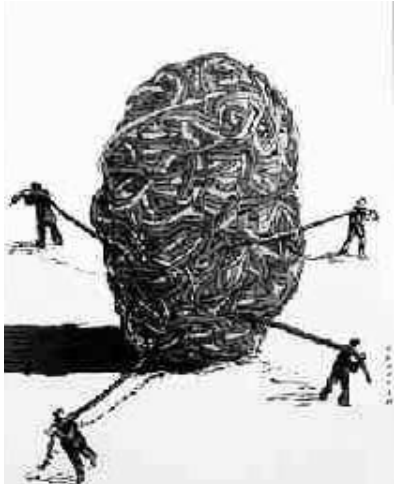
VOLUME 26 ■ NUMBER 1 SPRING 2001

ERAR ENROLLED ACTUARIES REPORT

Untangling Proposed Regulations for New Comparability Plans

BY JAMES TURPIN

NEW COMPARABILITY PLANS are primarily defined contribution (DC) plans that comply with the nondiscrimination requirements of IRC §401(a)(4) by testing the benefit accrual provided at retirement rather than the contribution. They began to emerge following the issuance of final regulations on nondiscrimination under IRC §401(a)(4).



While DC plans based on the benefit provided at retirement were not entirely new (target benefit plans have been in existence for more than 20 years), cross-testing the contributions in a profit-sharing plan was not common. In fact, the concept of cross-testing was introduced in Revenue Ruling 81-202 to compare the benefits and contributions provided by different types of plans.

Clearly, new comparability plans provide a significant advantage to highly compensated employees (HCEs) when HCEs have a higher average age than non-highly compensated employees (NHCEs). A series of news articles in 1993 pointed this out, causing a stir among Treasury Department officials and members of Congress. However, eliminating new comparability plans would have required substantial revision to the cross-testing provisions of the new nondiscrimination regulations, thereby creating significant difficulty for large employers with multiple entities, or many different plans, in complying with the nondiscrimination rules. As a consequence, no changes were made.

The issue resurfaced last year, prompting renewed discussion between the department, various professional and employer groups, and other organizations, including the Academy. These discussions centered on revising nondiscrimination regulations to eliminate what representatives of the department viewed as an inappropriate disparity between contributions for HCEs and NHCEs in new comparability plans.

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ERAR ENROLLED ACTUARIES REPORT

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

More Comments Sought on Proposed Pension Standard

BY BRUCE GAFFNEY

LAST JUNE, the Actuarial Standards Board (ASB) proposed an innovative new actuarial standard of practice, *Projected Benefit Illustrations in Connection with Retirement Plan Amendments*.

The proposed standard is intended to provide direction for actuaries who are preparing, reviewing, or advising on the preparation of benefit illustrations used to communicate retirement plan changes to participants.

Specifically, the proposed standard contains guidance on what constitutes comprehensive and fair disclosure to participants, what alternative scenarios should be communicated, and which optional forms of payment should be illustrated. It highlights areas in which particular care should be taken to disclose the nature and scope of the changes in benefits, as well as the expected level (and rate of accrual) of future benefits. Even greater care is expected when plan amendments require participants to choose between alternative plans.

The proposed standard also discusses methods of dealing with complicated situations, such as treatment of benefits that vary greatly

PENSION STANDARD continues on Page 6 ►

Goss, Gebhardtsbauer on C-SPAN

Social Security's chief actuary, Stephen Goss, and the Academy's senior pension fellow, Ron Gebhardtsbauer, participated in a panel discussion on the future of Social Security Jan. 25 at the annual conference of the National Academy of Social Insurance in Washington. The roundtable discussion was carried live on C-SPAN.

Panelists were Goss, a member of the Academy's Committee on Social Insurance, Dean Baker, co-director of the Center for Economic and Policy Research, and Eugene Steuerle of the Urban Institute. Gebhardtsbauer served as moderator. The discussion focused on whether long-range projections for Social Security are too optimistic, too pessimistic, or just about right. To view the program online, go to www.cspan.org/social_policy.

