

The
SFL
EPIC Plan
Update



Know the Rules!

Regulations were issued for Internal Revenue Code § 419A(f)(6) establishing requirements for “10 or more employer” welfare benefit plans.



Know the Rules!

What we knew was required by law to be a § 419A(f)(6) plan before the Regulations were issued:

- A plan must provide employees with welfare benefits
- More than one employer must contribute to a plan
- No individual employer normally contributes more than 10% of the total contributions under the plan.

Know the Rules!

What we knew was required by law to be a § 419A(f)(6) plan before the Regulations were issued:

- A plan may not maintain experience rating arrangements with respect to individual employers.
- All assets have to be available to provide benefits to covered employees, and
- Experience (positive and negative) is shared by all employers and employees.

The Final Regulations

The Regulations now reveal 5 characteristics -- Fatal Flaws

A Plan that has one or more Fatal Flaws may lose its “10 or more employer” plan status.

One Flaw may be all it takes.



The Final Regulations

The Internal Revenue Service (IRS) presumes that if a plan exhibits one or more of the Fatal Flaws, a plan is not a “10 or more employer” plan.

However, the Regulations allow a taxpayer the opportunity to establish “to the satisfaction of the Internal Revenue Service that section 419A(f)(6) is satisfied” even if a plan exhibits one or more of these Fatal Flaws.

The Final Regulations

What are the Fatal Flaws and how has Security Financial addressed them?

First, understand what they are.



The Final Regulations

What is the Service trying to get at with the Fatal Flaws?
Support for its new definition of experience rating.
Prohibited experience rating has morphed under the Regulations from the traditional notion to a much more expanded notion.



The Final Regulations

Traditional experience rated arrangement – a participating employer is entitled to a refund of a portion of its contribution if its claims experience is better than expected; a participating employer is assessed a higher contribution if its claims experience is worse than expected.

419A(f)(6) Regulations definition: the past experience of an employer/its employees is used - in some way – to determine the employer's future cost of coverage.

And now, the Fatal Flaws....

The Final Regulations

Flaw #1 - Plan Assets are allocated by Employer.

Assets of a plan are allocated to individual employers through separate accounting of contributions and expenditures for those employers.

This flaw may tend to indicate that there are multiple plans, rather than one plan with multiple contributing employers.



The Final Regulations

Flaw #2 - Differential pricing.

The amount charged under a plan is not the same for all participating employers. Differences are due to factors other than current risk or rating factors commonly taken into account in manual rates.

This flaw may tend to indicate that an arrangement is experience rated.



The Final Regulations

Flaw #3 - No fixed welfare benefit package.

A plan does not provide for fixed welfare benefits for a fixed coverage period for a fixed cost.

This flaw may tend to indicate that an arrangement is experience rated.

The Final Regulations

Flaw #4 - Unreasonably high cost.

A plan provides for fixed welfare benefits for a fixed coverage period for a fixed cost, but that cost is unreasonably high for a plan's covered risk.

This flaw may tend to indicate that an arrangement is experience rated.



The Final Regulations

Flaw #5 - Nonstandard benefit triggers.

A plan provides for the payment of benefits or distribution of an insurance contract to an employer's employees for any event other than illness, personal injury, or death of an employee or family member, or the employee's involuntary separation from employment.

This flaw may tend to indicate that an arrangement is experience rated.

The Final Regulations

Understanding the Flaws and how post-12/31/03 SFL
EPIC is designed to continue to comply with § 419A(f)(6)
and avoid the Flaws...

The Final Regulations

Flaw #1 - Plan Assets are allocated by employer.

- Assets of a plan are allocated to individual employers through separate accounting of contributions and expenditures for those employers.





SFL EPIC Plan Design

Absence of Flaw #1

- Security Financial has administered the SFL EPIC Plan without allocating contributions and expenditures among employers.
- The SFL EPIC Plan does not account for assets separately for each employer for purposes of providing benefits or determining cost of coverage.
- Contributions are used to pay the premium for one group term insurance policy covering all employers' employees.



SFL EPIC Plan Design

Absence of Flaw #1

Each employer is informed that all assets are available to provide benefits to all employees.

No employer is insulated from the claims experience of other participating employers' employees.

Security Financial will continue these practices with post-12/31/03 SFL EPIC.

The Final Regulations

Flaw #2 - Differential pricing.

- Premiums are not the same for all participating employers covering employees with the same actuarial characteristics, and
- Those differences are due to factors other than current risk or rating factors commonly taken into account in manual rates.

The Final Regulations

Flaw #2 - Differential pricing.

