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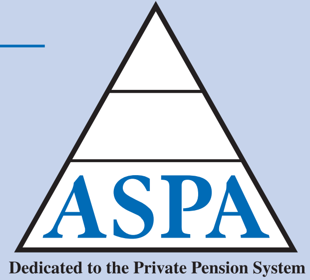

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ASPA President Testifies on Capitol Hill

On March 23, 1999, ASPA President Carol Sears, FSPA, CPC, testified before the House of Representatives Ways & Means Oversight Subcommittee on the issue of pensions. The well-attended hearing was intended to be the first of several that Subcommittee Chairman Amo Houghton plans on holding this Congress.

At the hearing, Carol Sears spoke in strong support of H.R. 1102, the Comprehensive Retirement Security and Pension Reform Act, introduced by Representatives Rob Portman (R-Ohio) and Ben Cardin (D-Maryland). In particular, she emphasized the small business retirement crisis and the benefits of loosening the top-heavy rules and raising retirement plan limits.

The Portman-Cardin legislation contains several provisions that will bring some sense to the overly burdensome top-heavy rules. Ms. Sears said, "In particular, these changes will allow small businesses, even if they employ some family members, to offer a basic 401(k) plan to their employees. It's time to give small business an extra break, not an extra burden."

Ms. Sears also told the story of a trucking and shipping company that established a defined benefit plan shortly after ERISA passed. About 15 years later, however, they terminated their generous defined benefit plan because of reductions Congress made in the amount of annual compensation that could be taken into account for purposes of accruing retirement benefits and reductions in the amount of benefits employees can earn. The company replaced the generous defined benefit plan with a 401(k) plan, thus significantly reducing the retirement benefits for rank-and-file workers.

Of this trend, she asked, "Is this sensible retirement policy?"

In her written testimony, submitted for the record, Ms. Sears pointed to other beneficial aspects of the legislation, including the re-

WASHINGTON UPDATE

Cash Balance Plans Under Attack

by Brian H. Graff, Esq.

As many of you know, over the past few months cash balance plans have been discussed, often unfavorably, in newspaper articles throughout the country and on television news programs as well. The *Wall Street Journal* ran what seemed to be a series of articles critical of cash bal-

Continued on page 8

peal of the current liability full funding limit, the reduced PBGC premiums for new small business plans, the tax credit for small business plan start-up costs, and the simplified defined benefit plan for small business. These are among the many positive reforms included in the Portman-Cardin legislation. (Ms. Sear's testimony is available on the web at **www.aspa.org**.)

Assistant Treasury Secretary Donald C. Lubick also testified at the hearing. He expressed the concern that pension simplification proposals could result in smaller benefits for moderate and lower-income workers by modifying top-heavy and nondiscrimination rules. He also said that certain elements of proposals to simplify top-heavy rules "warrant serious consideration."

Also testifying at the hearing were Leslie Kramerich, Deputy Assistant Secretary of Labor of the PWBA; David Strauss, Executive Director of the PBGC; Teresa Heinz, chairman of the Heinz Foundation philanthropies; Robert G. Chambers on behalf of the APPWP; Daniel P. O'Connell on behalf of ERIC; Paula Calimafde on behalf of the Small Business Council of America; and others.

The Government Affairs Committee will be working with Congressmen Portman and Cardin to help pass pension reform this Congress.

EWA Travel

EWA travel is ASPA's new official travel agency. ASPA members receive discounted airline fares of up to 15% on United Airlines flights to and from ASPA meetings. To take advantage of these special fares, refer to ASPA's meetings code: United 555QD. EWA will compare the lowest savings with United to promotional fares for all other airlines. They will also assist you in getting the best fares for non-ASPA-related travel. As an added benefit, EWA can secure rental car reservations and provide free flight insurance.

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Correction

In the article "Trends in Pensions," published in the last issue of *The Pension Actuary* (March/April 1999), there was an error on page 5, first column, in the given example. The points given for service beyond 10 years should be 2.5, not 1.5 as printed. We apologize for any confusion this error may have caused.

The Pension Actuary is produced by the executive director and Pension Actuary Committee. 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 Pension Actuary*.

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.

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FOCUS ON GAC

IRS, Treasury, DOL and PBGC Meetings

In March, members of ASPA's Government Affairs Committee (GAC) met in Washington, D.C., to assess the activities of the past and to set goals for the future. In conjunction with these meetings, teams of GAC members visited the offices of the Internal Revenue Service, Treasury, Department of Labor, and Pension Benefit Guaranty Corporation for face-to-face discussions with top agency officials. These meetings create an effective forum for retirement plan professionals to review, with people inside the government, how the regulations function in practice. Following are summaries of the meetings prepared by GAC members in attendance.

IRS and Department of the Treasury

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

Representatives of the Government Affairs Committee (GAC) met with officials of the Employee Plans Division of the IRS and with the Benefits Tax Counsel of the Treasury Department and members of his staff to discuss current regulatory issues and developments. These discussions (along with meetings at the Department of Labor, Pension and Benefits Welfare Administration and at the PBGC) are semi-annual events held in conjunction with the spring and fall meetings of the GAC steering committee. This article summarizes the most significant items of discussion.

IRS Meeting

At the IRS meeting, we met with Carol Gold, Director of the Employee Plans Division, and members of her staff, as well as with Marjorie Hoffman from the office of the Chief Counsel, EB/EO. The following is a summary of the discussion:

Plan Document Issues

1. The big news was the extension of the remedial amendment period for the "GUST" amendments (GATT, USERRA, SBJPA and TRA '97). We were told at the meeting that it would happen, and the IRS has now released Revenue Procedure 99-23, giving us a 12-month extension. This is something GAC has pushed for, and the IRS listened.
2. We urged the IRS and Treasury to change their approach on requiring that testing decisions and other variables (such as prior year testing and the HCE top 20% election) be included in 401(k) plan documents. We presented a letter of comment, which addressed the reasons for our concerns. Some of the key factors are the expense of plan amendments and the fact that requiring amendments creates a trap for plan sponsors (that is, the plan may be properly administered, but through inadvertence, it is not timely amended, resulting in plan disqualification). The failure to amend could only be corrected through the Closing Agreement Program (CAP), which increases the expense.
3. The IRS is working on a major revision to the 401(k) regulations in light of law changes since the issuance of the final regulations in 1991 and the amendments in 1994. Among the changes are the definition of a highly compensated employee, the availability of look back testing, and the change in the HCEs who receive a return of excess contributions in the event of an ADP test failure.
4. The IRS is also working on the following items of guidance:

   a. The guidance on the repeal of Code section 415(e), the combined plan limit, is expected to be released very soon. This guidance is still needed in order to prepare the GUST amendments.

   b. Last year, the IRS issued Notice 98-29 in which it requested comments on the issuance of guidance on permissible elimination of qualified joint and survivor annuity (QJSA) requirements

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Technologically Improved Plan Administration Will Enhance Retirement Savings

by Franco Modigliani

Two Views on Credit Card Participant Loans

Congress has been reviewing the appropriateness of permitting participant loans with a credit card. Here are two points of view on this subject.

View 1 of 2

There is broad agreement among knowledgeable observers that the 401(k) program and related ones have proved to be highly successful - indeed the most successful innovation among the many designed to foster retirement saving. The key to this success is the combination of tax incentives and the philosophy underlying the program of giving the saver, as nearly as possible, the same freedom of choice which he enjoys with respect to his personal savings, subject only to the constraint of protecting the terminal accumulation for retirement. That freedom of choice relates to when and how much to save, and, within some limits, to the portfolio in which he wishes to invest his accumulated capital.

To appreciate the significance of this freedom, it is enough to point out that the one program which in the past was the most important vehicle for retirement saving for the vast majority of Americans, Social Security, is a system that offers the saver none of these choices; indeed, it tells the participant when to save, how much, and when to draw down his credit in the form of a pension, and gives him no choice about how to invest his accumulated capital that does not even exist, except in the form of a moral claim on future generations. In

The "Magic Box" Solution to the "Loan Problem"

View 2 of 2

by Lawrence C. Starr, CPC

In the previous article in this issue of *The Pension Actuary*, we are honored by a submission by Franco Modigliani, Institute Professor Emeritus at MIT - the only Nobel Laureate to have won a prize for work in the field of retirement saving. His article is a discussion of the application of a process which he holds a patent on — the process of using bank credit cards to administer and issue employee loans in 401(k) plans. Mr. Modigliani does a fine job of laying out his methodology for handling these loans, along with some explanations as to the rationale for these loans to participants. In the interest of providing another viewpoint, I have been asked to provide some alternative commentary on this issue, and I am pleased to do so.

Mr. Modigliani and I have a fundamental difference in our philosophy, and I know from experience that many members of ASPA share mine (though certainly not all of them). Succinctly stated, I am **not** a fan of participant loan provisions in 401(k) plans or otherwise. Mr. Modigliani assumes (rightfully, I believe) that participant 401(k) loans are going to be with us for the long haul. He also points out that such loans are bureau-

addition, the credit accumulating in Social Security, in contrast to that accumulated through personal saving, is totally illiquid; it cannot be used by the participant until retirement, no matter how urgent and pressing his need might be.

One of the most valuable and attractive options that the 401(k) program has sanctioned is that of permitting plan sponsors to allow 401(k) and 403(b) participants to invest a portion of their capital in a temporary loan to themselves. This facility has the effect of increasing the liquidity of the capital accumulated in the account, making the accumulation much more affordable and attractive, especially for young people and people of more limited income, who tend to have little by way of reserves and therefore cannot afford to stash money away in a form where it becomes inaccessible for decades, no matter how great the need. In addition, the 401(k)/403(b) self-loans provide a source of credit that is not only available but also generally cheaper than available alternatives, especially for younger and poorer people.

To appreciate this proposition, consider the sources available to satisfy temporary cash needs in excess of current income. The most straightforward, when available, is to draw on accumulated assets outside the 401(k). Provided this reserve contains enough liquid assets, it can be verified that it is the cheapest source, for the cost of using this source of cash (call it a "self-loan") is equal to the income you lose because of the money you draw out, multiplied by (1 - marginal tax rate). The ratio of the income you lose per year to the amount drawn, measures the interest rate you implicitly pay - call it the "self-lending rate". But, if you have enough liquid assets, there should not be much of a reason to borrow, anyway. The only other source that may compete with this is borrowing from an equity loan because the interest you pay is tax deductible. So, the comparative advantage depends on the difference, if any, between the equity and the self-lending rates. Borrowing from a security margin account may be a good source of temporary cash, provided you have such an account and enough income from financial assets to offset the interest.

The cost of any other typical loan, from merchants and suppliers by credit card, is likely to be higher and mostly much higher because the rates are generally higher and they are not tax deductible. Now consider the cost of borrowing from one's retirement account balance. The contractual interest

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cratically complex, time consuming, and expensive for employers to administer - particularly so for small employers (though he does not define what *small* means).

So, Mr. Modigliani has come up with a solution for making these loans less bureaucratic, less time consuming, and less expensive to the employer. Sounds like a perfect solution to these problems, doesn't it? And for some plan sponsors, it very well might be so. I know of a large insurance company with over 40,000 employees in its own plan and almost 20,000 loans. Though one might question whether this is a retirement plan or a window at the local credit union, is it likely that they will eliminate the loan provision from their plan? Not in this lifetime! Would they be a possible candidate for a simplifying application of technology to this situation? Sounds like a sure bet!

My significant disagreement with Mr. Modigliani is in his assumption throughout his article that loans to participants really are a "good thing". He says: "*one of the most valuable and attractive options that the 401(k) program has sanctioned is that of permitting plan sponsors to allow 401(k) and 403(b) participants to invest a portion of their capital in a temporary loan to themselves*". We all know that, technically, loans have nothing to do with 401(k) per se. Even a profit sharing plan with no participant elective deferrals can provide for loans to participants; but being a Nobel Laureate, we should forgive him this little technical oversimplification. Nonetheless, I reject the notion that loans to participants are inherently a good thing. I also reject the notion that loans are necessary to get or increase employee participation in making elective deferrals to a 401(k) plan.

