The Swerdlin Quarterly

Swerdlin & Company
Actuaries ❖ Employee Benefit Consultants

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Is Automatic 401(k) Enrollment a Good Idea?

The answer depends on who you ask. Some believe it is a great way to boost participation, while others think it is company paternalism at its worst.

Whether you call it automatic enrollment, negative election, or mandatory enrollment, it's the same thing. Instead of relying on employees to take action and sign up for your 401(k) plan, you automatically enroll them unless they opt out. The idea is to use employee inertia to get them into the plan instead of keeping them out.

The obvious reason for doing this is to increase participation. Greater participation makes it easier to pass the 401(k) tests and also increases the level at which higher paid employees can save in the plan. Fast food giant McDonald's has been using automatic enrollment for more than ten years and boasts a 95% participation rate.

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Dorn's Corner

On the surface, Swerdlin & Company provides retirement plan services to employers and their employees. However, at a deeper level we develop relationships. In order to develop relationships in our business, we must first develop the technical skills of our people to insure their skills are always honed to a state-of-the-art edge. Next, we must provide our people with the latest technological tools to perform their work with the greatest efficiency and highest quality. This is not an easy task.

However, much more important and much more difficult to provide are the human developmental characteristics needed to maximize and develop people-to-people relationships.

The "new science" based in quantum physics says that relationships among "things" are much more important than the "things" themselves. Our old way of thinking focuses on separate things and virtually ignores relationships.

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Dorn's Corner

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This makes teaching people about relationships very difficult because people (coming from our old way of thinking) believe they are separate from everyone else, and have no idea how their thoughts, words, and actions affect others.

I believe the most important contribution we can make is to develop a sense of relationship. This is my commitment to my employees and clients.

In order to assess our relationships with our clients, we are sending a new client perception survey in the near future. We always appreciate your input on these surveys.

Hope you're having a great summer! ■

Good News!

You have until the end of the plan year beginning in 1999 to amend your plan for compliance with the new rules of the Small Business Job Protection Act (SBJPA)

Is Automatic 401(k) Enrollment a Good Idea?

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Even if you don't have trouble passing the 401(k) tests, you may still consider automatic enrollment to capture those employees who are least likely to join the plan on their own. Getting these people to begin saving for their retirement can mean the difference between them retiring without adequate funds or retiring comfortably.

The IRS's opinion of automatic enrollment is unclear

Why are some people opposed to automatic enrollment? Your employees are adults and if they don't want to do something that's good for them, who are you to say otherwise?

Of course, automatic enrollment is not the only way to increase participation. Two other proven methods are:

1. Educating employees to better understand the benefits of joining the 401(k) plan; and
2. Boosting your employer match to attract greater participation.

Automatic enrollment is also untested on the legal front. Issues such as the effect on minimum wage employees, application of state withholding restrictions, and the IRS's opinion of automatic enrollment are all unclear. It is clear that plans with automatic enrollment cannot claim 404(c) protection. To receive this shield from fiduciary liability, participants must make an affirmative election and choose their plan investments.

Should you consider automatic enrollment? There is no right or wrong answer. Call us if you would like to discuss automatic enrollment or other strategies for increasing plan participation. ■

Where Should I Invest My Money?

If your retirement plan allows participants to choose the investment mix of their account balances, they may ask you for advice on their investment choices. Do you feel compelled to answer their questions? Do you make suggestions? If so, you are not alone. Many employers feel if they don't help, employees will just put their money in a money market account or not participate at all.

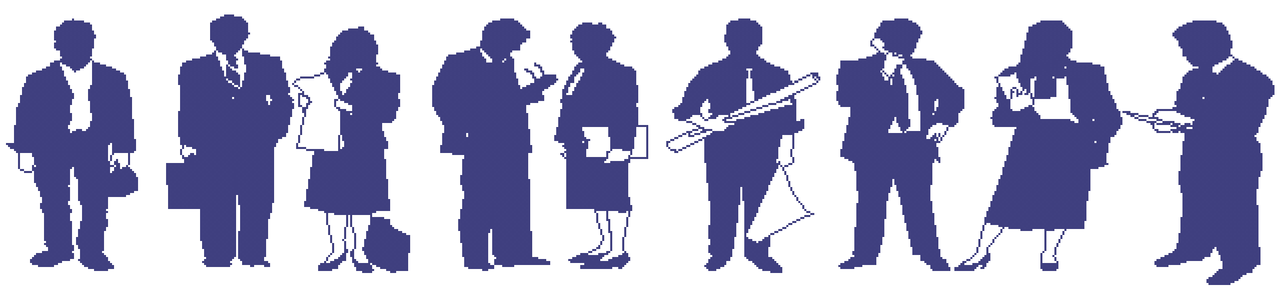
If you advise employees about their investment choices, you put yourself and your employer in a dangerous situation. If you give participants investment advice, you become responsible for their investment choices and you could be forced to make up their investment losses resulting from your advice.

