Finding the Right Solutions for Your Clients

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Instead of competing, all we have to do is create…

Earl Nightingale

Living the American Dream?

- What will happen to 100 individuals by the time they turn age 65 ?
  - One will be rich
  - Four will be financially independent
  - The remaining will still be working or financially broke

So… how will you make the difference working with plan sponsors to provide some financial security for the 95 who aren't there yet? Plan design can make a significant difference!

Make Plan Design Work for Your Clients

- Unfortunately
  - Traditional plan designs seem unaffordable because higher contributions for owners result in higher contribution costs to cover other eligible employees.
- Fortunately
  - Plan design leverages customized provisions that maximize contributions and benefits for owners, while controlling the cost of covering other eligible employees.
- Often, the most successful plan design results for plan sponsors come from a DB/DC combo plan.

Pension Protection Act of 2006 (PPA) Creates Plan Design Opportunities

- Most significant retirement plan reform since ERISA became law in 1974

- Plan design opportunities
  - Auto enrollment easing, Auto Increases, Roth permanence, and Qualified Default Investment Alternatives (QDIAs)
  - Vote of confidence for cash balance plans, specifically authorized by Congress
  - Significant DB and DC considerations - tax deductibility & funding limits increased
  - Form 5500 disclosure requirements

Return of the Cash Balance Plans

- Type of defined benefit plan
- Benefit expressed as a hypothetical account balance instead of a monthly annuity payment
- Benefit formula specifies both:
  - A pay credit for each participant
  - An interest credit to participant's account

Example:

- Pay credit might be 30% of pay
- Earnings credit might equal 30 year Treasury bond yield

Cash Balance Plans

- For participants, the cash balance hypothetical account looks like a profit sharing account.

Current Year Pay	$150,000	
Pay Credit	30%	
Interest Credit	5%	
Beginning Balance	$ 42,000	
Contribution	$ 45,000	($150,000 * 30%)
Earnings	$ 2,100	($42,000 * 5%)
Ending Balance	**$ 89,100**	

Why Use a Cash Balance Plan?

- All defined benefit plan contributions are age-dependent
  - The older the participant, the higher the maximum potential contribution
  - Maximum contributions can range from $100,000 to more than $200,000 for employees 50 or older
  - Benefits more easily understood by participants
  - Costs more understandable for plan sponsor
  - Contribution credits for the staff (as a % of pay) can remain the same

DB/DC combination plans

- Not a type of plan
  - Pairing of two plans to achieve desired results
  - “Super Age-weighted” Plan
- Significant increase in maximum allowable contributions and benefits for owners
- Relatively modest additional contributions and benefits to other staff members.
- Tax savings on additional contribution for owners often will offset additional contribution cost for staff

DB/DC combination plans - testing

- Contributions or benefits under the combined plans must not discriminate in favor of HCEs (Highly Compensated Employees)
- How do combined plans pass non-discrimination testing?
  - DB and DC plans tested as a single plan
  - Contributions treated as though provided under single plan
  - Single combined plan tested on a benefits basis, instead of contribution basis
  - Employer contributions converted into benefits payable at retirement age and combined with benefits provided under defined benefit pension plan
  - If combined benefits do not discriminate in favor of HCEs, then EACH plan deemed nondiscriminatory

DB/DC combination plans - coverage

- Minimum requirements
  - DB plan must provide meaningful benefits to lesser of
    - 50 employees **or**
    - 40% of employees who satisfy statutory minimum age and service requirements
  - At least 70% of all eligible employees must benefit under both plans
  - Each staff employee must receive a contribution of at least 5% of pay per year under the defined contribution portion of a DB/DC combo

DB/DC combo – small physician group

- ABC Radiologists
  - 30 employees and is consistently profitable
  - Two main classes - Owners and Staff
  - 3 Owners and 27 employees

- Owners want to increase own retirement plan contribution while controlling costs to staff

