Can Be Just As Bad

After reading about the problems experienced by Nozama and looking at the IRS twenty-factor test, you may be tempted to conclude that the easiest route is to classify all workers as employees and simply not deal with the issue of whether they are in fact your employees. Although that certainly sounds easy and tempting, you will see below that Nozama found out the hard way that classifying workers as employees when they are not can be just as bad.

In 1998, Nozama formed SubCo, a wholly owned subsidiary, to start a new Internet retail venture. Although Nozama and SubCo were part of the same controlled group of corporations, each company had its own separate retirement plan. A new CEO was hired to run SubCo and two mid-level managers employed by Nozama were assigned responsibility for getting the new company up and running. Initially, in 1998, the two managers spent approximately 80% of their time doing work for SubCo under the supervision, direction, and control of SubCo's CEO. Beginning in 1999, the two managers spent 100% of their time doing work for SubCo, but they remained classified as Nozama employees on the Nozama payroll.

Nozama continued to include the two managers as participants in its profit sharing plan for 1999–2002, allocating contributions to them based on their compensation. After the excitement from the IRS audit had subsided, Nozama's controller realized that the two managers should no longer be on Nozama's payroll. He began to wonder if they had misclassified the two workers for 1999–2002.

Continued on page 22

ASPA Welcomes Its 5,000th Member!

We are pleased to announce that on March 3, ASPA welcomed Neal S. Cohen, QPA, QKA, as our 5,000th member! As the recipient of this distinction, Neal has won a complimentary ASPA conference registration, a voucher good for one year's annual dues, and an official ASPA polo shirt.

Neal currently works for Strong Retirement Plan Services, Inc., in Menomonee Falls, Wisconsin. He is an ERISA Specialist handling DC plan compliance and has worked in the pension field for 10 years. Prior to joining Strong, Neal worked at Merrill Lynch and ADP in plan administration and relationship management.

Neal began taking ASPA's exams in 1997 and is considering continuing in the examination program in order to obtain his CPC. ASPA's specific focus on pension plans, and the fact that the training relates most directly to what he does on a daily basis, both played a role in Neal's decision to choose ASPA's examination program. According to Neal, "ASPA is a top-notch organization dedicated to quality and excellence. This was important to me in making my decision about an educational program."

Neal received his MBA from Illinois State University and his BA from The University of Kansas. He has a two year old son named Jacob and just brought a baby girl named Grace Elizabeth into the world on February 16. Neal enjoys running, following Kansas basketball, and spending time with his family. He also enjoys taking ASPA exams in his spare time! Please join us in welcoming him as a new ASPA member.

A special thanks goes to Kenneth S. Eberle, CPC, for referring our 5,000th member. Kenneth won a complimentary ASPA webcast and an ASPA polo shirt for the referral.

Continued from page 1

The DOL's Enron Brief: What it Means for 401(k) Investments

the Administrative Committee and an officer of Enron. In its brief, the DOL responds that Ms. Olson would have been a fiduciary even if her involvement had been limited to fiduciary acts as an agent or officer of the plan sponsor. That is, she would have been a "functional" fiduciary because she was making fiduciary decisions [*e.g.,* selecting the investment options for the 401(k) plan].

However, the DOL asserts that the court does not need to conclude that Ms. Olson was a functional fiduciary because she was a named fiduciary as a member of the Administrative Committee. (The Enron plan document identified the Administrative Committee as a plan fiduciary.)

There have been conflicting court decisions on whether a corporate officer who does not serve in an official (*i.e.,* named or appointed) fiduciary capacity runs the risk of becoming a fiduciary by making fiduciary decisions on behalf of the corporate plan sponsor. The DOL and most of the courts have concluded that such a corporate officer would be determined to have fiduciary status.

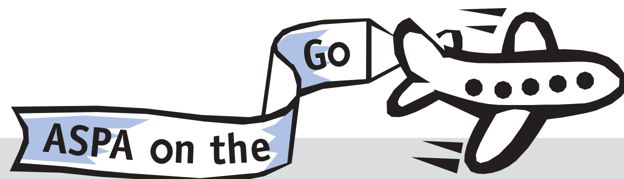
There is no dispute that service as an appointed or named fiduciary (*e.g.,* a plan committee member) results in fiduciary status.

Since fiduciary status means potential personal liability under ERISA, while acting as an agent for the corporation does not, the determination of fiduciary status is significant—particularly to Ms. Olson and the other members of the Administrative Committee who, under the DOL analysis, have their personal net worths exposed to the claims of the 401(k) participants.

Persons Who Have the Power to Appoint Other Fiduciaries Are Themselves Fiduciaries

The DOL stated in its brief that Enron, Kenneth Lay, and the members of the Compensation Committee were fiduciaries because they had the power to appoint, retain, and remove the members of the Administrative Committee.

The DOL's position is not new. Shortly after the enactment of ERISA in September 1974, the DOL expressed its position in Interpretive Bulletin 75-8 that the persons who appoint fiduciaries are themselves fiduciaries. It is the DOL's position that fiduciaries must prudently select and regularly monitor their appointees as well as terminate them when they are not properly performing their duties. The plaintiffs claim that the Compensation Committee failed to monitor the performance of the Administrative Committee. As a result, the plaintiffs say, the failure of the Administrative Committee to perform its duties was not identified and corrected. Assuming the Compensation Committee members were fiduciaries (which appears to be the case), and that the



While ASPA continues to work diligently on issues of importance to its members, it is equally as important that what ASPA is accomplishing is heard by key media sources. ASPA receives frequent mentions in the press for its activities and has been busier than ever writing and distributing press releases. As you can see, February was a particularly busy month:

February 2003 ASPA in the Press

Business Week quotes Brian H. Graff, Esq., ASPA Executive Director, in an article on the President's Savings Proposal.

Employee Benefit Plan Review mentions the 2003 401(k) Sales Summit.

Employee Benefit Plan Review covers ASPA's online exams.

Employee Benefits News covers ASPA's online exams.

Financial Planning Magazine mentions ASPA in an article on cash balance plan issues.

Investment Advisor quotes Brian H. Graff, Esq., in an article on 401(k) Plan Providers.

Investment News mentions the 2003 401(k) Sales Summit.

The New York Times quotes Brian H. Graff, Esq., in an article on the President's Savings Proposal.

Plan Sponsor quotes Bruce L. Ashton, APM, ASPA President-Elect, in an article on Enron and WorldCom events.

If you are interested in reading recent ASPA press releases, go to ASPA's online Press Room at http://www.aspa.org/press/index.htm. Did you see ASPA in the press and want to tell us about it? Contact Amy Iliffe, Director of Marketing and Development, at (703) 516-9300 or e-mail **ailiffe@aspa.org**.

allegations are correct, the members of the Compensation Committee are exposed to potential personal liability.

In our experience, in most cases the plan committee members are appointed by the board of directors or a key officer (*e.g.,* the CEO). In those cases, the directors or the appointing officers would be fiduciaries under this principle.