Academy Updates Issue Brief on Social Security Reform

THE ACADEMY'S SOCIAL INSURANCE COMMITTEE has updated a 1998 issue brief, "Social Security Reform: Trust Fund Investments," to incorporate figures from the 2000 Social Security trustees' report.

The issue brief examines questions Congress should address if it considers allowing part of Social Security's trust funds to be invested in stocks instead of government bonds. These include:

► What will be the impact of equity investments by Social Security on the national economy and capital markets, on government financing, and on trust fund assets as the trust funds accumulate equities? And what will be the effects if the program is not reformed and assets are liquidated after 2015?

► How will the Social Security investments be structured to prevent undue government influence on markets?

► How will the government deal with issues of proxy voting and corporate governance?

► How will the American public and the government respond to gains and losses in equity values that are bound to occur?

To read the issue brief online, go to **www.actuary.org/pdf/socialsecurity/sstrustfund_1200.pdf**.

EAR ENROLLED ACTUARIES REPORT VOLUME 26 ■ NUMBER 1 ■ **SPRING 2001** ■ PUBLISHED BY THE AMERICAN ACADEMY OF ACTUARIES

Pension Volunteers Visit Capitol Hill

FANNING OUT IN SEVERAL TEAMS, 12 volunteers from the Academy's Pension Committee met Feb. 5 with staffers in 17 Capitol Hill offices, including key aides to senators and representatives and General Accounting Office (GAO) and Congressional Research Service staff.

One of the volunteers' two main objectives was to offer the Academy's actuarial expertise to policy-makers. And that objective met with instant success: The GAO has asked for the Academy's assistance on several projects, including research on extending pension coverage to more workers, trends in pension design, and pension benefit adequacy issues.

The other objective was to get a sense of which issues are expected to dominate the congressional agenda this year. There were few surprises.

Policy-makers who met with Academy volunteers predicted that the Comprehensive Retirement Security and Pension Reform Act—or the Portman-Cardin bill (its primary sponsors are Rep. Rob Portman [R-Ohio] and Rep. Benjamin Cardin [D-Md.])—will move forward this session. The bill encourages greater investment in IRAs and 401(k) plans through increased benefit and contribution limits (see box).

Other pension issues that may see legislative action include extending pension coverage to more workers; oversight of pension design trends, including hybrid plans; and pension benefit adequacy.

Although no quick action is expected on Social Security reform, Hill staffers expressed interest in the Academy's briefing on the issue, which is being planned for later this spring.

"In sharp contrast to five years ago when we first started making Hill visits, most of the staffers we met with this year already knew about the Academy and its mission. More importantly, several of the staffers were ready with specific items on their agenda for which they were looking for assistance from the Academy," said James Turpin, the Academy's vice president for pension issues.

Participating in the Capitol Hill visits with Turpin were Ethan Kra, vice chairperson of the Pension Practice Council; Carolyn Zimmerman, vice chairperson of the Pension Committee; Ron Gebhardtsbauer, the Academy's senior pension fellow; Ted Goldman; and Pension Committee members Chet Andrzejewski; Dick Barney; Dennis Graf; David Kass; Chris Mahoney; Brian O'Konski; Larry Sher; and Jim Verlautz.

Pension Reform on Tap?

During recent visits to congressional offices, the Academy's Pension Committee learned that chances are good for Congress to pass some version of the Portman-Cardin bill this year.

The bill is designed to address the retirement income needs of private sector workers, particularly those who work in small businesses. Its key provisions include:

► Increased contribution limits for defined contribution plans. The bill would raise the employee annual contribution limits for 401(k), 403(b), and 457 plans to $15,000. The limit for SIMPLE plans would rise to $10,000 by 2005.

► Catch-up provisions for older workers. Workers age 50 and older would be able to contribute an additional $5,000 to their defined contribution plans.

► Increased contributions to IRAs. The Portman-Cardin bill gradually raises the annual contribution limit for both traditional and Roth IRAs to $5,000 by 2005 and indexes the limit thereafter for inflation. There would be no phase-in period for workers age 50 and older.

