

employee benefits update

year end 2007



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in the right place**

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COMMON OPTIONS FOR RETIREMENT PLANS

So your company wants to start a retirement plan. Or maybe you've thought about changing your plan's investment options. But how do you decide what to invest in?

For many employers, investment product choices are daunting. And these choices will vary depending on the size of your plan's assets. Let's take a closer look at some common investment options for both smaller and larger plans.

Smaller plans

Generally, smaller plans have fewer participants to consider. They can focus on the participants' lifestyles to help set the parameters of their investment choices. This includes a target maturity for a much smaller group of participants. Small to midsize employers — generally those under \$10 million in assets — typically turn to options such as:

Mutual funds. Mutual fund companies must register with the Securities and Exchange Commission (SEC) and comply with specific securities and legal requirements. In return for a fee, mutual fund companies invest funds in securities (collections of stocks or bonds) according to specific investment objectives. The units of participation in a mutual fund may fluctuate daily according to market prices.

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Retirement plans earn money from mutual funds in several ways, including dividends, interest and capital gains. When a fund receives income, it pays it out to fund owners with an income distribution, either in dividends or interest. Capital gains are due to sales of securities



that are sold higher than the original value. These are also distributed to investors in the form of a distribution.

Group fixed accounts. Group fixed accounts have been known as guaranteed accounts and group annuities. Group fixed accounts provide a stated interest rate backed by an insurance company, similar to a CD at the bank. Investors generally get a higher rate for CDs than a money market account, and the same is true for the group annuity.

With a group annuity, participants will know how much money they will make every year with virtually no risk. But, compared with stocks and bonds, the returns are typically less.

Group fixed accounts don't have to pay a mortality and expense (M&E) fee that regular fixed annuities must pay. Moreover, most group fixed accounts don't have a contingent deferred sales charge that regular annuities charge. And group annuities for qualified plans are "benefit sensitive," meaning participants aren't charged a fee to cash out when leaving the plan.

Registered investment advisors (RIAs). An RIA manages the investments of others and must register with the SEC or state, depending on the amount of money under investment. Employers can hire an RIA, who would then have employees fill out a questionnaire

to determine which of the RIA's investment portfolios might provide the most benefit. Some RIAs point participants to Web sites for automated services that gauge client risk tolerance and allocate their funds accordingly.

For plans that aren't self-directed, plan sponsors can hire any RIA they want. 401(k) custodians must link electronically to the RIA so account information is available 24 hours a day, seven days a week.

Larger plans

In addition to offering the investment choices typical to smaller plans, larger employers that maintain significant investments in retirement plans often invest in direct filing entities (DFEs). This gives employers a measure of investment simplicity and the Department of Labor gives some Form 5500 reporting relief for plans that invest with DFEs. For example, limited investment reporting is required on Schedule D. Some of these DFEs include:

Master trust agreements. In this type of investment, the trust maintains the assets of more than one retirement plan together. Employers who have multiple plans or a group of employers under common control generally use master trust agreements.

A government regulated financial institution — a trust company, bank or similar institution — holds the assets. The financial institution has some control over the plan's assets, but it doesn't bear the same responsibility as that of a fiduciary or plan sponsor.

The assets of a master trust may consist of many assets (pooled) or a single asset. If the master trust contains several pools, the trust may designate and treat each pool as a separate master trust.

Common collective trusts (CCTs). This is a combination of investment units and can include many plans, which may invest some or all of their assets in a CCT. The purchase price of the assets is based on current market values of the fund's underlying assets.

Financial institutions hold the CCT assets in a manner similar to that for master trust agreements. CCTs are considered to be a single fund of diversified securities that operate much like mutual funds.

Pooled separate accounts. In this type of account, an insurance company offers mutual funds through a group

annuity contract. The annuity contract buys units of investments in separate accounts according to the participant's investment elections. The separate accounts purchase and hold units of actual mutual funds.

