VOLUME 26 ■ NUMBER 3 FALL 2001

EAR
ENROLLED ACTUARIES REPORT

Retiring Thoughts

BY JAMES TURPIN

AS MY TERM AS THE ACADEMY'S VICE PRESIDENT for pension issues comes to an end, I look back at the past two years with a strong sense of satisfaction and only a few disappointments. One of the great things about being part of a profession of talented people is that many of these people routinely step forward and volunteer their time and effort to improve the profession. We are also fortunate in having a dedicated staff at the Academy who make being a vice president an easier and enjoyable experience.

I am particularly pleased with the work that went into redesigning the *Enrolled Actuaries Report* and the Academy's website. Often we acknowledge general improvement in the work products or operation of the Academy without specifically recognizing that they are the result of a lot of hard work. Overall, the Academy is a far better operation today than it was when I first joined the board in 1998.

Over the past 15 years, the Academy has evolved into a first-class organization with a strong, well-defined mission that not only advances the actuarial profession but also reaches out to the various publics that we serve. As a result, actuaries are now viewed as professionals who bring certainty in an uncertain world. While we do not have all the answers, we are considered an important resource for balanced, informed, and unbiased analysis on important issues such as Social Security and Medicare.

As I began my term, the profession was embroiled in the

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Inside this issue

The *Enrolled Actuaries Report* is a quarterly publication of the American Academy of Actuaries (www.actuary.org).

Treasury Ponders Disclosure Regulations

OVER THE PAST FEW MONTHS, members of the Academy's Pension Committee have been providing input to Treasury Department officials on the cash-balance-disclosure provisions in President Bush's new tax cut law.

The 2001 Tax Act includes a provision that would expand section 204(h) of the Employee Retirement Income Security Act (ERISA) to require disclosure of plan amendments that significantly reduce future benefit accruals. Specifically, the provision requires employers to provide a written notice to plan participants within a "reasonable time" before any plan amendment that results in a "significant reduction" in the rate of future benefit accruals.

The provision also applies the penalties under existing law to plans that fail to comply with the new disclosure requirements. Under the law, plan sponsors are assessed an excise tax of $100 per day per participant for failure to meet 204(h) notice requirements. Plan amendments that do not meet these requirements can be nullified retroactively.

Under the new legislation, which was signed into law on June 7, the Treasury Department is charged with issuing regulations on the timing and content of such notices. The regulations would define what constitutes a "reasonable time" in which to notify participants, as well as what constitutes a "significant reduction" in future benefit accruals.

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cash balance debacle. In many respects, the issue remains contentious. The other practice areas wondered what pension actuaries were doing to the good name of the profession. After all, we weren't accustomed to being on the 6 o'clock news, and we certainly never anticipated that this kind of bad press would be directed at us. One of my disappointments was the degree to which we were unprepared to respond to criticism from the media, from Congress, and within the profession.

> What a long way we had come, from being vilified in the media over cash balance plans in the spring of 1999 to positive mention in every major news outlet in the fall of 2000.

Fortunately, we have learned from our shortcomings. The profession has demonstrated that actuaries operate within a strong code of professional conduct and are dedicated to a quality work product that is guided by professional standards of practice. Working together, actuarial volunteers, Academy staff, and Ron Gebhardtsbauer, the Academy's senior pension fellow, succeeded in getting the appropriate message out. In the process, we focused an introspective eye on ourselves and emerged stronger from the effort, better prepared to meet such challenges in the future.

Over the past two years, the Pension Practice Council has had hundreds of external contacts. Those contacts reflect the expanding role of the Academy in providing information that shapes public policy. Gebhardtsbauer is a regular participant in congressional hearings on Social Security and pension issues. The council's various committee and task force members have markedly increased their contacts with congressional staff and regulators. We have reached the enviable position of often being sought out for our analysis before legislation or regulations are even drafted.

Despite some glitches in the process, last fall we were able to elevate actuaries to the lofty position of mediating between the Medicare and Social Security reform proposals of the two presidential candidates. The unbiased expertise of actuaries and the Academy was touted in news media all over the country. What a long way we had come, from being vilified in the media over cash balance plans in the spring of 1999 to positive mention in every major news outlet in the fall of 2000.

While there is always room for improvement, I conclude my term knowing that the Academy has performed well in the past two years and will continue to play a vital contributory role in the formation of good public policy.

James Turpin, president and consulting actuary for Turpin & Associates, is the editor of the *EAR*. He completes his term as the Academy's vice president for pension issues in November.