If you don't want to assume liability for employee investment choices, you must be sure to provide only general educational information. Topics that can be discussed safely include basic plan information as well as general financial and investment principles. You can also provide asset allocation models and interactive investment materials.

If you give employees basic investment education and they still ask you for investment advice, you may need to rethink your plan's investment structure. Not everyone wants to or is able to make their own investment decisions. ■

You may want to consider some of these techniques for delivering investment information to your employees:

- Hold brown bag seminars. Invite investment professionals or educators to speak to employees while they are on their lunch break.
- Tell employees about investment related classes at local colleges and community education programs. You may be able to arrange discount admission for your employees. If you have enough interest, ask the school about holding the class at your office.
- Use your company newsletter, web sites or E-mail to send employees information about the plan and investment basics.
- Maintain a company library with books, videos, CD-ROMS and computer programs about investing.



What's Happenin'

Tony Brizzolara was featured in the July 3rd issue of *The Atlanta Business Chronicle.*

Laura Matlock was appointed to the Atlanta Benefits Council (ABC) planning committee of the American Society of Pension Actuaries (ASPA).

Susan Petrirena received the Human Relations award from the Dale Carnegie Excellence Course.

Adam Pozek was promoted from Associate Pension Administrator to Pension Administrator.

Dee Robbins was appointed Chapter Administrator of the Georgia ESOP Association.

Joanne Swerdlin was elected Vice-President of Programming for the WEB Network of Benefits Professionals.

Swerdlin & Company will co-sponsor the upcoming Women In Pensions (WIPs) dinner.

What is the Cost of Waiting?

When it comes to retirement planning, people often say, "Retirement is a long way off, why should I worry about it now?" By addressing the situation early on, you can avoid worrying in the future.

Two often-overlooked factors to consider when saving and investing for retirement are inflation and the time value of money. Inflation is when the price rises on food, clothing, cars and the other items we buy. The following chart shows the effect over time of inflation on a $100 bag of groceries:

	Inflation Rate		
Years	**3%**	**5%**	**7%**
5	$116	$128	$140
10	$134	$163	$197
15	$156	$207	$276
20	$181	$265	$387
30	$243	$432	$761
40	$326	$704	$1,497

As you can see, even if inflation averages only 3%, the same bag of groceries will almost double in price after 20 years.

The second most-overlooked factor is the time value of money. By getting an early jump on retirement planning, it is possible to not only keep up with inflation, but to surpass it. Just as inflation can reduce your buying power over time, the time value of money can dramatically increase your buying power.

Assume Joe Smith, age 25, begins investing $2,000 at the beginning of each year for 10 years and then stops at age 35. If Joe averages a return of 8% (just over half the average S&P 500 return over the past 20 years), his $20,000 investment will be worth $340,059.97 when he reaches age 65.

Jane Smith, also age 25, decides to wait 10 years until age 35 to begin investing. She then invests $2,000 at the beginning of each year until she reaches age 65. Jane's total investment of $62,000 will be worth $266,427.07.

Because Jane waited 10 years to get started, she had to invest $42,000 more to end up with $73,632.90 less at age 65.

If you are already over age 25, don't be discouraged. This same principal holds true at any age. The sooner you begin saving, the longer your money has to grow. Of course, you must remember, past investment performance is no guarantee of future results.

Time can be either a friend or an enemy when planning for retirement. Begin saving now, and get time on your side. ■

How Can I Get Money Out of My Account?

A loan is one way a participant can get money from the plan. Here are some of the most commonly asked questions about loans:

Q Can I get a loan from the plan?

A Yes, if the plan contains a loan provision, and you meet all the requirements spelled out in the written loan program.

Q Who decides what the interest rate will be, and where does the interest go?