The board of directors or whoever appoints the plan committee members should review and discuss the qualifications of the candidates—and only qualified people should be appointed to the plan committee. After all, the selection and monitoring of the investment options will have a profound effect on the retirement benefits and post-retirement standard of living for the employees. They should provide the appointees with adequate resources to do their jobs. The appointees should report to their appointer at least once a year as to their activities. The appointing fiduciaries (*i.e.,* the board or the officers) should review that report and approve it, once they are satisfied with its contents. If the appointees are not fulfilling their duties, they should be removed. Finally, all of these activities should be documented and kept in a due diligence file.

Fiduciaries Must Override the Terms of the Plan If They Would Require the Fiduciary to Act Imprudently

The defendants argue that they did not violate their fiduciary duties, as the terms of the plan required them to include Enron stock in the plans.

The DOL indicates in its brief that ERISA §404(a) forbids fiduciaries from following the terms of the plan document where it would be imprudent to do so or would otherwise violate ERISA. The DOL asserts that the defendants should not have allowed participants to invest in Enron stock when they knew it was not a prudent investment. The DOL concludes that, if the stock was no longer a prudent option, the defendants were required to remove it from the plan, even if the plan document provided for it.

Fiduciaries must act prudently and in accordance with ERISA, even if the terms of the plan document require otherwise. Where the terms of the plan conflict with ERISA, fiduciaries are required to ignore those terms. This concept conflicts with the IRS position that the qualification rules require that a plan be administered according to its terms. While it is, from an academic perspective, possible for the two agencies to enforce those conflicting interpretations, as a practical matter it is inconceivable that they would. The likely outcome is that the IRS would defer to the DOL by acknowledging that fiduciaries may override the terms of a plan where it would be imprudent to follow them.

Fiduciaries May Be Liable for Losses Resulting from Participants' Imprudent Investment Options if Requirements of §404(c) Are Not Satisfied

In its brief, the DOL interprets ERISA to say that fiduciaries are not liable for losses sustained by participants resulting from participants' imprudent selection of investments *only* if the requirements of ERISA §404(c) are satisfied. This position is consistent with the language in the preamble to the regulations for ERISA §404(c). The preamble indicates that the DOL considered and rejected the idea of a safe harbor where fiduciaries could either comply with the requirements of the regulation or, alternatively, satisfy the statute by other means. As a result, it appears as though the only way fiduciaries may be relieved of liability for losses resulting from participants' imprudent investment selections is if all of the requirements of ERISA §404(c) are complied with. There are over 20 requirements specified in the regulations to ERISA §404(c).[2]

The DOL brief asserts that the fiduciaries (*i.e.,* the defendants) did not demonstrate that they satisfied the following requirements of ERISA §404(c): (1) participants and beneficiaries must be provided with an explanation that the plan intends to qualify as a 404(c) plan; (2) participants and beneficiaries must be provided with an explanation that fiduciaries will be relieved of liability for losses; and (3) the requirements for employer stock must be satisfied.

While the DOL highlighted those examples, we have seen several other common failures to satisfy ERISA §404(c), including: (1) the failure to appoint a 404(c) fiduciary; (2) the failure to notify participants as to the identity of, and contact information for, the appointed fiduciary; (3) the failure to provide participants with prospectuses immediately before or after their initial investment in a particular option; and (4) the failure to notify participants of the additional information they may request.

The consequence of failing to comply with ERISA §404(c) is that fiduciaries may be personally liable for losses sustained by participants as a result of their imprudent investment decisions.

Trustees May Be Required to Override a Fiduciary's Instructions If the Trustee Knows or Should Know That a Breach Will Occur If It Follows the Instructions

In its brief, the DOL states that if the facts are true as alleged, Northern Trust was required to stop the lockdown. (Prior to Enron, lockdowns were called blackouts. However, politicians, reporters, and plaintiffs' attorneys have added this colorful and dramatic language to our vocabulary.) Northern Trust was a directed trustee and the recordkeeper for the plans. The DOL states that, as a directed trustee, Northern

Trust was a fiduciary. Pursuant to the DOL brief, if Northern Trust "knew or should have known" the truth about the volatility of Enron's stock and the instability of the company, then Northern Trust should have stopped or delayed the lockdown.

The American Bankers Association (ABA) and the SPARK Institute (also known as the Society of Professional Administrators and Recordkeepers) have filed "friend of the court" briefs in the Enron matter arguing against the positions taken by DOL in its brief.[3] The ABA argues that ERISA requires a trustee who is directed by a named fiduciary (*i.e.,* a directed trustee) to comply with the fiduciary's instructions "unless it is clear on its face" that the directions violate the terms of the plan or ERISA. The SPARK Institute argues that the DOL position effectively means that recordkeepers (as opposed to directed trustees) are required to prevent lockdowns if they would be imprudent. This DOL position is only relevant for directed trustees who have the ability to intercede. Northern Trust was in a unique position in that it was a directed trustee as well as a recordkeeper. As a result, it was a fiduciary who, as a recordkeeper, had the ability to stop the lockdown. In most cases, the DOL's position would not be relevant for third party administrators, recordkeepers, and investment providers, as they are not fiduciaries.

Service Providers May Be Liable If They Participate in a Breach of Fiduciary Duty

Service providers who are typically non-fiduciaries may be liable under ERISA if they have actual or constructive knowledge of the circumstances that make a fiduciary's actions a breach of fiduciary duty and if they participate in the breach. The DOL brief states that Arthur Andersen may be liable to the plaintiffs for participating in the fiduciaries' breach of fiduciary duty. It cites the Supreme Court's holding in *Harris Trust v. Salomon Smith Barney* as authority for its position.

If a service provider (*e.g.,* a third party administrator, consultant, or broker) becomes aware of actions that may be a breach of fiduciary duty, the service provider should consult with an ERISA attorney to determine if it has any exposure. As a general comment, be particularly cautious about advising, documenting, or reporting any such activities. For example, if the service provider falsely completes a Form 5500 by failing to disclose a prohibited transaction, there may be exposure. Similar issues exist for documenting transactions like plan loans or other transfers of money or assets that are imprudent or prohibited.

Conclusion

The DOL's Enron brief provides a unique opportunity to understand the DOL's positions on ERISA's requirements for 401(k) fiduciaries. ERISA requires fiduciaries to act prudently in all of the aspects of their fiduciary duties. Fiduciaries should be cognizant of those requirements, should perform their duties in a thoughtful and thorough manner, and should carefully document their activities in order to avoid potential problems. ▲

[1]See **www.reish.com/publications/pdf/dol_enron.pdf**

[2]See **www.reish.com/pa/benefits/20steps.cfm**

[3]See **www.reish.com/publications/pdf/aba_enron.pdf** and **www.reish.com/publications/pdf/spark_enron.pdf**

Fred Reish, Esq., APM, is a founder and partner of the Los Angeles law firm Reish Luftman McDaniel & Reicher. He is a former co-chair of ASPA's Government Affairs Committee (GAC) and is currently the chair of GAC's 401(k) Fiduciary Task Force.