I freely admit that this will quickly come to a "moral" issue: *Should* participants be kept from getting at their retirement money for their own good? When tied to the complexity of loan administration for the small employer (which *I'll* define as fewer than 100 employees and which constitutes *97% of all businesses* in the U.S.), I have no problem saying that loan provisions should simply not be part of the retirement plan design. The small employer has no desire to open up a banking window in the workplace for their employees. Of course, Mr. Modigliani's patented process is intended to *eliminate* the complexity of loan administration, which then theoretically reduces our discussion to just the issue of "Should there be loans at all?"

Mr. Modigliani clearly says

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The Qualified Sign-On Bonus

by Amy Cavanaugh

The Small Business Job Protection Act of 1996 (SBJPA '96) made several changes to pension law in an attempt to simplify the annual administration and data collection. Included in the list of changes was a modification to the definition of highly compensated employees (HCEs). In addition to making the testing process easier, this change brought about an interesting planning opportunity.

The definition of HCE was amended effective for plan years beginning in 1997 to include only the following classifications of employees:

- Employees who own 5% or more of the employer in the current or prior plan year; and
- Employees who *in the prior* plan year made more than $80,000.

The $80,000 amount will be indexed at the same time and in the same manner as the defined benefit dollar limit under Code Section 415(b) (in multiples of $5,000) and is rounded to the next lower multiple of $5,000. In applying the $80,000 threshold, the employer is permitted to limit its HCEs to the top-paid group. The top-paid group is defined to mean the highest paid 20 percent of the employer's non-excludable employees.

This means, under the new law, unless an employee acquires a 5% or greater ownership interest in his first plan year of employment, he cannot be considered to be an HCE in his first year of employment. The intent of this change in the law was to enable the employer to determine who is a HCE prior to the beginning of the plan year. It was thought that this would make it easier for employers to design plans that were nondiscriminatory and eliminate the year–end shuffle to adjust coverage and/or nondiscrimination testing results by either expanding the group of benefiting NHCEs or limiting the number of benefiting HCEs. To a large extent, this modification has helped with plan design and compliance testing.

Curiously, the change in the definition has also offered up some interesting planning opportunities, especially in the case of employers who hire highly-paid individuals, which is common in professional industries as well as many hi-tech fields. These design opportunities are borne of the fact that during an individual's first plan year of employment, the employee is not yet deemed to be an HCE (unless of course, he is hired and immediately acquires a more than a 5% ownership interest in the company). Because IRC 401(a)(4) only tests for patterns of discrimination in favor of the HCEs, these highly-paid individuals can be given a bonus in the form of a large contribution to the employer's defined contribution plan without violating the rules of IRC 401(a)(4). Interestingly, in addition to providing a valuable benefit to the new hire, this contribution can also help the employer's plan pass coverage and/or nondiscrimination testing since the contributions will be improving the applicable rates for the NHCE workforce, whether it be in the ADP or ACP test (presuming the contribution is given the characteristics of a targeted QNEC), the average benefits test, or the general test for nondiscrimination.

A qualified sign-on bonus is an effective mechanism for attracting and retaining new employees. With unemployment lower than ever and highly specialized workers continuing to demand high salaries, total compensation packages are becoming more important than ever. Enhancing a compensation package with a sign on-bonus that escapes current taxation because it is contributed into a qualified plan could be

an added benefit that seals the deal when an employer is attracting people who are in high demand.

For example, XYZ, Inc. sponsors a 401(k) profit sharing plan, which offers salary deferrals as well as employer matching and discretionary profit sharing contributions. The salary deferrals are tested using the ADP test, and the match is tested using the ACP test. To the extent that the discretionary profit sharing contribution does not meet the criteria to be considered a safe harbor plan, the plan will need to test the profit sharing contributions using the general test either on a contributions or benefits basis. A qualified sign-on bonus allocated to a new employee can be used to enhance those test results. By declaring a targeted qualified non-elective contribution (QNEC) to the highest paid NHCE (one who will presumably be an HCE in his second year of employment), the test results can improve dramatically. See the above table for several examples.

Employee	*Compensation*	*Salary Deferral*	*Match*	*ADP*	*ACP*
HCE A	$160,000	$10,000	$ 5,000	6.25%	3.12%
HCE B	$100,000	$10,000	$ 5,000	10.00%	5.00%
HCE Totals	***$260,000***	***$20,000***	***$10,000***	***8.12%***	***4.06%***
NHCE A*	$160,000	$10,000	$ 5,000	6.25%	3.12%
NHCE B	$ 40,000	$ 2,000	$ 1,000	5.00%	2.50%
NHCE C	$ 20,000	$ 0	$ 0	0.00%	0.00%
NHCE D	$ 15,000	$ 1,000	$ 500	6.66%	3.33%
NHCE E	$ 10,000	$ 1,000	$ 500	10.00%	5.00%
Totals	***$245,000***	***$14,000***	***$ 7,000***	***5.58%***	***2.79%***

* New employee to receive sign-on bonus.

Based on the above example, the plan fails the ADP test because the maximum ADP for the HCEs is 7.58% (NHCE average plus 2.00%) which is less than 8.12%.

The ADP test failure can generally be cured by one of three ways:

1. Returning excess deferrals to affected HCEs;
2. Recharacterizing excess deferrals as after-tax voluntary contributions; or
3. Making additional contributions on behalf of the NHCE testing universe in the form of QNECs or QMACs.

Qualified nonelective contributions (QNECs) are an attractive design tool because of their versatility. They can be used for a number of corrective purposes, including preventing refunds of elective deferrals to HCEs because of ADP failures and to provide top-heavy minimums for non-key employees in a top-heavy plan.

In addition, if a plan is drafted properly, a targeted QNEC can be made on behalf of only certain NHCEs. There are no rules that prevent treating one NHCE differently than another; because of this, a targeted QNEC can be made to designated NHCEs. In general, the specific employees will not need to be specifically named, rather the plan can state that a QNEC contribution will be made to a definitely determinable class of NHCEs in an amount sufficient to pass applicable 401(k) testing. A common alternative is to make the contribution to the lowest paid NHCE (or the lowest paid NHCE still employed by the employer, if the employer has a philosophical problem in giving plan dollars to an individual who is no longer employed). While this is a cost-effective way to pass the test, it is often hard to explain to the plan sponsor the rationale for giving low paid (or perhaps ter-

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Washington Update

ance plan conversions. It was rumored, although this has not been substantiated, that the articles were precipitated by some internal management discussions at Dow Jones, Inc., the parent of the *Journal*, about converting their own plan to a cash balance plan.

The majority of these articles have focused on the issue of inadequate disclosure in the context of cash balance plan conversions. Section 204(h) of ERISA is presently the governing law in this area. Under this rule, if an employer sponsoring a defined benefit plan (or money purchase plan) chooses to significantly reduce the rate of future benefit accruals, the employer must provide participants with notice of the reduction in benefits no later than 15 days before such reduction takes effect. Such notice must also be given after the employer formally adopts the plan amendment reducing future benefit accruals, often complicating matters for the plan sponsor and administrator. Final Treasury regulations, issued last December, provide that the notice may include a "plain-English" summary of the plan amendment reducing future benefit accruals. However, the regulations explicitly provide that the notice need not explain how the individual benefit of each participant will be affected by such plan amendment. The articles generally state that the current disclosure scheme fails to provide participants with the information necessary to fully understand how their own individual benefits will be impacted by the plan amendment.

In addition to questions about adequate disclosure, some of these articles have also suggested that cash balance plans may violate the Age Discrimination in Employment Act (ADEA). In general, ADEA prohibits employers from discriminating against older workers with respect to employment issues, which include compensation and benefits. The articles point out that sometimes when employers, typically larger employers, convert from a traditional final-average pay defined benefit plan to a cash balance plan, older workers with significant years of service may not accrue any additional benefits under the new plan for several years. Although previously accrued benefits for these employees cannot be reduced because of the anti-cutback rules, the articles nonetheless typically describe these situations as a "reduction in benefits" since the affected employees are earning lower benefits than they would have under the old plan. The ADEA question arises in these situations because older workers end up with marginal increases in benefits which are lower than their younger counterparts. A number of class-action lawsuits have been filed throughout the country arguing that these situations violate ADEA. The articles typically fail to mention that employers could simply terminate the plan if they so choose.

Needless to say, these articles have made an impact in Washington. When the articles first starting coming out, ASPA, along with several other members of the Retirement Savings Network, conducted a congressional staff briefing on cash balance plans. Carol Sears, FSPA, CPC, and ASPA's president, explained to congressional staff why cash balance plans can be attractive to both employers and employees (see Carol's article in the March-April issue of *The Pension Actuary*). However, trial attorneys representing participants in a number of the cash balance plan conversion lawsuits also held a congressional staff briefing. At their briefing, they played recorded excerpts of presentations on cash balance plans made at actuarial conferences (fortunately not ASPA's), where consultants were heard suggesting that cash balance plans were an excellent tool for masking reductions in benefits. For example, one consultant was quoted as saying, "It is easy to install a cash balance plan in place of a traditional defined benefit plan and cover up cutbacks in future benefit accruals." Not surprisingly, a number of congressional staff reacted negatively to these quotes.

The attention given cash balance plan conversions has led Senator Daniel Moynihan (D-NY) and Representative Jerry Weller (R-IL) to introduce legislation greatly expanding the 204(h) notice requirements. They argue that the expanded notice requirements are necessary to give participants the information they need to reasonably assess how their benefits are being affected. Under the proposal, participants would have to be given an individual statement of benefit change no less than 15 days prior to the effective date of a plan amendment, significantly reducing the rate of future benefit accruals. The individual statement of benefit change would have to detail how an individual participant's benefits under the plan would compare both before and after the amendment as of the effective date of the amendment, three years hence, five years hence, 10 years hence, and at normal retirement age. The statement would be prepared using proscribed actuarial assumptions, including increasing compensation based on the consumer price index.

The proposal applies to all amendments reducing future benefit accru-

als, not just cash balance plan conversions. However, in recognition of the special administrative pressures facing defined benefit plans maintained by smaller businesses, and that cash balance conversions are chiefly a phenomenon of larger corporations, the proposal does not apply to plans with less than 1,000 participants. Further, in response to an ASPA GAC suggestion, any 204(h) notice, regardless of the size of the plan, could be made before the plan sponsor formally adopts the plan amendment reducing future benefit accruals.

ASPA's Government Affairs Committee believes that requiring individual benefit comparison statements for every participant will be extremely difficult and expensive for plan sponsors and may lead many employers to instead terminate their plans. ASPA supports an alternative proposal requiring the plan sponsor to distribute detailed illustrative examples showing how different classes of employees at different ages and with different levels of service will be affected by the plan amendment. At a significantly reduced burden to the plan sponsor, this would provide participants with meaningful information clearly identifying which class of employees would likely be negatively affected. Under this alternative proposal, after receiving the illustrative examples, individual participants could request an individual benefit comparison statement if so desired. Also under this proposal, actuarial assumptions used in preparation of the examples and individual statements would be subject to actuarial discretion, subject to standards issued by the Actuarial Standards Board. ASPA is currently discussing this alternative with key members of Congress.

If any package of pension reform legislation is enacted this year (or perhaps next year), right now it appears likely that some form of enhanced 204(h) notice requirements would also be enacted. The final form and application for such enhanced notice requirement remains to be seen. ASPA, as always, will continue to advocate for a more sensible approach. We will keep you posted.

Brian H. Graff, Esq., is executive director of ASPA. Before joining ASPA, Mr. Graff was legislation counsel to the U.S. Congress Joint Committee on Taxation.

Announcements from the Joint Board for the Enrollment of Actuaries

May 1, 1999

At this time, the Joint Board is still receiving inquiries from a number of actuaries who have not yet received their notices of re-enrollment. They have asked how they are to sign the Schedule B (and other government forms requiring an enrolled actuary's signature) that will be dated May 1, 1999 or later.

The Board today restated its position that an enrolled actuary currently having a "96-" prefix to his/her enrollment number is not permitted to use the "99-" prefix until such time as the notice of re-enrollment has actually been received. The use of the "96-" prefix is currently permitted up to April 30, 1999. By this announcement, an enrolled actuary may use the "96-" prefix after April 30, 1999, for an additional three-month period, provided he/she has satisfied the requirements for re-enrollment including (1) having earned the required continuing professional education credits, (2) having filed the application for re-enrollment, and (3) having paid the re-enrollment fee.