DB/DC combo – small physician group

Employees	Traditional profit sharing plan	% of pay	Traditional profit sharing plan with 401(k)[2]	% of pay[1]	Class-based profit sharing plan and 401(k)	% of pay[1]
Dr. Adams	$49,000	20%	$54,500	20%	$54,500	20.0%
Dr. Baker	$49,000	20%	$54,500	20%	$54,500	20.0%
Dr. Cox	$49,000	20%	$49,000	20%	$49,000	20.0%
Doctor total	**$147,000**		**$158,000**		**$158,000**	
Staff	$165,400	20%	$109,704	13.27%	$41,350	5%
Total	**$312,400**		**$267,704**		**$199,350**	

[1]Excludes catch-up contributions | [2]Assumes safe harbor 401(k) with Qnec of 3% and profit sharing contribution of 10.27%

DB/DC combo – small physician group

Reduction in profit sharing costs through plan design

Employees	Traditional profit sharing plan	% of pay	Traditional profit sharing plan with 401(k)[2]	% of pay[1]	Class-based profit sharing plan and 401(k)	% of pay[1]
Dr. Adams	$49,000	20%	$54,500	20%	$54,500	20.0%
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DB/DC combo – small physician group

Reduction in profit sharing costs through plan design

Employees	Traditional profit sharing plan	% of pay	Traditional profit sharing plan with 401(k)	% of pay[1]	DB/DC Combo Plan[3]	% of pay[1]
Dr. Adams	$49,000	20%	$54,500	20%	$233,760	95.4%
Dr. Baker	$49,000	20%	$54,500	20%	$198,760	81.1%
Dr. Cox	$49,000	20%	$49,000	20%	$124,760	50.9%
Doctor total	**$147,000**		**$158,000**		**$557,280**	
Staff	$165,400	20%	$109,704	13.27%	$82,700	10%
Total	**$312,400**		**$267,704**		**$639,980**	

1 Excludes catch up contributions

2 Assumes safe harbor 401(k) with QNEC of 3% and profit sharing contribution of 10.27%

3 Cash Balance Plan with Benefits Payable at 62 and Safe Harbor 401(k) with a Cross Tested Profit Sharing Plan

NOTE: As a result of the funding rules of The PPA of 2006, a slightly lower contribution is expected for the benefits accrued by Highly Compensated Employees for the first year of the plan. Future years' contributions will likely increase.

DB/DC combo – large law firm

- XYZ Attorneys and Assoc.
  - More than 350 lives and consistently profitable
  - 10 shareholders and 43 partners
  - Four main classes
    - Shareholders
    - Partners
    - Attorneys
    - Staff
- Shareholders want to increase own retirement plan contributions while controlling costs to staff

DB/DC combo – large law firm

Overall contribution and tax savings results

	Salary	Cash Balance	Profit Sharing	401(k)	Total Contribution
Total Target Employees	11,725,312	443,000	1,555,398	1,050,500	**3,048,898**
Total Others	10,936,983	0	628,877	0	**628,877**
Total	22,662,295	443,000	2,184,275	1,050,500	**3,677,775**
Portion to Target employees	52%	100.0%	71.2%	100.0%	**82.9%**

Total Qualified Retirement Plan Contributions	3,677,775
Estimated tax rate	35%
Tax Savings on Company Contributions	1,287,221
Total Others - Contributions for Staff	628,877
Net (Cost)/Benefit of Proposed Plan Design	**658,345**

NOTE: As a result of the funding rules of The PPA of 2006, a slightly lower contribution is expected for the benefits accrued by Highly Compensated Employees for the first year of the plan. Future years' contributions will likely increase.

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DB/DC combo – large law firm

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Estimated First Year Cash Balance Maximum Pay Credits