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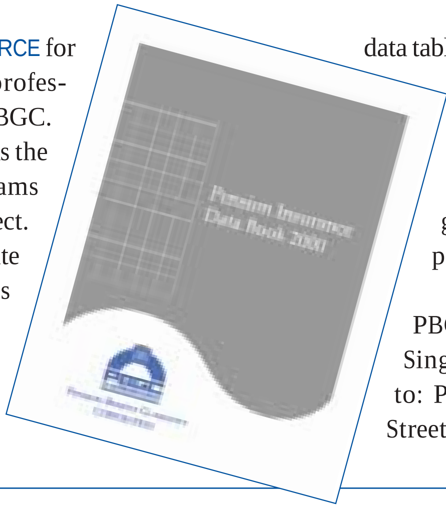
Got a Pension Question? Go to the Source

A COMPREHENSIVE INFORMATION RESOURCE for enrolled actuaries and other pension professionals has just been published by the PBGC.

The Pension Insurance Data Book 2000 tracks the experience of the PBGC's two insurance programs and the defined benefit pension plans they protect. The 2000 edition also features graphs that illustrate current data and trends, both in PBGC operations and in the universe of private pension plans insured by the PBGC.

For both PBGC multiemployer and single-employer insurance programs, the book includes data tables on participants receiving or eligible to receive benefits from the PBGC and the agency's benefit payments, the financial condition of the program, the people and plans protected by the program, and the overall funding level of the pension plans covered by the program.



The data book is available on the PBGC website at **www.pbgc.gov/pubs.htm**. Single copies may be obtained by writing to: PBGC Data Book, Suite 240, 1200 K Street, NW, Washington, DC 20005-4026.

Keeping Qualified

THE REGULATIONS for the Joint Board for the Enrollment of Actuaries require an enrolled actuary to complete 36 hours of continuing professional education (CPE) credit each enrollment cycle to qualify for renewal of enrollment. Core subject matter must make up at least 18 of those hours. For newly enrolled actuaries who were enrolled during the current enrollment cycle, lesser requirements apply.

For the current cycle, which ends March 31, 2002, the period during which CPE hours can be earned runs from Jan. 1, 1999, to Dec. 31, 2001 (all CPE hours must be obtained three months prior to the end of the enrollment cycle).

For three years after the end of the enrollment cycle, enrolled actuaries are required by the regulations to retain the following supporting documentation of their CPE credit:

- Name of the sponsoring organization
- Location of the program
- The program's title and a description of its content
- Dates attended
- The name of the instructor, discussion leader, or speaker
- The certificate of completion and/or a signed statement of the hours of attendance from the sponsor
- The total core and noncore credit hours.

The joint board conducts random audits of claims for CPE credit, including a review of all the documents listed above. Enrolled actuaries are urged to pay close attention to those sections of the regulations that discuss the criteria for courses or programs fulfilling CPE requirements.

The regulations allow a limited number of CPE hours for teaching, publishing articles, and certain other activities. Similar record-keeping requirements apply to these activities as well.

PBGC BULLETIN

At the request of the Pension Benefit Guaranty Corporation, the Academy recently sent the following information in a blast e-mail to members who practice in the pension field.

QUESTION: Certain plans are required to take into account the occurrence of "significant events" in calculating unfunded vested benefits for purposes of the variable-rate premium. Significant event 7 (described in § 4006.4(d)(2)(vii)) is "[a]ny other event or trend that results in a material increase in the value of unfunded vested benefits." Does this include investment losses on a plan's assets if those losses result in a material increase in the value of the plan's unfunded vested benefits?

RESPONSE: A plan need not recognize under significant event 7 investment losses sustained in the ordinary course of business, provided that the plan's assets are invested in accordance with applicable legal requirements.

For more information, contact Jane Pacelli at the PBGC, 202-326-4080, ext. 6775.

Pension Professionalism

Enrolled actuaries often create work products that affect and are of interest to several types of audiences. Seeking some clarity in an area that can be murky, a group of pension actuaries recently sent a letter requesting guidance from the Actuarial Board for Counseling and Discipline (ABCD).

That letter, and the response from the ABCD, are printed below with permission from the signers of the letter, Donald Segal, chairperson of the Academy's Pension Committee; Pension Practice Council members Vince Amoroso and Dennis Polisner; Robert Rietz, president of the Conference of Consulting Actuaries; and David Flagg; and from Robert Sturgis, chairperson of the ABCD.

The topic will also be discussed in a session at the annual meeting of the Conference of Consulting Actuaries (CCA), Oct. 15, in San Antonio, Texas. Panelists in the session "Pension Professionalism—Smile, You're on Candid Camera" will be Amoroso, Flagg, Dan McCarthy, the Academy's president-elect, and Ed Burrows, a member of the Pension Practice Council. For more information, go to the CCA's website, **ccactuaries.com/meetings/am2001/index.html**.