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Top-Heavy Requirements After EGTRRA

by William G. Karbon, MSPA, CPC, QPA

TOP-HEAVY RULES WERE ESTABLISHED WITH THE INTENT OF PROVIDING ADDITIONAL MINIMUM BENEFITS TO RANK-AND-FILE EMPLOYEES. HOWEVER, THE COST AND ADMINISTRATIVE BURDENS BROUGHT ABOUT BY THESE RULES ARE BELIEVED TO BE A DETERRENT TO THE ESTABLISHMENT OF NEW PLANS BY SOME SMALL EMPLOYERS. EGTRRA SOUGHT TO EASE THIS DETERRENT BY SIMPLIFYING THE TOP-HEAVY RULES, ALLOWING EMPLOYERS TO MEET MINIMUM CONTRIBUTION RULES BY CREDITING ALL CONTRIBUTIONS AS WELL AS ELIMINATING CERTAIN PLANS FROM TOP-HEAVY REQUIREMENTS.

Tax qualified retirement plans that primarily benefit key employees are known as top-heavy plans. Specifically, a top-heavy plan is a plan that, as of a determination date, provides more than 60% of its benefits to key employees. If a plan is top-heavy, it is subject to certain minimum benefit or contribution requirements as well as minimum vesting standards. The determination of top-heavy status as well as the crediting of minimum contributions or benefits, which are set forth at Internal Revenue Code (IRC) §416, were significantly changed by EGTRRA as discussed below.

Key Employees

Prior to EGTRRA, a key employee was defined as an employee who, during the plan year that ends on the determination date or any of the four preceding plan years, is as follows:

- An officer with compensation in excess of 50% of the defined benefit dollar limit. For 2001, this compensation threshold was $70,000.
- One of the ten employees with the largest interest in the employer who has compensation in excess of the annual addition limitation for a plan year. For 2001, the annual addition limitation was $35,000.
- An individual with a greater than 5% interest in the employer.
- An individual with a greater than 1% interest in the employer who has compensation in excess of $150,000 for a plan year.

For plan years beginning after December 31, 2001, the definition of key employee has been simplified by eliminating the top-ten shareholder component and the 4-year look back provisions. Post EGTRRA, a key employee is defined as an employee who during the plan year that ends on the determination date, is as follows:

- An officer with compensation in excess of $130,000. The $130,000 compensation threshold will be increased in $5,000 increments to reflect cost of living adjustments.
- An individual with a greater than 5% interest in the employer. No change from the pre-EGTRRA rules.
- An individual with a greater than 1% interest in the employer who has compensation in excess of $150,000 for a plan year. No change from the pre-EGTRRA rules. In fact, as with the pre-EGTRRA rules, the $150,000 compensation threshold is not subject to cost of living adjustments.

In applying the ownership tests above, the ownership attribution rules of IRC §318 apply both pre- and post-EGTRRA.

The number of officers that can be considered key employees is limited to the lesser of three or 10% of the number of employees. However, under no circumstances can the number of officers exceed 50.

Distribution Look Back Rules

In determining top-heavy status, the total benefits attributable to key and non-key employees include the present value of accrued benefits in a defined benefit plan and the value of participant accounts (including balances resulting from catch-up contributions) in a defined contribution account. These values, which exclude rollovers from plans sponsored by unrelated employers, are determined without regard to vesting. In addition, distributions during a look back period are included in a top-heavy determination. The look back rules were dramatically changed by EGTRRA.

Prior to EGTRRA, top-heavy determination included distributions made during the plan year containing the determination date as well as the four preceding plan years. The determination date is the last day of the plan year preceding the plan year being tested. The determination date for a plan's initial year is the last day of that year.

Effective for plan years commencing after December 31, 2001, distributions made on account of a participant's separation from service, death, or disability during the one-year period ending on the determination date will be taken into account for top-heavy determination purposes.

IRC §416(g)(3)(A)(ii), as amended, states that the one-year look back period also applies to a terminating plan only if the terminating plan would have been required to be included in the aggregation group if it did not terminate. However, a distribution from a terminated plan that is either rolled over or transferred to another plan of the employer must continue to be counted for top-heavy purposes as a related rollover.

However, IRC §416(g)(3)(B), as amended, states that the five-year look back period applies to any distribution that is not made due to separation from service, death, or disability without reference to the plan termination exception. This has led some practitioners to question whether distributions resulting from a plan termination are truly eligible for the one-year look back exception. The requirements of IRC §416(g)(3)(B) subjects in-service distributions such as corrective distributions, hardship withdrawals, or age 59½ withdrawals to the five-year look back period.

The treatment of QDRO distributions have not been specifically addressed in any guidance received from the IRS. However, in Notice 87-21, the IRS treated an alternate payee similarly to a death benefit beneficiary. Therefore, it may be reasonable to conclude that QDRO distributions are subject to the new one-year look back rule.

Special Rule

A special rule applies to any employee who was previously a key employee and subsequently becomes a non-key employee. The benefits of these employees who cease to be a key employee are excluded from the determination of top-heavy status. This provision had limited applicability prior to EGTRRA because the 4-year look back in the key employee determination prevented most key employees from becoming a non-key employee. However, EGTRRA eliminated the 4-year look back in determining key employee status and that will significantly increase the applicability of this special rule. (Please note that there is no corollary rule for when a non-key employee becomes a key employee.)

Crediting of Top-Heavy Minimum Contributions and Benefits

Generally, qualified plans are subject to the following minimum contribution and benefit requirements in any year that the plan is deemed top-heavy:

- Defined contribution plans must provide a contribution of 3% of compensation, or the greatest percentage of compensation allocated to a key employee if such percentage is less than 3%. Only plan participants who are employed on the last day of a plan year are required to receive a top-heavy minimum contribution.
- All employer contributions as well as salary deferrals, excluding catch-up contributions, are used to determine a key employee's greatest percentage of compensation.
- Defined benefit plans must provide a benefit of 2% of average compensation times years of service credited in years that the plan is deemed top-heavy, not to exceed ten.

Additional minimum contribution and benefit requirements apply to employers who sponsor both a defined contribution plan and a defined benefit plan. These rules were simplified when the dual plan limit of IRC §415(e) was eliminated for plan years commencing in 2000. Basically, the plan document must clearly provide which plan will provide the top-heavy minimum benefits or contributions for employees who participate in both types of plans sponsored by the same employer.

Prior to EGTRRA, defined contribution plans were not permitted to use matching contributions to meet their top-heavy minimum contribution requirement unless the matching contribution was not used in the annual ACP test. However, post-EGTRRA matching contributions can now be used to meet minimum top-heavy contribution requirements as well as being used in the annual ACP testing.

A significant difference between a top-heavy defined contribution and defined benefit plan is that in a top-heavy defined benefit plan a non-key participant must receive a top-heavy minimum benefit regardless of the benefits provided to key employees. Therefore, prior to EGTRRA, a top-heavy defined benefit plan that froze benefits was required to continue to provide top-heavy minimum benefits to non-key employees. However, EGTRRA changed this requirement. Frozen defined benefit plans are no longer required to provide top-heavy minimum benefits.