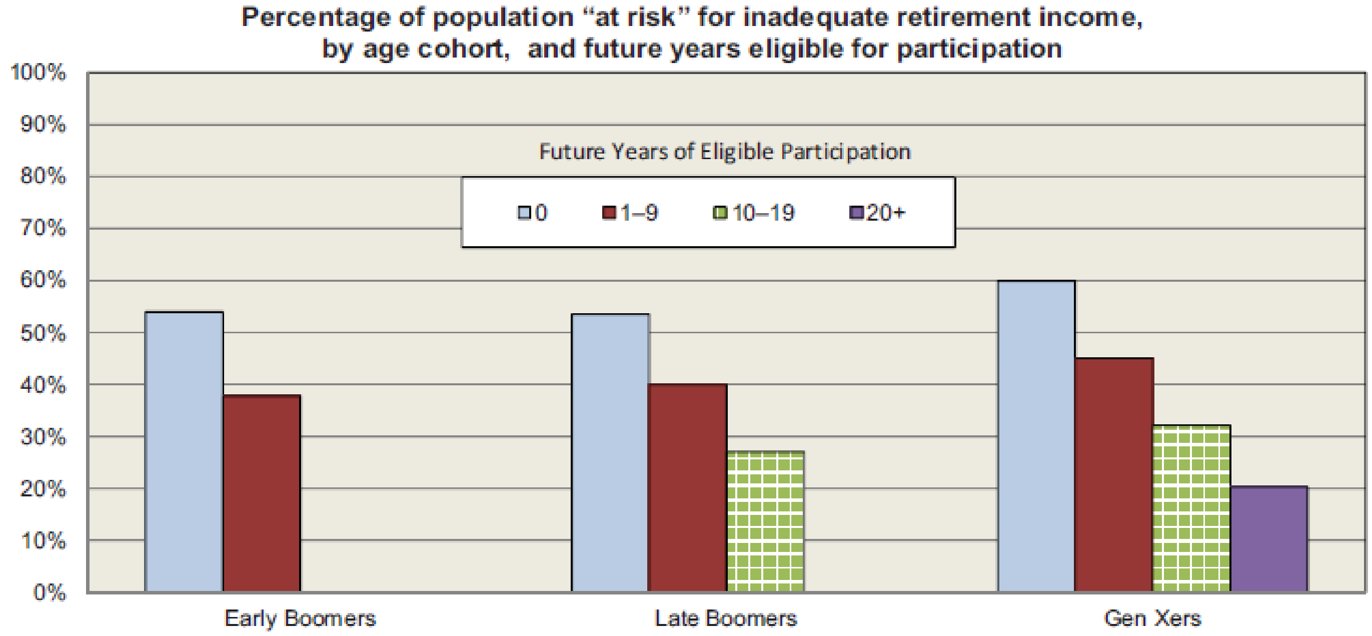
Subject to reduction under PPA funding rules

Age	NRA 65	NRA 62	Age	NRA 65	NRA 62
64	$220,000	-	50	$111,300	$138,100
63	$210,000	-	49	$106,00	$131,100
62	$190,800	-	48	$101,00	$125,200
61	$190,500	$236,200	47	$96,200	$119,300
60	$181,400	$224,900	46	$91,600	$113,600
59	$172,800	$214,200	45	$87,200	$108,200
58	$164,500	$204,000	44	$83,100	$103,000
57	$156,700	$194,300	43	$79,100	$98,100
56	$149,200	$185,000	42	$75,300	$93,400
55	$142,100	$176,200	41	$71,800	$89,000
54	$135,400	$167,800	40	$68,300	$84,700
53	$128,900	$159,800	39	$65,100	$80,700
52	$122,800	$152,200	38	$62,000	$76,900
51	$116,900	$145,000	37	$59,000	73,200

What about Auto Enrollment?

Figure 6

Impact of Age and Future Years Eligible for Participation in a Defined Contribution Plan on At-Risk* Probabilities

