The Swerdlin Quarterly

Swerdlin & Company

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What Happens When a Bull Market Becomes a Bum Steer?

We've often heard there are two great certainties in life -- death and taxes. We are adding one more -- market corrections. The stock market will fall; how far and how fast no one knows.

Will your plan be protected when the next correction comes? We're not talking about protection from the market decline. We're talking about protection from your participants' expectations.

The year is off to a great start. The market is up for the first quarter of 1998 and investors are thrilled. They are eagerly waiting to see what new records the stock market will break this year.

Some of these investors include the participants in your retirement plan, and as the

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Dorn's Corner

I'm working on a presentation to be given at the next Society of Actuaries meeting. Now before you start heading for the door, this one should be interesting (no, interesting actuarial presentation is NOT an oxymoron)! The title of the session is "Do Actuaries see a role in the 'Soft Side' of Business?" So, what is the "soft side?"

- Relationships
- Loyalty (employee and customer)
- Teams and teamwork
- Company culture
- Values
- Vision

As we transition from the Industrial Age to the Information Age, we need to adjust the way we think. Our thinking seems to lag behind in the old mechanical "Newtonian" based thought, where everything is machine-like with no room for these "non-scientific" areas. The old thinking did not

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What Happens When a Bull Market Becomes a Bum Steer?

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market soars, so do their expectations of greater investment results within their retirement plans. After all, the current market is the longest bull market in history; 20% and 30% annual returns have become the norm.

> ***"20% and 30% annual returns have become the norm"***

What can you do to protect your plan and its fiduciaries from the unrealistically high expectations of your participants? Some people may advise you to set up your plan to meet the requirements of ERISA Section 404(c) which gives some fiduciary liability protection. See our article in the third quarter 1996 of the Swerdlin Quarterly for more information on 404(c). However, if you don't combine 404(c) with sound investment decisions, this veil of protection is easily swept away. To protect yourself and your plan, you must exercise prudent investment practices, including but not limited to:

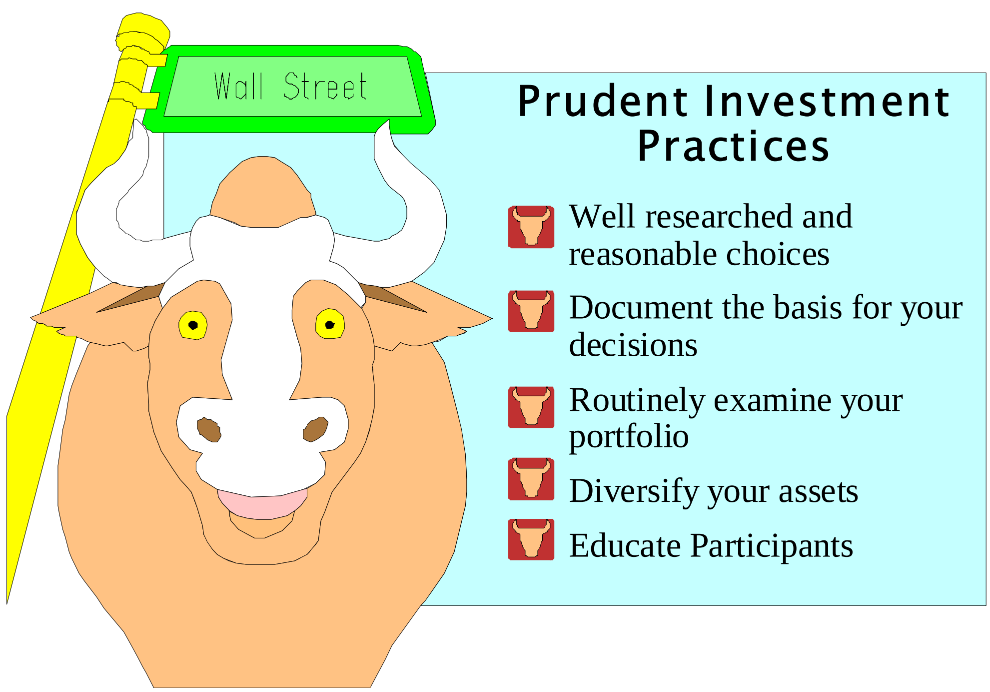
Well researched and reasonable choices. This may seem obvious, but too often investment decisions are made by persons who consider their own interest first. Make sure all recommendations are in the best interest of your plan participants. A little bit of independent research goes a long way in protecting your plan and yourself.

Document the basis for your decisions. Keep a record of the investments you choose and why you chose them. In a few years you may forget the finer points you used to make your selections.

Routinely examine your portfolio. Look at your reasons for selecting an investment and make sure it continues to live up to your expectations. Remember that good years can hide a history of poor performance.

Diversify your assets. Spread your portfolio among different asset classes, geographic regions, industries and investment objectives. Diversification reduces overall risk and gives protection against declines in any individual class of investment.

Educate Participants. Now is a good time to emphasize to plan participants the risks of investing, the concept of time horizons, and the inevitability of a market decline. Informing participants prepares them for changes in the market and encourages them to look at their long- term retirement goals and needs.■



FAQ

Frequently Asked Questions

Q Our company has a profit sharing plan. Can we also sponsor a SIMPLE 401(k) plan?