Service centers of the Internal Revenue Service have agreed to accept any of the forms mentioned in the first paragraph that are signed by an enrolled actuary using the "96-" prefix, provided the signature date is not later than July 31, 1999.

The Board also announced revised rules relative to the waiver of Segment A of its basic (EA-1) examination to be given in 2000 and its sequel, the EA-1 examination to be given in 2001 and thereafter.

The Board stated that beginning in 2000, it would grant waiver of this examination to any person who has received credit from the Society of Actuaries for examinations 2 and 3 of the Society's new examination program, which will be initiated in 2000.

The Board also clarified its position regarding the waiver of this examination on account of completed academic work. The Board stated that a waiver would be granted to any person who had (1) received a bachelor's degree from an accredited institution, and (2) completed the Board's required courses through a combination of undergraduate and graduate education, provided that the graduate credits were obtained as part of a degree program even if the applicant for waiver did not actually receive a degree.

Paulette Tino, Chairman
Joint Board for the
Enrollment of Actuaries

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IRS Meeting

from non-pension plans (*i.e.*, plans that are not required by Code section 401(a)(11) to pay benefits in the form of QJSAs, such as 401(k) plans and profit sharing plans). Under current rules, the form of payment is a protected benefit that cannot be eliminated because of Code section 411(d)(6). The IRS is working on the issuance of regulations which would permit plans, such as 401(k) plans, to eliminate QJSAs. While we do not expect the guidance to be out in the next few months, it should be out this year. In our meeting, we asked the IRS to consider requiring nothing more than a lump sum form of payment on the basis that once spousal consent is eliminated, then the plan should not be required to offer other payment options because the participant can roll over the distribution to an IRA and shape his or her own distributions. We also suggested that some form of notice be required if a plan is going to eliminate optional forms of benefit in case people have done personal planning around the benefit options previously provided for in the plan.

IRS Restructuring

1. The IRS restructuring project is almost complete. We should not see a significant change in how we work with the Tax Exempt Section, which will absorb the current Employee Plans Division, with a couple of notable exceptions. First, the IRS expects that all of the voluntary compliance programs (including SVP and VCR, which are currently handled in Washington, as well as the CAP programs and APRSC) will be handled in a "rulings and agreements branch," possibly on a local office basis. This would not include Audit CAP, which is expected to stay in the division that conducts plan examinations. Nevertheless, consolidating all of the voluntary correction programs in the field offices should be a welcome change, since it would permit practitioners to handle complex qualification issues on a "face-to-face" basis. We did express concern about the possible loss of uniformity among the offices, but were told that the IRS would make every effort to ensure coordination on policy issues. It also appears that audits will be conducted much as they are now, though it may be that the local agent will end up reporting to a manager who is at a remote site. Finally, there will be increased emphasis on public outreach and education. What form this will take is not clear, though the IRS will apparently continue to sponsor the Mid-States, Northeast Key District, and Los Angeles Benefits Conferences along with ASPA.

> **It appears that the IRS will grant the additional 12-month extension of the remedial amendment period for users of prototype and volume submitter plans.**

2. We discussed a number of issues regarding prototype plans. The IRS will be combining the national and regional prototype programs to create one category of prototype. They anticipate that they will keep the most flexible parts of each program, such as pairing of plans (which is currently available only for national prototypes). They have drafted a Revenue Procedure on this that they soon expect to issue. One change we should see is an expansion of permissible sponsors of "national" prototypes. Put another way, all prototype documents will be national, and there will not be a special category reserved just for financial institutions.

   It also appears that the IRS will grant the additional 12-month extension of the remedial amendment period for users of prototype and volume submitter plans. This would permit plan sponsors who adopt a prototype or volume submitter plan to do so during the 12-month period after the IRS issues the approval letter on the prototype or volume submitter document, even if that is after the normal remedial amendment period for the plan. In the discussion, we urged the IRS to adopt a good faith standard in applying the 12-month extension to prototype and volume submitter plans. Our concern is based on the fact that it is possible to make non-material changes to prototype and volume submitter plans without losing prototype or volume submitter status. Since there are no formal standards on how extensive the changes may be before the plan will be treated as an individually-designed plan, what happens if a plan sponsor adopts

a prototype or volume submitter plan during the 12 month extended remedial amendment period, and then makes changes which, the IRS believes, changes the plan to an individually designed plan? If the amendment is adopted after the normal remedial amendment period for the plan, the plan would be treated as a non-amender and be required to go through the Closing Agreement Program to preserve its qualified status on a retroactive basis. We urged the IRS to adopt a good faith standard in this situation. We also suggested, as we have before, that the IRS permit cross-testing to be included in prototype plans, as well as in volume submitter documents.

EPCRS

1. We were again promised that the correction examples, which the IRS has been working on, will be issued "very soon." However, we were also told that the number of examples will be limited and may only include correction examples for 401(a)(17) issues; failure of the ADP and ACP tests; methods of determining and allocating earnings in connection with a failure to make timely contributions; the exclusion of eligible employees from profit sharing and 401(k) plans; and 415 issues. We pointed out that a very common problem was the admission of ineligible employees to plan participation, especially in 401(k) plans, and that guidance on correction of this defect would be most helpful. It is unlikely that this issue will be addressed in the first group of correction examples. We anticipate that GAC will offer comments on the correction examples when they come out. The IRS representatives were careful to point out that the examples reflect areas where there is consensus within the IRS on the form of correction. They stressed that if we do not see a particular type of correction discussed in the examples, we should not read anything into that omission. In other words, the fact that a form of correction is not included does not mean that the IRS would reject the form of correction.
2. Under Revenue Procedure 98-22, it is possible to amend a plan to conform to its operation as long as the amendment does not violate Code sections 401(a)(4), 410(b), and 411(d)(6). This is referred to as "reformation CAP." In Rev. Proc. 98-22, the IRS said it would issue additional guidance on when reformation CAP would be appropriate. The IRS representatives indicated that we should not expect such guidance in the near future. We again urged the IRS to grant a limited form of correction by plan amendment under APRSC, such as where the plan made hardship distributions or loans, but there was no plan provision, or where the sponsor failed to check a box on a prototype adoption agreement.
3. Over the past several years, GAC has urged the Department of Labor to establish a voluntary fiduciary breach correction program, which we labeled "VFC." The DOL announced earlier this year that it is working on such a program. Because it will address correction of prohibited transactions, over which both IRS and DOL have jurisdiction, the agencies have established a joint task force to address issues of correction in connection with the VFC program.
4. Earlier this year, the IRS issued a "best practices memo" regarding the coordination between Walk-in and Audit CAP and the determination letter program. Several of the items addressed in the memo were unclear, so we asked for and obtained clarification from the IRS in the meeting. They indicated that the portion of the memo dealing with qualification failures discovered after an application for a favorable determination letter has been filed is not limited to plan document failures, but would include operational and demographic failures as well. (Remember, however, that operational failures can only be corrected under Walk-in CAP if there is also a plan document or demographic failure; otherwise, they can be corrected under APRSC if correction is made within the two plan years after the failure occurs or is insignificant or under VCR.) The IRS officials stressed the importance of notifying the IRS in writing when such a defect is discovered after a determination letter application has been submitted to ensure treatment under the Walk-in CAP program, even if the plan sponsor does not yet know the Specialist to whom the case has been assigned. They also noted that the instruction in the memo that EP Specialists should routinely waive excise taxes in connection with use of the voluntary correction programs is limited to Walk-in CAP. Finally, the memo discusses a new type of qualification failure, a "minor failure." If a plan document failure is minor and is discovered by the EP Specialist, the case will be handled under the Audit CAP procedure, but the maximum sanction will be limited to the presumptive amount of the compliance fee under the Walk-in CAP program.
5. The IRS has no information on how many people are self-correcting under APRSC. Based on an-

ecdotal evidence, they believe it is substantial. This is based on the fact that VCR applications have declined from 150 per month prior to the issuance of APRSC in March 1998 to approximately 60 per month currently. In addition, the IRS officials indicated that field agents are applying APRSC in larger numbers in plan examinations.

6. The IRS expects to issue a revamped Revenue Procedure to replace 98-22 later this year, possibly by the fall. They indicated that it will be a major re-write, possibly as a result of the IRS restructuring discussed above. GAC is submitting comments on a possible "Group CAP" program which will permit correction of plan document failures for a large number of similarly-situated clients of a single service provider. Such a program could be especially important in years 2000 and 2001 because ASPA members will be amending and restating all the plans they represent. In the event of a widespread failure to amend plans, whether due to a systematic failure or otherwise, a Group CAP program would provide a vehicle for walking them in.

403(b) Arrangements

1. We indicated to the IRS that we were generally pleased with Revenue Procedure 99-13, extending the remedial programs to 403(b) arrangements (or tax-sheltered annuities — TSAs). The IRS officials stated that it was unlikely that any correction examples for TSAs will be issued in the near future. However, they indicated that a number of large TSA vendors are beginning to inquire about the meaning of "practices and procedures" (which are required to be eligible for self-correction under APRSC). As a result, the IRS may issue a "best practices memo" to instruct the field on how to apply APRSC on audit of TSAs.
2. On other guidance areas, the IRS officials said that they were close to finalizing the 403(b) examination guidelines, possibly as soon as May 1999. In the meantime, the GAC Tax Exempt and Governmental Plans Committee is working on comment letters regarding the definition of the employer and discrimination testing. Finally, with respect to the restructuring, the IRS said that they anticipated that there will be four regional coordinators who will have as one of their principal functions engaging in educational outreach. Also as part of the restructuring, they will gain jurisdiction over 457 plans, and expect to begin a substantial program of education and outreach on these types of plans before they start a major enforcement project.

Other Guidance Issues

1. We urged the IRS to move ahead with guidance on rollovers to make it less burdensome on a plan that receives direct or regular rollovers. The IRS' proposed regulations seem to require the recipient plan to have some evidence of qualification, such as a favorable determination letter or a letter from the distributing plan. We suggested that this requirement imposes an unreasonable burden on the recipient plan. We noted that the current rules are a trap for the unwary and impose a barrier to rollovers because of the requirements they impose on the recipient plan. The IRS officials said it was unlikely that the IRS would try to "trace" funds from a plan which is disqualified to see if they were rolled over to another plan.
2. The IRS officials said they were addressing certain aspects of the "worker classification" issue, principally those related to leased employees. (These issues relate to whether workers are properly classed as independent contractors who do not need to be covered by a plan or should be classified as employees who are entitled to benefits.) The leased employee issues arise in several ways. One concern is whether the worker is truly an employee of the leasing organization as opposed to the recipient organization. They stated that they currently have a number of cases involving leasing organizations and whether those organizations can sponsor plans that cover the leased employees. Their preference is to have testing for coverage done at the recipient company level. On all of the worker classification issues, we urged the IRS to engage in more educational outreach to achieve voluntary compliance rather than embarking on enforcement through plan examinations.

The principal focus of our Treasury meeting was on whether 401(k) testing decisions should be included in the plan document.

Treasury Meeting

At the Treasury meeting, we met with Mark Iwry, Benefits Tax Counsel, and members of his staff. The following is a summary of the discussion:

1. The principal focus of the meeting was on whether 401(k) testing decisions should be included in the plan document. The Treasury position is that normally, when a taxpayer has to make an election on something, they have to file a form with the IRS. Thus, by "merely"

requiring that testing decisions be included in the plan document, they felt that they were providing a break to taxpayers and that, from their perspective, this was a fallback position. We urged them to view the issue the other way around, and indicated that inclusion of a checkbox on the Form 5500 would be preferable, so long as failure to check the correct box did not itself become a basis for plan disqualification. We also pointed out that most plan sponsors will chose testing methodologies and make other elective choices and stay with them unless they have a large change in demographics. GAC submitted written comments on this issue. We anticipate that this will be an on-going dialogue over the next months.

2. We also discussed the IRS notice on safe harbor plans, Notice 98-52. We indicated that our members generally liked the guidance but that the notice requirement was overly burdensome and not required by the legislation. GAC also submitted written comments on Notice 98-52. We urged that the notice requirement be simplified and said that notice should not be required at all where the employer is using the employer contribution, rather than the match, to satisfy the safe harbor, since that alternative will have little impact, if any, on an employee's deferral election.