► Modernized pension laws. Under this bill, workers would become vested in the employer match in three years. There would be more portability to and from 401(k)s, 403(b)s, and 457s, and top-heavy rules would be eased. Additionally, section 415(b) would not limit benefits in multi-employer pension plans.

A Preview of the Enrolled Actuaries Meeting

BY AMY VIENER

THE 26TH ANNUAL ENROLLED ACTUARIES MEETING, sponsored by the Academy and the Conference of Consulting Actuaries (CCA), is only a few weeks away. The Program Committee has been busy planning for several months, and we wanted to take this opportunity to thank last year's attendees for providing valuable input—the survey results were a key part of this year's planning process.

While most respondents were pleased with last year's general sessions on cash balance plans, some indicated that the subject was overdone. It is, of course, impossible to satisfy everyone, but we try to design general sessions that are timely, interesting, and important. We believe we've accomplished that goal for this year's meeting.

The first two general sessions will look at the impact of changing demographics on actuarial assumptions and plan design. Noted demographer and epidemiologist Jay Olshansky will talk about his recent *Scientific American* article on aging, and a group of panelists will discuss the ramifications of aging and delayed retirement. For the third general session, we'll showcase a new mock ABCD hearing.

In some cases last year, respondents said, sessions didn't measure up to expectations. For example, it seems we missed the boat in the new 5500 session by spending too much time discussing how the form is processed rather than how it should be completed. That's been rectified. This year's 5500 session will focus on how to complete the form and will include tips on avoiding common mistakes.

Some respondents commented on incomplete outlines or presentations that didn't follow the handouts. We understand the importance of handouts, but we also appreciate that our speakers are busy consultants who volunteer their time. We've been working diligently with the speakers to increase the number of up-to-date outlines. However, because last-minute changes are inevitable, we've asked all speakers with late or revised outlines to bring hard copies to the meeting and to provide a final electronic copy so that our records will be complete. Revised handouts will be posted on the Web shortly after the meeting on the website of the Conference of Consulting Actuaries, **www.ccac-**

Draft Minimum Distribution Rules Relax Pay

BY MARJORIE MARTIN

THE IRS HAS ANNOUNCED revised proposed regulations under Internal Revenue Code section 401(a)(9) that would significantly change the rules regarding the minimum required distributions from IRAs and defined contribution plans as well as the rules on incidental death benefits provided to non-spouse beneficiaries under qualified plans. The change applies a uniform table to determine required distributions regardless of the age of the beneficiary (see box).

The proposed rules will likely reduce the minimum required payment amount for most payees. Under the new rules, the existing minimum distribution incidental benefit (MDIB) table would be used to determine the minimum required distribution for all individuals except those with a spouse 10 or more years younger than the individual whose account is at issue. This would eliminate the need for determining a beneficiary at the required beginning date or deciding whether the minimum distributions should be based on recalculated life expectancy each year. There wouldn't be a separate incidental benefit rule under the proposal. In addition, TEFRA 242(b)(2) elections are respected under the proposed revision.

After the death of the original participant, beneficiaries would be allowed to calculate the minimum required distribution over their remaining life expectancy. In the current rule this calculation is based on whether the participant had initially chosen recalculation of life expectancies at an earlier point in time. Distributions to non-spouse beneficiaries would be based on the remaining life expectancy at the time of the participant's death without recalculation in subsequent years (that is, the remaining life expectancy of the beneficiary at death would be reduced by one in each subsequent year unless the beneficiary is the spouse). The spouse would be allowed to use his or her single life expectancy. If death occurs before the required beginning date, the proposal would allow the use of the life expectancy rule as a default. It would also waive any excise tax during the first five years after the individual's death if the entire benefit is distributed by the end of the fifth year.

The proposal retains rules governing the provision of survivor annuity benefits to non-spouse beneficiaries — rules that have gained additional impact in recent years as pension plans evaluate whether to allow the payment of survivor benefits to domestic partners. The annuity rules have been expanded to deal with changes in survivor benefit amounts due to a qualified domestic relations order.