Top-Heavy Vesting Schedules

As was the case prior to EGTRRA, for plan years in which a plan is deemed to be top-heavy, the plan is subject to more stringent vesting standards than non-top-heavy plans. Specifically, a top-heavy plan must vest at least as rapidly as under a three-year cliff vesting schedule or a six-year graded vesting schedule. The three-year cliff vesting schedule requires no vesting until a participant completes three years of service, at which time the participant becomes 100% vested. The six-year graded vesting schedule requires 20% vesting after a participant completes two years of service, with an additional 20% vesting being earned for each year of service thereafter.

Continued on page 24

401(k) Sales Summit Highlights

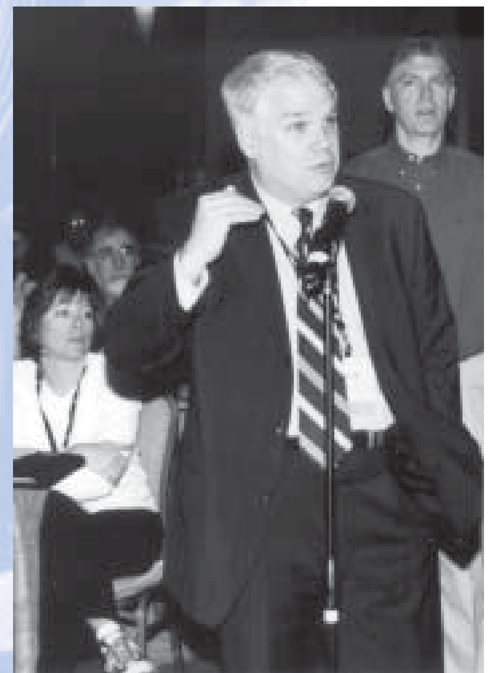
The 2003 ASPA 401(k) Sales Summit (February 27–March 1) surpassed all expectations! 750+ attendees, 68 exhibitors, great speakers, pre-conference insurance continuing education sessions and sales and marketing sessions, and the Arizona sunshine all added up to one spectacular event!

Brian H. Graff, Esq., ASPA's Executive Director, gave a "Washington Update" with all the latest news from Capitol Hill, including the President's budget proposal and its potential effects on the retirement industry.

Andrew Davis, president of Davis Advisors and portfolio manager for Davis Real Estate and Convertible Securities Portfolios, and Foster Friess, chairman, Friess Associations, manager of the Brandywine Funds, spoke on "Growth Investing in the Real New World."

Plan now to attend the 2004 401(k) Sales Summit, February 22–24, at the Marriott World Center in Orlando, Florida.

Bruce Ashton, APM, ASPA's President-Elect, spoke on 412(i) plans with Joyce Gordon, CPC.



Conference Co-Chair, Mark Davis, asked a question from the floor.

All photos courtesy of Chip Chabot,
ASPA's Webmaster/Multimedia Manager

Lunch provided a networking opportunity to broaden business contacts.

Exhibitors enjoyed the chance to demonstrate their products and services to a sold-out audience.

The Keynote Presentation was entitled "Conquering Mountains." Alan Hobson, who has conquered Mt. Everest as well as cancer, set just the right tone for how to meet and surpass your potential.

The success of the 2002 401(k) Sales Summit lured many exhibitors back for a second year, but there was also room for several new booths. Next year, in Orlando, the exhibit hall space will be nearly double what it was in 2003.

The exhibit hall was filled with a lot of "qualified" traffic.

Steff Chalk, president, Chalk 401(k) Advisory Board, presented one of the workshops in the Sales Track, "What Do Sponsors Expect From You?" In addition to the Sales Track, Summit tracks included Plan Design and Legal, Investments, and Cross Sales.

401(k) Sales Summit

2003 ASPA 40l(k) Sales Summit Speakers

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Upcoming ASPA Conferences

ASPA and the IRS, working together, co-sponsor five employee benefits conferences each year. The conferences provide retirement plan professionals and government agency representatives an oppotunity to discuss the latest regulations, legislation, and business practices relating to the pension industry.

Upcoming ASPA/IRS conferences include:

- **Great Lakes Area Benefits Conference**
  May 1–2, 2003
  Chicago, IL
- **Mid-Atlantic Benefits Conference**
  May 13–14, 2003
  Philadelphia, PA
- **Northeast Area Benefits Conference**
  June 12–13, 2003
  Boston, MA and White Plains, NY
- **Mountain States Benefits Conference**
  Co-sponsored with the Western Pension & Benefits Conference
  September 12–13, 2003
  Denver, CO
- **Los Angeles Benefits Conference**
  January 29–30, 2004
  Universal City, CA

A Conference Designed for
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the Pension Professional,
in Mind

2003 Mid-Atlantic Benefits Conference
Philadelphia, PA

Loews Philadelphia Hotel
May 13–14, 2003

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The MABC is an essential learning and interactive experience for serious pension practitioners.

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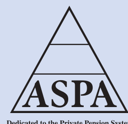

Washington Update
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www.aspa.org

For updated information on all ASPA conferences, visit our Web site at **www.aspa.org**.

Welcome New Members

Welcome and congratulations to ASPA's new members and recent designees.

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James L. Losey Jr.
Gregory Edward Matthews
Timothy J. Snyder
Agnes T. Szabo

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Donald C. Atherton
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Jacquelyn Battles
Catherine M. Beaver
Michael Beal Benedict
Santo L. Blumke
Shelly C. Boldizsar
Sharon D. Bolduc
Richard A. Bond
Arup K. Bose
Susan B. Brown
Jeffrey H. Burg
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Blair T. Campbell
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Nathan O. Carlson
Phoebe A. Chambers
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Melinda K. Harris
William A. Haycraft
William C. Hoeffer Jr.
Troy A. Holbrook
Pam S. Hrubes
Susan A. Jarnagin
Edward N. Johnson
Jeffrey L. Johnson
Joel L. Kline
Renee Diggan Laychur
Candice L. Leto
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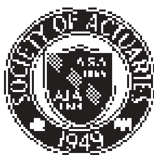
Louis Sergi
Ashok Shendure
Gregory T. Shields
Eric M. Sholberg
Rhett R. Smith
Steven L. Spurling
Greg C. Steber
Peter J. Sullivan
John A. Taylor III
David B. Test
Laura J. Tetterton
Stilson N. Tomita
Klaas D. Vander Baaren
Dale R. Vlasek
David C. Wade
Phylyp A. Wagner
Jessie Ellen Waller
Mark G. Walton
Martin A. Watkins
Todd A. Wetzel
Ernest R. Widmann
Kenneth D. Wilke
Wade P. Wilson
Stephen D. Wilt
John M. Wirtshafter
Miranda L. Wisniach
David S. Woodward
Jason A. Woon
Angela S. Zewe

Actuarial Research Exchange Launched

THE ACTUARIAL RESEARCH EXCHANGE, AN ONLINE-BASED SERVICE DESIGNED TO LINK ACADEMIC RESEARCHERS AND PRACTICING ACTUARIES FOR COLLABORATIVE WORK ON PRACTICAL BUSINESS PROBLEMS, WAS LAUNCHED IN JANUARY 2003. THIS SERVICE WAS ESTABLISHED BY THE COMMITTEE ON ACADEMIC RELATIONS, WHICH IS A JOINT COMMITTEE OF THE CASUALTY ACTUARIAL SOCIETY, THE CANADIAN INSTITUTE OF ACTUARIES, AND THE SOCIETY OF ACTUARIES.



