Swerdlin & Company
Actuaries ■ Pension Consultants
Celebrating 25 Years

The Swerdlin Quarterly

Your News Source on Retirement Plans

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What's Inside

In Every Issue

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Swerdlin & Company
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Ready to Roll

Last quarter, we brought you information on how the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) changed the manner in which qualified retirement plans address the small balances of terminated participants. Since then, the IRS has issued additional guidance on the implementation of the new automatic rollover rules. These new rules require plan sponsors to automatically roll over small balances between $1,000 and $5,000 instead of paying them directly to the terminated participants. Balances below $1,000 may be rolled over or cashed out at the plan sponsor's discretion.

These new regulations are effective March 28, 2005, and plan sponsors must amend their plans no later than the last day of the plan year beginning on or after that date. For calendar year plans, the deadline is December 31, 2005. These rules only apply to plans that currently permit the involuntary cash out of small balances.

There are several options for addressing the automatic rollover requirements. The IRS guidance includes a "good faith" model amendment but it does not include the flexibility to select an option. For clients who use Swerdlin & Company's document, we will provide an amendment that allows you to select one of the options described below.

First, plan sponsors can implement the new regulations and begin rolling over these

continued on page 5

Dorn's Corner

Hello everybody. This quarter I have a story for you - an actuarial story. Okay, now I've already lost some of you. But that's what my story is about - how people view actuaries. You've all heard the jokes, "The actuary is someone who wanted to become an accountant but didn't have enough personality." That sort of joke.

My story begins in 1995. I started a 5-year research project to find a connection between actuarial science and quantum thinking. Have I lost the rest of you yet? This project led me to join the Actuary of the Future Section of the Society of Actuaries (Society). Our Section's job is to look down the road and see where we want the profession to be in the future. We also focus on what changes are needed to get us there. Each Section has a Council, which leads the members of the Section. I became involved, was elected to the Council, and became its chair in 1998.

continued on page 6

Client of the Quarter

National Allergy™
The Nation's Largest Allergy, Asthma & Sinus Products Supplier

We are pleased to present National Allergy Supply, Inc. as our Client of the Quarter. We have been providing administrative services for their ESOP since its inception.

Sixteen years ago Ryner and Evelyn Wittgens began "allergy proofing" their home for their daughter, Katie, who was diagnosed with six different airborne allergies. As a result of their efforts to locate products (many of which were not easy to find), the Wittgens family decided to create their own allergy products business. Beginning as a local effort to make products available to allergy sufferers, it developed into a catalog company serving the Southeast and then the entire nation. Today, National Allergy Supply is the largest supplier of allergy products in the U.S., serving all 50 states as well as many foreign countries.

On April 5, 2004, every employee became an owner of the company through an Employee Stock Ownership Plan (ESOP). Everyone now has a personal interest in delivering the best possible service to their clients. Their goal is to provide educational information as well as tested and proven products to complement physician prescribed treatment for allergy, asthma and sinus patients. Physicians, nurses and hospital clinics depend on the service and support National Allergy Supply gives to their patients who suffer with airborne allergies.

All employee-owners receive continuous training to keep them up-to-date on what's happening in the allergy world and what's new in National Allergy's product line. So, from customer service reps competently answering a patient's question all the way through to warehouse personnel ensuring the right product gets in the right box, customer satisfaction is guaranteed.

The company publishes a full-color, 32-page catalogue, featuring such items as pillow encasings, home treatments, air cleaners and vacuums. They developed a helpful "How to Allergy Proof your Home and Feel Better" video, and built a web site to communicate their many available products and services. CNN Headline News recently featured their video in an "On The Market" segment. The company has added other non-drug relief

items to its product offerings in such areas as Safe Cleaning and Personal Care. By adding these new product lines, the company is positioned to respond to the needs of a rapidly expanding customer and prospect base.

The Sales and Distribution Division of National Allergy Supply is in a 33,000 square foot facility in Duluth, Georgia. Their Manufacturing Division, with both cut-and-sew and management staff, is located in a 30,000 square foot facility, 45 miles north of Duluth, in Cornelia, Georgia.

Both Tom Short, President and CEO, and John Fry, Vice President, Marketing and Sales, are very active in the New South Chapter of The ESOP Association. Mr. Short participated in a panel discussion on "Management Challenges in New vs. Mature ESOPs" at the recent Southeast Regional Conference.■

National Allergy™
The Nation's Largest Allergy, Asthma & Sinus Products Supplier

For more information, visit www.nationalallergy.com

Plan Fees 101: Dispelling the Myth

Have you ever heard the expression, "If something sounds too good to be true, then it probably is?" This definitely applies to the term "free 401(k) administration." There is no such thing as free 401(k) administration. If the plan sponsor isn't paying for administrative services, then the participants are, and more often than not, they don't even realize they're footing the bill.

