

AN INTERVIEW WITH
PATRICK McDONOUGH AND MARTIN PIPPINS

Tweaking the Joint Board

A LOT HAS CHANGED IN THE PENSION WORLD since the passage of ERISA in 1974. Has the Joint Board for the Enrollment of Actuaries, formed 28 years ago when ERISA was implemented, kept up?

It was a question that the IRS put to Patrick McDonough, executive director of the joint board, and that McDonough passed along to the rank and file at last year's Enrolled Actuaries Meeting.

Nine months later, the answers are in: Yes — and no.

In an interview with the *EAR*, McDonough, who is an attorney, and Martin Pippins, an IRS actuary who is current chairman of the joint board, discussed the results of McDonough's recently completed design study on improving the functioning of the joint board. Key respondents to the study included an ad hoc group put together by the Academy with representation from other actuarial groups.

The study addressed a variety of considerations, including whether the joint board's current makeup adequately represents all interested parties. Currently, there are five voting members on the joint board, three representing the Department of Treas-



Martin Pippins



Patrick McDonough

ury and two from the Department of Labor. One nonvoting member represents the PBGC.

One result of the study is an IRS decision to retain jurisdiction over the employees who provide administrative and legal services to support the joint board. This extends the IRS' action

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

Retirement Revolution

BY KEN KENT

AS THE ACADEMY'S NEW vice president for pension issues, I will have the opportunity to regularly communicate with other pension actuaries on relevant issues. I wish I had the skill of my predecessor John Parks, who enlivened his articles with references to an old favorite song or a walk in the park. I hope I can encourage him to continue to write for the *EAR* in his familiar and calming voice. With all that is going on in our practice, I think many of us ap-

preciate the tone of his writing style.

A warning: those who know me will suspect that I'm more likely to throw a number of ideas out on the table all at once and see which ones stick. My style may be different, but I hope I can engage you either to react (preferably in a nonviolent manner) or to provide some ideas to help all of us work through these challenging times in our profession. Another warning: as vice presi-



RETIREMENT continues on Page 6 ►

The Future of Human Longevity: How Important Are Markets and Innovation?

Social Security's chief actuary, Stephen Goss, testified on the future of human longevity at a June 3 hearing of the Senate Special Committee on Aging. His testimony and accompanying charts are reproduced here with his permission. Goss is a member of the Academy's Committee on Social Insurance.

PAST AND FUTURE IMPROVEMENT IN MORTALITY

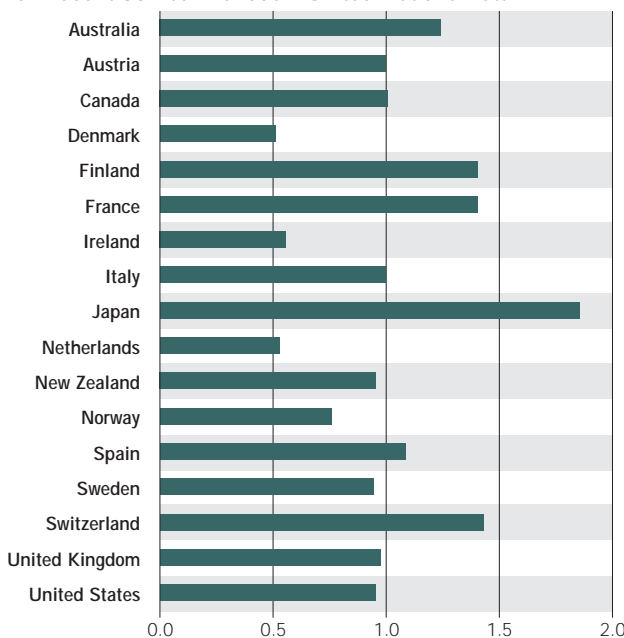
During the last century human longevity exploded as much of the world became industrialized. Productivity and income rose to unprecedented levels, permitting vast improvements in the standard of living. Innovation in agriculture permitted adequate nutrition for whole populations. Innovation in engineering resulted in sanitary and safe living and working conditions. And affluence and innovations in medicine resulted in immunizations and antibiotics that could be provided through primary medical care for all.

In recent decades, Europe, North America, and Japan have experienced great increases in life expectancy at age 65, averaging nearly a one-year increase per decade. Some have risen faster, most notably Japan, and some slower. The United States has been about average for this group, as seen in the first chart.