Essentially a matching service, the Actuarial Research Exchange links faculty researchers with opportunities, taking into consideration the issue to be addressed and the background, expertise, and interests of the potential researcher. The service is hosted online through the Web site of the Actuarial Education and Research Fund (AERF), and represents more than a year's work of the Committee and the cooperative effort of AERF and the three sponsoring actuarial organizations.

The chairperson of the Committee on Academic Relations, Dale Porfilio, was ebullient when asked to describe the inspiration behind the new service. "The existing research programs of each actuarial society already produce high-quality research. However, this research is usually performed independently by practicing actuaries *or* academics. At the same time, some research ideas sit in the minds of practicing actuaries but do not get done due to lack of resources. The Committee on Academic Relations is creating the research exchange to more fully apply the excellent research abilities of academics to the research needs of the actuarial profession in a cooperative, interactive format," explained Porfilio.

The goal of the Committee on Academic Relations for the Actuarial Research Exchange is to increase the number of collaborative projects between practitioners and the academic community. In time, joint faculty and business research projects will be more common, such as having a faculty member spend a summer on sabbatical leave at a business working with the organization's actuaries on practical actuarial problems.

The Actuarial Research Exchange consists of two main components. One section lists the research opportunities posted by organizations, and the other section lists the faculty members interested in conducting research, including specific areas of interest.

Organizations are encouraged to post their research needs on the Actuarial Research Exchange Web site, where faculty researchers can review the opportunities and respond to those that match their research interests. There is no cost to the organization to post a research opportunity, which can be submitted through the Web site by completing an online form.

An additional benefit to organizations is provided through the list of faculty members who are interested in conducting research. The listing allows companies to contact faculty members directly about research projects. Faculty members who want to take advantage of this complimentary service can post their contact information, research interest, and brief vitae.

Completed research projects that are not proprietary will be published on the Web site to serve as a showcase for joint projects between academic researchers and practicing actuaries.

The Actuarial Research Exchange is the latest project of the two-year old Committee on Academic Relations. The focus of the committee is to encourage and facilitate the evolving relationship between the actuarial profession and the academic community in order to achieve partnership on key initiatives. The committee's responsibilities include maintaining the Academic Relations e-mail discussion list and the Actuarial College Listing. In addition to Chairperson Porfilio (CAS), committee members include Grover Edie (CAS), Nasser Hadidi (CAS), Bryan Hearsey (SOA), Michel Jacques (CIA), Steve Kopp (CIA), Arnold Shapiro (SOA), Alice Underwood (CAS), and Catherine Wallach (SOA).

The Actuarial Research Exchange can be accessed at **http://www.aerf.org**. ▲

Information provided by the Casualty Actuarial Society, the Canadian Institute of Actuaries, and the Society of Actuaries.

Focus on E & E

Using Better Technology, E&E Makes Big Changes in 2003—and There's More to Come

by Michael L. Bain, MSPA

THE ENTIRE EDUCATION AND EXAMINATION (E&E) COMMITTEE AND OUR NATIONAL OFFICE STAFF ARE EXCITED ABOUT THE CHANGES WE ARE MAKING TO E&E'S PROGRAM DURING 2003. AFTER REVIEWING CANDIDATE SURVEYS AND LISTENING CLOSELY TO NEW IDEAS, WE KNOW THAT THE ACTIONS BEING TAKEN WILL ONLY IMPROVE AN ALREADY GREAT EDUCATION PROGRAM.

Working with Prometric, we piloted the use of a new test driver for the C-2(DB) exam in the fall of 2002. The new test driver's use will be expanded from not only the C-2(DB) exam, but also to the C-1 and C-2(DC) exams for the spring 2003 exam administration.

How will the new test driver affect the exam candidate? The candidate will leave the Prometric site with a scaled score instead of a simple pass or fail. The "instant grade" will enable Prometric to print a list of chapters in which the candidate scored 70% or less and deliver that list to the candidate before the candidate leaves the testing site.

In addition, in the spring of 2003, the C-3 exam will be administered at Prometric. We will be adding C-3 in the spring and possibly C-4 in the fall to the exams administered by Prometric. The candidate will have more test sites and better exam security with the ease of typing answers instead of writing in blue books. It is our hope that having more easily read exams available for online grading will eventually decrease the length of time that it takes to get the grades to the candidates.

Our take-home exams are being positively impacted, too. 2003 will be the first full year of having the PA-1 and Daily Valuation exams available online through the new and improved ASPA Web site. (If you have not visited the new ASPA Web site at **www.aspa.org** since the first of the year, you should do it today! There are many new features and enhancements.) The advantage to the candidate is instant grading and the ease of online exam administration. Since their availability in late September 2002, more than 1,000 candidates have taken their exams online at ASPA's site. We expect that number to more than double this year.

Yes, E&E is excited about 2003. With the changes outlined earlier, we have greatly improved the exam delivery system. We are now focused on improving statistical reviews and clarifying learning objectives. If you have any questions about the changes occurring in 2003, contact the ASPA office at (703) 516-9300 or **educaspa@aspa.org**.

Look for more changes and enhancements planned for 2004! ▲

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

Nominations Open for Educator's Award

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

If you know an ASPA member who has made a significant contribution to pension education (*e.g.,* through instruction, conferences, ASPA Benefit Councils, promotion of ASPA's education program, or preparation of education materials), please go online at **www.aspa.org/edu/** and submit the online form by June 1, 2003. Please include a few paragraphs in support of your nomination, including nominee background information. Nominations may also be faxed to (703) 516-9308.

The recipient of the Educator's Award will receive a plaque in recognition of his or her achievement, complimentary registration to the 2003 ASPA Annual Conference to attend the award presentation, one night's accommodation, and feature articles in *The ASPA Journal* and *The Candidate Connection.*

You may mail the nomination (and supporting paragraphs) to:

Director of Education Services, ASPA
4245 North Fairfax Drive, Suite 750
Arlington, VA 22203

Continued from page 8

Tinker, Tailor, Soldier, Sailor...Employee?

Looking carefully at the situation, the controller realized that the two managers had performed services for SubCo under the direction, supervision, and control of SubCo's CEO. Even though they had been paid by Nozama and treated as Nozama employees, legal counsel confirmed that the two managers had been SubCo employees during 1999–2002 (and perhaps during 1998). Since the two managers had not performed services for Nozama, they were not employees of Nozama for these years. Accordingly, they were not entitled to participate in Nozama's profit sharing plan. This misclassification created a serious problem—money had been allocated to the two managers and they had been given statements showing amounts allocated to their accounts. However, technically they were not entitled to the money and there was no basis for distributing the funds held in their accounts or returning the monies to Nozama. Once again, the Nozama profit sharing plan was threatened with disqualification—this time for providing benefits to individuals who were not employees of Nozama (a violation of the exclusive benefit rule under the Code). What's more, the two managers should have participated in SubCo's plan because they were SubCo employees during 1999–2002. SubCo had not covered them, determining that they were leased employees excluded under the plan's terms.