- The Regulations prohibit pricing with a difference in premiums charged for covering employees who currently have the same actuarial characteristics.
- The Regulations prohibit different levels of premiums based on issue ages.
- The Regulations appear to prohibit level premium pricing.



SFL EPIC Plan Design

Absence Of Flaw #2

- An employer's interest with respect to the SFL EPIC Plan is like the relationship of an insured to an insurer, not like an employer to a fund
- Like the relationship of an insured to an insurer.
 - All assets are available to provide benefits to all employer's employees
 - Risk is spread across all covered employees
 - Cost of coverage for employees with similar actuarial characteristics (age, sex, health) is the same without regard to employer, years of coverage under the Plan or years of service with the employer.



SFL EPIC Plan Design

Absence Of Flaw #2

- Post 12/31/03 SFL EPIC will not offer issue age premium pricing.
- Post 12/31/03 SFL EPIC will not offer level premium pricing.
- Security Financial has designed a new cost of coverage structure for the post-12/31/03 SFL EPIC Plan.

SFL EPIC Plan Design

Absence Of Flaw #2

- Security Financial has established a uniform annual conversion charge for employees with the same actuarial characteristics in three rating groups.
- In the three rating groups, post 12/31/03 SFL EPIC covers employees that are the same attained age (and whose other actuarial characteristics are the same) for the same premium amount, regardless of how long the employee is covered under the Plan or is employed by the employer.

SFL EPIC Annual Cost Comparison Chart

- M-NS; \$1,000,000 coverage
- 2 employees—one 45 years old, one 50

Age	Pre 12-31-03		Post 12-31-03	
Age 45	\$44,362		\$43,300	
Age 46	\$44,479		\$43,450	
Age 47	\$44,509		\$43,550	
Age 48	\$44,556		\$43,700	
Age 49	\$44,586		\$43,800	
Age 50	\$44,553	\$48,532	\$43,900	\$43,900
Age 51	\$44,501	\$48,586	\$44,000	\$44,000
Age 52	\$44,468	\$48,638	\$44,150	\$44,150
Age 53	\$44,412	\$48,648	\$44,300	\$44,300
Age 54	\$44,483	\$48,854	\$44,600	\$44,600
Age 55	\$44,526	\$49,050	\$44,950	\$44,950
Age 56	\$44,497	\$49,184	\$45,300	\$45,300
Age 57	\$44,390	\$49,258	\$45,650	\$45,650
Age 58	\$44,185	\$49,234	\$45,950	\$45,950
Age 59	\$43,887	\$49,117	\$46,150	\$46,150
Age 60		\$48,989		\$46,500
Age 61		\$48,797		\$46,900
Age 62		\$48,559		\$47,200
Age 63		\$48,224		\$47,500
Age 64		\$47,759		\$47,800

SFL EPIC Annual Cost Comparison Chart

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Age 45	\$44,362		\$43,300	
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Age 51	\$44,501	\$48,586	\$44,000	\$44,000
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Age 64		\$47,759		\$47,800

The Final Regulations

Flaw #3 - No fixed welfare benefit package.

- A plan that does not provide for fixed welfare benefits for a fixed coverage period for a fixed cost is not a 419A(f)(6) plan.

The Final Regulations

- What is required?
 - One or more welfare benefits must be provided.
 - A fixed cost to provide those welfare benefits.
 - A fixed coverage period during which a plan agrees to provide those welfare benefits.

SFL EPIC Plan Design

Absence Of Flaw #3.

- The SFL EPIC plan provides life insurance benefits.
- A fixed death benefit and a right to a fixed conversion policy available for a fixed cost.
- Even in the event of a temporary business hardship, the employer continues to be obligated for the fixed cost.

SFL EPIC Plan Design

Absence Of Flaw #3

- An employer must demonstrate “temporary business hardship” in a Plan year according to the Plan’s objective standard.
- An employer must pay the re-amortized fixed cost.
- The Plan administrator determines the employer’s amortization period, which cannot exceed 18 months.

The Final Regulations

Flaw #4 - Unreasonably high cost for the covered risk for the plan as a whole.

- The Regulations do not tell what “unreasonably high cost” is.



The Final Regulations

- What we know from what we see in the examples in the Regulations:
 - A level premium may be considered an unreasonably high cost in the early years. (Regulations Example 4)
 - The rates in Table I of the § 79 Regulations are not an unreasonably high cost. (Regulations Example 7)

SFL EPIC Plan Design

Absence Of Flaw #4

- The post-12/31/03 SFL EPIC Plan is funded with contributions based on uniform pricing.
- The annual contribution for all employers is the amount actuarially determined to cover the Plan's risk as a whole for that year.
- The total annual contribution is intended not to exceed the qualified direct cost for all employers.