THE SOCIAL SECURITY TRUSTEES REPORT TO THE CONGRESS ON THE ACTUARIAL STATUS OF THE TRUST FUNDS

The long-range projections needed for this assessment depend

CHART 1. Change in Life Expectancy at 65 per Decade—for Recent 30-Year Periods—United Nations Data



VOLUME 28 ■ NUMBER 4 ■ WINTER 2003 ■ PUBLISHED BY THE AMERICAN ACADEMY OF ACTUARIES

Enrolled Actuaries Report

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critically on assumptions for the future course of longevity. How good have those projections been? The second chart shows that the period life expectancies projected in the 1983 and 1992 Annual Trustees Reports for the year 2000 were pretty accurate. If anything, the projections in 1983 were a little optimistic, slightly overestimating life expectancy for 2000, particularly for women.

For the future, mortality at higher ages, at age 65 and above, is what we pay most attention to. Mortality at younger ages has declined so much that now three-fourths of all deaths occur at ages 65 and above. Chart 3 shows that in 1900 less than one-fifth of all deaths were at 65 and older. Infant mortality and death at ages under 65 declined dramatically over the last century.

The average annual rate of decline in mortality for men at 65 and older was fairly consistent over the last century. Chart 4 shows an average annual decline of almost 0.6 percent for the last 100 years, and about 0.7 percent over both the last 50-year and 18-year periods. For the future, we project continued declines in male aged death rates at over 0.7 percent per year. This is no small assumption. Matching the accomplishments of the last century, with the pure positive effects of improved sanitation, nutrition, and medical accessibility for all, will not be easy. AIDS, SARS, and antibiotic-resistant microbes, along with increasing obesity and declining levels of exercise, remind us that mortality improvement will not be automatic. Gains from replacement organs and genetic engineering will be expensive and may be difficult to provide for the population as a whole.

For women, the last 18 years have been challenging, with no improvement in mortality for the age group 65 and older, as seen in Chart 5. The trend toward an ever widening gap in life expectancy between men and women ended in 1982. Going forward, we now feel even more confident than in the past in projecting mortality improvement at about the same pace for men and women.

Mortality for the total population, men and women combined, is shown in Chart 6. The average annual decline between 1900 and 2000 for the age group 65 and over, of a little over 0.7 percent, is about twice as large as experienced during the most recent 18 years of this period. Going forward, we believe that achieving mortality improvement for the aged at nearly the same rate as for the last century is a reasonable assumption, with a roughly equal likelihood of doing better or worse.

For ages under 65, there is some agreement that mortality declines will diminish from the level of the last century. The 1999 technical panel appointed by the Social Security Advisory Board endorsed the trustees' pattern of improvement by age group. Moreover, the rate of improvement diminished through the last century, with slower average rates for the last 50-year and 18-year periods.

CHART 2. Projected Period Life Expectancies for 2000 Trustees Report

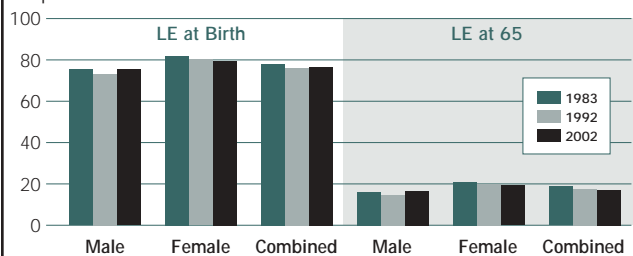


CHART 3. Deaths in the United States by Age

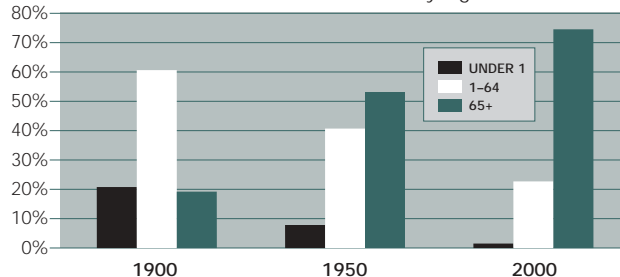


CHART 4. Male Average Annual Decline in Death Rates Historical and 2003 Trustees Intermediate Projections