3. Finally, we discussed the GAC request that the IRS issue a revenue ruling dealing with "restoration" payments. These payments are made when there has been a fiduciary breach, and the fiduciary wishes to restore lost benefits to the plan participants. The Treasury officials indicated that they had been looking at the issues involved and had a number of concerns, including how to determine whether there has actually been a fiduciary breach so that the payment to the plan is truly being made to restore lost benefits resulting from such a breach. We urged that they consider adopting safe harbors (*e.g.*, a breach will be presumed if the participants have filed a lawsuit, if there has been a written claim of a fiduciary breach by or on behalf of the participants, or if the DOL has demanded correction of a fiduciary breach). We also suggested that outside of the safe harbors, the IRS leave it to the plan sponsor to determine whether the loss falls within the parameters of the ruling.

Conclusion

Over the last few years, the relationships with the IRS and Treasury Department have improved substantially. This is due in part to the efforts of the Government Affairs Committee and, more recently, to the work of ASPA's executive director, Brian Graff, Esq. We are pleased that these agencies (as well as the DOL and PBGC) are prepared to provide ASPA with an opportunity to explain the practical issues involved in the operation and administration of plans and to air our views on compliance issues. Based on some of the guidance the IRS has released and on the tenor of our semi-annual meetings, we believe that they are listening to our concerns and are trying to address highly technical problems with practical understanding.

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Department of Labor

by R. Bradford Huss, APM

Representatives of ASPA's Government Affairs Committee met with senior personnel from the Pension and Welfare Benefits Administration of the Department of Labor on March 16, 1999. Brian Graff, Executive Director of ASPA, thanked the DOL for its discussions with ASPA concerning the DOL's small plan asset reporting project and for Secretary Herman's letter indicating that the DOL would not proceed with its proposal for requiring institutional trustees for small plans. ASPA expressed its concern that any potential requirements for the certification or other verification of plan assets be practical in terms of costs and actual marketplace practices so as not to be burdensome on plan administration. ASPA specifically recommended that a certification from one regulated financial institution should be sufficient where that institution holds in a plan account shares of other regulated institutions, such as mutual funds. ASPA offered to consult with the DOL on the framework of the proposal before publication.

The DOL told the GAC representatives it had presented a briefing to Congress on a new proposal to limit the availability under ERISA of limited scope audits. DOL's prior proposal was to eliminate limited scope audits alto-

gether. The new proposal is to allow limited scope audits only for plans that have 95% or more of their investments in assets with readily ascertainable fair market value, such as publicly-traded securities. ASPA suggested that the DOL establish a definition for qualifying assets that would include insurance company and other appropriate products. A key new component of the proposal is to include a "SAS 70" style report requirement for those regulated financial institutions that are eligible to certify plan assets under the current rules. The report would include an audit of the institution's internal controls. ASPA expressed particular concern with the portion of the proposal that would require unaffiliated entities providing necessary recordkeeping, such as third party administrators, to also provide a "SAS 70" style report. ASPA also emphasized that an adequate transition period for any new requirement would be necessary. Other aspects of the DOL's legislative proposal are the same as last year, including penalties for failing to report plan asset irregularities.

ASPA's long-standing proposal that the DOL establish a program for voluntary fiduciary corrections was discussed. The DOL indicated that it was aiming to shortly issue a VFC pilot project that would probably run for one year, and it has been coordinating with the IRS on prohibited transaction aspects of the VFC program. ASPA offered to supplement its previous detailed recommendations for the structure of the VFC program.

The Department has completed hearings on the recent proposed changes in claims processing and SPD procedures. ASPA recommended that the deadline for any new DOL requirements in these areas be coordinated with SPD changes for the GUSTO required plan amendments so as to avoid multiple SPD changes in a short period of time. ASPA pointed out that the extension of the remedial amendment period by the IRS will facilitate the DOL's ability to accommodate similar deadlines and that any new and more restrictive claims procedures felt necessary for health plans should not be extended to retirement plans.

The issue of the possible conflict of negative 401(k) elections with state wage laws was discussed. ASPA requested that the DOL provide guidance as to whether ERISA preempts the application of these laws to negative elections.

The DOL is wrapping up the enforcement component of its 401(k) fee project, with several investigations still to be completed, and options as to additional regulatory requirements still being considered.

DOL plans to issue a notice for comment very soon, that concerns scannable Forms 5500. A Y2K alert has been put on the face of the 1998 Form 5500. The DOL indicated that it believes its Y2K awareness program has been successful and that most plan fiduciaries are working on achieving systems compliance.

R. Bradford Huss, APM, is a partner in the San Francisco, California law firm of Trucker Huss which specializes in ERISA and employee benefits. Mr. Huss concentrates his practice on qualified pension and profit sharing plans, ERISA litigation, and IRS and DOL audits of employee benefit plans. He serves on ASPA's Board of Directors, is a past president of the San Francisco Chapter of the Western Pension & Benefits Conference, and is a member of the American Bar Association, the Bar Association of San Francisco, and the International Foundation of Employee Benefit Plans.

Pension Benefit Guaranty Corporation

by Kurt F. Piper, MSPA

Representatives of ASPA's Government Affairs Committee met on March 15, 1999 with representatives of the Pension Benefit Guaranty Corporation. This was our semi-annual conference to discuss a range of issues of importance to ASPA members. Items discussed included:

- The first item of discussion was the recent legislative proposals to ease some of the burdens of compliance with the top-heavy rules. The PBGC was most sympathetic to the problems of frozen plans being required to provide top-heavy minimum accruals when the key employees are not receiving accruals. Also discussed was the possibility of requiring a lower accrual than 2% when the highest accrual rate for a key employee was less than 2%. ASPA invited consideration of whether this could result in any possible abuse. Of note is that the PBGC, like the Administration, does not favor the repeal of top-heavy.
- The second item of discussion was additional premium rates. ASPA suggested two possible changes: the return of the flat rate (instead of calculating the variable premium) for additional premiums for very small employers (to save on administrative fees); or risk-related additional premiums, which take into account the fact that the benefits for substantial owners are less insured, and allow majority owners to waive out of PBGC coverage and, thus, ad-

ditional premiums on their part of the Plan. The PBGC continues to be concerned about creating unreasonable distinctions between large and small plans. The PBGC is thinking of increasing the coverage for substantial owners so that full coverage will occur in, perhaps, 10 years instead of 30. ASPA would prefer less coverage and lower premiums.

In addition, the PBGC has requested input on simplifying the Alternative Calculation Method so that it doesn't require an actuary to run the calculation. ASPA's Regulations/PBGC Committee will explore the possibilities and comment after tax season.

As part of the additional premium discussion, it was noted that the PBGC's current liability interest rate will change from 85% of the 30-year Treasury rate to 100% in the year 2000 when the Secretary of the Treasury changes the mortality table.

- The third item of discussion was the need to preserve the pre-GATT PBGC lump sum interest rates for the foreseeable future. There are a number of plans which will need these rates either because plan sponsors and/or plan participants are comfortable with them or else they will need them to implement their GATT 415 limit calculations under a fresh-start-without wearaway basis. (ASPA wrote a comment letter in late December supporting this extension.) The PBGC is willing to continue to publish these rates. Of minor note is that the PBGC no longer fits these particular rates to annuity rates but, rather, tries to follow a corporate bond market index.
- The fourth item of discussion was that ASPA was pleased with the lack of member problems with PBGC audits.
- The fifth item of discussion was the proposed expansion of the missing participant program. As the existing program continues, there will be a reduction of "woodwork participants", namely, participants who pop out of the woodwork long after a plan is terminated and distributed. Unfortunately there is opposition in the profit-sharing community to extending the missing participant program to defined contribution plans. ASPA suggested that the program could at least be extended to non-Title IV defined benefit pension plans, as ASPA believes that this program provides a valuable service to plans and to ASPA members.
- The sixth item of discussion was on proposals to stimulate the expansion of defined benefit pension plans. Since one of the reasons for the popularity of 401(k) plans is the degree of control employees have over the contributions, ASPA suggested a type of defined benefit pension plan with a fixed benefit, plus the ability of a participant to buy additional accruals on a pre-tax basis. If there was some sort of non-discrimination test on these extra accruals, then employers would have an incentive to sell defined benefit pension plans to their employees.
- Also discussed was the ability to buy defined benefit annuities with 401(k) money. Among the issues involved are the choice of conversion rates, PBGC guarantees, the need for adequate records, and gaming issues.
- Another issue discussed was that of volatility, which could be partly addressed by fixing the IRC Section 415(b) interest rate at 5% again instead of using the 30-year Treasury rate. This would allow a plan sponsor to more accurately project future liabilities.

Conclusion

The meeting with the PBGC was very constructive. The PBGC is anxious to promote the growth of defined benefit pension plans by changing the law to create incentives and remove obstacles. If the politics of last year can be avoided, the momentum of both Congress and the Administration is to enact into law some positive pension legislation this year.

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Technologically Improved Plan Administration

you pay on this loan is immaterial, for it is entirely credited back to your account except for a small fixed spread or fee needed to cover the transaction costs. However, this does not mean that the cost of the loan is simply the fee. One must add to it the income lost because of the money you draw out of the account (i.e., the self-lending rate again, though from a different account). The two self-lending rates may be deemed to be similar, since they belong to the same investor, and hence we can conclude that the cheapest borrowing comes from reducing one's liquid assets.

When you do really need to borrow to satisfy temporary cash needs, of the remaining sources, only two may be cheaper - equity loans, and possibly borrowing from unused security margin accounts, but these are sources available only to richer and older people. For the younger and poorer, the opportunity of borrowing from a retirement account is clearly a very valuable one.

In the past, the option of 401(k) and 403(b) borrowing has been limited because the procedure to secure a loan was typically bureaucratic, and time consuming, discouraging the use and limiting the benefit of utilizing it. It was also costly for the employers, so that many, especially among the small firms, have ended up not offering or severely limiting the loan option.

But very recently, utilizing innovative ideas and modern data processing technology, an important new development has occurred that would permit the borrowers (401(k) and 403(b) plan participants), for limited amounts and for a limited time, to access their own account in an immediate and painless way through a bank card and/or writing a check against their account.

The newly-enhanced system enabling bank card access to retirement plan loans is very beneficial to the employers who would be interested in offering their 401(k) and 403(b) participants the privilege of limited borrowing from their accounts. In fact, the bank card and check and any other 401(k) and 403(b) participant loan will be administered by a professional third party and thereby the cost will be reduced and will be paid by the user of the credit. Thus, plan sponsors would be able to offer a borrowing facility at little or no cost to themselves, thereby increasing the availability of 401(k) and 403(b) borrowing to participants. This is especially true of smaller firms who typically employ lower-paid employees.

The borrowing privilege (from 401(k) and 403(b) plans), in particular using bank cards, has come under some criticism on the very superficial and unfounded argument that borrowing from your retirement account threatens to reduce the resources that will be in that account at time of retirement.

It is superficial and unfounded for many reasons. The first is that it ignores the fact that loans have to be paid back within a maximum of five years as prescribed by the DOL and IRS, and which any plan sponsor can shorten if it feels prudent. Failure to pay within the set limits is treated as a total withdrawal of the outstanding loan amount and is seriously penalized with taxes and penalties.

In a world in which the average 401(k) and 403(b) participant already possesses many credit cards and is reasonably smart, people can be counted upon with practical certainty to repay their debt to themselves and avoid the disastrous consequences of 401(k) card default by either cutting spending or borrowing from some other source. The likelihood of default on the 401(k) and 403(b) card is negligible.

Another unfounded concern is that once participants are offered a bank card they will use that card to increase the volume of consumer credit card debt. That concern is unfounded since it is known that, on the average, consumers have four or five credit cards in hand and are continuously solicited to take more. They can already borrow more than they are currently borrowing, a fact that we know from the observation that lines of credit are a multiple of the average credit balance outstanding. There is no reason or evidence why access to one more card should increase the overall borrowing of a consumer. What does happen if the latest bank card offers more favorable credit conditions, is that the consumer may use it to consolidate debt. This development could very well occur with the 401(k) and 403(b) card, but the borrowing will be offset by a reduction of other debt, as occurs in any debt consolidation.

Instead, one result that may be expected with great confidence is an increase in the inflow into and the balances of 401(k) and 403(b)

accounts. People, especially those with a lower income, will be much more inclined to add to their 401(k) and 403(b) balances if they know these funds have not been locked away until retirement and are illiquid; but instead they are readily and easily borrowable when the need arises.