The Final Regulations

Flaw #5 - Nonstandard Benefit Triggers

- If benefits or other amounts that are plan assets are paid, distributed, transferred, or otherwise provided
 - 1) on the occasion of the employer's withdrawal or spin off from the plan or
 - 2) as a right to convert from a group to an individual policy without demonstrating evidence of insurability if there is “additional economic value” associated with the conversion right.

SFL EPIC Plan Design

Absence Of Flaw #5

- No employer has an interest or share in the group term policy purchased for the Plan.
- No employee has an interest in the Plan other than a death benefit and a right to convert.



SFL EPIC Plan Design

Absence Of Flaw #5

- In the post-12/31/03 SFL EPIC Plan, as in the current SFL EPIC Plan, when an employer withdraws from the Plan, its covered employees have the right to convert to an individual whole life policy.
- Because the cost of any economic value is equally shared across the Plan, the cost is not a “proxy for an employer’s experience.”

(Ref. Example 8 (iii), special rule under Regulations at (b)(2)(iii)).



SFL EPIC Plan Design

Absence Of Flaw #5

- Even if there is economic value, this “sharing” should allow “an employer participating in this arrangement ... to establish to the satisfaction of the Commissioner that the plan does not maintain experience-rating arrangements with respect to individual employers.”

(Ref. Example 8 (iii), special rule under Regulations at (b)(2)(iii)).



SFL EPIC Rules

The SFL EPIC Plan rules continue:

- Participating Employers are Required to Cover All Eligible Employees
 - o Eligible employees include anyone age 21 or over who is working at least 1,000 hours a year unless they're a non-resident alien or covered by a collective bargaining agreement.
 - o Leased employees and independent contractors are not eligible for coverage.
 - o Contributing employers must provide the Plan Administrator with an annual certification that all eligible employees are covered under the Plan.

SFL EPIC Rules

Post-12/31/03 SFL EPIC's definition of compensation:

- Remuneration for employment, as reported to the Internal Revenue Service as wages in the first year employee is covered by the Plan.
- The first year of coverage concept may be extended to accommodate farmers who average their income for income tax purposes.

SFL EPIC Rules

Death Benefit formula:

- Multiple of compensation or Class Option (employer choice):
 - o Multiple of compensation: 2, 3, 4, 5, 7.5, 10
 - o Class Option: Base coverage amount \$500k, \$1m, \$2m, \$4m
 - Class 1, 100%;
Class 2, 40%;
Class 3, 16%;
Class 4, 10% of base amount



SFL EPIC Rules

Entry-age conversion eligibility:

- No entry age conversion under age 40 regardless of years of service
- Age 50 or 10 years of service

Annual Cost:

- Age based formula calculated using age of employee when first eligible
 - 40-50 – Rating group 1
 - 51-60 – Rating group 2
 - 61plus – Rating group 3

Additional Points

What you communicate in your sales presentations continues to be critical.



Additional Points

The Regulations allow the IRS to use all promotional materials and policy illustrations to determine whether a Plan has one or more of the Five Fatal Flaws.

“An expectation created through marketing that an individual employer’s actual experience will be passed through to that employer or its employees may create an experience-rated arrangement.”

Additional Points

Don't promise the sun, the moon, the stars, or an investment. The Plan provides none of these; the Plan provides a death benefit and a conversion right.

Additional Points

The Regulations affect contributions paid or incurred by the participating employers in taxable years of an employer beginning on or after July 11, 2002.





Additional Points

The Regulations impose record-keeping requirements.

A Plan administrator is required to maintain records for each taxable year of the plan beginning after July 17, 2003, so that the IRS or any participating employer may verify a plan's compliance with § 419A(f)(6) and provide the IRS and any employer the right to inspect and copy these records.

Security Financial continues to comply with these requirements.

Additional Points

Security Financial continues to maintain a list of employers participating in SFL EPIC, whether or not required by the IRS's Listed Transaction rules, as amended.



Additional Points

Form 8886 - Reportable Transaction Disclosure Statement

Security Financial has not determined whether a Form 8886 is required to be filed by participating employers. This determination is for each participating employer to make.

For any participating employer who wants assistance in disclosing its participation in SFL EPIC, Security Financial has prepared a model IRS Form 8886.

What the Regs Did Not Address

- Non-discrimination?
 - Even though the Regulations did not address discrimination, the SFL EPIC Plan will continue to be a non-discriminatory Plan.