Advantages and disadvantages

Investment choices for all sizes of plans have their positives — and negatives. For example, mutual funds are maintained by professional fund managers. Rather than having plan sponsors with limited investment knowledge pick investments, the investor of a mutual fund purchases the fund and manages the portfolio.

Also, mutual funds are typically diversified — meaning they hold different stocks — so that a loss in any particular investment is minimized. And, costs tend to be lower because there is more buying and selling going on at any given time.

Larger retirement plans (those with more than 120 participants) are generally subject to an audit by an independent CPA. During an audit, the CPA will perform several tests regarding the assets. The plan sponsor must disclose the audit report summarizing the various types of investments on Form 5500. And, as a result of the audit, the plan sponsor or the plan may pay more expenses for the plan.



Make the right choice

By understanding the various types of investments, plan sponsors can be better equipped to address the issues involving their plans. In all cases, whether it's a small plan, large plan or multiple plans, consult an experienced investment advisor. This will ensure that you meet your fiduciary responsibilities related to your plan. 🕒

Do you know the total cost of your 401(k) plan?

Presumably, most companies that offer a 401(k) plan do so because they see it as a viable way to help employees save for retirement. Some also make a matching contribution or profit sharing contribution to assist employees in accumulating even more dollars. Participants' accounts grow because of the contributions, but plan fees and expenses can reduce the bottom line. It's important to understand your plan's total cost and the impact of the plan fees and expenses on your participants' investment returns.

ERISA requirements

ERISA requires plan sponsors to ensure participants receive fair value for the associated costs of their individual accounts and a fair return on their invested money. This means that plan fiduciaries should consider cost when choosing plan investment options and service providers.

Because many variables determine the fees and expenses that relate to the plan, it may be difficult to estimate your plan's total cost-adjusted return. But not doing so may affect your fiduciary responsibilities to your plan participants. Your plan advisor can help you understand your plan's total cost-adjusted return.

Plan administration costs

One thing that can drive up a plan's costs is its day-to-day expenses. For example, you must pay your third-party administrator (TPA) and your recordkeeper for their services. You may also have the cost of an accountant as well as legal consultation and services.

In addition, you may need to pay the trustee for holding the investments. And don't forget about the expense of annual audits and compliance testing. You may also have a member of your staff handling your benefits program. His or her salary, expenses and overhead count toward plan administration costs, too.

The plan sponsor can pay these fees as a tax-deductible employer expense or charge them to the plan. If the fees are charged to the plan, they will be deducted from the participants' accounts by the TPA and they will reduce the participants' total cost-adjusted returns. To fulfill your fiduciary obligation to the participants, discuss these fees with your plan advisor to ensure that they're competitive.

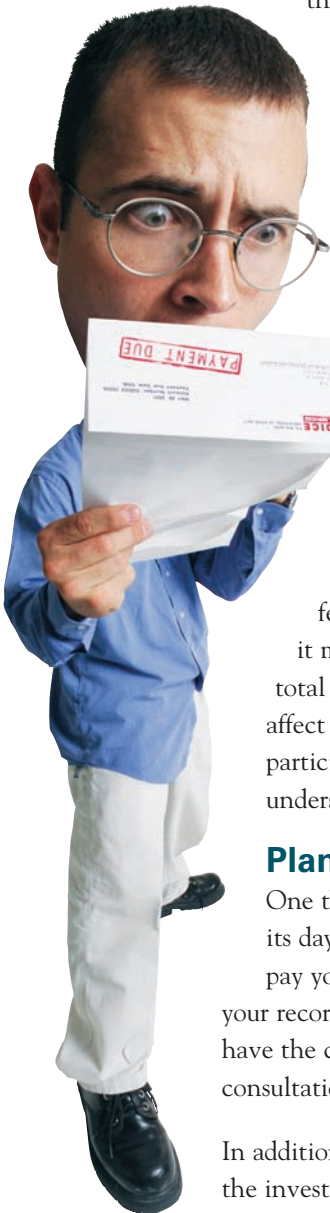
Investment fees

The bulk of all fees associated with 401(k) plans are investment fees. These are usually the most expensive fees and they're often very complex. Investment companies generally assess investment services fees as a percentage of assets invested. Remember that there are fees associated with all services, even though they may be difficult to find.