In order to determine how much it costs to maintain your plan (regardless of who pays for it), you need to understand the different fee components of retirement plan administration.

1. **Asset Charges -** "Free 401(k) administration" can be very costly to your plan participants. When an insurance or mutual fund company provides free recordkeeping services, they don't bill the plan sponsor directly. They are paid through asset charges that reduce the investment returns credited to participants' accounts. Because these charges reduce investment returns but never show up on statements as fees, most participants don't realize how much they are paying to invest in their own retirement.
2. **Plan Administration Fees -** These fees are charged for the day-to-day operation of the plan, including recordkeeping, compliance, accounting, legal and trustee fees. More specifically, these fees may cover daily recordkeeping and associated technology such as participant websites, voice response units, education materials and other services offered to participants.

   These fees can be paid by the employer, the participant or both. When a plan sponsor passes these costs on to the participant, often the fee is clearly labeled on the statement so he is aware the fee is taken from his account.
3. **Investment Fees -** These fees are generally assessed as a percentage of assets and make up the largest portion of all retirement plan administration costs. They include the cost for active management of plan assets and sales charges directly associated with funds. These fees are referred to in many different ways within the industry. You will hear them described as management fees, investment advisory fees, account maintenance fees, sales charges, front-end loads, back-end loads, deferred sales charges, redemption fees, 12b-1 fees and sub transfer agent (SubTA) fees.

   Some investment fees can be paid by the employer, the participant or both. When the fees are charged against the participant's account, they can be assessed indirectly or directly. An indirect fee is taken from the actual investment return so the participant isn't aware of the fee he pays. A direct fee is taken out of the participant's account and labeled as such.
4. **Individual Service Fees -** These fees are charged for optional services on a plan-by-plan basis, such as loan or transfer requests.

   They can also be paid by the employer, the participant or both. Usually the participant pays these fees at the time the transaction is requested.

Determining the cost of your plan can be very difficult and time consuming, but it's the responsibility of the Fiduciaries and Trustees to ensure the fees being charged are reasonable. Free administration is a myth we would all like to believe but, unfortunately, it is just that - a myth. Free 401(k) administration does not exist.■

FAQ

Q We have a safe-harbor plan to which we contribute 3% each year. The plan allows an employee to irrevocably waive his right to any profit sharing allocation. Does this waiver also apply to the safe-harbor contribution?

A Yes, since he has already waived his right to any contribution under the plan, he will not share in the safe-harbor contribution.

Q We make a safe-harbor matching contribution to our plan, and have some participants who defer very small amounts. Can we add a minimum deferral requirement to the plan?

A Yes. The plan can be amended to specify a minimum deferral amount, typically 1% or 2% of pay.

Q We gave the appropriate notice to our participants saying we will make a safe-harbor contribution for 2005. We are having cash flow problems and want to stop making the contribution. Can we do this?

A Probably. If the safe-harbor wording in the plan document says it is discretionary, you will have provided a conditional notice prior to the beginning of the plan year. However, if the safe-harbor contributions cannot be made for the whole year, you need to provide a written notice at least 30 days before the contributions are to be stopped; they must continue to the date contained in such notice. If the contributions stop, the ADP/ACP tests must be performed for the entire year.■

Happy New Year from the IRS

The world of 401(k) plans has changed dramatically over the last 10 years with the introduction of new options such as safe-harbor plans and prior-year testing. To consolidate all the new rules, the IRS issued a complete restatement of the regulations governing 401(k) plans on December 29, 2004.

Many of the new provisions are "behind the scenes" and will not affect the day-to-day operation of 401(k) plans. However, there are some issues that will require attention. Following is a brief summary of some of the new provisions:

Hardship Distributions: The list of safe-harbor hardship definitions has been expanded to include funeral expenses. Also added are repairs to a principal residence due to casualty. For instance, repairing a roof due to storm damage would be permitted, while replacing a roof simply because it is leaking would not.

Pre-Funding of Contributions: In order to prevent practices designed to accelerate tax deductions, the new regulations prohibit funding salary deferrals and matching contributions prior to the date on which those amounts are actually earned by a participant. There is an exception for a bona-fide administrative need, such as a payroll date falling in the middle of the payroll manager's vacation. To avoid being late with 401(k) deposits, the payroll manager could make the deposit just prior to leaving for vacation, even though such a deposit would technically be considered "pre-funding."

