



AMERICAN ACADEMY *of* ACTUARIES

June 22, 1998

The Honorable Bob Graham
United States Senate
Washington, DC 20510

Re: Modification of Timing of Plan Valuations

Dear Senator Graham:

The American Academy of Actuaries Pension Committee has the following comments regarding your proposal (Section 506, Retirement Security for the 21st Century Act) to amend the Internal Revenue Code and allow plan sponsors to utilize prior year data in determining current year pension contribution requirements. The Academy, which does not support or oppose specific legislation, believes your proposal would have the effect of significantly simplifying the administration of some pension plans. We offer supplemental suggestions below, designed to extend simplification of pension plan valuations more broadly, consistent with the policy objectives of your proposal.

Your proposal's modification of pension funding rules would provide pension plan sponsors with much of the flexibility currently afforded by the Financial Accounting Standards Board and the Securities and Exchange Commission in determining pension expense for purposes of Statement of Financial Accounting Standards No. 87 ("SFAS 87"). The carefully controlled use of prior year participant ("census") and financial data enables a plan sponsor to determine its pension expense (or contribution) prior to, or early in the year, thereby providing employers additional lead time for financial planning, and reducing compliance costs.

Your proposal would be available to any plan with assets equal to at least 125 percent of its current liability. As you have noted, the intent of the proposal is to simplify plan funding rules and not allow employers who maintain underfunded plans to delay the proper funding of their plans. As currently drafted, your proposal will most likely have the intended effect¹, but would apply to a limited range of plans (e.g., those funded at, or above, 125 percent of current liability).

¹We note that the proposal would permit a plan sponsor to ignore plan amendments adopted in the previous year. This would be a significant simplification, but in unusual cases (e.g., large benefit improvements) might result in underfunding. A possible solution would be to base the 125% test on a projection from the prior year, taking into account plan amendments adopted during that year. This change would address possible underfunding concerns, at the cost of a slight increase in complexity.

The Academy believes that your proposal could be extended to a wider range of defined benefit plans (subject to the criteria set forth below) and still fully support your policy objectives.

Thus, in addition to plans with assets at least equal to 125 percent of current liability, we believe that the “prior year valuation data” option could be extended to any defined benefit plan², so long as:

- **The demographic data used is as of a date no more than one year prior to the first day of the current plan year.**³ Pension valuations are based on an assessment of a plan’s assets and liabilities. The valuation of liabilities requires collection of extensive demographic data, very often from multiple payroll sites and subsidiary locations. For the many plans that base a participant’s pension benefit on his/her compensation, this process cannot even commence until after W-2’s have been issued. Collecting, processing and reconciling this information can be quite time-consuming. By allowing use of demographic information from an earlier time period, recognition of actuarial gains and losses due to actual deaths, employee turnover, retirements and payroll practices differing from actuarial assumptions would be delayed by up to one year. However, since such actuarial gains and losses tend to be offsetting over the life of a plan, and are amortized into future contribution streams, the effect on any one year’s contribution should be minimal;
- **The asset information used is as of a date no more than three months prior to the first day of the current plan year**³. Asset information is usually available within 15 to 30 days after the end of a fiscal period⁴. Thus, assets should be available in most cases before the beginning of the plan year;
- **Liabilities developed from the demographic data should be appropriately rolled-forward (i.e., projected) to the asset collection date using standard actuarial techniques.** The “valuation date” would be the asset collection date;

²Plans that are funded at, or above, 125 percent of current liability would not have to meet these conditions.

³Under proposed regulations issued in 1982, the IRS allows both assets and liabilities to be valued up to 30 days before the beginning of the plan year.

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⁴Although asset information provided by plan trustees at such time may not have undergone the required ERISA audit, the information is usually substantially accurate and therefore adequate for actuarial valuation purposes.

- **The liabilities to be valued should reflect all plan amendments, or other “significant” events⁵**, that occurred before the valuation date. Subsequent plan amendments or significant events would be reflected only to the extent that existing laws and regulations would require or allow such post-valuation date recognition.

Furthermore, any change in the choice of dates for measuring assets or liabilities or modification of the rolled-forward technique used in the valuation could be deemed to be a “change in funding method subject to IRS approval.” Plan sponsors could adopt this proposal more easily if your proposal allowed automatic approval for the first time this method is implemented by a plan.

In conclusion, we believe your proposal for using prior-year valuation data would reduce administrative overhead for some defined benefit plans without materially changing their actuarial funding status, and could be extended to other defined benefit plans with similar effects. Moreover, as modified, this proposal would permit practices that are common under SFAS87, but are prohibited under proposed IRS regulations.

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⁵For example, Significant Events rules specified by PBGC regulations regarding the use of prior year data for determining risk-related premiums.