To calculate the total costs of your plan, contact your TPA and investments vendor.

Investment fees typically fall into one of three categories:

- 1. Sales charges.** This can include loads (fees assessed when the fund is bought or sold), commissions and 12(b)-1 fees (fees associated with a mutual fund's expense ratio).
- 2. Management fees.** These are ongoing charges for managing the funds' assets. They may come in the form of investment advisory fees or account maintenance fees charged by the investment company, which likely will calculate them as a percentage of assets.
- 3. Other fees.** A myriad of other fees may affect your plan's bottom line. Examples include investment recordkeeping costs, the cost of furnishing statements to participants, the expense of providing toll-free phone numbers to participants, and the cost of providing participants with investment advice.



Participant service fees

Some fees are charged only to participants who take advantage of certain plan features. These include redemption fees for selling a fund before a minimum holding period expires and stock fund fees for buying or selling shares of stock.

A plan may also charge advice-related fees (sometimes including online advice) as well as distribution and loan fees. If a plan must complete a qualified domestic relations order (QDRO), it will usually charge a fee for doing so.

The participant usually pays participant service fees, but sometimes the plan sponsor will cover them. Regardless, all fees should be evaluated for reasonableness and competitiveness.

Where to get more information

To calculate the total costs of your plan, contact your TPA and investments vendor. Several other documents or sources you might review include:

Investment prospectuses. A prospectus for each investment option is available. This will help you determine management and other associated fees and expenses pertaining to each investment you offer in your plan.

Your summary plan description (SPD). This document will tell you specific details about what the plan provides and how it operates.

Your summary annual report. This summarizes your company's annual report (Form 5500). It will contain information pertaining to your plan's assets, liabilities, income and expenses.

A statement of your bundled services. If you receive "bundled" services, meaning that all of your 401(k) plan services are provided by one vendor, review the monthly or annual statement that this vendor provides.

Find the fees

Make no mistake, accurately compiling a list of 401(k) fees and expenses to determine your plan's total cost is time consuming. But it's necessary. Each fraction of a percent of additional fees compounded over several years of growth can add up to a substantial decrease in your participants' end balance. 🕒

Plan fees and expenses checklist

Generally, fees and expenses contributing to the total cost of a 401(k) plan fall into three categories: plan administration, investment, and participant service. Here's a handy checklist to use while assessing your plan:

1. Plan administration fees

- Third-party administration (TPA)
- Recordkeeping services
- Accounting services
- Legal consultation and services
- Trustee expenses
- Annual audits
- Compliance testing

2. Investment fees

- Sales charges:
 - Loads
 - Commissions
 - 12(b)-1 fees
- Management fees:
 - Investment advisory fees
 - Account maintenance fees
- Other fees:
 - Investment recordkeeping
 - Furnishing statements to participants
 - Toll-free phone numbers
 - Investment advice

3. Participant service fees

- Redemption fees
- Advice-related fees
- Stock fund fees
- Distribution fees
- Loan fees
- Qualified domestic relations order (QDRO) fees

Finally, 403(b) regs bring both flexibility and restrictions

The 403(b) plan (tax-sheltered annuity) is a retirement plan that can be adopted by public schools, tax-exempt organizations and certain churches. Although 403(b) plans have been around for over 40 years, the first comprehensive proposed regulations were issued in 2004. Replacing the existing regulations adopted in 1964, the final regulations were passed into law in July 2007.

Start date

These regulations generally apply to 403(b) plans after the 2008 calendar tax year. But the regulations have other effective dates for:

Collective bargaining agreements. For 403(b) plans maintained by collective bargaining agreements in effect on July 26, 2007, the regulations don't apply until the earlier of 1) the date the collective bargaining agreement terminates, or 2) July 26, 2010.