A No. A SIMPLE plan rule that is often overlooked is the restriction on multiple plans. If you have a qualified retirement plan, you cannot have a SIMPLE plan. If you inadvertently combine a SIMPLE plan with another plan, then contributions to the SIMPLE plan which exceed the $2,000 IRA limit are subject to penalties.

Q I have an IRA. Can I roll it into my employer's profit sharing plan?

A Generally, an IRA cannot be rolled over into a corporate plan because it is qualified under a different section of the Internal Revenue Code. The one exception is a "conduit" IRA. A conduit IRA is established when you roll your money out of a previous employer's qualified plan, into a new IRA. As long as this "qualified" money is not mixed with other funds, it can be rolled out of the conduit IRA into another employer's qualified plan.■

Dorn's Corner

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allow for these "soft" concepts because they didn't fit in the mechanical model. We know that in the real world economics and business depend very heavily on these soft, people related issues. Our conclusions will include:

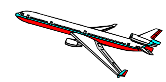
- The key to competitive advantage is the "soft side"
- The financial impact of the "soft side" is measurable
- The demand for these measurements is cutting edge

As mentioned in my last Corner, I'm searching for new applications for actuarial science. This presentation asserts that actuaries are good candidates to come up with calculations to tie these soft side changes to the employer's bottom line.

The worst part of this Society of Actuaries meeting is that I have to go all the way to Maui, Hawaii. Tough duty.■

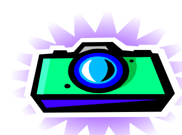
What's Happenin'

Welcome to Michael Miller who joined the Swerdlin Community in April from KMPG Peat Marwick. Congratulations to Michael and his wife Erica - they just had their first baby, Ross Morgan Miller, who weighed in at 7 lbs.14 oz.



Lisbet Flaxman attended the annual Enrolled Actuaries meeting in Washington, DC in March.

Some of us decorated Jaynie Cormier's office in shades of black to help her celebrate her 50th birthday.



We hope you enjoy the pictures in this issue. We thought you would like to "put a face to the name," and we hope to include more photos in future issues.■

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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Are You a Fiduciary?

Are you a retirement plan fiduciary? You are if you exercise discretionary authority or control over the management of the plan or its assets. You are also a fiduciary if you provide investment advice to the plan or its participants. Plan trustees, company officers and directors, and investment advisors are often considered fiduciaries.

You are not a fiduciary if your contact with the plan is limited to administrative functions. Activities such as calculating benefits, preparing reports, processing payroll, enrolling new employees and following the orders of a fiduciary do not make you one. These functions do not require discretion.

So what does it mean to be a retirement plan fiduciary? It means you must act solely in the interest of plan participants and beneficiaries. More specifically, you must:

- Use plan assets for the exclusive benefit of the plan participants
- Follow the "prudent man standard"
- Diversify plan assets to minimize the risk of loss

As a plan fiduciary, you are responsible for protecting the assets of the plan. Guidelines have been issued to help fiduciaries reduce their risk of personal liability. However, fiduciaries are ultimately responsible for the protection of plan assets, and if they don't fulfill their duties, they could be held responsible for losses incurred by the plan.■

Update on the Involuntary Cash-Out Limit

In our last Newsletter, we said you needed to amend your plan before you could change the involuntary cash-out amount from $3,500 to $5,000.

According to Internal Revenue Procedure 98-14, under the special reliance procedure, you can use the new limit without currently amending your plan.

Fidelity Bonds

Fidelity bond coverage is an often overlooked requirement. All retirement plan fiduciaries and anyone who handles plan funds must be covered by a fidelity bond to protect the retirement plan and its participants.

What is a fidelity bond ? A fidelity bond is an insurance contract which reimburses the plan if there is a loss due to fraud or dishonesty. A fidelity bond does not cover investment losses.

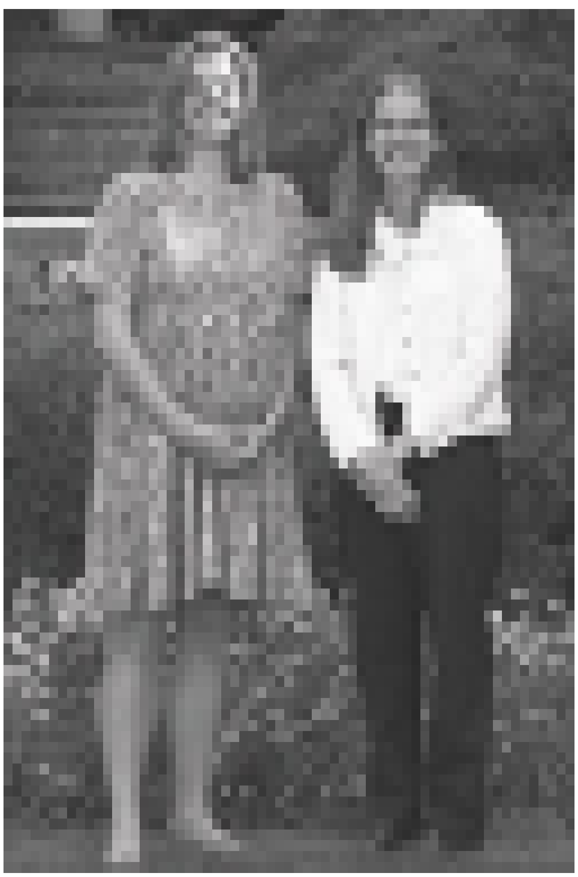
How much coverage do we need? You must secure coverage for 10 % of the value of the plan assets determined as of the beginning of each plan year. Minimum coverage is $1,000; the maximum requirement is $500,000. So, if the value of your plan assets exceeds $5 million, the required fidelity bond coverage is capped at $500,000.