A The loan program states the interest rate. Generally, it is the rate you would pay if you borrowed from a bank, or it can be calculated using a publicized rate such as Prime. The plan document says if the interest is credited to your account or is treated as income to the plan.

Q Do I need to reduce my 401(k) deferrals by the amount of my loan payments? If I don't, I will go over the $9,500 limit on employee contributions.

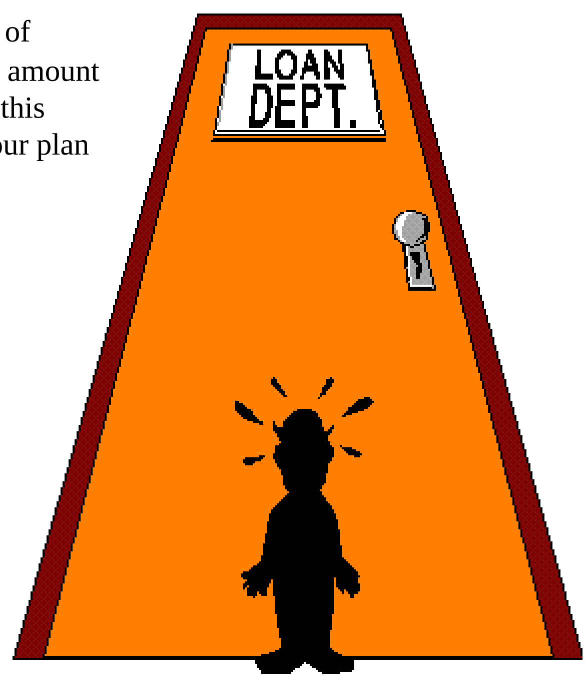
A No. Loan payments are not contributions. Repayment of a plan loan does not affect the deferral limit.

Q Are my loan repayments taken out of my salary on a before tax basis?

A No, you pay back the loan from money after all taxes have been deducted.

Q Is there a limit on the number of loans I can have, or on the amount I can borrow?

A The loan program specifies if there is a limit on the number of outstanding loans you can have at one time. The maximum amount you can borrow is 50% of your vested account balance, but this amount may be reduced if you already have other loans. Your plan administrator will perform this calculation for you.



Q Can I pay off the loan early?

A Yes. There is no penalty for paying off a loan earlier than planned.

Q What if I terminate employment before I pay off the loan?

A The loan will be treated as a taxable distribution unless it is fully repaid. ■

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Vision Statement

We strive for financial strength for our clients, our employees and our company by caring to be the best. We are committed to being the leading pension consulting firm in our market. We achieve this through cooperative teamwork, community building and continuous learning and development.

Mission Statement

We focus primarily on design and administration of qualified retirement plans. Our mission is to develop relationships with our clients, our employees and our community so that all parties grow and develop financially and otherwise.

Relief for Small Defined Benefit Plans

Defined benefit plan sponsors can now enjoy some relief from the Pension Benefit Guaranty Corporation (PBGC). Until now, plan sponsors had to report to the PBGC if they missed a quarterly contribution payment. They had only 30 days after the payment's due date to file with the PBGC. Many small plans found it difficult to comply with this reporting requirement. Small plans often don't have a completed actuarial report before the due date of their first quarterly payment. Without this report, they have no way of knowing how much (if any) their required contribution will be. If they don't know what the payment will be, they obviously cannot comply with this requirement.

A recent PBGC technical update simplifies the reporting for missed payments. Instead of reporting to the PBGC each quarter, all missed payments may now be reported in a single notice. This applies to payments due on or after January 1, 1997 for the 1996 or 1997 plan years. You must file this notice by the deadline for filing PBGC Form 1 (September 15 for calendar plan years).

This new simplified reporting applies to:

- Plans with 100 or fewer participants; and
- Plans with 500 or fewer participants which were not required in the prior plan year to file a participant notice for missed quarterly payments.

Call us if you have any questions about your reporting requirements. ■

All In the Family

Parents, grandparents and spouses are often asked to help finance new business ventures. Often they help by lending money to their entrepreneurial relative in exchange for some ownership in the new company.

How you split ownership among family members is important, especially if you already own another business. When the same people control (own) two companies, the IRS considers all employees as working for the same company. Depending on the extent of your ownership in the new business, you may be required to provide the new employees the same retirement benefits as employees of your current business. Providing retirement benefits can be expensive for a new business; so take care how ownership is divided so you won't incur any unexpected expenses.