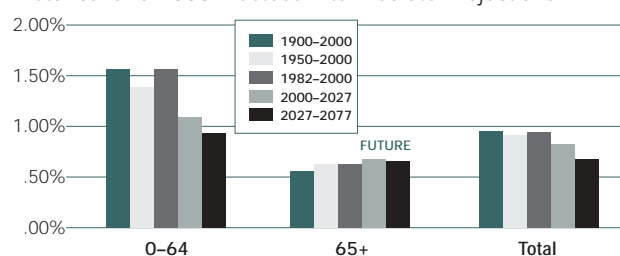


CHART 5. Female Average Annual Decline in Death Rates Historical and 2003 Trustees Intermediate Projections

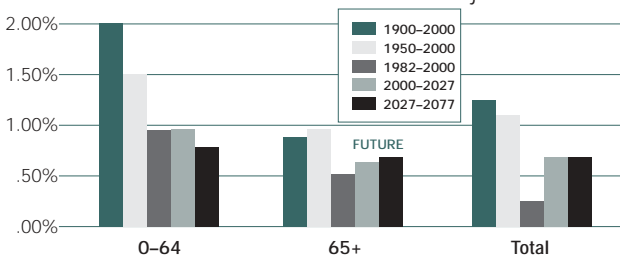
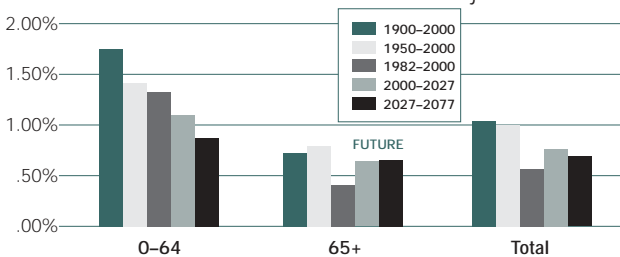


CHART 6. Total Average Annual Decline in Death Rates Historical and 2003 Trustees Intermediate Projections



LONGEVITY continues on Page 8 ►

Updated Social Security and IRS Amounts for 2004

These three tables list updated figures for IRS pension limits, Social Security amounts, and covered compensation for 2004.

The tables were compiled by Andrew Eisner of Mellon's Human Resources & Investor Solutions.

Covered Compensation, 2004

2004 Wage Base \$87,900

YEAR OF BIRTH	AGE IN 2004	SSRA	YEAR OF SSRA	COVERED COMPENSATION ROUNDED TO:			
				\$1*	\$12	\$600**	\$3,000
1937	67	65	2002	39,451	39,444	39,600	39,000
1938	66	66	2004	44,003	43,992	43,800	45,000
1939	65	66	2005	46,291	46,284	46,200	45,000
1940	64	66	2006	48,580	48,576	48,600	48,000
1941	63	66	2007	50,834	50,832	51,000	51,000
1942	62	66	2008	53,037	53,028	52,800	54,000
1943	61	66	2009	55,171	55,164	55,200	54,000
1944	60	66	2010	57,280	57,276	57,000	57,000
1945	59	66	2011	59,354	59,352	59,400	60,000
1946	58	66	2012	61,394	61,392	61,200	60,000
1947	57	66	2013	63,400	63,396	63,600	63,000
1948	56	66	2014	65,257	65,256	65,400	66,000
1949	55	66	2015	67,029	67,020	67,200	66,000
1950	54	66	2016	68,691	68,688	68,400	69,000
1951	53	66	2017	70,277	70,272	70,200	69,000
1952	52	66	2018	71,769	71,760	72,000	72,000
1953	51	66	2019	73,200	73,200	73,200	72,000
1954	50	66	2020	74,580	74,580	74,400	75,000
1955	49	67	2022	77,151	77,148	77,400	78,000
1956	48	67	2023	78,377	78,372	78,600	78,000
1957	47	67	2024	79,517	79,512	79,800	81,000
1958	46	67	2025	80,563	80,556	80,400	81,000
1959	45	67	2026	81,549	81,540	81,600	81,000
1960	44	67	2027	82,474	82,464	82,200	81,000
1961	43	67	2028	83,340	83,340	83,400	84,000
1962	42	67	2029	84,120	84,120	84,000	84,000
1963	41	67	2030	84,883	84,876	84,600	84,000
1964	40	67	2031	85,603	85,596	85,800	87,000
1965	39	67	2032	86,246	86,244	86,400	87,000
1966	38	67	2033	86,803	86,796	87,000	87,000
1967	37	67	2034	87,240	87,240	87,000	87,000
1968	36	67	2035	87,574	87,564	87,600	87,900
1969	35	67	2036	87,789	87,780	87,900	87,900
1970	34	67	2037	87,874	87,864	87,900	87,900
1971	33	67	2038	87,900	87,900	87,900	87,900

*Represents exact average of wage bases, as permitted by law and regulations.