Who must be covered? All fiduciaries and anyone handling plan funds. This includes trustees, the Plan Administrator, members of an investment committee or anyone else who has discretionary control over plan assets.

What is meant by handling funds? Handling funds is defined as: (1) physical contact with invested assets, such as cash, stocks or any other investment; (2) the ability to secure possession of the assets.

Where do I get fidelity bond coverage? The bond can be obtained through any agent of a qualified surety company. Often bonding requirements are added as a rider to an existing business liability policy. Your property and casualty insurance agent should be able to assist you with this coverage.

There is no specific penalty for having inadequate bond coverage. However, if you are audited by a government agency, proof of fidelity bond coverage is always on the list of requested items.■



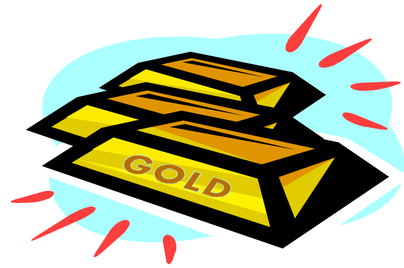
Welcome Back to the Swerdlin Staff (left to right):
Melodi Kline and Jennifer Krebs

Valuing Plan Assets

Do you have non-publicly traded securities such as limited partnerships, real estate, gold coins, etc., in your retirement plan investment portfolio? If so, are you aware these investments must be valued once a year? This can be a difficult task and often requires the help of an independent third party appraiser.

Several questions on the Form 5500 ask about non-publicly traded securities. The IRS is concerned because the valuation affects participant account balances, benefit payments, minimum funding requirements in defined benefit plans and deductions in ESOPs.

The IRS has issued examination guidelines instructing their field agents to give these assets special attention. The agents are to look for same values being reported year after year, sudden jumps in value and the lack of unrealized gains or losses. They are to take a close look at contributions of property or the purchase of non-publicly traded investments without an independent appraisal.



It is important that you, as sponsor of a qualified retirement plan, have all non-publicly traded assets appraised at their fair market value. IRS examination guidelines identify "fair market value" as "the price at which an asset would change hands between a willing buyer and a willing seller when either party is not under any compulsion to enter into the transaction." Fair market value is not the K1 value of a Limited Partnership and it's not what you paid for it. You need to report the asset value as if the investment was traded on the open market. An independent appraiser should be able to provide this information along with a basis for the determination.

You can look up the IRS Valuation of Assets Examination Guidelines at www.benefitslink.com. Use the "Topical Links" window at the top of the main page and select "IRS Rulings."■

The Swerdlin & Company Red Team (left to right):
Melissa Watts, Melissa Spencer, Julie Isom, Nancy McMurtrie, and Adam Pozek

ESOPs Are Not a Fable

An Employee Stock Ownership Plan (ESOP) could be the secret ingredient for making your business grow. An ESOP can motivate employees by giving them a stake in the business. It is also a valuable financial tool for the business and its owners.

What is an ESOP? An ESOP is a tax-qualified retirement plan which invests primarily in the sponsoring employer's stock. As a tax-qualified plan, it shares many of the benefits of other retirement plans. It offers current tax deductions for the employer, tax deferred retirement income for employees, and tax deferred accumulation of investment earnings. ESOPs also have added tax benefits with regard to plan distributions.

In addition to tax benefits, ESOPs offer an intangible benefit if they are properly communicated to your employees. Everyone works harder when they understand they are working for themselves. ESOPs give employees ownership in the business and allow them to tap into their ownership spirit.

An ESOP can be used to buy out a retiring or departing owner. Instead of trying to find an outside buyer for your company, you can sell your shares of stock to the ESOP so your employees can ultimately buy you out.

If you use the *leveraging* feature, the ESOP can borrow to purchase the stock, and as the company pays off the loan, the shares of stock are "released" and allocated to employees' accounts.

We see a lot of growth in the ESOP market for many of the reasons discussed above, and we're administering more and more ESOPs. Swerdlin & Company is very active in the Georgia Chapter of the ESOP Association, with Joanne Swerdlin as the Secretary, and Dee Robbins as the Administrator.

If you would like to discuss the possibility of an ESOP for your company, please give us a call. We can help you examine the possibilities and advise you on your options.■

Additions to the Swerdlin Staff (left to right):
Michael Miller, Rebecca Drumm, Darlene Coulter, and Mara Boyak