Swerdlin & Company

# The Swerdlin Quarterly

A Trusted Source for all your Benefits Needs.

1st Quarter 2012 | Volume 18, Issue 1

## Why an ESOP?

An Employee Stock Ownership Plan (ESOP) is a qualified retirement plan which is invested primarily in company stock. ESOPs are considered "qualified" because, like most retirement plans, they qualify for favorable federal income tax treatment.

The first ESOP was created in 1957 for the employees of Peninsula Newspapers, Inc. as an exit strategy for its owners. However, the number of companies sponsoring ESOPs did not begin taking off until the early 80s. This expansion was primarily the result of changes in the tax code making ESOPs more attractive to business owners. The number of companies with ESOPs has grown from 9,000 in 1990 to approximately 11,300 covering over 13 million employees. Overall, employees now control about 8% of corporate equity.

The National Center for Employee Ownership (NCEO) finds the majority of ESOPs are used as an exit strategy for a departing owner of a profitable, closely-held company. Other objectives include enhancing an employee-ownership culture, providing an additional employee benefit, and raising capital.

In the current economy, an owner who wants to retire from his business has limited options and an ESOP may be the best available alternative. An ESOP offers employers many advantages. The company can borrow through the ESOP so the Plan can

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## Dorn's Corner

Happy New Year to all my readers. As promised last quarter, this article continues my discussion on The Year of Transformation (my declaration for 2012). This year's winter solstice is the end of the calendar calculated by the Mayans about 1,500 years ago. Many different theories and prophesies have commented on the significance of December 21, 2012. I believe super significant transformations are already occuring.

I'd like to share some scientific viewpoints about 2012.

**Sunspots**

Scientists have analyzed sunspot cycles since 1610. Sunspots are massive magnetic storms on the sun. The analysis shows that since 1610 there have been 23 cycles averaging about 11 years each. The last cycle was 1996 to 2006. On March 10, 2006 the sunspots stopped abruptly, ending the cycle. History indicates that the end of a cycle is an indication that a new cycle is beginning. The cycles are expected to hit a maximum level this year. Muasumi Dikpati of the National Center for Atmospheric Research (NCAR) says, "The next sunspot cycle will be 30-50 percent stronger than the previous one."

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# Plan Loans

Although loans are a popular feature in many plans, they are not beneficial to the participant's long-term investment results. Most participants don't understand that borrowing from the plan will ultimately reduce their retirement benefits.

Over the past few years, we have seen a substantial increase in plan loans. With this steady increase, now is a good time to look at the benefits and costs of taking a loan.

**Benefits of taking a loan from a retirement account:**

1. Few restrictions for taking a loan – no credit check.
2. Lower interest rates than many commercial loans.
3. Convenience – can often apply online or over the phone.
4. Tax and penalty free when fully paid back to the plan.

**Costs of taking a loan from a retirement account:**

1. Fees – most plans charge a setup fee and some also charge maintenance fees.
2. Taxes – the loan is made from before-tax money and is paid back with after-tax money. When the participant terminates, the entire distribution is taxed so loan payments will have been taxed twice.
3. Penalties – if the loan is not repaid when the participant terminates, the outstanding balance becomes taxable and, if the participant is under age 59½, a 10% penalty is also incurred.
4. Loss of future income – the participant feels he is not losing income because the interest he is paying on the loan is going back into his account. However, since his account balance was reduced by the loan, his long-term investment return may also be reduced.

Some plans allow a participant to have two loans at the same time, and we are often asked to explain how we calculate the amount available for a second loan. Below is an example:

| | | |
|---|---|---|
| A. | Account balance (excluding outstanding loan) | $10,000 |
| B. | Current loan balance | $5,400 |
| C. | Total balance for calculation (A+B) | $15,400 |
| D. | 50% of total balance (C/50%) | $7,700 |
| E. | Less current loan balance | $5,400 |
| F. | Amount available (D-E) | $2,300 |

Your Client Manager can answer questions you may have about loans from your plan. ■

# How Important is the SPD?

The first disclosure a participant is required to receive is the Summary Plan Description (SPD). The SPD describes the plan provisions, as well as the participant's rights under the plan. It must be written in a style and format that is easily understandable by the average participant. The SPD should avoid complex terms and language and include examples where needed. All participants and beneficiaries entitled to benefits must receive an SPD.