** After 1993, IRS does not authorize the use of covered compensation tables rounded to \$600 multiples under 401(l). Thus, integrated plans using this table are not safe-harbor plans.

Social Security—2004 Factors

On Oct. 16, the Social Security Administration announced updated factors for 2004.

Wage Base	The maximum amount of earnings taxable in 2004 is \$87,900 for Social Security purposes.
COLA	The cost-of-living increase in benefits is 2.1% applicable to December 2003 benefits, payable in January 2004.
Wage Index	The average annual wage figure of \$33,252.09 will be used in computing benefits for workers who become eligible in 2004. This figure is based on data for the last complete year (2002) and was used to determine other wage-indexed numbers given in the table below.

FACTOR	2003	2004
Wage base:		
for Social Security	\$87,000	\$87,900
for Medicare	No Limit	No Limit
old-law wage base, for indexing PBGC maximum, etc.	\$64,500	\$65,100
Cost-of-living increase (applies to December benefits, payable in January)	1.4%	2.1%
Average annual wage (based on data 2 years earlier)	\$32,921.92	\$33,252.09
PIA formula, 1st bend point	\$606	\$612
PIA formula, 2nd bend point	\$3,653	\$3,689
Maximum family benefit, 1st bend point	\$774	\$782
Maximum family benefit, 2nd bend point	\$1,118	\$1,129
Maximum family benefit, 3rd bend point	\$1,458	\$1,472
Retirement test exempt amount (annual):		
below SSNRA	\$11,520	\$11,640
year of SSNRA	\$30,720	\$31,080
Wages needed for one quarter of coverage	\$890	\$900
FICA (employee) tax rate:		
Social Security (OASDI)	6.20%	6.20%
Medicare (HI)	1.45%	1.45%
Total	7.65%	7.65%
SECA (self-employed) tax rate, total	15.30%	15.30%

IRS Pension Limits for 2004

Here are the official 2004 pension limits.

PRINCIPAL LIMITS

IRC §	LIMIT	LIMITS		TO PROJECT FUTURE VALUES		
		2003 ROUNDED	2004 ROUNDED	2004 UNROUNDED	NEXT INCREMENT	INCREASE NEEDED
415(b)(1)	Defined benefit plan limit	\$160,000	\$165,000	\$166,128	\$170,000	2.3%
415(c)(1)	Defined contribution plan limit	40,000	41,000	41,532	42,000	1.1%
401(a)(17)	Limit on includable compensation*	200,000	205,000	207,660	210,000	1.1%
402(g)(1)	Limit on 401(k)/403(b) elective deferrals**	12,000	13,000	13,000	14,000	N/A
414(q)	HCE definition	90,000	90,000	93,824	95,000	1.3%
414(v)(2)	401(k)/403(b)/457(b) catch-up deferral limit**	2,000	3,000	3,000	4,000	N/A

OTHER LIMITS

IRC §	LIMIT	LIMITS		TO PROJECT FUTURE VALUES		
		2003 ROUNDED	2004 ROUNDED	2004 UNROUNDED	NEXT INCREMENT	INCREASE NEEDED
457(b)	Limit on nonqualified deferrals**	\$ 12,000	\$ 13,000	\$ 13,000	\$ 14,000	N/A
409(o)(1)(C)	ESOP payouts, 5-year limit	810,000	830,000	830,640	835,000	0.5%
409(o)(1)(C)	ESOP payouts, additional 1-year limit	160,000	165,000	166,128	170,000	2.3%
408(k)(2)(C)	SEP pay threshold	450	450	467	500	7.1%

*Governmental plans have special rules for eligible participants as defined in OBRA '93.

** The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) prescribed \$1,000 annual increases in the 401(k), 403(b), and 457(b) limits and the 414(v) catch-up deferral limit through 2006. Thereafter, these limits will be adjusted for inflation.

dent, I listen to a diverse chorus of viewpoints (sometimes these discussions sound more like the seven-scale tonal discord of Oriental music). You will have to work with me on my tendency to love the one I'm with — meaning that the last argument often seems the most compelling one (this may simply be a function of my long-term memory loss and the fact that the last argument is the only one I remember).

