THERE REALLY ARE NEW DEFINED BENEFIT PLANS by George W. McCauslan

To paraphrase Mark Twain: "The reports of the death of defined benefit plans is an exaggeration" …at least for some types of businesses..

It is certainly true that many larger corporations have converted their traditional defined benefit plans to cash balance plans, or have terminated them and increased contributions to 401(k) or other defined contribution programs. New corporations are often foregoing defined benefit plans entirely. These changes have generated frequent articles in the public and business press, concern in Congress, lobbying by senior citizens' groups, and the like. This activity is affecting a large percentage of the US work force and, ultimately, those actuaries who provide services to larger corporations.

However, for very small businesses, the situation is quite different. (At least in the US—see the companion article about the situation in Canada.) Since many of us who maintain small pension consulting practices tend to serve smaller businesses, this difference can mean a significant opportunity. At my own firm, for which the traditional defined benefit valuation practice is a fairly small piece of the whole, we saw over 30 newly established defined benefit plans for 2003.

As we all learned at some point in our exam careers, pension plans often play a very different role for the small businesses than for large ones. That means that the forces that are leading the large businesses to jettison their defined benefit plans do not always apply to smaller businesses. For the small professional firm or other closely-held business, the main purpose of tax-qualified retirement plans is often the tax-deferred savings for the owner. For many of these businesses, the traditional defined benefit plan provides the ability to contribute significantly larger amounts than could be contributed under a defined contribution plan.

There are several reasons for the growth of the number of businesses for which a defined benefit plan is appealing. Some of these are:

1. We are getting older. I mean this not as individuals, but as an average age in the workforce, particularly for professionals and business owners. Given the nature of pension plan funding, the available deductions are larger for someone who is older when the plan is established.

2. The law changed several years ago to allow us to ignore any amounts previously contributed to defined contribution plans in determining the benefit that can be provided in a defined benefit plan. This means the business owners with long histories of defined contribution plans can now "convert" to defined benefit plans and get increased contributions at earlier ages.

3. There is growth in the number of very small businesses, including the self-employed consultant (like many of the members of our section). For businesses

with no (or few) common-law employees, the defined benefit plan can operate more as a savings vehicle for the owner.

4. Folks who have been "downsized" by larger corporations, often with generous early retirement pensions, are frequently starting businesses. They have less need for current income, and can use a significant percentage of their income to accumulate a larger retirement benefit to be used when they actually stop working.

5. In my experience, a larger number of CPA's and other accounting or tax professionals who serve smaller businesses have not been well informed about defined benefit plans, and have not suggested them to their clients in the past.

The opportunity, then, comes from finding the small business for which a defined benefit plan makes sense, and then providing services on a basis that is cost-effective for those businesses.

On the issue of finding the clients, we all have approaches to business development that work for us. We work in different-sized markets and have different referral networks. However, for my office and for one of the rapidly growing pension administration firms for which we provide actuarial services, the effort of educating the CPA's and other financial advisors of small businesses on what a defined benefit plan can do for their clients has paid off in new business. Sometimes, this can be an uphill battle, since some of these financial advisors were taught at some point in the past the defined benefit plans "didn't work" for small businesses. But, when you consider that one CPA could have dozens of good prospects for a defined benefit plan, the effort can be worthwhile.

On the issue of cost-effective delivery of services, most of us have lots of experience. We certainly need to be fairly compensated for our time, or else it makes no sense to be looking at this market. Using standardized materials and plan structures (for most cases) can certainly help achieve a cost that is acceptable to both the client and the actuary.

It seems to me that there is a more general lesson here for the actuary in the smaller consulting firm. There is a danger in making a decision about where to focus your practice based on a general pattern of change in the environment, particularly one that is receiving much press coverage. If an actuary looks as his or her individual market, the likely changes may be quite different from the average change. This could arise because smaller consulting firms tend to provide services to smaller businesses, or because any individual may have developed a niche market, or from any other source. What is important is to identify clearly how an external change will affect <u>you</u> and <u>your clients</u>, not just some "average" actuary or client. In that way, you can make decisions that keep your practice alive and growing.

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