The SPD must provide the following information:

- The type of plan (e.g., Defined Benefit, 401(k), 403(b), Profit Sharing, Money Purchase Pension);
- The plan sponsor's IRS Employer Identification Number and the Plan number;
- Contact information for the plan fiduciaries and administrator;
- A description of the eligibility, vesting, contribution allocation method or benefit accrual, as well as rules for determining years of service;
- Summary of provisions allowing plan sponsor to amend or terminate the plan;
- Description of fees that may be charged to participant accounts;
- Types of contribution sources provided under the plan;
- Benefit claim procedures; and
- Statement of ERISA rights.

The SPD must be distributed no later than 120 days after the plan is adopted. New participants must receive an SPD within 90 days after becoming participants. If the plan is amended, either an updated SPD or a Summary of Material Modifications (SMM) must be provided to participants and beneficiaries within 210 days after the close of the plan year in which a material modification occurs.

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# F.A.Q.



**Q** *If I enroll in my company's Flexible Spending Account (FSA), are my spouse and children's expenses eligible?*

**A** Yes, your spouse and dependent's expenses can be reimbursed as well.

**Q** *Who qualifies as a dependent?*

**A** A dependent must be the employee's child or qualifying relative. For medical coverage under the FSA, the child must be under age 27. A qualifying relative is an individual who lives with the employee and receives over half of his or her support from the employee.

**Q** *If over-the-counter medications are no longer covered, what can I use my FSA for?*

**A** The FSA can be used for expenses at the doctor's office or hospital, dental visits, eye exams and glasses/contacts, as well as prescriptions. In addition, you can use your FSA for over-the-counter medical supplies such as Band-Aids, Ace bandages, thermometers, first aid kits, etc.

**Q** *Can I change my election any time?*

**A** No. Unless you are in your company's open enrollment period, you can only change your election if you have an eligible change in status. This would be a major life change such as a marriage, divorce, birth or adoption of a child, death of a dependent, etc.

**Q** *What happens if I do not use my funds by the end of the plan year?*

**A** The FSA has a "use it or lose it" policy. If you do not use all your funds by the end of the plan year, you will lose any money left in your account. Check with your employer to see if you have a grace period which will give you extra time to use your funds after the end of the plan year.

# Are Your Plan Documents in Order?

Do you know if your plan is up-to-date? Are the document and all necessary plan amendments signed and dated properly, with copies placed in your files? Have you distributed the required Summary Plan Description and Summary of Material Modifications to all participants?

A recent court case, Tatum vs. R.J. Reynolds Tobacco Co., alerts us to the importance of following plan procedures when implementing changes. RJR Tobacco was spun off from the Nabisco Plan; a separate plan was created for these employees and the Nabisco stock was eliminated as an investment option. The RJR plan participants claimed the stock was sold when the price was low, thus depriving them of profits they would have otherwise been entitled to when the stock rebounded. The key issue here is the "amendment" requiring the liquidation of the Nabisco stock. The complainants challenged its validity.

The court reminded RJR that ERISA requires every plan to have a written amendment procedure specifying who is authorized to adopt amendments and how they are to be adopted. The amendment procedure in question stated that the RJR Employee Benefits Committee (EBC) had authority to amend the plan "by written instrument." It also stated that "All resolutions or other actions taken by the EBC shall be by vote of a majority of the members of the Committee." The challenged amendment, which the Court invalidated, was signed only by the secretary of the EBC. No formal EBC meeting took place. No vote was taken to eliminate the Nabisco stock.

Setting aside this amendment could win the case for RJR participants, since the EBC members can no longer claim that the challenged amendment required selling the Nabisco stock at the time they did. The court has not yet issued a final determination.

This is just one example of the consequences of not following plan amendment procedures properly. Determining whether a certain plan amendment is adopted by the required deadline is also a common issue. Below are some suggestions on how to avoid exposure.

- Make sure everyone understands your plan amendment procedure.
- If amendment authority is delegated to a committee or specific officers, make sure the plan document incorporates this delegation.
- Keep clear minutes reflecting votes approving plan amendments.
- If you intend one board or committee member to have the authority to act unilaterally, make sure it is documented in the plan.
- Retain in your files the original signed and dated copies of all plan documents, amendments, board resolutions, Summary Plan Descriptions and Summary of Material Modifications. ■

# More Alphabet Soup — QDIA and DIA


Do you have QDIAs or DIAs in your plan investment lineup? Most plans do, even if plan sponsors don't know them by their acronyms!

QDIA stands for **Q**ualified **D**efault **I**nvestment **A**lternative. The Pension Protection Act of 2006 (PPA) stated that using a QDIA allows plan sponsors relief from fiduciary liability for limited investment decisions made for employees in participant-directed retirement plans. A QDIA allows plan sponsors to invest participant contributions into an appropriate default fund, if the participant has not made an investment election.