So with this brief description and warning of what you might expect, let me touch on a couple of topics and conclude with a thought for your consideration.

THE VANCOUVER EPIPHANY

This spring the Academy and the SOA jointly sponsored a symposium on financial economics, "The Great Controversy: In Light of Financial Economics." I found the title a little misleading, since from my experience attending many of the sessions, I think most attendees found the concept of financial economics appropriate to the way we view what we do. I thought the symposium was a great success, due largely to the presentation of thought-provoking papers and to the resulting discussions — unencumbered by the constraints of funding rules, investment policy, and clients' objectives and issues — on the practice of actuarial science and financial markets.

The symposium included sessions on topics such as pension funding without liabilities, how to look differently at the relationship of liability measurements for different end users, exploring conversion from defined benefit (DB) plans to equivalent defined contribution (DC) arrangements based on risk-adjusted equivalent contribution amounts, and how to hedge funded ratios.

For the first time in a long time, pension actuaries got together and discussed the practical application of financial theories in actuarial science and consulting practice. It reminded me of college days when we were free to explore ideas without the constraint of actually applying them in the real world. I think we called this idealism, and there is no question that our world today reflects many of those ideas that eventually became real. Ultimately, that is my hope for financial economics — not as an overhaul of our entire system of practice (present regulatory and accounting restraints may make that impractical) but as an influential force in how we address retirement security and relative risk going forward.

This meeting was a great opportunity for actuaries to benchmark practice with financial realities and discuss the risk-related implications of retirement programs and the matching of liabilities and assets for various stakeholders. It added a significant component to the discussions we are all engaged in over the future of DB plans and overall retirement security in our country. The next step is to educate our clients about the risk relationship and their choices when making investment deci-

sions relative to the ongoing obligations of existing plans and future plan design.

All symposium papers are posted at www.soa.org/sections/pension-financial-econ.html.

EMPLOYEE RETIREMENT SYSTEM

I would like to change the subject and focus on another paradigm shift that may play a part in the changing direction of DB plans. Here, I'll be as brief as possible and invite your comments.

Historically, our pension programs have been called employer retirement systems because employers are the sponsors. But the system has evolved from one in which paternalistic employers sponsor DB plans to provide retirement security (and allow turnover of older workers under a tax-favored program) to one in which employers sponsor programs that are perceived as providing more return on investments, particularly 401(k) plans where employees can watch the day-to-day value of their benefit grow as markets boom. And the system is continuing to evolve as more employees realize that lump sums are not secure, that regular income in retirement is both more secure and less expensive when their employer provides it, and that they may actually reach retirement age with their current employer.

Whether this leads to another form of employee consumerism is a good question. Is future demand for DB plans going to come from the employees' side? Several recent court cases provide evidence that employees are more focused on the value of their DB plans. But the type of plan employees will want may need to include features that better meet their needs, including:

- Portability
- Reasonable value accrual throughout a career
- Phased retirement opportunity
- Measurable security level.

A critical element in employee demand will be educating the public about the value of pooling mortality risk, aggregating investments for lower risk, and accumulating wealth in a tax-advantaged program. The Academy is exploring this idea in cooperation with the other actuarial organizations. I invite your thoughts. Drop me an e-mail at editor@actuary.org. ▲

KEN KENT, a principal with Mercer Human Resource Consulting in Washington, is the new editor of the *EAR* and the Academy's vice president for pension issues.

CORRECTION: Explanatory text in the first "Lump-Sum Phase-Ins" chart, which ran on the top of Page 3 in the Fall 2003 *EAR*, contained a typo. It should have read: Age = 35 and Service = 20 years.

PBGC Sets 2004 Maximum Guarantee

In a November announcement, the Pension Benefit Guaranty Corp. set the maximum benefit for retirees in underfunded single-employer defined benefit plans terminating in 2004 at \$3,698.86 per month, or \$44,386.32 per year.

Under ERISA, the maximum guaranteed amount must be adjusted annually based on changes in the Social Security contribution and benefit base. The maximum guarantee applies to workers who retire at age 65. Maximum guarantees are reduced for those who retire at younger ages or who elect survivor ben-

efits. In some instances, where a pension plan has adequate resources or PBGC recovers sufficient amounts, a participant may receive benefits in excess of the maximum guarantee. A participant's benefit may also be reduced, even though it doesn't exceed the maximum guarantee. For example, limits on PBGC coverage of early retirement supplements and recent benefit improvements could cause a reduction.