Here is the research which supports the contention that retirement plan loan availability enhances retirement savings:

- The Response Center in Philadelphia conducted a survey of 640 employees having access to 401(k) plans (491 plan participants and 149 nonparticipants). 22% of the participants said that if this feature (401(k) cards and checks) were available, they would increase their contribution rates. This percentage rose to almost 30% among participants earning less than $35,000 per year and dropped to 15% for those earning over $50,000. More importantly, among non-participants (i.e., those not contributing to their 401(k) plan) 22% said that they would be "very likely" to begin participating if this borrowing feature were available, and an additional 28% said they would be "somewhat likely" to begin participating. Thus, this innovative borrowing feature could motivate a significant 50% of employees not yet participating to start contributing to their 401(k) plan for their retirement. These responses are just what a national observer would expect. It is interesting to note that when Merrill Lynch added bank card access to their brokerage accounts, it revolutionized the industry and caused huge amounts of funds to move into these accounts. The impact of liquidity in attracting investments can be very powerful indeed.
- From the United States General Accounting Office, October 1997: Plans that allow borrowing have a somewhat higher proportion of employees participating than other plans, all other factors being equal. In addition to employer matching, allowing borrowing increases participation among eligible employees, especially lower-income employees. (In other words, plans that allow borrowing have dramatically reduced refusal rates. These rates show the percentage of employees refusing to participate. By actual statistics, plans that allow borrowing have refusal rates about 20% lower than plans that do not!) Allowing pension plan borrowing also significantly affects how much employees contribute. Participants in plans that allow borrowing contribute, on average, 35% more to their pension accounts than participants in plans that do not allow borrowing.
- The Profit Sharing Council of America, a respected industry association, maintains statistics on average contribution rates to 401(k) plans. Plans that provide no matching employer contributions offer the cleanest comparison available. One recent compilation looked at averages among non-highly compensated employees in these plans. These were the averages:

Without a loan feature 2.93%

With a loan feature 3.83%
(an increase of almost 31%)

When workers perceive increased ease of access to their account balances, their willingness to participate will increase. The innovation enhances this perception without compromising the availability of savings for retirement needs.

When workers perceive increased ease of access to their account balances, their willingness to participate will increase.

The benefits of a bank card loan provision in a 401(k) or 403(b) plan may now be summarized:

- reduces the administrative burden and related expense of loan processing. (For example, the issuing bank could provide sign-up, payment processing, delinquency monitoring, and customer service.)
- lets the plan sponsor deal more fairly, effectively, and efficiently with terminated employees who have outstanding loan balances in their 403(b) or 401(k) plan. With the card, the employee can continue paying the issuing bank after termination and thus keep all of the accumulated pension funds within the retirement system. There would be no mandatory tax (and possible penalty) which typically occurs when termination of employment occurs with a loan outstanding.
- does credit-bureau reporting on all credit lines, outstanding credit balances, and default occurrences associated with the account. This serves to keep the plan loan within the context of the participant's overall financial evaluation and credit history. This can be an advantage to the participant because it provides a safeguard against future inadvertent overuse of credit. A traditional 403(b) or 401(k) plan loan typi-

cally does not provide for credit-bureau reporting.

- encourages increased employee participation and contributions to 403(b) or 401(k) plans. It is particularly helpful to younger and lower-paid employees, who tend to have a harder time managing their borrowing and savings because they do not put aside enough money for emergencies. Also, these employees are less likely to own a home and thus do not enjoy the advantages of deducting interest on a home-equity line of credit.
- gives plan participants more flexibility than a traditional plan loan. By permitting access to and termination of a line of credit, the bank card helps individuals to get the money they need for emergencies when they need it, not at the end of a frustrating bureaucratic procedure, and to repay as soon as the need has terminated.

There are other considerations which make it clear that bank card facilitation of participant loans is a "plus":

a. Exposure to unwanted taxation and possible penalties as a result of inadvertent distribution of loans in excess of the limit in the law will be avoided. The card issuer will automatically flip any excess borrowing to a regular consumer loan, thereby restricting the participant loan to the exact limit in the law.

b. The finance charge applicable to these "flipped" consumer loans may be less than the finance charge applicable to a regular consumer loan (which is not linked to participant loan borrowing via the card). This is true because the card issuer may have evaluated the risk associated with lending to the kind of individual involved in retirement plan borrowing, concluding that such lending will involve a reduced risk.

But one of the most important advantages of bank card facilitation is reduced "leakage". Leakage is currently receiving considerable attention among policy planners in Washington. Leakage is the departure of retirement funds from the system before retirement. Participants who change jobs and take lump sums present leakage risks. Participants who receive hardship distributions present leakage risks.

Participant loans that are repaid during employment involve no leakage. However, under current practices, participant loans that are still outstanding at employment termination involve major leakage. Almost without exception, these loans close out when termination occurs. When this happens, the best possible outcome is a smaller rollover. Leakage has occurred.

Contrast this with what happens with bank card facilitation. Here, the soon-to-be-former employer has no reason to force close out. The sponsor can encourage the terminating employee to continue with orderly loan repayments. The worker's retirement money stays where it belongs: in the system and available to provide retirement income. Leakage is avoided.

Let no one underestimate the problem of loan leakage upon employment termination. Some observers speculate that if we cannot find a device like bank card facilitation to solve the problem, we may need legislation. This legislation would prohibit sponsors from forcing loan repayment upon employment termination.

Here are seven highlighted differences between conventional participant loans and bank card participant loans:

	Conventional	ELAC *
Old vs. Modern Technology	Bureaucratic paper shuffling permeates the conventional arrangement. Each loan requires a separate loan application, a separate individually-signed note, and a nonroutine accounting transaction. Even loans by phone and Internet may take 2-4 days to process.	Each participant obtains a card by completing paperwork only once. This generates both the application and the note. Then, a participant initiates each loan, without sponsor intervention, using the ELAC card. Modern technology provides automatic processing of each transaction.

*Electronic Loan Administration Card

	Conventional	ELAC *
Over-Borrowing	Since loans are difficult, participants facing a need will borrow to meet the entire need at its outset.	Participants borrow what they need when they need it, reducing average outstanding 401(k) loans.
Expense to Sponsor	Plan sponsors incur substantial expenses to administer the program. Fees account for part. Internal staff resources account for much more.	After initial card issuance, all administration expenses flow through the outside loan administrator. This introduces total outsourcing. The sponsor will pass this administrator's entire charge on to participants.
Loss of Retirement Savings Upon Termination	Employment termination inevitably closes out the loan, causing retirement assets to leave the system - usually forever - to pay off the loan.	Loan repayments continue beyond employment termination - at no administrative cost to the former employer. Retirement savings remain intact to provide retirement income.
Privacy	Participants must expose their personal finances to clerks and supervisors with each borrowing.	After obtaining the card, a participant initiates each loan in total privacy.
An End To Negative Arbitrage	Because loans are difficult and invade privacy, participants carry substantial credit card debt, paying up to 18% at the same time they invest in conservative 401(k) options earning prime rates or less.	With technologically innovative administration, participants borrow from themselves instead of the banks. The spread between what they earn and what they pay is reduced to sensible proportions.
Advantages To Women, Younger Employees, Lower Paids	The lowest 401(k) participation rates involve working women, younger employees, and the lower paid. These groups cannot risk tying up resources in an illiquid form. This seriously undermines 401(k) as a useful tool to encourage retirement savings.	Working women, younger employees, and the lower paid will greatly value reasonable access through ELACs. If they want ELACs, they must join a 401(k) or 403(b) plan. RESULT: improved participation in this critically important area.

*Electronic Loan Administration Card

Franco Modigliani is an economist known throughout the world for his work in macroeconomics and finance. He is the only Nobel Laureate ever to have won a prize for work in the field of retirement saving. Mr. Modigliani is a co-holder of a patent regarding card facilitation of plan participant loans. His participation in developing the proposed arrangement reflects his belief in its socially beneficial effects. Mr. Modigliani is Institute Professor Emeritus of the Massachusetts Institute of Technology.

CONTINUED FROM PAGE 5

The "Magic Box" Solution To The "Loan Problem"

that loan provisions within a retirement plan are going to be best suited to the younger and poorer people, since older and richer people will do better (economically) by borrowing using either an equity line or drawing on accumulated assets (that is, the "no loan" loan). He also clearly shows how borrowing from the plan would be expected to be cheaper than borrowing by the use of a regular bank credit card (say, at an 18% annual rate). He then goes on to suggest that utilizing a professional third party to administer these 401(k) credit card loans will reduce the cost to the employer (since the borrower will pay the cost of administration via the fees charged by the credit card company). I do not doubt the above statement, but when he says that "*this is especially true of smaller firms who typically employ lower paid employees*", I wonder how many small businesses of 100 or fewer employees he really believes will be targeted for this product by the banks that will be marketing it. Somehow I think Mr. Modigliani's definition of small employer will be limited only to the largest of our clients. Perhaps in the 1,000 employee and larger "small business", this program will find acceptance and marketability. I find it difficult to believe that it will be anything but an interesting talking point for the vast majority of our clients - never to be implemented.

So, let's discuss the issue of whether loans are a good thing. Mr. Modigliani believes that it is a *superficial and unfounded* argument that borrowing from your retirement account threatens to reduce the resources that will be in that account at time of retirement. It is funny how those of us who operate in the real world with real clients and employee participants have no doubt that borrowing has such an affect; but then, surveys and studies are always so much more persuasive than real world experience, aren't they? As one argument for why his position is correct, he says that the argument against borrowing ignores the fact that loans have to be paid back within a maximum of five years under DOL and IRS rules. Though here I do agree with his interpretation of the law, I disagree with his application of this to the real world. He argues that since the average 401(k) participant already has many credit cards and is reasonably smart (Are these the same *smart* employees who invest all their funds in money market accounts, or are these the *other* smart employees?), that they can be counted on "*with practical certainty to repay their debts to themselves and avoid the disastrous consequences of 401(k) card default by either cutting spending or borrowing from some other source*". Though I certainly support the reduction of spending when someone can't afford to go into debt (and maybe "going into debt" shouldn't be made so easy for those folks), I find it mystifying how he seems to suggest that borrowing from some other source to pay off your 401(k) loan puts the participant in a better situation than he would have been if he hadn't borrowed in the first place! Wouldn't the better choice to have been simply not to have borrowed in the first place?

Mr. Modigliani also suggests that an unfounded concern is that once participants are offered a bank card that they will use that card to increase the volume of consumer credit card debt. He suggests that is unfounded because it is known that, on the average, consumers already have 4-5 credit cards and are continuously solicited to take more. Since they already can borrow themselves into deep trouble with all the cards they already have, why should adding one more card increase their outstanding debt? Rather, he argues, they are more likely to transfer their debt to the card that costs less, thus consolidating their debt and reducing their costs for carrying that debt. That all sounds wonderful, doesn't it? But I believe that participants absolutely **don't** think of plan loans as *real* loans. *"It's only money that I owe to myself"* is a common refrain from participants who want to know why they *have* to make their payments. Participants don't understand that this is a real loan - just like if they borrowed from the bank. In the real world that we inhabit day in and day out, trying to teach participants fundamental economics is like trying to teach pigs to fly. It won't work, and it's annoying to the pig! If employees are so smart, how come so many of them are still paying 18% to credit card companies when they can, with a little effort, find cards that allow them to substantially reduce their cost of credit. Two answers: First, employees are not all that knowledgable when it comes to fundamental economics or finance, and second, there is tremendous inertia.

As to the survey results that Mr. Modigliani cites, I just don't believe them. It's not that the surveys themselves are slanted (and they might be, even inadvertently), but rather that you cannot believe what employees say they will do when presented with a hypothetical choice. Again, most employees are not particularly savvy when it comes to financial decisions. Basically, the survey from The Response Center says what one would expect. To the question that I read: *"Would you put more money away in your plan if you could treat it like a Christmas Club?"* employees said they would be more inclined to put money away. Well, as my 14 year old daughter would say, *"duuuhh"*!

What is it that employees fear, for which a plan loan possibility is a solution? It is, quite simply, the inability to get money when you need it. For that reason, and here I agree with Mr. Modigliani, employees will be more inclined to put money away when they see that there is liquidity attached to it, that they can get the money if they really need it. Now, is this an argument for loan provisions? I'd suggest that this is really an argument for hardship withdrawal provisions!