The proposal affects qualified plans, IRAs, Code §457 plans, Code §403(b) annuity contracts, custodial accounts, and retirement income accounts. It would apply in determining re-

tuaries.org, and in "What's New" on the Academy's website, www.actuary.org.

Comments were also made about the schedule (the 8 a.m. start on Tuesday was difficult for West Coasters, some topics didn't need 90 minutes, there was too much time between the last session and the reception, etc.). We took a look at the schedule and made some changes we think you'll like.

Some individuals suggested that the meeting be held in another city. However, by meeting in Washington we can maximize governmental participation. In fact, this year's meeting features more government speakers than ever before.

An overwhelming majority of respondents preferred the current lunch format of having no speaker one day and light entertainment on the other day. The most frequent request was to bring back the Capitol Steps, and so we did. Their entertaining performance is sure to be a highlight of the meeting.

Other survey results included:

- A request to repeat popular sessions. (Done.)
- Requests for snacks at some of the breaks. (This is very expensive because the hotel mandates we use its catering department. Offering snacks at all of the breaks would require raising registration fees, and we decided that would be inappropriate. However, we were able to find room in the budget for snacks at one of the breaks.)
- Comments that material covered in sessions did not match descriptions. (Speakers have been given a chance to revise the descriptions to ensure consistency.)
- Comments that sessions were too basic or too advanced. (More detailed session descriptions should resolve this issue.)
- A suggestion that more tables be available in the breakfast area and at the Tuesday evening reception. (Space is a problem, but we've asked the hotel staff to increase the number of tables as much as possible.)
- Request for larger binders. (You've got it.)

It's not too late to register for the meeting. Registration forms are available at www.ccactuaries.org. If you don't have Internet access, just call (847) 419-9090.

Amy Viener is a consulting actuary with William M. Mercer Inc. in Washington and chairperson of the Joint Program Committee for the Enrolled Actuaries Meeting.

YOUT REQUIREMENTS

quired minimum distributions for calendar years beginning on or after Jan. 1, 2002. In the case of distributions for 2001 and subsequent calendar years beginning before the effective date of final regulations, plan sponsors are permitted—but not required—to follow the proposed regulations in the operation of their plans by adopting a model amendment provided with the proposed regulation.

There was some confusion about the ability to use the new rule for 2000 calendar-year distributions, due by April 1, 200l for individuals who were age 70½ in 2000. In response, the IRS issued Announcement 2001-18 to correct the model amendment and make it clear that the new rules wouldn't apply except for distributions made for calendar years beginning on or after Jan.1, 2001.

The IRS warned that plan sponsors shouldn't adopt other amendments to attempt to conform their plans to the changes in these proposed regulations before the publication of final regulations. The service doesn't anticipate the need for determination letters when plans are amended to meet the final rules. These can be filed the next time the plan is otherwise amended.

The proposed regulations can be found at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=2001_register&docid=01-304-filed.pdf. Announcement 2001-18 can be found at ftp://ftp.irs.ustreas.gov/pub/irs-drop/a-01-18.pdf.

MARJORIE MARTIN is a consulting actuary and director of standards & review for Aon Consulting\ASA in Somerset, N.J.

THE MODEL AMENDMENT

With respect to distributions under the plan made for calendar years beginning on or after January 1, 2001 (alternatively, specify a later calendar year for which the amendment is to be initially effective), the plan will apply the minimum distribution requirements of section 401(a)(9) of the Internal Revenue Code in accordance with the regulations under section 401(a)(9) that were proposed on January 17, 2001, notwithstanding any provision of the plan to the contrary. This amendment shall continue in effect until the end of the last calendar year beginning before the effective date of final regulations under section 401(a)(9) or such other date as may be specified in guidance published by the Internal Revenue Service.

Comparability Plans *continued from Page 1*

Treasury recently proposed a regulation for new comparability plans that would establish minimum contribution levels for NHCEs and/or the relative contribution rates for HCEs and NHCEs. For new comparability plans, the proposed regulation requires that a DC plan comply with one of two gateways: either the lowest NHCE contribution rate is at least one-third of the highest HCE contribution rate or all NHCEs receive a contribution of at least 5 percent.