Other “419A(f)(6) Plans”

Know what to look for in competing products and how to discuss their potential shortcomings.

- Using individual WL, UL or VUL policies as a plan investment may not be prohibited by the Regulations.
- Using these policies to provide benefits may be simply an aggregate of separate Plans providing separate benefits and funding them with separate life insurance policies.
- This practice is prohibited by the experience rating concept in the final Regulations explained earlier.



Other “419A(f)(6) Plans”

Provider Example 1

- Plan type: “419A(f)(6)”
- Benefits promoted: Death and severance benefits
- Vehicle to provide promoted benefits: Multiple carrier off-the-shelf life insurance policies



Other “419A(f)(6) Plans”

- What they tell you about their approach:
 - o They claim to be compliant!
 - o Employer makes a contribution each year for both one-year term insurance and a “...current liability of future severance benefit”.
 - o The amount contributed is placed into a UL/VUL policy from a variety of reputable insurance carriers.
 - o The employee is provided with life insurance and severance benefits.

Other “419A(f)(6) Plans”

- What they don't tell you about their approach:
 - The informal exit strategy likely triggers Flaw #1 – Allocation of Plan Assets.



Other “419A(f)(6) Plans”

- What they don't tell you about their approach:
 - The severance benefit provides the reason to fund more than one year term insurance.
 - The plan may rarely, if ever, actually pay out a severance benefit.

Other “419A(f)(6) Plans”

- What they don't tell you about their approach:
 - o A problem exists - benefits are allocated based upon individual employer experience.

	COI	Sever.	Total
Age 45	\$ 1,000	\$ 9,000	\$ 10,000
Age 50	\$ 1,500	\$ 13,500	\$ 15,000
Age 55	\$ 2,000	\$ 18,000	\$ 20,000
Total		\$ 40,500	
Total/3		\$ 13,500	

Other “419A(f)(6) Plans”

This plan has at least one Fatal Flaw:

- Flaw #1 - Allocation of Plan assets





Other “419A(f)(6) Plans”

Be wary of Plans claiming to be compliant that use individual off-the-shelf cash value policies!

Watch out for Flaw #1.



Other “419A(f)(6) Plans”

Provider Example 2

- Plan type: “419A(f)(6)”
- Benefits promoted: Death benefit only
- Vehicle to provide promoted benefits: Multiple carrier off-the-shelf life insurance policies



Other “419A(f)(6) Plans”

What they tell you about their approach:

- o They claim to be compliant!
- o Employer makes contributions each year for cash value life insurance from a variety of reputable insurance carriers, (usually) for key employees only.



Other “419A(f)(6) Plans”

What they tell you about their approach:

- o The employees are divided into several “rating groups”, each of which is similar enough that the Plan can charge the same rate for each employee for a given age and large enough that each “rating group” is itself, a TOME plan.
- o Each year, the Plan provider redistributes individual gains and losses within rating groups to preserve a non-experience rated plan.



Other “419A(f)(6) Plans”

The untold flaws in the approach:

- o Upon withdrawal each employer (usually one employee) terminates participation and adopts a SEP.
- o The SEP accepts the insurance policy. The SEP is terminated; the policy may be distributed to the individual.



Other “419A(f)(6) Plans”

- o This plan potentially violates at least 2 of the 5 characteristics:
 - Flaw #1 – Allocation of plan assets
 - Flaw #5 - Nonstandard benefit triggers



Other “419A(f)(6) Plans”

Provider Example 3

- Plan type: “419A(f)(6) VEBA”
- Benefits promoted: Disability, Life, Long term care, etc...
- Vehicle to provide promoted benefits: Variable annuities

Other “419A(f)(6) Plans”

- What they tell you about their approach:
 - Covered employees have the opportunity to receive several different types of welfare benefits.



Other “419A(f)(6) Plans”

- The flaws that aren’t discussed:
 - Similar to provider example 1, the disability, LTC, and death benefits of this plan are promoted as reasons for employers to make large contributions.

Other "419A(f)(6) Plans"

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INSURANCE COMPANY, LTD.

CERTIFICATE BENEFITS

"Own Occupation"



If disability occurs under the "own occupation" section of the policy, the benefit paid shall equal 110% of aggregate premiums paid or the insured's experience adjusted benefit, whichever is greater. The insured's experience adjusted benefit shall equal 96% of premiums paid as adjusted by the experience of the total pool of insureds as described in the Policy.

"Any Occupation"

If disability occurs under the "any occupation" section of the policy, the benefit shall equal 400% of aggregate premiums paid less any benefits paid under the "own occupation" benefit. No "any occupation" benefits shall be paid until the "own occupation" benefits are fully exhausted.