If you ask employees the same questions that Mr. Modigliani cites in his article, but offer a choice of the loan provision (where the participant *must* pay back the money) contrasted with an option of a hardship withdrawal *without* any requirement to have to pay back the money, I would venture to say that the loan provision would fall off the scale of desirability and the hardship provision would rule the day. Though I am no more personally in favor of having hardship withdrawal provisions in plans than loan provisions (because it does ultimately reduce the retirement accumulation), it is my preferred method of giving access to funds and increasing the contributions made by employees. When an employee *needs* his money, he does not want to have to borrow it and then have to pay it back; he wants it *no strings attached*. Of course, there are the tax consequences, but employees just do not care about that issue when they need the money (and, of course, the hardship distribution can be grossed up to take care of the taxes and penalties incurred).

Why do we hear so much about loans and so little about hardship withdrawals? If we were really interested in meeting employee needs, we would have all kinds of studies comparing loans with hardships and asking employees which they prefer and which will produce higher elective contributions. I suggest that the reason we do not see such studies is that it is not in the interest of most organizations that pay for such studies, which usually seem to be connected to investments. Offering loans that require payback to the plan definitely is in the best interests of the organizations that sell investments. They (only) temporarily lose the funds, with a strong promise that they will be paid back over five years. And if that is the only way they can sell the plan in the first place, then it is a good tradeoff for them. However, if the employee *really* needs the money, a hardship withdrawal has no requirement that the money be paid back and no credit card company charging interest and no insurance company or mutual firm counting on cash flow in the form of loan payments.

If participants take a hardship withdrawal, even if it is a safe harbor hardship withdrawal, they can go back to contributing deductible dollars to the plan either immediately or in a year. If anything, we should lobby to remove the one-year prohibition on contributions on the safe harbor withdrawals. Then, a participant can pull out the money he needs when he has a hardship, but he is *not* forced by law to pay that back within five years when maybe he will not be able to afford such a repayment schedule. His early distribution penalty will be offset by the interest charge he won't be paying; and if he can afford to start re-contributing to the plan, he can do so on his own time frame and by setting his own amounts. Does the hardship withdrawal risk the ultimate accumulation for retirement? Of course it does. You cannot spend the same dollar twice. But, it seems to me that this is the far more appropriate choice of design features to give the employee what he really needs, to allow for increased contributions to the plan (because of the liquidity factor now in play), and for simplifying out of existence the whole process of individual participant loans. Who loses? Seems to me it will be Mr. Modigliani's credit card companies.

At least, that's my opinion!

Lawrence C. Starr, CPC, EA, CEBS, is President of Qualified Plan Consultants, Inc. (QPC), a West Springfield, Massachusetts firm providing pension and profit sharing plan consulting, administration, and actuarial service on a fee-for-service basis. Starr is also a partner and operator (Sysop) of a nationwide electronic pension bulletin board system called The Pension Information eXchange (PIX). A holder of a graduate degree in Economics and Finance, Mr. Starr has served as ASPA's Vice President, and on the board of directors, and Education and Examination Committee. Mr. Starr is currently Communications Chair of the Government Affairs Committee and serves on ASPA's Communications and Technology Committee. He is also a frequent lecturer and speaker and has participated in many seminars across the country.

CONTINUED FROM PAGE 7

The Qualified Sign-On Bonus

minated) employees more money. Alternatively, the targeted QNEC could be allocated to a defined high paid NHCE. While this is certainly more costly than a targeted QNEC to the lower end of the NHCE workforce, it may be dollars that are easier for the employer to rationalize, or money that can be worked into a sign-on bonus.

To see how this might work, let's return to our above example. The first step is to correct the failed ADP test. Our options are refunds to the HCEs or increase the ADP of the NHCEs. The ADP of the NHCEs must be increased to at least 6.12% or by .54%. This could be done several different ways.

1. Each of the NHCEs could be given a QNEC equal to .54%. This would cost .54% times the total NHCE compensation of $245,000 or $1,323.
2. Alternatively, the lowest paid NHCE could be given a targeted QNEC of .54% times 5 or 2.7%. This works out to be $270.
3. The third alternative would be to target the highest paid NHCE (who actually is a future HCE). The targeted QNEC would be equal to 2.7% of his $160,000, which is $4,320.

While option three is more expensive, the highly paid individual (but not yet HCE) is likely an individual that the employer would be more willing to compensate than the lower paid NHCE, especially if the lower paid NHCE is no longer even employed by the employer. The larger the bonus, the more significant its effect on the test results. Remember however, a QNEC requires full vesting.

The sign-on bonus does not need to be a QNEC. For example, a newly hired, but not yet highly compensated employee, could be offered a qualified sign-on bonus, (i.e., a special contribution made only to a select NHCE) of any amount not to exceed his applicable maximum annual addition (25% of compensation or $30,000). Assuming that he is not yet eligible for the other contributions offered under the plan, this could be a nice tax-deferred addition to the individual's compensation package and is a good way to distinguish an employment package from the competition's offer. It may also be a great way to enhance a plan's nondiscrimination test results, be it the ADP and or ACP test, the average benefits test or the general test for nondiscrimination. In some cases, the sign-on bonus may not be able to be used to help the testing, for example, if it is necessary to disaggregate employees with less than one year of service. However, it would still fulfill its primary mission of recruiting the desired new employee.

This type of design would probably not work for a similarly situated HCE. This is because the rules regarding both coverage and nondiscrimination prohibit a benefiting classification that discriminates in favor of HCEs. The allocation would not pass the nondiscriminatory classification portion of the average benefits test. It would also undoubtedly be considered a discriminatory right, benefit or feature, so even if the allocation could be absorbed into the applicable mathematical test results, it would be clearly discriminatory on its face. In addition, the amendment creating the special allocation may not pass the IRC 401(a)(4) requirement that a plan not be amended in a manner or at a time that would be discriminatory.

Amy Cavanaugh is an employee benefits consultant with the actuarial and consulting firm of Milliman & Robertson in Albany, New York. She has over 18 years experience in matters of plan design, compliance, and administration.

MARK YOUR CALENDAR NOW AND PLAN TO ATTEND

1999 ASPA Annual Conference

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You're Invited! Don't Miss ASPA's Premier Summer Event

Summer Conference • July 11-14, 1999

You are invited to attend the first ASPA Summer Conference, July 11-14, 1999 at the Fairmont Hotel (hotel cut-off date is June 11) in San Francisco, California. The theme of the Summer Conference is "Education for the Millennium" and, like all ASPA's conferences, promises to provide you with the skills and knowledge to prepare you for next year and beyond.

The ASPA Summer Conference combines the former East and West Coast Regional Seminars into one event with a west coast location. It features workshops on defined benefit plan administration from A to Z, cross-tested plans, daily-valued plans, nonqualified plans, marketing techniques, legislative updates, documents and restatements, mergers and acquisitions plus much more. Attendees will earn 20 ASPA continuing education credit hours.

The program has been designed to earn 20 JBEA credit hours for enrolled actuaries.

In addition to outstanding educational opportunities, a full complement of vendors will display the latest tools, products, and services that make your job easier and more manageable.

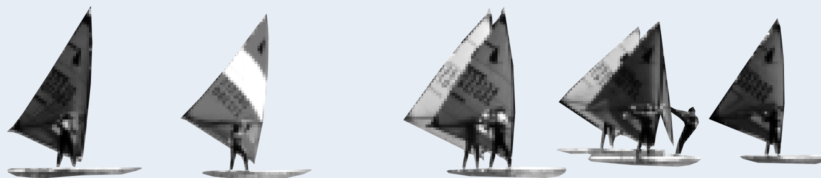
For more information, contact Piper J. Deuschl, CMP, at ASPA (703) 516-9300, or visit the ASPA website at **www.aspa.org**.

Register early....this conference is expected to sell out quickly!

Registration Fees:

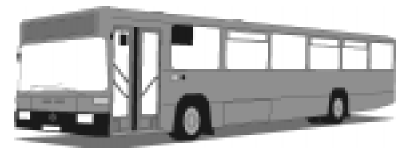
	Early Bird	Late	On-Site
	(by 6/11)	(after 6/11)	(after 7/5)
Member	$550	$690	$ 860
Non-member	$690	$860	$1075
Additional Registrant*	$500	n/a	n/a

* To qualify for the additional registrant fee: Additional registrants must be from the same location of the same firm and all registration forms must be submitted together with payment by the early registration deadline.



ASPA's March on the Hill Rides in Style!

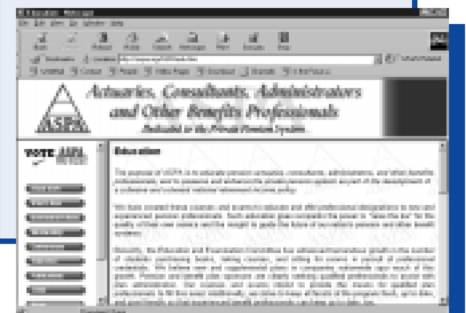
Join other ASPA members as they march on Capitol Hill to discuss the latest pension proposals with their Senators and Representatives as part of the annual conference in October! More details to come later!



ASPA Exam Results Posted Online

Exam results for the December 1998 C-1, C-2(DB), C-2(DC), C-3, C-4, and A-4 exams are now posted alphabetically by name at **www.aspa.org/aspaedu.htm**.

A list of candidates who earned the Pension Administrators Certificate effective August 31, 1998 is also available at the site.



WELCOME NEW MEMBERS

Welcome and congratulations to ASPA's new members and recent designees. March — April 1999.

MSPA

Andrew D. Eisner
Barry R. Naugle

CPC

Stacie L. Brass
Susan L. Breen-Held
Randy O. Cater
Irene F. Diamond
Stephen L. Dobrow
Heather H. Fenimore
Michael J. Flis
Mary Jo Hartman
Victoria L. Kennedy
Daniel E. LaGrone
Cary Cleveland Lucas
Barbara Y. Phillips
Donna Thomas Sharp
Lisa A. Showalter
Deborah L. Sjostrom
Susan L. VanMeter
Michael E. Wesson
Michelle X. Zhang
Andrew J. Zollman

QPA

Barbara E. Allen
Mary Arcand
Sandra D. Bartash
Avaneesh K. Bhagat
Jeanne L. Blake
Debra L. Blankenship
Carolyn A. Campbell
Phyllis A. Carter
Amy L. Cavanaugh
Jennifer Marie Crickenberger
Michael W. Curran
Kathleen Ann DiMonda
Dale Drees
Paul F. Eisenhardt
Terri L. Ely
Pamela S. Ernsting
Claire M. Eyges
John W. Fox
David Frazer
Cathy J. French
Scott Freund
Michael J. Gardyasz
Gene M. Gutschenritter
Elizabeth K. Harrington
Robert A. Hartnett Jr.
Patrick G. Henn
Pamela A. Johnson
Beth A. Koch
Kevin J. Krogstad
Kathleen Laird
Stephen Sean Lewis
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Bonny Mannina
Shannon M. Meyer
Mary T. Miller
Kimberly L. Oros
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Marina Rolbin
Michelle Suzy Steffens
Eric D. Swiggum
Tanya J. Uptegraph
Tamara M. Vaughn
Dennis R. Wiley, Jr.
Michelle M. Young
Katie J. Younker

APM

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James T. Comer III
Kevin J. Konzen
Richard A. Nelson
Robin T. Sproles
Doris P. Watson

Affiliate

Kimberly A. Baker
Thomas E. Barrett
Mary Jo Baumann
Quynhchau Le
Sue McCall
Jon M. Michelizzi
Stacey Miller
Michael Murray
Lori A. Parker
Charles R. Parks
Jerry L. Slater
Bryan D. Uecker
Shirlee Walker
Ernst A. Wright
Todd Yagoda

Agenda Finalized for Three Best of Midstates Workshops

ASPA is teaming up with the Internal Revenue Service's Midstates Key District Employee Plans/Exempt Organizations Division to offer three workshops that will take six topics from the Midstates Benefits Conference and present them in Kansas City, Missouri, on July 21; Minneapolis, Minnesota on July 23; and Milwaukee, Wisconsin on July 30.