The reduction by law of PBGC's maximum guarantee for retirees under age 65 (down to age 55) is as follows:

AGE	PERCENT	PAID GUARANTEE
65	100	\$3,698.86
64	93	3,439.94
63	86	3,181.02
62	79	2,922.10
61	72	2,663.18
60	65	2,404.26
59	61	2,256.30
58	57	2,108.35
57	53	1,960.40
56	49	1,812.44
55	45	1,664.49

JOINT BOARD *continued from Page 1*

last December to take the position of executive director, which had been one of several hats that McDonough wore, and make it a full-time position.

The next step, McDonough said, will be to beef up support staff within the department. McDonough is currently interviewing for another full-time assistant, giving the board two attorneys and two support staff assigned to work solely with the joint board. "The joint board will be their job one," McDonough said.

For the working enrolled actuary, this should mean a smoother re-enrollment process. "We've had problems in the past with renewal because 4,000 actuaries would come in with their renewal applications and all their continuing education information, and it was just very difficult for us to process them on time," McDonough said.

Greater responsiveness, said Pippins, will also be evident in the board's ability to handle questions on technical and ethical matters. "There is a high volume of questions, e-mails, letters coming in on a variety of matters — how to get enrolled, how to stay enrolled, whether certain conduct or standards are appropriate — and I think they will be better able to respond quickly," Pippins said.

McDonough is particularly interested in improving the response on referrals of

potential actuarial misconduct. "In the past, when these referrals would come in, they would have to compete for the attention of the legal staff with misconduct referrals on attorneys, CPAs, and enrolled agents. And we never had enough attorneys to work all the cases, so you just had to triage and pick the most egregious cases," McDonough explained.

The joint board is forbidden from referring disciplinary cases to the Actuarial Board for Counseling and Discipline. "First of all, the ABCD rules differ from our regulations. But the big problem is that the vast majority of these referrals include tax return information that is proprietary," McDonough said.

As part of the effort to revitalize the referral program, McDonough said, he will meet with the managers of the IRS examiners who look at form 5500. His purpose will be to explain the joint board's regulations so that if the managers see evidence of noncompliance with the rules — or any ethical missteps — they will know to send a referral to his office.

At the same time, Pippins said, the joint board is launching a review of its regulations, some of which are several decades old. "They may need updating for new technologies, new developments in actuarial practice, and deregulation," Pippins said.

Nearly all who responded to the joint board study agreed that the PBGC should gain voting representation. But such a change will require an amendment of the bylaws and may take time, McDonough said.

Similarly, no action has been taken on suggestions that the board needs to include a practicing private sector actuary among its members. "There was a lot of strong feeling but on both sides," McDonough said. "For some, it's a great idea and long overdue. Others say no, that's a terrible idea." Either way, McDonough said, it's a decision that will be made higher up because it requires Treasury, Labor, and the PBGC to agree on the change.

Both McDonough and Pippins had nothing but praise for the work of the actuaries who serve on the joint board's Advisory Committee on Actuarial Examinations, currently chaired by Carl Shalit, and the subcommittees responsible for creating the exams and pretesting them. "It's a big network," Pippins said. "It's extremely functional, efficient, professional, and great to work with. And they are all volunteers."

In addition to the pleasure of the company and the satisfaction of serving the profession, advisory committee and examination subcommittee members — who are all enrolled actuaries — receive continuing education credit for their work. ▲

IMPLICATIONS FOR THE COST OF SOCIAL INSURANCE

The benefit structure of Social Security is indexed to reflect average wage growth and price inflation, and is thus relatively insensitive to variation in these parameters. However, the program and its financing are not automatically adjusted to offset the effects of changes in demographic parameters like birth rates and mortality.

The apparently permanent drop in the total fertility rate for the United States that started in the 1960s is slowing the growth in the population. More important, it is changing the age structure of the population, increasing the aged-dependency ratio, i.e., the ratio of population age 65 and over to that at ages 20 to 64. The rise in Chart 7 between 2010 and 2030 shows this effect. Continued increases in the ratio after 2030 reflect the more subtle and increasing effects of increasing longevity.