Ownership of a company is not always black and white. In the view of the IRS, you may own company stock you think belongs to your children or spouse. Here is a brief outline of the IRS rules about stock ownership:

1. You are considered to own your spouse's stock if you meet any *one* of the following conditions (unless you and your spouse are legally separated):

    - You directly own stock in the business. Community property is consider~d direct ownership.
    - You are a director or employee, (you participate in the manageme the business.
    - More than 50% of the gross business receipts are from sources such as rents, royalties, dividends, or interest.
    - If your spouse wants to sell the business, he/she is forced to sell to you or your minor children.

2. You are considered to own your children's stock if they are under age 21. If your children are over 21, you are considered to own their stock if you also own or control more than 50% of the business.

3. You are considered to own your parents' stock if you are under age 21.

4. You are considered to own the stock of your grandchildren and grandparents if you already own more than 50% of the business.

5. You are considered to own the stock held by another company if you own 5% or more of that company.

    Example: You own 10% of Company A and Company A owns Company B; you are considered to own 10% of Company B.

As you can see, when family is involved, the ownership of a company can be complicated. If you help a family member start a new business, call us before you complete your plans. We can help you structure the new company's ownership so it won't affect the retirement plan of your current business. ■

FAQ

Frequently Asked Questions

This is the place where you, our readers, can get answers to your employee benefit questions. If you have a question for our FAQ, fax it to Dorn Swerdlin or your client manager.

Q One of my employees read that they should have the right to choose the investments in our 401(k) plan. Is this correct? The money in our 401(k) plan is in a pooled account and a money manager invests the money. Are we doing something wrong?

A Either your employee misread the article or the reporter got the facts wrong. Although some plans allow employees to direct their investments in the plan, the law does not require it. The confusion over this issue may have come from a set of regulations known as 404(c). The regulations say if you let employees invest their plan money, and you want liability protection from their investment decisions, you must meet certain specific requirements. Call us if you would like more information on 404(c).

Should you allow employees to direct their investments? It depends on who you ask. Some say investment control encourages employee involvement. Others argue that over time employees won't do as well as professional money managers. It's too soon to tell.

Q If I rehire an employee, when is he eligible to enter the plan?

A Your plan document states whether he is eligible to enter on his rehire date or if he has to wait until the next entry date. If he is eligible to enter immediately, and he had been making salary deferrals when he terminated, you must begin deductions with his first paycheck at the same percentage he was contributing before he left. Of course, he can authorize you in writing to stop deductions at any time. If he had not been making salary deferral contributions when he terminated, and now wants to, he must wait until the next entry date. ■

Swerdlin & Company

We can help you with the following services:

- Actuarial Consulting
- Plan Consulting and Design
- Plan Installation
- Annual Administration
- Employee Communication
- Regulatory Compliance
- Educational Presentations
- Special Studies

We are dedicated to making your employee benefit program a tool for reaching your organizational goals.

We provide services for:

- Profit Sharing Plans
- 401(k) Plans
- Money Purchase Plans
- Target Benefit Plans
- Defined Benefit Plans
- ESOPs
- Age-Weighted Plans
- New Comparability (Cross-Tested Plans)
- TSAs/403(b)/457 Plans
- Comprehensive Employee Benefit Statements
- Supplemental Executive Programs.

Give us a call to discuss how we can help you make the most of your employee benefit program.

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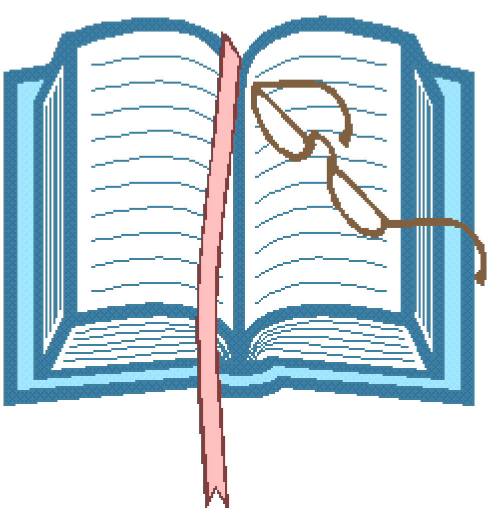
Ten Ways to Protect Your Plan

The following can help you protect the tax-favored status of your retirement plan:

1 Follow your plan document. It is the encyclopedia and reference guide for your plan.

2 Get some help. Don't try to do it all yourself. Laws governing retirement plans are complex and constantly changing. It is almost impossible for the average person to keep up with the complexities of administering a qualified retirement plan.