The IRS Twenty-Factor Test

Federal employment tax regulations generally provide that the relationship of employer and employee exists when the company for which services are provided has the right to control and direct the individual who performs the services, not only with regard to the result to be accomplished, but also in the details and means by which the desired result is accomplished. In other words, an employee is subject to the will and control of the employer, not only in *what* should be done, but *how* it should be done. It is not necessary that the company for which services are performed actually direct or control the manner in which services are performed; it is sufficient if the company has the right to do so.

How's that for clear as mud? To further aid companies in determining whether workers are employees or independent contractors, the IRS has identified twenty separate factors, listed here, which indicate whether sufficient control is present to establish an employer-employee relationship. The IRS has stated that these factors may be given different weights depending on the facts of each case. In other words, the fact that eleven out of the twenty factors point to independent contractor status does not necessarily mean that a worker is an independent contractor. The IRS and the courts also have clearly stated that calling a worker an "independent contractor" or entering into an agreement designating the worker as an independent contractor will not make any difference if the facts indicate that sufficient control is exercised over the worker to establish an employer-employee relationship.

If the questions in the table on the next page are answered "Yes," this indicates that the worker is an employee of the company receiving services performed by the worker.

In the case study, it is clear that Nozama's workers were employees. In real life, the factors can be hard to apply and companies can be left with serious questions as to whether workers are independent contractors or employees. If you find yourself in that situation, get tax advice from a qualified professional. As you can see from the experiences of Nozama, misclassifying workers can be costly. ▲

This article originally appeared in Focus On Benefits, *Volume 8, Issue 1–Spring 2000, Copyright 2002, and is republished with permission from Chang Ruthenberg & Long PC. All rights reserved.*

James C. Paul is a shareholder of Chang Ruthenberg & Long PC, an employee benefits law firm. Jim's practice includes working with qualified retirement plans, nonqualified deferred compensation plans, welfare plans, stock based compensation plans, and all aspects of employee benefits law. His experience includes pension and welfare benefits litigation, fiduciary litigation, and representation of Taft-Hartley trust funds. Jim is the current chair of the ASPA IRS subcommittee and he frequently speaks and writes on employee benefits issues.

Factors	Application to Temps-R-Us Workers Used by Nozama
1. Instructions: Is the worker required to comply with instructions given by the company receiving the services?	The Temps-R-Us workers were required to comply with detailed instructions from Nozama regarding when, where, and how services were to be performed.
2. Training: Does the company receiving the services provide training to the worker by requiring an experienced worker to work with them, by corresponding with the worker, by requiring the worker to attend meetings, or otherwise indicate that the services are to be performed in a particular method or manner?	Nozama provided on-the-job training, along with required meetings for the Temps-R-Us workers.
3. Integration: Are the services performed by the worker integral to the business operations of the company receiving the services?	Nozama clearly determined that warehouse workers were required as an integral part of its business.
4. Services Rendered Personally: Is the worker required to personally render services or can he sub-contract or hire others to do the work?	The Temps-R-Us workers were required to render services personally to Nozama and were not permitted to sub-contract or hire others to do their work.
5. Hiring, Supervising, and Paying Assistants: Does the company receiving the services hire, supervise, and pay assistants for the worker?	In this case, all warehouse assistants were hired and paid by Temps-R-Us, but they were supervised by Nozama.
6. Continuing Relationship: Does the worker have a continuing relationship with the company receiving the services?	With the exception of normal turnover, the Temps-R-Us workers had a continuing relationship with Nozama over a three-year period.
7. Set Hours of Work: Does the company receiving the services set working hours?	Nozama set the working hours for the Temps-R-Us workers.
8. Full Time Required: Is the worker required to work full time for the company receiving the services?	The Temps-R-Us workers were required to work full time for Nozama.
9. Location: Is the work performed on the premises of the company receiving the services?	All services performed by the Temps-R-Us workers were performed on the premises of Nozama.
10. Set Order Or Sequence: Must the worker perform services in a set order or sequence?	The order or sequence of work for warehouse workers was set by Nozama management.
11. Reports: Is the worker required to submit regular oral or written reports?	The Temps-R-Us workers were required to routinely provide oral and written reports to Nozama management concerning orders received and shipped.
12. Periodic Payments: Is the worker paid by the hour, week, or month (vs. payment by the job or on a project basis)?	The Temps-R-Us workers were paid every two weeks, based on an hourly rate.
13. Expenses: Does the company receiving the services pay business and travel expenses for the worker?	This factor is inapplicable because the warehouse workers did not regularly incur business or travel expenses.
14. Tools and Materials: Does the company receiving the services supply tools and materials for the workers?	Nozama supplied all necessary tools and materials.
15. Investment In Facilities: Does the worker lack a significant investment in facilities used by the worker in performing services?	The Temps-R-Us workers had no investment in facilities used in performing services for Nozama.
16. Profit Or Loss: An employee generally does not realize profit or loss on a job; an independent contractor can realize a profit or loss.	The Temps-R-Us workers were paid by the hour and did not have the opportunity to realize a profit or loss.
17. Exclusive Services: Does the worker perform services exclusively for one company?	Since Nozama required full time workers, the Temps-R-Us workers would likely not have had the time to work for other companies. However, they were not prohibited from doing so.
18. Services Available To General Public: Does the worker offer his services only to the company?	None of the Temps-R-Us workers made their services available to the general public on a regular and consistent basis.
19. Right To Discharge: Does the company receiving the services have the right to discharge the worker?	Nozama retained the right to terminate the warehouse workers, by giving notice to Temps-R-Us. Nozama exercised this right on several occasions from 1997–2002.
20. Right To Quit: Does the worker have the right to stop providing services without incurring liability?	All Temps-R-Us workers retained the right to voluntarily quit without incurring liability.

Continued from page 13

Top-Heavy Requirements After EGTRRA

As a side note, EGTRRA requires that employer matching contributions be subject to the same minimum vesting standards that are applicable to top-heavy plans.

Plans Exempt From Top-Heavy Minimum Requirements

EGTRRA amended the definition of a top-heavy plan to exclude a plan consisting *solely* of a 401(k) feature that complies with IRC §401(k)(12) ADP safe harbor requirements and matching contributions that satisfy the safe harbor requirements of IRC §401(m)(11). If not for this exception, if a plan is considered a top-heavy plan because of membership in an aggregation group, contributions to the plan may be taken into account in determining whether any other plan in the group meets the IRC §416(c)(2) minimum contribution requirements.

The "contingent benefit rule" states that a 401(k) plan is tax qualified only if no other benefit (other than a matching contribution) is conditioned upon an employee's election to defer. EGTRRA specifically states that the dual use of the employer match to meet the top-heavy contribution requirements as well as the meeting the requirements of the ACP test does not violate the "contingent benefit rule."