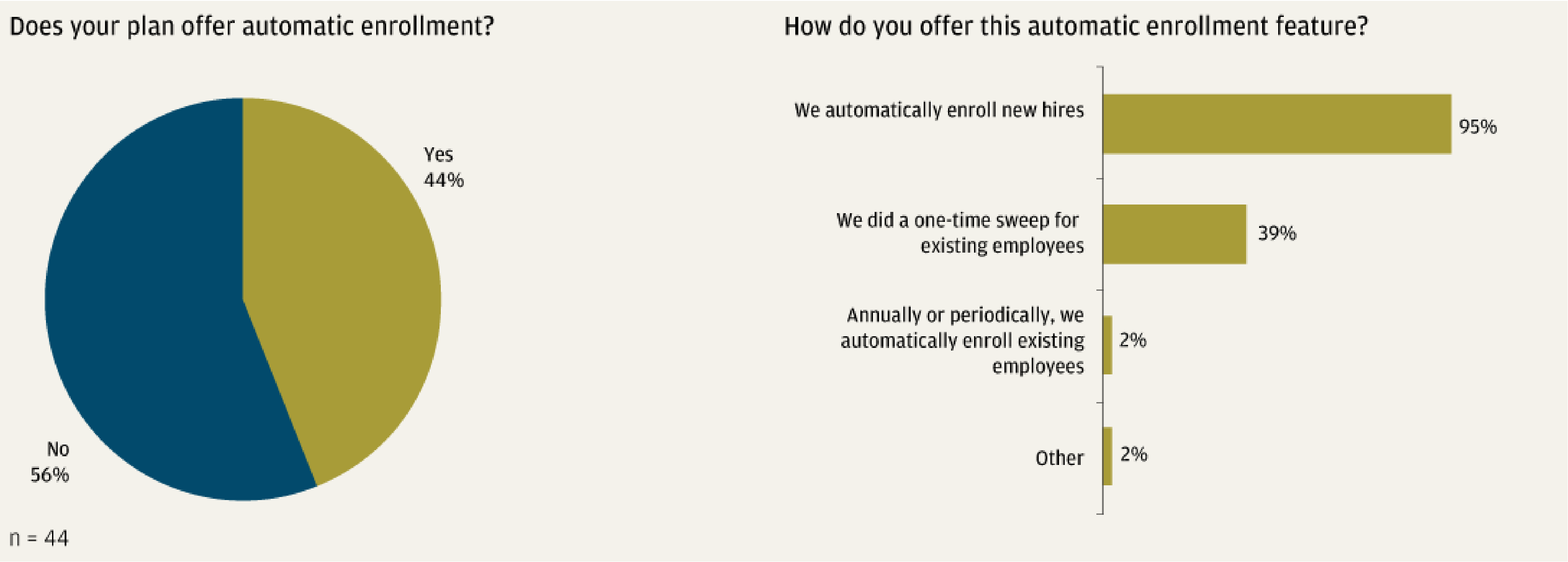


Source: EBRI/ERF Retirement Security Projection Model® version 100504e.
* An individual or family is considered to be "at risk" in this version of the model if their aggregate resources in retirement are not sufficient to meet aggregate minimum retirement expenditures defined as a combination of deterministic expenses from the Consumer Expenditure Survey (as a function of income) and some health insurance and out-of-pocket health-related expenses, plus stochastic expenses from nursing home and home health care expenses (at least until the point they are picked up by Medicaid). The resources in retirement will consist of Social Security (either status quo or one of the specified reform alternatives), account balances from defined contribution plans, IRAs and/or cash balance plans, annuities from defined benefit plans (unless the lump-sum distribution scenario is chosen), and (in some cases) net housing equity (either in the form of an annuity or as a lump-sum distribution). This version of the model is constructed to simulate "basic" retirement income adequacy; however, alternative versions of the model allow similar analysis for replacement rates, standard-of-living, and other ad hoc thresholds.