Church-related organizations. For a 403(b) plan maintained by a church-related organization in which

a church convention holds the authority to make plan amendments, the regulations don't apply before the beginning of the first plan year following Dec. 31, 2009.

These aren't the only special effective dates. Other provisions contain separate effective dates. Your plan administrator can provide more information about specific compliance questions.

What's new

The new 403(b) regulations contain many new items, including additional provisions addressing:

The necessity of a plan document. Previously, a 403(b) plan wasn't required to have a written plan document. Thus, a plan could exist in which responsibilities weren't clearly allocated to any particular person or entity. The new regulations require a plan document in both form and operation. The plan document must delineate the plan responsibilities among the employer, the issuer of the contract and anyone else involved with the plan.

If your organization doesn't have a written plan document, now is the time to start gathering information in anticipation of this task. Sources you may need include employee handbooks, collective bargaining agreements, 403(b) contracts and administrative procedures, to name a few.

The IRS and Treasury Department expect to publish a model plan provision that public school employers can use. This may help lower the administrative costs of implementing a plan document.

Employee participation. Under the new rules, plans have to cover more employees. Employers must provide employees with a notice of their "effective opportunity" to make or change their elective deferrals as well as note the timing and conditions of making the deferrals.

Almost all employees of a participating employer should be permitted to make salary deferral contributions. There are only a few exceptions, one being an employee who normally works fewer than 20 hours per week. This creates problems with some school districts because most



exclude substitute teachers and bus drivers. Some of these employees may work more than 20 hours per week, and not allowing them to contribute would violate the “universal availability” requirement.

The IRS launched a compliance project to examine the universal availability rule by school districts. A school district that is investigated could be fined. School districts that think they may be at risk should make compliance and operational corrections as soon as possible.

Contract exchanges. The new regulations prohibit plan sponsors from exchanging one 403(b) contract for another contract. Only three nontaxable exchanges or transfers are now permitted:

1. An investment change within the same plan,
2. A plan-to-plan transfer in which another employer plan is receiving the contract exchange, and

3. A transfer to buy permissive service credit or repayment to a defined-benefit governmental plan.

Plan termination. As opposed to the old rules, the new rules allow plan sponsors to terminate 403(b) plans. On termination, the plan will make distributions to participants.

Life insurance. Plan sponsors cannot issue new life insurance policies to 403(b) plan participants.

Discrimination testing. For many 403(b) plans, nonsalary reduction contributions must pass nondiscrimination testing. The exceptions are public school and church-sponsored 403(b) plans.

Give and take

The new 403(b) plan regulations have a certain amount of give and take. Although they provide a little more flexibility, they also contain more stringent guidelines. 🕒

Hiring and retaining older workers

As baby boomers age, employers will be faced with a dwindling workforce. While many companies concentrate on hiring and retaining “new generation” employees, you may want to reach out to older workers and find ways to hire and retain them. These workers tend to change jobs less often, demonstrate more flexible workplace attitudes and have more experience than their younger counterparts.

Older workers may be enticed to continue working by the prospect of receiving additional and more valuable benefits payments during retirement. Also, under the Pension Protection Act of 2006, for distributions in plan years starting after 2006, defined-benefit plans may make in-service distributions to participants age 62 or older who want to phase into retirement.

Here are some ways to incorporate older workers into your workforce:

Be flexible. Flexible work options, such as flex time and telecommuting, are important to older workers. Consider hiring through temporary agencies or employee leasing. Or try using home-based employees or simply hiring part-timers.

Educate them. Some older workers may not be familiar with the latest technology. Employers who offer training and learning opportunities will likely benefit from this investment. Continued education can help your employees develop positive work habits, self-confidence and the ability to work independently.

Offer competitive health and retirement benefits. Among the most common reasons a worker selects one employer over another is to procure a better benefits package. Make sure yours isn't lagging behind that offered by your competitors.

Wellness programs. Provide programs that encourage your employees to live as healthfully as possible. This is particularly important to baby boomers, who are typically intent on living a very active lifestyle.