THE LETTER

April 3, 2001
Actuarial Board for Counseling and Discipline
1100 Seventeenth Street NW
Seventh Floor
Washington, DC 20036

Re: Questions to ABCD on Pension Actuarial Professionalism

Gentlemen:

The undersigned respectfully request the assistance of the ABCD in helping shed some light on the practical decisions that pension practitioners must face each day.

The attachment describes five sets of facts. For each, we seek guidance from the ABCD as to whether or not the actuary has (or may have) violated any precepts in the Code of Professional Conduct (as adopted January 1, 2001). The fact sets are hypothetical, and any similarity to actual matters pending before the ABCD or individual practitioners is entirely coincidental.

We intend to seek publication of this letter and any guidance that the ABCD provides to us.

FIRST SCENARIO:
A pension actuary is providing consulting advice to his/her plan sponsor client on plan design matters. The actuary also serves as the enrolled actuary for the client's ERISA defined benefit plan. The plan sponsor wants to change the current plan design to:

- allow employees to earn benefits more evenly throughout their careers, and eliminate the financial "back loading" effect which exists in the current final-pay related plan design;
- reduce the existing plan's heavy inducements for early retirement; and
- make the plan more understandable and a greater asset for recruitment purposes.

The actuary actively assists the client with the plan redesign project, and suggests approaches to achieve the sponsor's goals that the sponsor had not previously thought of, such as a cash balance plan design with a so-called benefit "wear away" feature. All of the approaches suggested by the actuary have been used by the actuary's other clients, and the actuary believes that all of the approaches are fully permissible under current laws. The actuary points out that under each of the design alternatives, expected benefits for individual employees will either increase or decrease (creating so-called "winners and losers"), but that under the cash balance design alternatives, this will be hard for employees to determine on their own.

SECOND SCENARIO:
A plan sponsor has decided to convert his final-pay related pension plan to a cash balance plan. Although the sponsor's expected costs are unchanged, the actuary has advised the client that there will be some losers, and that some of those individuals will experience very large reductions (for example, as large as 50 percent or more) in the value of their expected pensions. The plan sponsor indicates that he will "deal with" any negative fallout from the new design. The plan sponsor asks the actuary to send a series of examples on the actuary's letterhead that illustrate different classes of hypothetical employees who are winners, but specifies that no losers should be included in the examples. The plan sponsor has indicated that he is preparing an internal memo to employees describing the plan design change. The memo will reference the professional assistance provided by the actuary's firm, and the examples will be attached.

ACTUARY'S RESPONSE A
The actuary complies and sends only examples of winners. The actuary caveats the transmittal letter to the plan sponsor and each of the illustrative examples with a statement to the effect that the examples only show winners but that some participants may be losers.

ACTUARY'S RESPONSE B
The actuary provides examples that illustrate both winners and losers. The actuary's transmittal letter to the plan sponsor indicates that all of the examples should be provided to affected employees. None of the examples have caveats on them.

ACTUARY'S RESPONSE C
The actuary provides many examples that illustrate winners and one example that illustrates a loser with a 5 percent reduction in expected benefits. The actuary's transmittal letter to the plan sponsor indicates that all of the examples should be provided to affected employees. None of the examples have caveats on them.

ACTUARY'S RESPONSE D
The actuary complies and sends only examples of winners. The actuary caveats the transmittal letter to the plan sponsor to the effect that the examples are not a "fair" representation since no losers are shown. The examples do not include a caveat.

Thank you in advance for your participation.

Sincerely,

Vince Amoroso, David Flagg, Dennis Polisner, Robert Rietz, Donald Segal

THE RESPONSE

David M. Flagg, FSA, MAAA, FCA, EA
Watson Wyatt Worldwide
461 Fifth Avenue
New York, NY 10017

Dear Mr. Flagg:

Your letter of April 3, 2001 is a request for guidance on certain matters related, principally, to cash balance plans. It involves the conversion of traditional defined benefit plans to a cash balance format. It includes questions related to transition provisions and participant disclosure. We are mindful of this background:

- "Wear-away" features of the type you describe have been challenged in currently pending litigation as violations of the anti-backloading rules of ERISA and the Internal Revenue Code. We understand the Internal Revenue Service has filed a brief supporting this challenge.