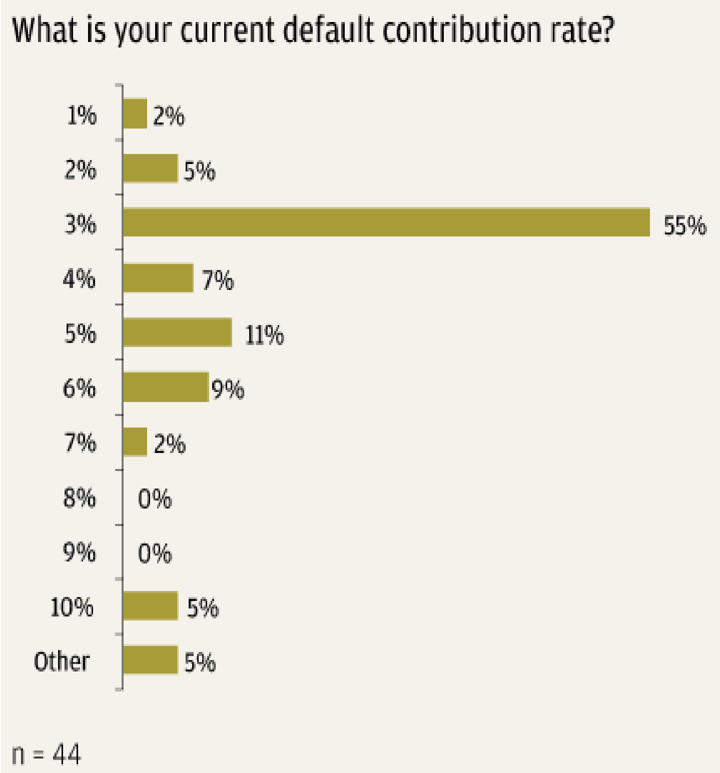
Auto Enrollment

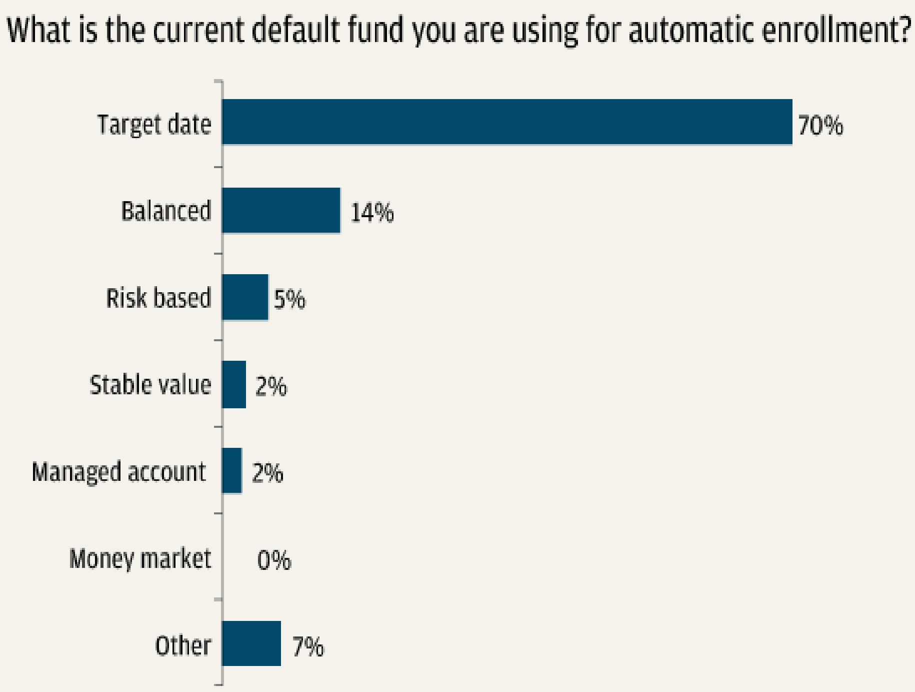
- 2011 Defined Contribution Institutional Investment Association Survey Findings:
  - 30% increase in enrollment compared to pre-automatic enrollment implementation
  - Auto enrollment viewed favorably by employees
  - 3% auto enrollment is too low; some suggest a starting point of 10% (four out of ten respondents believe that participants need to save between 10%-15%)