Prior to PPA, there was no protection for plan sponsors using default investments, and most plan sponsors would use a stable value or money market fund to avoid making a decision that could lead to investment losses. The IRS recognized this was not the best decision for the long-term benefit of the participant, so PPA introduced changes to default investments in the form of QDIAs.

A QDIA is generally a balanced fund, a professionally-managed account or a life-cycle fund. Balanced funds and professionally-managed accounts are more like "one size fits all" investments. They have a certain investment philosophy regardless of the age of the participant or time to retirement. Life-cycle funds tend to change over time. The participants' money is invested more aggressively when they are younger and first begin to invest, and more conservatively as they get closer to retirement.

Plan sponsors who take advantage of QDIAs don't get an automatic pass just for offering the recommended default investments. They must comply with certain notification requirements in order to retain fiduciary protection from offering a QDIA in the plan.

A **D**efault **I**nvestment **A**lternative (DIA) is any investment alternative designated by the plan where participants may direct the investment of their individual plan assets. If a plan offers twelve mutual funds as investment choices, then those twelve funds are considered DIAs. Note that self-directed brokerage accounts are not considered DIAs.

If your plan offers DIAs, you must annually disclose to participants some very specific and comprehensive information about these funds. The following must be disclosed about each DIA offered in the plan:

1. Identifying information such as the fund name, asset category and trading symbol;
2. Performance data such as historical returns;
3. Benchmark comparisons to similar funds;
4. Fee and expense information including the expense ratio and any trading restrictions;
5. Website address; and
6. Glossary of financial and investment terms.

If changes are made to the DIAs during the year, then updated information must be provided about the funds removed and/or added.

If you need guidance with the new regulations, please contact your Client Manager. Our job is to help keep your plan in compliance while you continue to provide a great benefit to your employees! ■

## Why an ESOP? *(continued from page 1*

purchase stock. Then it can deduct both the repayment and interest as it pays back the loan. In addition, the business owner who sells his stock to the ESOP can often defer or even avoid capital gains taxes associated with the sale of the business. ESOPs offer the exiting owner great flexibility. An owner can sell all or most of his stock to the ESOP and still have the option of retaining control.

As a result of adopting an ESOP, many employers experience an increase in employee loyalty and productivity. When employees have a "piece of the pie" they act more like owners. An ESOP can also help small businesses recruit and retain employees by offering ownership benefits.

ESOP participants tend to fare quite well. According to a 2010 NCEO analysis, the average ESOP participant has an account balance of $55,836. In addition, 56% of ESOP companies have at least one additional employee retirement plan such as a 401(k). Less than half of non-ESOP companies have a retirement plan, and many of these are funded entirely by employee contributions.

To learn more about the feasibility of an ESOP for your company, please call Susan Petrirena at 678-775-5527 or Joanne Swerdlin at 678-775-5512. ■

Dorn Swerdlin congratulates Lee Swerdlin on his promotion to President and Chief Operating Officer of Swerdlin & Company. Joining Dorn are the other members of the Leadership Management Team, Laura O'Connor, Glenda Devechio and Joanne Swerdlin.

# Updating Defined Benefit Plans

We want to remind plan sponsors of the approaching April 30, 2012 deadline for restating Defined Benefit (DB) prototype and volume submitter plan documents. Even if no substantive changes to the plan provisions are needed, restating your prototype or volume submitter DB plan is required. An actuary's input is usually needed to complete the document update. If it has not already been started, the process should begin as soon as possible. This is also a good time to make any other changes you have been considering.

An Individually Designed Plan (IDP) is generally more complicated and requires the expertise of an ERISA attorney.  These plans have a different restatement deadline.

If you have questions about updating your plan document, please contact your Client Manager. ■

# What's Happenin'

Congratulations to **Lee Swerdlin**, who was promoted to President and Chief Operating Officer of Swerdlin & Company in January. **Dorn Swerdlin** will remain Chief Executive Officer and continue to play an active role in the daily activities of the company. **Joanne Swerdlin**, as Executive Vice President, continues to be active in marketing and client relations.

In December, **Connie Woodmansee**, **David Benoit**, **Donna Martin**, **Gary Anderson**, **Kathy Latour**, **Lee Swerdlin**, **Ricky Cox**, **Rigbe Hailessellassie**, **Shenita Spivery** and **Steve Olson** attended Sal Tripodi's "ERISApalooza" at the Retreat at Perimeter Summit.

Also in December, **Ed Ilano** and **Janet Wadlington** attended the Relius Southern Users Group meeting at the Hilton Garden Inn at Perimeter Center.