letter continues, next page ►

- These same “wear-away” features are considered by some to be in violation of ADEA, to the extent they may reflect discriminatory intent or to the extent they may cause disparate impact detrimental to older workers.
- ERISA directs that a plan actuary be engaged “on behalf of all plan participants.” Some observers feel this means the plan actuary has an obligation to plan participants that precludes assisting in the design of transition provisions that may be considered unfair to some participants. We are mindful that many observers believe this ERISA provision applies only to the oversight of plan funding. Likewise, many observers feel the plan actuary can advise the employer respecting so-called “settlor” functions without entering into a conflict of interest. Nevertheless, we are also mindful that there is not unanimity of opinion on these matters.
- The Internal Revenue Service is currently unwilling to issue favorable determination letters respecting cash balance conversions.
- Events of the last several months related to cash balance conversions have had a significantly adverse impact on the reputation of the pension actuarial community.
- The 2001 Tax Act calls for new disclosure rules applicable to cash balance conversions and conversions of similar significance.
- Any comprehensive guidance we offer in response to your letter is in danger, if published, of being quoted out of context.

In view of this background, we offer these observations regarding the two hypothetical scenarios you presented:

1. In providing assistance relative to implementation of transition provisions, the plan actuary’s position is much stronger if the plan actuary finds such provisions fair and reasonable. Fairness and reasonableness are not precise, objective terms. The actuary should be encouraged to exercise personal judgment regarding their existence, recognizing nevertheless that at least some of the adversely affected participants will *not* find the changes fair or reasonable.
2. In the first scenario recited in your letter, you state that it would be hard for employees to determine, on their own, the impact of the change. We see a very narrow line between leaving employees with this difficulty and misleading employees. It would be unacceptable to cross over this line. See Precept 8 of the Code of Professional Conduct (effective January 1, 2001) calling for “reasonable steps to ensure that services are not used to mislead other parties.”
3. In the second scenario, the actuary has been asked to provide a misleading set of illustrations on the actuary’s letterhead. Any such request must be viewed with great concern. The actuary would appear to be under an important and special obligation to ensure that the final result is not misleading. This obligation could involve taking steps (that ordinarily might be considered unnecessary) to ensure that participants actually receive non-misleading communication. In responses A and B, it is not clear that the actuary has satisfied that special obligation.
4. In the second scenario, responses C and D appear to violate Precept 8 of the Code of Professional Conduct. We believe there is a clear risk that these responses may mislead other interested parties—namely, plan participants.

We have addressed these comments to the hypothetical cases you recite. We are always prepared to comment more definitively on specific actual cases, provided the actuary involved furnishes adequate information on facts and circumstances.

Sincerely yours,

Robert W. Sturgis
Chairperson, Actuarial Board for Counseling and Discipline

Interest Rates Defined

THE PENSION PRACTICE COUNCIL's recent public statement about sagging 30-year Treasury bond interest rates and their effect on defined benefit pension plans sparked considerable media interest. It also triggered a qualifying letter to James Turpin, the Academy's vice president for pensions, from actuaries at the PBGC.

While finding the statement interesting, C. David Gustafson, chief policy actuary, Jane Pacelli, chief research actuary, and Joan Weiss, chief valuation actuary, expressed concern that it lent support to a misconception about PBGC's interest rates.

"The PBGC's 'interest rates' are not market interest rates—they are just interest 'factors.' The factors are derived so that, along with a given mortality table (currently 83 GAM), they will reproduce average group annuity prices," the letter states. "The group annuity prices are reported to us in quarterly surveys from insurance companies issuing group annuities and are net of administrative expenses. PBGC's interest factors stand in for all the many components used in annuity pricing that are not reflected in the given mortality table (e.g., assumed yield on investments, margins for profit and contingencies, premium and income taxes, marketing and sales expense)."

"If the PBGC's mortality table is varied, a different interest factor will result," the letter continues. "For example, assume the average quarterly survey price of a monthly life annuity for a 65-year-old male is $120 per dollar of monthly annuity. Using 83 GAM mortality would result in an interest factor of 5.88 percent. Using 94 GAM mortality would result in an interest factor of 6.41 percent. Yet both combinations (83 GAM with 5.88 percent or 94 GAM with 6.41 percent) produce the same price."

> Because of the relationship among annuity prices, a mortality table, and the derived interest factors, it is *never meaningful* to compare PBGC's interest factors to market interest rates.

The letter concludes: "Because of this relationship among annuity prices, a mortality table, and the derived interest factors, it is *never meaningful* to compare PBGC's interest factors to market interest rates."

The council is currently in the process of formulating a suggested alternative replacement interest rate for use in pension calculations. To read the council's statement, go to **www.actuary.org/pdf/pension/treasurybonds_071101.pdf**.

Preparing for Retirement

RON GEBHARDTSBAUER, the Academy's senior pension fellow, recently testified before the ERISA Advisory Council on increasing pension coverage and benefits and preparing for retirement.