The agenda for the Best of Midstates workshops has been finalized. The information-packed agenda will be presented by local practitioners and representatives from the IRS who will address the following topics:

1. Plan Amendments and Restatements During the Remedial Amendment Period
2. 401(k) Plan Design and Compliance - Emphasis on 401(k) Safe Harbor Plans
3. Fiduciary Responsibilities, Prohibited Transactions, Plan Expenses
4. IRS Voluntary Compliance Programs
5. Cross-Testing Your Defined Contribution Plans
6. A session with local members of the IRS

The workshops begin at 8:30 am and conclude at 4:45 pm. They provide up to eight hours of ASPA continuing education credit hours. More information on CE credits is provided in the promotional brochure.

These intermediate level workshops are designed for people with two to five years of plan and benefits administration experience, including: actuaries, consultants, in-house administrators, lawyers, recordkeepers, and others. To receive a brochure, please contact the ASPA Meeting Department at (703) 516-9300 or check ASPA's website at **www.aspa.org**.

CANADIAN INSTITUTE OF ACTUARIES

Symposium on Aging: Call for Papers

What will retirement mean in the coming years and what will retirement benefits look like? Can public policy improve the current retirement picture?

The Canadian Institute of Actuaries (CIA) is sponsoring a call for papers to encourage and expose new ideas for retirement benefit public policy debates. The audience will include actuaries, policy makers, employers, human resource professionals, unions, academics, and others interested in retirement policy. Accordingly, this call for papers is addressed to all professionals interested and knowledgeable in retirement issues. It is not restricted to members of the CIA.

Fresh insights into the issues impacting public policy for retirement and retirement benefits are being sought. These include, but are not limited to, an exploration of the following questions:

- How is our current understanding of retirement changing, and will it still be valid in the future?
- What is the appropriate role of government, employers, and individuals in securing one's retirement?
- What is the role of government guarantees regarding private programs?
- Can work and retirement be integrated, and if so, how?
- What makes up an adequate retirement benefit?
- At what age should benefits be provided?

Papers accepted will be published. It is also anticipated that the papers will form the basis for a conference, scheduled for May 1-2, 2000, in Toronto. Authors may be eligible for continuing education credits from ASPA, the CIA, the Academy of Actuaries, and the Conference of Consulting Actuaries.

An abstract and outline of your proposal must be submitted by June 1, 1999. For more information, contact the Organizing Committee on Symposium on Aging at (613) 236-8196 or e-mail symposium2000@actuaries.ca.

www.aspa.org

Check out the Meetings Webpage to download information, brochures, and registration forms for upcoming conferences, including the 401(k) workshops and the new 1999 ASPA Summer Conference.

Get your copy of *The Pension Actuary* early... before it is even mailed out!

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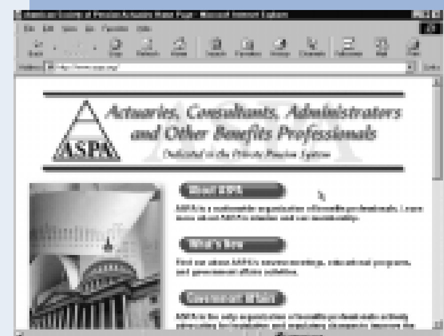

403(b) IRS Voluntary Correction Program
Partnership for Compliance

Tax-Sheltered Annuity Education Outreach Program

by Theresa Lensander, CPC, QPA
Chair, Tax Exempt and Governmental Plans Committee

ASPA's Government Affairs Committee had the opportunity to meet with the Internal Revenue Service in Washington D.C. on Monday, March 15. The following information was provided to introduce the new Educational Coordinators for the 403(b) voluntary compliance programs set forth in Revenue Procedure 99-13:

Northeast Key District
Charles Patrasanta
Internal Revenue Service
EP/EO Division, 4th Floor
150 Court Street
New Haven, CT 06511
Phone: (203) 773-2756
Fax: (203) 773-2279

Southeast Key District
Randall Reed
Internal Revenue Service
EP/EO Division, Room 480
400 N. 8th Street
Richmond, VA 23240
Phone: (804) 262-0954
Fax: (804) 771-8240

Midstates Key District
Diann Johnson
Internal Revenue Service
EP Group 7105
316 North Robert Street
MC 4915 STP
St. Paul, MN 55101
Phone: (651) 312-7750
Fax: (651) 312-7715

Western Key District
Terry Holloway
Internal Revenue Service
EP/EO Division
1244 Speer Blvd., Suite 442
Denver, CO 80204-3583
Phone: (303) 844-2545, Ext. 254
Fax: (303) 844-3596

The 401(k) Safe Harbor Blues: A Rap Song

by Bruce "Slim Daddy" Ashton

I gave my notice and I gave it right
Told my participants to just sit tight
Safe harbor, safe harbor

I used the match 'cuz it was so cheap
Told my TPA and he didn't
make a peep
Safe harbor, safe harbor

At the end of the year,
I got some bad news
"Plan'll be top-heavy" —
now I got the blues
Safe harbor, safe harbor

"No worries, man," the TPA said
"Make a contribution –
your plan ain't dead"
Safe harbor, safe harbor

"If you make a contribution,
you can cross-test, too
"Some for them, more money for you"
Safe harbor, safe harbor

I gave a new notice and I gave it right
I told my participants to just sit tight
Safe harbor, safe harbor

At the end of the year,
I got some more news
"Even those you fired,
they just can't lose"
Safe harbor, safe harbor

"3% for all, but you're a rich man
"Put the money in,
just as fast as you can"
Safe harbor, safe harbor

"Fully vested too, no for-fei-tures
"The money in the plan,
it ain't all yours"
Safe harbor, safe harbor

I put the money in and I did it right
I told my participants to just sit tight
Safe harbor, safe harbor

Thank you, Carol –
thanks a lot, Wick
My safe harbor plan, it sure is slick
Safe harbor, safe harbor

Safe harbor, safe harbor

Bruce L. Ashton, APM, a partner with Reish & Luftman, is cochair of the Government Affairs Committee, and serves on ASPA's Board of Directors.

Focus on CE

ASPA Conferences and Workshops – An Education and CE Credits, Too!

by Cathy M. Green, CPC, QPA

ASPA conferences and workshops provide educational and timely information on the latest government regulations. In addition, they are an easy way to earn your 40 required ASPA CE credits for the upcoming ASPA CE cycle.

At the top of the list are the new ASPA 1999 Summer Conference, July 11-14 in San Francisco, California and the 1999 ASPA Annual Conference, October 24-29 in Washington, DC. Each of these conferences earns 20 ASPA CE credits, half the requirement needed for retaining your post-1990 ASPA credential.

The Midstates Benefits Conference, April 29-30, in Chicago, Illinois, earns 15 credits and the Northeast Key District Employee Benefits Conference earns 14 ASPA CE credits.

CE opportunities are provided at any of the six 401(k) workshops in Philadelphia, Pennsylvania; Houston, Texas; Cleveland, Ohio; Atlanta, Georgia; Seattle, Washington; and Boston, Massachusetts; at the three defined benefit workshops in Newark, New Jersey; Dallas, Texas; and San Francisco, California; or at the Best of Midstates workshops in Kansas City, Missouri; Minneapolis, Minnesota; and Milwaukee, Wisconsin. Attendance at any of the 401(k) or DB workshops earns seven ASPA CE credits. Attendance at the Best of Midstates workshops earns eight ASPA CE credits. These workshops are conveniently located throughout the country and, like all of ASPA's conferences and workshops, provide quality pension education at an affordable price.

Tapes of the sessions, which can be purchased at any of these conferences or through the ASPA office, provide a chance to bring valuable conference information to ASPA members who could not attend in person. Tapes may be used for an in-house training session, preferably led by a CPC or a QPA, to earn ASPA CE credits for both the trainer and the trainee.

Each ASPA credentialed member is required to earn 40 continuing education credits in each continuing education cycle subsequent to the cycle in which the member received his post-1990 ASPA designation. For the initial continuing education cycle, the number of credits required is prorated based on the date of admittance or designation within the two-year continuing education cycle. The current cycle began on January 1, 1999 and will end on December 31, 2000.

For more information on ASPA's continuing education program, contact Kevin Scott, Assistant Director of Education Services, at (703) 516-9300 or e-mail educaspa@aspa.org. For more information on the 1999 ASPA conferences and workshops, contact the ASPA meetings department or e-mail meetings@aspa.org. Information about both these topics may be found on the ASPA web site, **www.aspa.org**.

Cathy M. Green, CPC, QPA, is vice president of CMC in Glendale, Calif. She is the chair of the Continuing Education Committee. Ms. Green, a member of ASPA's Board of Directors, also serves on the Conference Committee and is chair of the 1999 ASPA Summer Conference. She is also a member of the Ed Policy Committee.

Ideas? Comments? Questions? Want to write an article?

The Pension Actuary welcomes your views! Send to:

The Pension Actuary
ASPA, Suite 820
4350 North Fairfax Drive
Arlington, VA 22203-1619
(703) 516-9300
or fax (703) 516-9308
or e-mail aspa@aspa.org

Focus on ASPA PERF

PERF Awards Presidential Scholarship

by Scott D. Miller, FSPA, CPC

The ASPA Pension Education and Research Foundation Inc., or ASPA PERF, is a not-for-profit 501(c)(3) corporation formed to foster excellence in pension education and to promote scholarly research in the pension field. It is supported by tax-deductible member contributions.

In support of our educational objective, ASPA PERF introduced a new ASPA Presidential Scholarship in 1999. Each year, ASPA's president will be asked to designate a college or university to receive a one-time $2,000 ASPA PERF Scholarship. The scholarship will be awarded to an outstanding junior.

Carol Sears, FSPA, CPC, ASPA's 1999 president, selected the University of Illinois to receive the 1999 scholarship. Ms. Sears earned her degree in actuarial sciences and finance from the University.

The recipient of the 1999 scholarship is Michael E. Mielzynski from Des Plaines, Illinois. Michael graduated with highest honors from Elk Grove High School. He is expected to graduate from the University of Illinois with a degree in actuarial science and finance in May 2000. He has an overall GPA of 3.98 with a 4.0 in his major.

Michael served as an intern at a Chicago pension office during the summer of 1998 and is very interested in pursuing a career within the pension field.

The Actuarial Program at the University of Illinois has 125 students. In May 1999, 31 actuarial students are expected to earn a B.S. degree and three are expected to earn a M.S. degree. The undergraduate program requires eight courses in post-calculus mathematics and statistics (including theory of interest, three semesters of statistics, and a two-semester life contingencies sequence) and a minimum of four courses in finance. In addition to these courses, all students are expected to complete requirements in foreign languages, humanities, sciences, and in English composition.

Scott D. Miller, FSPA, CPC, is president of Actuarial Consulting Group Inc. in South Salem, N.Y. Mr. Miller is chairman of ASPA PERF, is one of ASPA's vice presidents, and serves on ASPA's Board of Directors and Executive Committee.

ASPA Seeks Technical Education Consultant

The American Society of Pension Actuaries is seeking an individual for the position of technical education consultant (TEC). The TEC will provide technical educational services to ASPA's national office staff, Education and Examination (E&E) Committee, and ASPA members.

A primary duty of the TEC will be to review materials prepared by the E&E Committee for consistency and technical accuracy. In addition, the individual will evaluate textbooks and assist in course development. The TEC will also attend E&E committee meetings. Various technical support for other committees and ASPA events may be required.

Candidates for this position should be credentialed ASPA members with five to 10 years of consulting experience and expertise in both defined benefit and defined contribution plans. An education background is a plus. It is also necessary to possess good writing and technical skills. Compensation will be determined based on ability. Resumes should be sent by July 15, 1999 to:

ASPA TEC
4350 North Fairfax Drive, Ste 820
Arlington, Virginia 22203-1619

Focus on E&E

Nominations Sought for Prestigious Educator's Award

by Gwen S. O'Connell, CPC, QPA

Two years ago, the ASPA Education and Examination (E&E) Committee established the Educator's Award to recognize and honor outstanding educators. Nominees for the 1999 award are being accepted now. The deadline for submissions is July 15, 1999.

The criteria for the award are ASPA membership and a significant contribution to pension education (e.g., through instruction, conferences, ASPA Benefits Councils, promotion of ASPA's education program, or preparation of educational materials).