The following plans, which were exempt from top-heavy requirements prior to EGTRRA, continue to be exempt from the top-heavy rules:

- SIMPLE IRAs and SIMPLE 401(k) plans. (However, as was also the case prior to EGTRRA, SEPs and SARSEPs continue to be subject to the top-heavy minimum contribution requirements.)
- Governmental plans maintained for employees of the US government, any state or political subdivision of a state, or any federal or state agency or instrumentality.
- Employees covered by a plan established pursuant to a collective bargaining agreement (but only if their pension benefits were subject to good faith bargaining).

Triple Use Of Top-Heavy Minimum Contributions

EGTRRA did not change the ability to use a top-heavy minimum contribution for three purposes, namely the top-heavy contribution, a non-elective safe harbor contribution, and a non-elective contribution for IRC §401(a)(4) cross-testing. An employer with the appropriate demographics can use one non-elective employer contribution to meet the employer contribution needs of a cross-tested profit sharing plan, with a safe harbor 401(k) component, that is top-heavy.

Although such a plan design can be very effective, there are some drawbacks. Unlike a required top-heavy contribution, a safe harbor contribution must be immediately vested. In addition, a safe harbor contribution must be allocated to all participants (other than those that could be statutorily excluded) who are eligible to make a salary deferral contribution without regard to hours of service or a last day of the year requirement, whereas, a top-heavy contribution must only be made for eligible participants who are still employed on the last day of the plan year.

Conclusion

Although EGTRRA attempted to reduce the administrative burden brought about by the top-heavy requirements, close attention must be paid to the new rules. Since in-service distributions are now treated differently than post-employment distributions, an additional level of complexity has been added to the distribution look back rules.

Although 401(k) plans consisting solely of safe harbor employer matching contributions are exempt from top-heavy minimum contribution requirements, the contribution of any employer monies in addition to the safe harbor match will once again subject the plan to the top-heavy contribution requirements. Therefore, clients must understand the consequences of this exemption from the top-heavy rules.

Planning with our clients is required as we attempt to develop a plan design that minimizes the requirements of the top-heavy rules on qualified retirement plans. We will also need to follow the progress of 2003/2004 legislation, as President Bush included the repeal of top-heavy rules for defined contribution plans in his 2004 federal budget proposal. ▲

William G. Karbon, MSPA, CPC, QPA, is a senior retirement plan consultant with CBIZ Benefits & Insurance Services, Inc., located in Plymouth Meeting, PA. Bill is also an Enrolled Actuary and holds a BA degree in economics from Rutgers University. Additionally, he serves on ASPA's Education and Examination Committee.

Bill has been a featured speaker for professional organizations such as ASPA, authors the Pension Roundup *on freeerisa.com, has done technical reviews for books on 401(k) plans, and has been an instructor for advanced consulting classes sponsored by ASPA.*

Focus on ABCs

ASPA Benefits Council of Cleveland

by Edward Paul Bock II, QPA

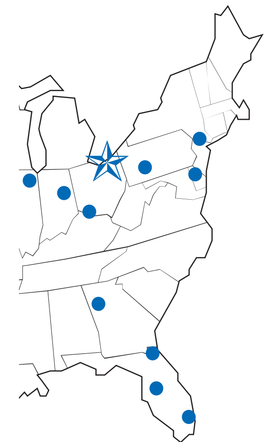
THE CLEVELAND AREA ASPA CHAPTER HAS A LONG AND SUCCESSFUL HISTORY. FORMED IN 1997, WE HAVE ENJOYED SIX YEARS OF NETWORKING AND SHARING IDEAS. WE ARE LOOKING FORWARD TO AN EXCITING 2003-2004. OUR SUCCESS HAS BEEN DUE IN LARGE PART TO THE FOLLOWING OFFICERS: DONNA BREWSTER, QPA, PRESIDENT; HARRY SLOCUM, APM, TREASURER; PETER KISH, SECRETARY; AND ROBYN MORRIS, IMMEDIATE PAST PRESIDENT. HONORABLE MENTION IS ALSO DUE TO CATHY WOLFORD, MSPA, CPC, WHO HAS COORDINATED OUR SUMMER WORKSHOP FOR THE PAST TWO YEARS AND IS CURRENTLY WORKING ON THIS SUMMER'S WORKSHOP.

Our planning year begins in August when we lay the groundwork for our luncheons. These are scheduled every other month between October and June. Extensive work goes into the coordination, procuring of speakers, and logistics for the Summer Workshop.

This year's luncheon topics include *Plan Sponsor Responsibility, Time and Stress Management During "Busy Season", DOL Correction Programs, Legislative Update,* and *Successfully Negotiating with the IRS/DOL.*

The Summer Workshop will be held on Thursday, August 21, 2003. Proposed topics include *Controlled Groups/Affiliated Service Groups, Distributions and Estate Planning, Compensation Definitions, Fiduciary Responsibility*, and a *Legislative Update*. The seminar is sectioned into beginning, intermediate, and advanced levels so that all attendees will find topics suited to their needs. For more information on the ASPA Benefits Council of Cleveland, contact us at **aspacleveland@aol.com**. ▲

Edward Paul Bock II, QPA, is a relationship manager for Manulife Financial who provides ongoing support and services for the third party administrators working with the Manulife product. Paul has been involved in all aspects of defined contribution plan administration for more than nine years and has been a member of ASPA since 1998.



ASPA Benefits Councils Calendar of Events

Date	Location	Event	Speakers
April 22	Atlanta	Benefit Plans under Current Economic and World Conditions	Eleanor Banister
April 22	Northern Indiana	Uniformed Services Employment and Replacement Act of 1994 (USERRA): What You Need to Know With Regard to Retirement Benefits as Employees Are Called to Active Duty	Tom Ackmann
April 22	Northern Indiana	Significant Issues in Regards to Blackout Periods and the Sarbanes Oxley Act	Kathy Bayes
April 30	Dallas/Ft. Worth	Legislative Update	Brian H. Graff, Esq.
April 30	Texas Gulf Coast	The Joys of Controlled Group, Common Control, and Affiliated Service Rules	Derrin Watson
June 17	Atlanta	How to Fix a Broken Plan	John Hartness, Esq. Mary Low Bailey-Funk
June 26	Cleveland	Successfully Negotiating with the IRS/DOL	TBA

FUN-da-MENTALs

FUN QUOTES

"Next to being shot at and missed, nothing is quite as satisfying as an income tax refund."

"April is a difficult month. Even if your ship comes in, the IRS is there to help you unload it."

"I'm proud to be paying taxes in the US. However, I could be just as proud for half the money!"

—Authors Unknown

SIDE FUN

"One good thing about the recession . . . we're not earning anything to be taxed on."

CONTEST

How Many Words Can You Make from the Word "ACTUARIES"?

Rules

- No plurals of a word that has already been listed.
- No proper nouns or names.
- Use a letter only as many times as it appears in the word ACTUARIES (*i.e.*, You can use the letter "A" twice, but you can only have one instance of every other letter.)