Social Security is financed on a primarily pay-as-you-go basis, largely from payroll taxes. Thus, the ratio of beneficiaries to current workers is a critical determinant of the cost of the program, per worker. Chart 8 shows a pattern almost identical to the aged-dependency ratio.

Because Social Security average benefit levels essentially track the average earnings levels of workers who pay the payroll-tax contributions, the pattern of cost rates (as a percentage of taxable payroll) is the same as the aged-dependency and worker-to-beneficiary ratios. Chart 9 displays this pattern.

Continued increases in human longevity will require change for the Social Security program. We have known that truth for decades, and it was even evident in the projections presented in the 1983 Trustees Report produced right after enactment of the last major Social Security reform legislation. How quickly longevity will increase is a subject we will continue to debate. The trustees' track record of the last 20 years has been good. If the further improvements now projected are realized or exceeded, we will need to choose as a nation from a range of options for putting Social Security back on firm financial footing ▲

CHART 7. Aged-Dependency Ratio—Actual and Projected by Alternative

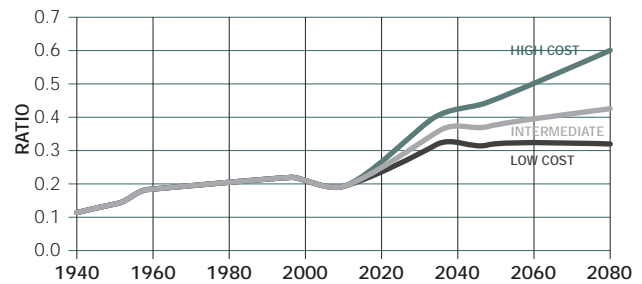


CHART 8. Number of OASDI Beneficiaries per 100 Covered Workers

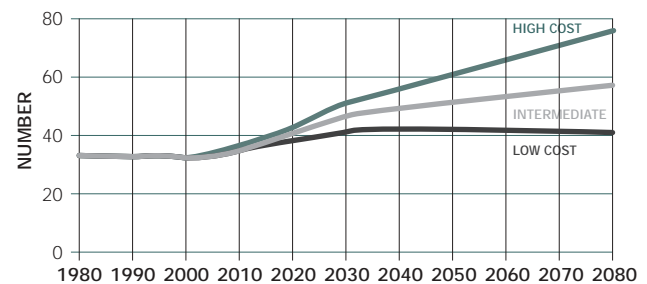
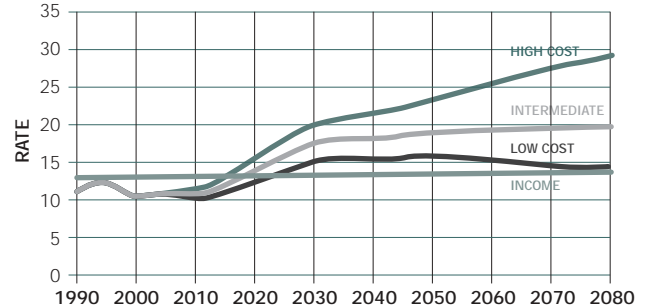


CHART 9. Long-Range OASDI Income and Cost Rates



A Word from the EA Meeting Committee

IT'S HARD TO BELIEVE WE ARE 29!

The 29th annual Enrolled Actuaries Meeting at the Marriott Wardman Park Hotel in Washington is coming up March 21-24.

As always, the meeting's general sessions this year will explore timely topics that are relevant to all enrolled actuaries, such as discussions of recent court decisions, Precept 8 of the Code of Professional Conduct, and the future of defined benefit plans. Our concurrent sessions have something for everyone,

from discussions of restricted lump sums to a panel on cash balance plans. You will have several opportunities to interact with personnel from the IRS and the Pension Benefit Guaranty Corp. — one of the traditional attractions of the EA Meeting. The meeting committee is also keeping up with proposed legislation that affects funding requirements, and the committee will offer relevant sessions in those areas as they develop.

For the Monday luncheon speakers, we

are pleased to have Tucker Carlson and James Carville. Both are co-hosts of CNN's "Crossfire," and they should provide lively political commentary for this election year.

The EA Meeting is a great place to keep up with our ever changing profession and a wonderful opportunity to network. Since this is the last year of the cycle, keep in mind that you can satisfy half of your EA continuing education requirements when you attend. Register today at www.ccactuaries.org! ▲