Minimum Premiums Required / Experience Adjusted Refund Benefit

If at least the minimum premium is not paid for any calendar year prior to the 7th anniversary (3rd anniversary in certain circumstances) of the first effective date of the certificate, the certificate and all coverage shall lapse with no benefit.

If at least the minimum premium is not paid for any calendar year subsequent to the 7th anniversary (3rd anniversary in certain circumstances), the certificate shall lapse and the experience adjusted refund benefit shall be paid in a single lump sum. Any experience adjusted benefit is subject to the experience of the total pool of insureds and the adjustment is calculated at the time of payment.

Other

There is no death benefit under the policy. If the insured dies, this certificate shall lapse with no benefit payable.

The company shall issue an amended certificate each year to reflect the benefits payable based on premiums received on an inception to date basis. Benefits will be payable on the cumulative premiums paid as of the first date of disability. All estimated benefits reflected above shall be reduced by benefits previously paid. Any conflict between the terms of this Certificate and the Policy shall be governed by the terms of the Policy.

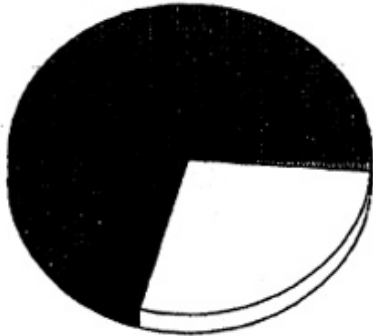
APPROVED: ~~XXXXXXXXXXXXXXXXXXXX~~ INSURANCE COMPANY, LTD.

By: ~~XXXXXXXXXXXX~~ (Authorized Signatory)

Other "419A(f)(6) Plans"

Your Portfolio

Your account was diversified among the investments specified below as of June 30, 2003. Please note that percentages and balances have been rounded.



Investment	Market Value
63% Domestic Equities	\$64,490.78
18% Large Cap Growth Fund	\$18,684.08
22% Large Cap Value Fund	\$22,205.58
2% Small Cap Growth Fund	\$2,045.26
2% Small Cap Value Fund	\$2,333.81
19% Other Domestic Equity	\$19,222.05
8% International Equities	\$7,648.88
8% International Equity Fund	\$7,649.68
28% Domestic Fixed Income	\$28,331.98
9% Core Fixed Income Fund	\$9,052.01
4% High Yield Bond Fund	\$3,699.85
15% Other Domestic Fixed Income	\$15,580.12
1% Cash & Equivalents	\$773.42
100% Total Portfolio Value	\$101,245.86

Your Performance Summary

 Your Total Portfolio Return

	3 Months	Year to Date	1 Year	Since 2001 Inception
Your Total Portfolio Return	11.74%	8.93%	2.50%	-14.11%

April 1, 2003 to June 30, 2003

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Other “419A(f)(6) Plans”

- o This Plan potentially violates at least 2 of the 5 characteristics:
 - Flaw #1 – Allocation of plan assets
 - Flaw #4 – Unreasonably high cost

Credibility

- Counsel for Security Financial has advised that the post 12/31/03 SFL EPIC Plan design is consistent with the §419A(f)(6) Regulations.
- No plan counsel can provide a guarantee that an employer's contribution to this Plan or any other §419A(f)(6) plan is tax deductible.

Credibility

- It is up to the employer to seek its own professional advice regarding its participation in the SFL EPIC Plan and the tax deductibility of its contribution to the Plan.
- Security Financial will make its counsel, David Levin, available (at SFL's expense) at the request of the employer to discuss these issues with the employer's advisor.

419A(f)(6) Terms

Accurate use of 419A(f)(6) terms can go a long way to demonstrate how the SFL EPIC Plan works.



419A(f)(6) Terms

Language used by an ignorant producer: “The employer’s 419 plan needs changing.”

The employer doesn’t have a plan. It joins the Plan.

Language used by a knowledgeable producer: “The employer’s participation options need to be changed”

419A(f)(6) Terms

Language used by an ignorant producer: “The employer’s money/assets/reserve...”

The employer does not have any assets in the Plan, rather the Plan provides benefits to covered employees.

Language used by a knowledgeable producer: “The benefits provided by the Plan to the employer’s employees ...”

419A(f)(6) Terms

Language used by an ignorant producer: “The employer is terminating its plan.”

Again, no employer has a Plan that it can terminate.

Language used by a knowledgeable producer: “The employer is terminating its participation in the Plan.”