Submit your entries by mail to Troy Cornett, Office Manager, by e-mail to **tcornett@aspa.org**, or fax them to Troy at (703) 516-9308. Entries should be formatted one word per line (preferably in Word or Excel). The winner will receive a free registration to an ASPA webcast and several ASPA "souvenirs." Include your name, company name, phone number, e-mail address, and mailing address on your entry. Applicants must be ASPA members to win.

Deadline: June 16, 2003.

WORD SCRAMBLE

Unscramble these four puzzles—one letter to each space—to reveal four pension-related words. Answers will be posted on the eASPA portion of ASPA's Web site at **https://router.aspa.org**. Login, go to Members Only>Newsletter, and look near the bottom of the page.

ROYAL MITT __ __ ◯ __ ◯ __ ◯ __ ◯

NT CREEP __ ◯ __ __ ◯ __ ◯

R SPOONS ◯ ◯ __ __ ◯ ◯ __

CALF IS ◯ __ ◯ __ ◯ ◯

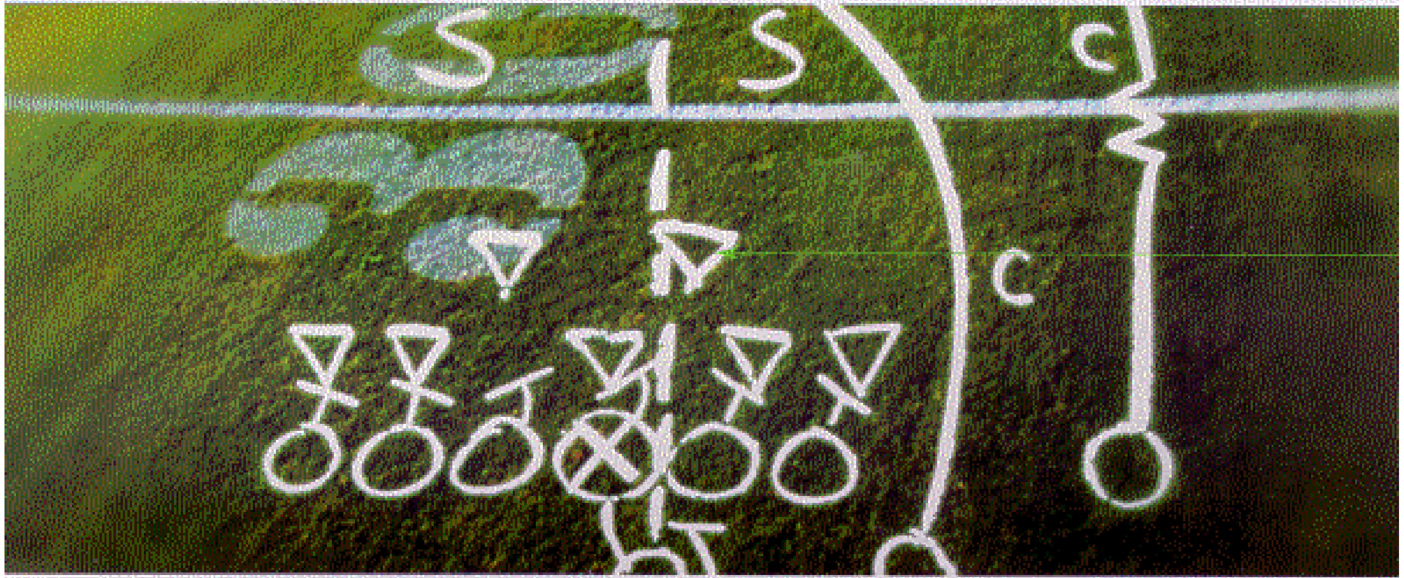
BONUS: Arrange the circled letters to form the Mystery Answer as suggested by the cartoon.

Mystery Answer:

"◯◯◯◯'◯" ◯◯◯◯◯ ◯◯◯◯◯

It was the favorite bedtime story book for this benefits consultant.

Flashy plays make the headlines, a solid strategy wins the game.



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Consistent success depends on a winning strategy – applied with discipline. That's why the Victory Special Value Fund is managed according to our proven value philosophy, team process, and independent fundamental research. We buy only stocks that meet our strict requirements, building well-diversified portfolios including stocks from all economic sectors. And our team actively manages the portfolio with the goal of superior long-term returns on a risk-adjusted basis. Put our game plan to work for your clients.

Victory Funds

Victory Funds are available through numerous platforms or the Victory Funds Financial Professional Line at 1-800-423-0898.

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Bulletin Board

Education

April 25
Registration Deadline for Spring Weekend Courses

May 1–June 30
C-1, C-2(DB), C-2(DC) Spring Examination Window

Conferences

May 1–2
Great Lakes Area Benefits Conference
Chicago, IL

May 13–14
Mid-Atlantic Benefits Conference
Philadelphia, PA

Membership

April 15
Deadline for Payment of 2003 ASPA Membership Dues

A New Face on a Trusted Name

Information is at your fingertips at **www.aspa.org.**

New features include:

- Complete redesign for easier navigation
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- User-friendly format
- Customized pages
- Improved search function
- Elevated member services
- More contemporary look

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Calendar of Events

2003		ASPA CE Credit
Apr 13–16	EA-2(B) Exam Course Chicago, IL	
Apr 15	Deadline for payment of 2003 ASPA membership dues	
Apr 25	Registration deadline for spring weekend courses	
Apr 30	Final registration deadline for spring examinations	
May 1–2	Great Lakes Area Benefits Conference Chicago, IL	15
May 1–Jun 30	C-1, C-2(DB), C-2(DC) spring examination window	
May 3–4	Weekend Courses in Chicago, IL	
May 13–14	Mid-Atlantic Benefits Conference Philadelphia, PA	16
May 21	C-3 and C-4 examinations	
Jun 12–13	Northeast Area Employee Benefits Conference Boston, MA & White Plains, NY	(each) 8
Jul 27–30	Summer Conference Irvine, CA	20
Sep 11–12	Mountain States Benefits Conference, Denver, CO	16
Oct 26–29	Annual Conference Washington, DC	20

2003 Harry T. Eidson Founder's Award Nomination Deadline Approaches

Harry T. Eidson Award 2003 nominations will be accepted until **May 15, 2003**. Nominations can be submitted directly from the Home Page or the Membership Awards and Honors sections of ASPA's Web site at **www.aspa.org** or you can complete and submit the nomination form insert in this edition of *The ASPA Journal*.

In 1995, ASPA established the Harry T. Eidson Founder's Award to honor the memory of our founder Harry T. Eidson, FSPA, CPC. Eidson was the inspiration behind the formation of ASPA. He firmly believed in the importance of a private pension system and was committed to building an organization dedicated to preserving and enhancing such a system.

The following criteria are used to determine the nominee:

- The contribution must be consistent with the ASPA mission statement and should have a lasting, positive influence on ASPA or the private pension system.
- The contribution may be current, one that spanned many years, or one made years ago which ASPA 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 voting ASPA member can submit a nomination form. The award is presented at the ASPA Annual Conference with the recipient receiving a personalized award memento.

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

We encourage you to submit a nomination for this prestigious award.