Preparing for retirement is much different and more difficult than it was 25 years ago, Gebhardtsbauer told the group. This is because more employees:

- Have worked for more employers (so their retirement money is in many different places).
- Are more likely to have DC-type money or IRA rollovers from prior plans.
- Have saved less.
- Want to retire before the age of 62.
- Will live, on average, two years longer than previous generations.

Additionally, if employees have DB benefits, it is not clear, even if they are combined with Social Security, that they will cover basic expenses for a long retirement.

In this climate, investment education is key, Gebhardtsbauer said. Employees need to learn how to realistically measure the adequacy of their lifetime income against their future income needs, he said.

Slides from his presentation are available online at **www.actuary.org/pdf/pension/ERISA_071701.pdf**.

Regulations, *continued from Page 1*

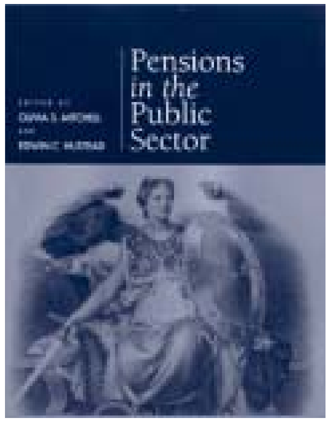
Representatives of the Pension Committee met with Bill Sweetnam, benefits tax counsel in the Treasury Department, and Harlan Weller, actuary for the Treasury Department, in June. Attending the meeting were Ethan Kra, vice chair of the Pension Practice Council; Donald Segal, chair of the Pension Committee; Carolyn Zimmerman, Pension Committee vice chair; Pension Committee member Adrien La Bombarde; Pension Council member Ken Steiner; Senior Pension Fellow Ron Gebhardtsbauer; and me.

The Treasury Department is expected to issue guidance on this provision before the end of the year.

—Bridget Flynn, pension policy analyst

New Book on Public Sector Pensions

THE PENSION RESEARCH COUNCIL of the Wharton School of the University of Pennsylvania has published a book detailing findings from its 1999 seminar on public pension plans.



Pensions in the Public Sector is edited by Olivia S. Mitchell, the council's executive director, and Edwin C. Hustead, senior vice president of the Hay Group, former chief actuary for the Federal Office of Personnel Management, and a member of the Academy's Communications Review Committee.

The book discusses many different aspects of public-sector plans, including state employee pension plans and federal, civilian, and military retirement systems. There are also chapters on determining the cost of public pension plans, including how actuarial assumptions and funding goals are set in the public sector and how these differ from private-sector practice.

Current issues for public plans are dealt with in chapters on investment practice, regulation, and the transition from defined benefit to defined contribution plans. The book concludes with a look at the future and how public pension design can respond to a changing workforce.

Six of the book's chapters are on the syllabus for the Society of Actuaries' course 8 on retirement benefits being offered this fall. For more information about the book, go to **www.upenn.edu/pennpress/book/13403.html**.

Cash Balance Practice Note in the Works

THE PENSION PRACTICE COUNCIL is currently drafting a practice note on accounting for cash balance plans under Statement of Financial Accounting Standard (SFAS) 87.

Adopted by the Financial Accounting Standards Board, SFAS 87 governs the method in which pension plan assets are reported in corporate financial statements. Although it does not specifically require that those who are preparing financial statements seek assistance from the actuarial profession when determining cost, it does require actuarial computations.

The council's practice note would assist actuaries in applying Actuarial Compliance Guideline 1, *An Actuary's Guide to Compliance with Statement of Financial Accounting Standards No. 87*, to cash balance plans. The practice note will focus on the most common methods of attribution of benefit accruals for cash balance plans under FAS 87. The practice note would not be a standard of practice and will not recommend one practice over another.

The practice note is being developed by the Pension Accounting Cash Balance Task Force under the direction of Stephen Alpert. The practice note is scheduled to be completed by late fall and distributed with the Winter *EAR*.

RETIREMENT SYMPOSIUM SET

Changes in work and family patterns, greater longevity in retirement, and other factors are creating new strains on public and private retirement systems and the workforce.

"Retirement Implications of Demographic and Family Change," a symposium on retirement and demographic change, will look at these and related issues Nov. 29-30 at Walt Disney World Swan Resort in Lake Buena Vista, Fla.

The symposium is a joint effort of the Society of Actuaries, the Academy, and other actuarial, employee benefits, government, and research organizations.

To save $50 on the registration fee, sign up before Nov. 5. For more information, go to www.soa.org/conted/bro150.html.