Each holiday season, Swerdlin has an office decorating contest, and in 2011 **Barbara Sneed** and **Kathy Latour** tied for first place.

We welcome new employees this quarter: **David Brown**, a Relationship Manager on the Daily Recordkeeping Team; **Travis Drummond**, Actuarial Assistant on the Actuarial Team; **Kenny Knapke**, an Implementation Analyst for the Technical Operations Team.

Two former employees returned to Swerdlin this quarter. We welcome back **Lisbet Flaxman** as a Consulting Actuary on the Actuarial Team and **Nick Wilson** as a Benefit Specialist for Swerdlin Benefits Company.

Anniversaries we celebrate this quarter: **Carol Friend**, 20 years; **Susan Petrirena**, 17 years; **Julie Isom** and **Kim Hall**, 15 years; **Kristin Hamilton** and **Mike Raker**, 8 years; **Linda Mathews** and **Shenita Spivery**, 5 years; **Lorene Pierre**, 4 years; **Christi Koberg**, 3 years; **Tiffany Enoch** and **Tina Gilbert**, 2 years; and **Christine Fu** and **David Benoit**, 1 year.

Congratulations to **Carol Friend** who has retired after 20 years at Swerdlin. She is looking forward to doing some travelling without having to work around deadlines. We are pleased to announce that Carol has agreed to continue as the Chairman of the Newsletter Committee. Please join us in wishing her a happy retirement.

**Lee Swerdlin** attended the TD Ameritrade Advisory Board meeting on February 1, in Orlando, Florida.

In March, **Beverly Bailey** and **Mike Raker** attended the 2012 Enrolled Actuaries Meeting in Washington, D.C.

We continue to visit our Penret office in Boston on a regular basis. **Susan Petrirena** accompanied **Joanne Swerdlin** for a week of meetings in January. **Dorn** and **Joanne Swerdlin**, along with **Laura O'Connor**, visited there for a week in March.

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## Dorn's Corner

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**Pole Reversal**

A pole reversal is when earth's magnetic poles actually shift 180 degrees so that the north and south poles' magnetic fields are exchanged. Geological records show that pole reversals happen routinely throughout the earth's history. Magnetic reversals have already happened 171 times in the last 76 million years. Although not a certainty, scientific evidence supports the idea that reversal can happen abruptly rather than gradually. Evidence also exists that the reversal has already started. For example, earth's abrupt changing weather patterns and a rapid weakening of the magnetic field are precursors to a pole reversal. These phenomenons are already happening.

**26,000 Year Cycle**

Our solar system makes a trip around our home galaxy, the Milky Way, every 26,000 years. The Milky Way spins around its center and at the center is believed to be a massive black hole. We are now at the end of one 26,000 year cycle and at the beginning of a new one. This transition to a new cycle allows an alignment between our earth and the galactic center which radiates a special energy to our planet. This energy could be a factor in the magnetic changes here on earth.

**So What?**

Although I enjoy learning about these scientific phenomenons, what practical use is it? I'll tell you. Scientists have proven that our brains contain millions of magnetic particles. These particles connect to magnetic fields on the earth and sun and in the Milky Way. So, if Earth's magnetic fields are changing in the 2012 time frame, then we too are affected. One theory concludes that the Earth's magnetics play a key role in how we accept new ideas and changes in our life. With the reducing magnetic field, we become more open to change our ways. Since our magnetic field varies at different locations on Earth, we see evidence of this phenomenon. The lower the field the more change is acceptable; the higher the field the tendency is to hold on to existing patterns and beliefs and show little interest in change. The lowest level of the field occurs in the Mideast and in California. California has been the source of many new and progressive ideas. The Middle East is certainly struggling for change. It appears the way we handle the desire for change depends on our culture.

Changing your beliefs is a way to expand consciousness and this year is set up by the cosmos to enhance our ability to do just that. Recognize that our chance for humankind's Transformation to a better life is highest during these current times. Let's all work to use these times to better ourselves individually and collectively.

Have a transformational quarter and I'll be back for more next time! ■

## How Important is the SPD?

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The SPD may be hand delivered at the workplace, mailed to the participants, or distributed electronically. The SPD may also be included as a special insert in a company publication, if the distribution list is comprehensive. The publication should include a prominent notice advising the reader that it contains a current copy of the SPD and that it should be read and retained for future reference. The Plan Administrator is required to take reasonable measures to ensure receipt of the SPD. It is not acceptable to just place copies of the SPD in a location frequented by plan participants. ■

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