3 Get plan contributions in on time. Employer contributions must be deposited before you file your corporate tax return. If you have a 401(k) plan, you must deposit employee contributions to the plan as soon as possible, but no later than the 15th business day of the following month.



4 Treat participant loans with the same care as any other investment. Participant loans are an investment of the plan and need to be handled accordingly. A written loan program outlines the necessary documentation, including a loan agreement, promissory note and amortization schedule. The loan program also calls for charging a reasonable rate of interest, and requires repayment of principal and interest in substantially equal amounts, at least quarterly over a period generally not to exceed five years.

5 Be sure to use the correct definition of pay. Compensation is used to calculate benefits and perform testing in all types of qualified retirement plans. Does the plan document's definition of pay include bonuses and overtime, cafeteria plan and salary deferral contributions? Check the plan document to see what is included. Be sure there have not been any amendments which might change the current definition of compensation.

6 Watch those minimum benefits. If your plan is top-heavy (most of the benefits in the plan belong to the Key employees) then you must give minimum benefits to the lower paid employees. The minimum required benefit depends on the type of plan. (Yes, this is also a requirement for 401(k) plans).

7 Don't confuse contractors and employees. It doesn't matter what name you use. If you control how, when and where workers do their jobs and you pay them, they are employees. Employees who meet eligibility requirements become plan participants.

8 Don't ignore part-time employees. People working less than 35 or 40 hours a week cannot be automatically excluded from your plan. You must include employees who once worked 1,000 hours in a year, full-timers who cut back to part-time and rehired employees.

9 Consider all divisions or businesses. If you own more than one business or your business has more than one division, you may need to combine them for retirement plan purposes. (See "All in the Family" on page 7).

10 Remember, plan assets can only be used for the benefit of the participants. It may be tempting to use money from the plan to relieve a cash flow shortage, but don't even think about it!! As soon as company money is deposited into the plan, it loses its employer identity and becomes a plan asset. Don't forget salary deferrals become plan assets as soon as they are deducted from the employee's check. Using plan assets for anything other than the benefit of the plan participants is a prohibited transaction subject to IRS penalties. ■

Where in the World (Wide Web)

This quarter we are bringing you two government sponsored sites and two investment-oriented sites.

search.pbgc.gov
When a defined benefit pension plan terminates, there are often participants who cannot be located. Many of the people due benefits left companies not knowing they had earned a benefit. Others may be women who have changed their names after marriage or divorce. Still others may be survivors of former workers entitled to benefits.

The Pension Benefit Guaranty Corporation (PBGC) sponsors this site to allow individuals to search the database to find out if they are entitled to a benefit from a terminated pension plan. This site also contains instructions for contacting the PBGC to claim any benefits that may be due. This search requires a forms capable Web browser such as Netscape Navigator or Microsoft Internet Explorer.

www.dol.gov/dol/pwba
The Pension and Welfare Benefits Administration (PWBA) protects the integrity of pensions, health plans and other employee benefits for more than 200 million people. In addition to answering many frequently asked benefit questions, this page also contains information on relevant new regulations.

The PWBA makes available on-line many of their publications as well as information on various programs they sponsor. Many of the required government reporting forms are also available for download.

www.investorama.com
This site's address says it all! It contains information and/or links to other sites on stocks, bonds, commodities, options, futures, mutual funds and collectibles, to name a few. Included here are:

- Links to various investment education sites;
- Links to membership organizations and government agencies;
- Links to investment forums and discussion groups; and
- Links to brokerage firms and investment advisors.

This site also provides information on personal financial issues such as retirement and tax planning, real estate and insurance.

www.money.com
Money Magazine is considered by many to be one of the top financial periodicals. Now they are also on-line, and you don't have to subscribe to the magazine to use the site! Money On-line is full of informative articles, interactive tools and links to other useful sites. Some of the numerous features include a retirement calculator, an investment lookup system and a quiz to test your investment expertise. In addition to the on-line features, you can also request a free copy of Money Magazine's retirement planning brochure, "Retire With Money."

While we have researched each of these web pages, we neither endorse any products or services offered, nor do we make any claims as to their validity, accuracy or appropriateness. ■