Self-Employed Participants: The new regulations clarify that self-employed individuals are permitted to make salary deferrals throughout the year from any draws they receive. It is important to note that the self-employed participant must be expected to have positive net income at the end of the year.

ESOPs: Employee Stock Ownership Plans that include 401(k) features will no longer have to conduct separate tests for the ESOP and non-ESOP portions of the plan.

Although not included in the final 401(k) regulations, the IRS is expected to issue additional guidance in the coming weeks on the newly created Roth 401(k) deferrals. These new contributions become available January 1, 2006.

As of this writing, it is not clear if/when plans will need to be amended to comply with the new regulations, but we will keep you posted.■

Whose Job Is It Anyway?

Loan payments must be made at least quarterly to prevent a participant loan from being considered a taxable distribution from the plan. Who is responsible for ensuring that participant loan payments are made?

Based on the outcome of a recent Tax Court case, the IRS feels the participant is ultimately responsible. In this specific case, the participant obtained a loan to be repaid through payroll deductions, then transferred to another division. As a result of miscommunications, a quarter passed when no loan payments were made. The plan later treated the loan as a deemed distribution and issued a Form 1099-R.

The participant contended he should not be taxed for the defaulted loan because he never received his quarterly benefit statement, a letter from the plan notifying him of the delinquent payments, or the Form 1099-R.

Nonetheless, the court concluded the participant failed to comply with the quarterly loan repayment requirement and did not make up the payments within the permitted grace period. The IRS and the court found the participant primarily responsible for determining whether loan payments were made since he was in the best position to monitor his paycheck.■

Cafeteria Serves Alphabet Soup

Have you heard the terms HSA or FSA and wondered what they meant? Here is a guide to some of the acronyms related to welfare benefits.

AAP -
Adoption Assistance Program

DCAP -
Dependent Care Assistance Plan

FSA -
Flexible Spending Account including Medical FSA and Dependent Daycare FSA.

HDHP -
High Deductible Health Plan

HRA -
Health Reimbursement Arrangement

HSA -
Health Savings Account

IIPA -
Individual Insurance Premium Account

POP -
Premium Only Plan

QTP -
Qualified Transportation Program

Now that you know what these acronyms stand for, call us and we can explain what they mean. We can assist you with your current cafeteria plan or help you set up a new one. If you have any questions or want to learn more about these great plans, please call Stephanie Davis at 678.775.5547 or visit www.swerdlin.net/flexpak.html.■

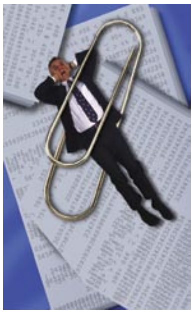
Are You Next?

The IRS is gearing up to audit more plans with over 2,500 participants. In 2003 they started a pilot program called Employee Plan Team Audit (EPTA). This program targets plans with large numbers of participants and assets. The IRS recognizes that although these plans represent only 1% of the nation's qualified plans, they account for 60% of all plan participants and 70% of all plan assets in the United States.

The IRS found a high level of noncompliance during the pilot phase and realized they needed to expand this program. Experienced agents are receiving specialized training and the multi-disciplinary audit teams include attorneys, actuaries, accountants, systems analysts and statisticians. These audits are more in-depth and aggressive than in the past. The audit team will spend between 100 and 200 staff days per examination. Peter Breslin, Senior Manager of the EPTA Program stated their mission is to protect the future retirement benefits of plan participants.

These auditors focus on industries that appear to have problems funding their retirement plans. They act on referrals from the Department of Labor, the Securities and Exchange Commission and other federal regulators.

Employers may want to conduct a voluntary review of plan operations in case they receive



an IRS notice of intent to audit. A voluntary review identifies many common or unintended violations, and gives the employer the opportunity to correct these violations before an audit. The EPTA program lists the following top ten issues found in audits.

1. Termination or Partial Plan Termination - potential vesting/distribution issues
2. Acquisitions
3. The accuracy of deferral percentage tests (ADP/ACP Tests)
4. Compensation
5. Plan document maintenance
6. Vesting
7. Plan distributions and loans
8. Plan assets
9. Compliance with IRS limits
10. Miscellaneous items, such as lack of sufficient internal controls to ensure that data provided to third party recordkeepers/plan administrators is accurate.

For more about the EPTA program, and the top ten issues, go to http://www.irs.gov/retirement/article/0,,id=129221,00.html.