Auto Enrollment in 401(k) Plans



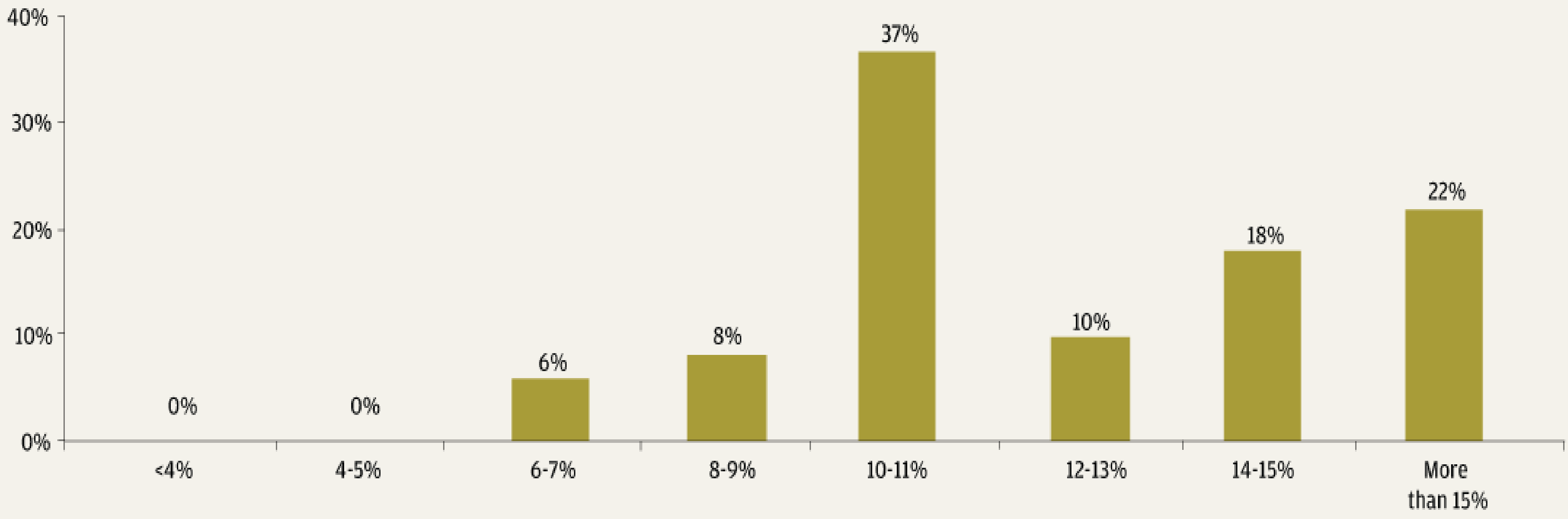
Current Auto Enrollment Practices





Recommended Participant Contribution Rates

What would you recommend as the optimal retirement savings rate for the average participant?



n = 101

Future of Auto Enrollment

- Expect to see a significant increase in plans implementing auto-enrollment over the next two years
- Has become a tool for plans to pass nondiscrimination testing
- Employers moving to auto escalation
- Starting percent will increase to at least 4%

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Does Adding Roth to the 401(k) Make Sense?

- No compensation limit (like there is for a Roth IRA)
- Possible employer match
- Financial planning tool
- No required minimum distribution at 70 ½ (assuming employee is not a 5% or more owner)
- Conversion ability to move existing pre-tax funds into the Roth 401(k) account

Do Your Clients' Plans Work?

Help Your Clients Avoid Making Mistakes

- Learn how to recognize operational errors
- Understand the consequences of these errors
- Learn about corrective actions to remedy these errors
- Learn how to avoid these errors

Types of Errors

- Fiduciary Errors
  - Failure to operate the plan exclusively for the benefit of participants
  - Performing duties at a level less than a "Prudent Expert"

- Document Errors
  - Plan document does not comply with IRS/DOL requirements
    - Delinquent execution of required legislative amendments
    - Individually designed documents containing errors or omissions

- Operational Errors
  - Failure to follow terms of the Plan document

Operational Errors -- Consequences

- Consequences to:
  - Participants
    - Taxed on vested contributions
  - Trust
    - Taxed on investment earnings
  - Employer
    - Loss of tax deduction for “For Profit” companies
    - Employee damages

Operational Errors -- Remedies

- Corrective actions available through
  - Employee Plans Compliance Resolution System (EPCRS)
    - IRS Revenue Procedure 2008-50
    - Self Correction Program (SCP)
    - Voluntary Correction Program (VCP)
    - Audit Closing Agreement Program (Audit CAP)

- Available for:
  - All qualified plans (e.g. 401(k), PSP, MPP, DB, ESOP, etc.)
  - 403(b) plans,
  - SEPs,
  - SIMPLEs

Understand Your Client

- Do you know your client?
- What are your client’s significant business challenges?
- Is their particular industry growing/contracting?
- Do you know the business succession plan?
- What are their short/long-term goals?
- When was the last time they did a health check-up on their retirement plan?
- Do they understand their fiduciary duties?
- **Be their trusted advisor!**

Thank you!

For questions or more information contact

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