Nominations for the award are subject to the following limitations:

- No prior recipient of the award may be considered.
- Nominations may be submitted by anyone in the pension field, excluding ASPA's E&E divisional chairs.
- Any divisional chairs nominated will be excluded during the evaluation and voting processes.

Upon receipt of all nominations, E&E's divisional chairs will evaluate the candidates and choose a deserving recipient by majority vote. The candidates will not only be evaluated solely on the number of nominations received, but also on the candidates' years of contribution to education.

The recipient of the Educator's Award will receive a plaque in recognition of their achievement, free registration to the 1999 ASPA Annual Conference for the award presentation, one night's accommodation, and feature articles in *The Pension Actuary* and *The Candidate Connection*.

If you know someone you would like to nominate, contact Holly Wilhelm, Education Services Coordinator, at (703) 516-9300 for a nomination form.

Janice Wegesin, CPC, QPA, was selected as ASPA's 1998 Educator's Award Winner. She won this recognition for her volunteer efforts in developing the Pension Administrator's (PA-1) course. Ms. Wegesin, president of JMW Consulting, Inc., has over 17 years of experience in retirement plan design and administration. She is a contributing author to several issues of the *Journal of Pension Benefits* and co-author of *The 5500 Preparer's Manual*. Janice is a current member of ASPA's Government Affairs Committee and has served on ASPA's board of directors and as chair of the Membership Committee. She has also served on ASPA's Conference and Programs and Education and Examination Committees. In addition, Ms. Wegesin is a very popular speaker at ASPA's conferences and workshops.

Chuck Klose, FSPA, CPC, was selected as ASPA's first recipient of the Educator's Award in 1997. He was recognized for his 13 years of experience as a coordinator and instructor of ASPA's C-1, C-2(DC), C-2(DB), C-3, and C-4 courses in the Philadelphia area. Mr. Klose, also an Enrolled Actuary and Certified Benefits Specialist, has taught EA-1, EA-2, and the Society of Actuaries' 210 and 200 exam review classes. He is vice president and actuary at Estate & Pension Advisory Board, Inc., in Bala Cynwyd, PA. Chuck is a former member of ASPA's board of directors and previously served on the board of directors of the ABC of Delaware Valley. In addition, Mr. Klose is a frequent speaker at ASPA and EA conferences.

Gwen S. O'Connell, CPC, QPA, is Principal of Summit Benefit & Actuarial Services, Inc. in Eugene, Oregon. Ms. O'Connell currently serves on ASPA's Executive Committee as its secretary, is a member of the Board of Directors, and is the general chair of the Education and Examination Committee.

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accumulation of years of data, much of which is not even attributable to current clients.

To read the entire thread, download the file howlong2.fsg.

401(k) Plans, Loans, and Home as Collateral

[Thread #73711]

401(k) plans and participant loans are inseparable. Of course, the code provides that plan loan interest is not deductible if the loan is secured with 401(k) deferrals. A PIX user posted a question regarding the use of a participant's home as collateral so that the interest would be deductible. Since the 401(k) plan has individual accounts, the loan would be allocable just to that participant's account. In the event of a default, the participant's account would suffer an investment loss in the amount of the loan, effectively the same result as if the loan was secured by the account. Would this lead to the IRS challenging the loan's collateral and deductibility?

Several users suggested that it would not be a problem, that the loan would meet the letter of the law by its terms. However, most of these users assumed that if the loan were defaulted, the account would simply be allowed to suffer a loss. Another user suggested that the trustees of the plan would be obligated to seek to collect the loan, possibly by foreclosing on the participant's home. This is no different than when a loan offset is applied to an account used as collateral for a loan, the trustee is acting to collect on the loan's collateral.

To read the entire thread, download the thread khomeln2.fsg.

Still Time To Register for ASPA's 401(k) Workshops!

Bringing ASPA to you! After two successful workshops in Philadelphia, PA and Houston, TX, ASPA still has space available in the four remaining 401(k) workshops in Cleveland, OH; Atlanta, GA; Seattle, WA; and Boston, MA.

Janice M. Wegesin, CPC, QPA, ASPA's 1998 Educator's Award winner, will be the featured speaker at each workshop. At each location, she will be accompanied by a local speaker. Some of the topics covered include: *Safe-Harbor Plans; Testing 401(k) Plans; Participant Loans;* and *Tricky Eligibility and Compensation Issues.*

These one-day workshops offer up to seven ASPA continuing education (CE) credit hours and up to seven noncore JBEA credit hours. These intermediate workshops are designed for pension and retirement benefits professionals with two or more years of experience.

For ASPA, ABC members, and coopertating sponsors' members (AAA, CCA, NIPA, SOA, and WEB) the "early" registration fee is $200. The "early" nonmember fee is $250. The "early" registration deadlines are set approximately three weeks prior to each workshop. For complete details, call Ken Morton, ASPA Meetings Coordinator, at (703) 516-9300, e-mail: meetings@aspa.org or access the web site at **www.aspa.org**.

The four remaining workshops:

Cleveland, OH	June 11	Cleveland South Hilton
Atlanta, GA	June 21	Hilton Atlanta and Towers
Seattle, WA	June 28	Crowne Plaza Hotel - Seattle
Boston, MA	July 16	The Seaport Hotel

ASPA Benefits Councils' Calendar of Upcoming Events

Date	Location	Event
June (*date tba*)	Philadelphia (Delaware Valley) Speaker: tba	Lunch Meeting: Cash Balance Plans
June 3	Chicago Speaker: Kevin J. Donovan, APM, CPA	Short Plan Year Issues
June 11	Cleveland	401(k) Workshop
June 16	North Florida (Jacksonville) Speaker: Robert M. Richter, APM, Esq., Corbel	Amending Plans for GUST
June 21	Atlanta	ASPA 401(k) Workshop
July 13	Orlando Speaker: Ilene Ferenczy	Limiting Liabilities and Risks in Takeover Plans
July 29	Atlanta Panel: Ilene Ferenczy, CPC, Cynthia Groszkiewicz, MSPA, QPA, David Levin, APM, Esq.	Breakfast/Workshop Panel Discussion: "In the Trenches"

For more information or for the name of a local contact, please call the ASPA office at (703) 516-9300.

San Francisco to Host DB Workshop

On July 10, immediately prior to the new 1999 ASPA Summer Conference, a one-day workshop on defined benefit plan design will be held at The Fairmont Hotel on Nob Hill in San Francisco, California. This intermediate level workshop provides an interactive forum for participants to learn and share information.

Joan A. Gucciardi, MSPA, CPC, President, Gucciardi Benefit Resources, Inc., Wauwatosa, Wisconsin and Norman Levinrad, FSPA, CPC, President, Summit Benefits & Actuarial Services, Inc., Eugene, Oregon, will provide hands-on instruction on ways defined benefit plans can work for you and your clients and how to effectively market them.

The workshop is designed for retirement and benefit plan professionals with two or more years of experience and will offer seven ASPA continuing education credit hours and up to seven hours of core credit for enrolled actuaries.

The early registration deadline is June 21. Registration fees until June 21 are $250 for members and $320 for non-members.

For more information and a brochure, please call ASPA at (703) 516-9300, e-mail meetings@aspa.org, or access our web site at **www.aspa.org**.

1999 Calendar of Events

		ASPA CE Credit
June 21	401(k) Workshop, Atlanta, GA	7
July 10	ASPA Defined Benefit Workshop, San Francisco, CA	7
July 11-14	ASPA 1999 Summer Conference	20
July 15	Deadline for nominations for the 1999 Educator's Award	
July 16	401(k) Workshop, Boston, MA	7
July 21	Best of Midstates Workshop, Kansas City, MO	8
July 23	Best of Midstates Workshop, Minneapolis, MN	8
July 30	Best of Midstates Workshop, Milwaukee, WI	8
Aug. 31	Final deadline for 10th edition PA-1A and B examinations	**
Sept. 16-17	LA Benefits Conference, Universal City, CA	15
Oct. 15	Early registration deadline for ASPA's fall exams	
Oct. 24-27	1999 ASPA Annual Conference, Washington, DC	20
Oct.- Nov.	EA-2 classes † (Washington, D.C., CA, Chicago, IL, and a west coast location to be announced)	20
Nov. 1	Late registration deadline for ASPA's fall exams	
Nov. 6-7	ASPA Weekend Courses, Denver, CO C-2(DB), C-2(DC), C-3, and C-4	15
Dec. 1	C-1, C-3, C-4, and A-4 examinations	*
Dec. 2	C-2(DC) examination	*
Dec. 3	C-2(DB) examination	*

* Exam candidates earn 20 hours of ASPA continuing education credit for passing exams, 15 hours of credit for failing an exam with a score of 5 or 6, and no credit for failing with a score lower than 5.

** PA-1A and B exams earn 5 ASPA continuing credits each for a passing grade.

† ASPA offers these courses as an educational service for students who wish to sit for examinations which ASPA cosponsors with the Society of Actuaries and the Joint Board for the Enrollment of Actuaries. In order to preserve the integrity of the examination process, measures are taken by ASPA to prevent the course instructors from having any access to information which is not available to the general public. Accordingly, the students should understand that there is no advantage to participation in these courses by reason that they are offered by a cosponsor of the examinations.

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Deduction of Required Contributions to Sole Proprietor DB Plan

[Thread #74606]

This thread discusses the IRS response to Question and Answer #13 from the 1999 Enrolled Actuaries meeting. The following question was posted:

> "A contribution is made to satisfy the minimum funding requirement. Due to net business losses, the contribution cannot be deducted because of 404(a)(8)(C), which says contributions fail to satisfy the 162 and 212 requirement if they exceed earned income.
>
> Can the deductions be carried over to future years? Can they be deducted up to the earned income limit in each succeeding year as contributions required to meet the minimum funding requirement of a prior plan year, or would a ten-year amortization rule be used?"

The response given by the IRS was, "The statute does not appear to accommodate a carryover of the 404(a)(8)(C) limit to later tax years. Section 4972(c)(4) exempts such amounts from the 10% excise tax on nondeductible contributions."

The PIX user who participated in this thread discussed this topic at length. Several users were adamant that the deduction for such a year is lost entirely. The possibility of amortizing the deduction over 10 years was quickly ruled out. Regulation section 1.404(a)-6(b) provides for a 10 year amortization where a contribution is not fully deductible in the final year of the plan, but it applies specifically to terminating plans.

Another PIX user pointed out that the future contribution calculations for the plan would use lower assets for 404 than for 412, and would therefore develop a higher 404 cost. However, the higher 404 limit in future years does not by itself permit the carryover of a contribution made in a prior year. IRC 404 generally permits a contribution to be deducted in the year contributed. Section 404(a)(6) deems a contribution made within the time for filing the tax return to be made on the last day of the year. Of course, in the following plan years, the contribution was made in a prior plan year, so does not meet the deductibility requirement of being made in the later years.

One user suggested that the plan sponsor intentionally incur a funding deficiency to move the contribution to the next plan year, as contributions required for Section 412 are generally deductible. However, the deductibility is still in doubt due to 1.404(a)-14(e)(1) which permits the deductibility of a contribution in a later year if the sole reason it was not deductible in a prior year was because the contribution was not made by the return filing deadline. Yet another user suggested that this technique might still work due to 1.412(b)-1(b)(ii) which provides that the charge to the Funding Standard Account for a deficiency is the first day of the following plan year. This implies that it should be deductible in the next plan year because it is a current charge to the FSA and is therefore a required 412 contribution for that year in its own right.

The issue remains, and practitioners should be advising clients and their tax advisors of these deductibility issues. To read the entire thread, download the file soledb2.fsg.

Record Retention - Again

[Thread #73108]

Usually a plan administration firm asks the question, "How far back do we have to keep records?" This thread started with a question from a user regarding a plan participant asking for copies of all his profit sharing statements, back to his entry date in 1970.

Several users immediately said that no more than the current year statement is required, however, other users took issue with this. Section 209(a) of ERISA was cited, requiring sufficient plan records to determine benefits. A number of participants discussed what the possible ramifications would be in court should a participant make such a request and the plan not be able to fully comply. Further discussion revolved around the participants' responsibilities to timely question a statement.

While there is no specific guidance to resolve this question, this thread is a valuable one for practitioners, as we all struggle with the

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