We can help you perform a comprehensive voluntary compliance review at your office. If you are interested, please give your Client Manager a call.■

Ready to Roll

continued from page 1

balances. Under this option, all involuntary distributions made on or after March 28, 2005 must be automatically rolled over into an IRA, if the participant does not elect otherwise. For plan sponsors unable to select an IRA provider and establish procedures by the effective date, the IRS permits the delay of the processing of involuntary distributions until procedures are established. However, the automatic rollover of such delayed payment must be made no later than December 31, 2005.

The second option completely eliminates involuntary distribution language from the plan. Choosing this option avoids the requirement of finding an IRA provider and prevents distribution without specific consent from the participant.

The third option reduces the involuntary distribution threshold to $1,000. Since the automatic rollover rules are mandatory only for amounts between $1,000 and $5,000, this option avoids the need for an IRA provider. However, it allows the plan sponsor to cash out balances under $1,000.

Regardless of the option selected, plan documents and participant disclosures should properly reflect the plan sponsor's decision. We are available to answer any questions on this amendment process even if you don't use our document. ■

What's Happenin'

Kudos to our Swerdlin Staff on contributing $825 to CARE International for the Asia Quake Relief Fund.

Congratulations to Aaron and Lori Cox on the birth of their son, Gareth Logan, on February 9.

Wedding bells will be ringing in June for Travis Rosenbaum and his finance, Sarah.

Tony Brizzolara and Joanne and Dorn Swerdlin attended the National Institute of Pension Administrators (NIPA) Business Managers Conference in Scottsdale, Arizona in January. Dorn was a member of the Program Committee and next year will be Chairman of the Committee.

Please join us in congratulating the following recently promoted employees:

- Jodi Burket to Quality Control Specialist
- Aaron Cox to Pension Administrator
- Kathy Latour to Pension Administrator
- Patti Williams to DayPak Operations Manager

We are proud of Mike Raker who recently passed his last required exam in order to become an Enrolled Actuary (EA).

Donna Martin attended the Sub-S ESOP Conference in Orlando in February.

Anniversaries we celebrate this quarter: Carol Friend 13 years; Susan Petrirena 10 years; Kim Hall, Julie Isom, Nancy McMurtrie, and Sonja Starks 8 years; Melodi Kline and Becky McDougal 6 years; Randy Pflueger 5 years; Sharon Kleinman, Mike Raker and Kristen Hamilton 1 year. ■

Dorn's Corner

continued from page 1

Meanwhile, back at the Society, the leadership started talking about how we are facing new challenges as a profession and how, if we don't make changes, we face threats to our value to our clients and others. A Strategic Planning Committee (SPC) was set up in the late 1990s to investigate options for the actuarial profession's future. The SPC initiated research on what we think of ourselves and what employers and clients think about us. We researched and researched (actuaries like to research). Sometimes we research better than we take action to change things that our research tells us to change. However, I am proud to report that we are actually taking action.

The research revealed many things, such as:

- We are strong technically, but we lack the "business savvy" skills needed to compete for the positions we want.
- We are losing ground to others who are performing services in our areas of expertise.
- Our image needs improvement. For example: *About Schmidt* is a movie in which Jack Nicholson plays an actuary who exhibits an unfavorable image of actuaries.

As a follow-up to the SPC, the Society set up Strategic Action Teams (SATs) to implement the needed changes. I am honored to be a member of one of those teams, The Marketplace Relevance SAT. As a first step, we are launching an image campaign for our profession.

As this story unfolds, we see that my journey is allowing me to be a part of some needed changes to my profession.

I also picked up some ideas to implement in my own company. The first has to do with taking action. I see similarities between problems encountered by the Society and those in my own company. Both seem to generate great ideas, but implementing and maintaining an action is not always successful. It got me focused on this issue, and we are working hard to develop structures to improve our ability to initiate actions and maintain them.

The second idea comes from changes at the Society. The Board of Governors now focuses more on strategic rather than operational issues. From this I realized our Leadership Management Team (LMT) at Swerdlin & Company needs to do the same. We are currently making fundamental changes in our agenda to focus on longer-term strategic issues.

As this actuarial story draws to a close, congratulations to those who made it to the end.■

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 be 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 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.

Shaping Your Retirement World

Knowing the complexities and understanding the choices and options available in the retirement world shouldn't be a focus of your job; it's a focus of ours. We help you shape your retirement program to better meet the needs and goals of your company and your employees. Swerdlin & Company is the only resource you need to answer all of your retirement plan questions. Our job is to make yours easier!

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