Shortly before the proposed regulation was issued, however, Treasury Department officials became concerned that through a combination of defined contribution and defined benefit (DC/DB) plans, plan sponsors could circumvent it. Consequently, additional requirements were included in the proposed regulation that apply specifically to combination DC/DB plans.

One type of combination DC/DB plan is a floor offset DB plan. In a typical floor offset DB plan, the participants who benefit from the plan are usually a relatively small percentage of the number of participants covered by the DC plan. For this reason, the proposed cross-tested regulation may be inconsistent with the traditional design and purpose of a floor offset DB plan. The proposed regulation requires a DB/DC combination plan to comply with a special gateway unless it is primarily a DB plan or unless the DC component and the DB component are both deemed to be broadly available when tested as separate plans.

For a DB/DC combination plan to be primarily a DB plan, 50 percent or more of NHCEs would have to receive a better normal accrual rate under the DB component than they do under the DC component. If the components of the combination plan must be aggregated to pass the nondiscrimination requirements and the combination plan is not deemed to be primarily a DB plan, then a modified version of the 5 percent gateway requirement for cross-tested plans would apply. If the highest combined allocation rate for an HCE isn't more than 25 percent, then the combined allocation rate for NHCEs would have to be at least 5 percent. In plans where the highest HCE combined allocation rate exceeds 25 percent, the minimum combined allocation rate for NHCEs would increase 1 percent for each additional 5 percent (or portion thereof) over 25 percent. For example, if the highest allocation rate for an HCE is 33 percent, then the NHCE minimum combined allocation rate would be 7 percent, rather than 5 percent.

By design, most floor offset DB plans when combined with their DC plan would not be deemed primarily a defined bene-

Pension Standard *continued from Page 1*

depending upon future investment returns, or benefits that may be subject to a period of "wear-away" (a benefit accrual plateau).

In fact, the content of communications to participants is ultimately at the sole discretion of the plan sponsor, not the actuary. The actuary can (sometimes) make suggestions or offer advice but has no authority over the final product. Unfortunately, this has not shielded actuaries from public criticism.

The challenge facing the ASB and its Pension Committee (which drafted the standard) is to develop a meaningful standard for actuaries in an area where they don't make the final decision. In response, the committee proposed the concept of the "actuarial opinion of compliance" (AOC).

The AOC would be a certification from an actuary indicating that a benefit illustration had been prepared based on generally accepted actuarial principles and that the illustration contained information that was comprehensive and fair. The hope of the committee is that the AOC would become a recognized mark of quality, enhancing the credibility of illustrations provided by plan sponsors who chose to obtain it. Any deviation from the standard's requirements would preclude the award of an AOC.

Clearly, the proposed standard is unusual. It attempts to codify good practice in an area where there has been little guidance and where no generally accepted practice has developed within the profession. Further, it introduces the innovative (but possibly unwieldy) concept of the AOC.

The introductory memo included with the draft standard contains extensive discussion of its new concepts, inviting comment on any aspect. Additionally, the memo poses a number of specific questions for consideration by the profession. In one instance, the ASB even provides alternative language, offering actuaries the chance to choose the version they prefer.

By the Nov. 30, 2000, deadline, the ASB had received over 40 comment letters on the proposed standard (including a number from employers representing actuaries, as well as a few from plan sponsors or others who aren't actuaries but are interested in the subject). The letters responded to the questions posed in the introductory memo and commented on many other aspects of the draft standard.

As was expected, the letters expressed a wide range of views, some complimentary and others not. Many voiced a need for some sort of standard in this area. Unfortunately, there was no consensus on controversial issues such as the viability of the

fit plan, nor would the floor offset DB plan pass the nondiscrimination requirements without being aggregated with its DC plan. While a cross-tested DC plan is relatively new, floor offset DB plans have been around for more than 20 years. Many floor offset DB plans are combined with profit-sharing plans that do not necessarily have contributions each year, but that rely on the average contribution rate over a number of years. In addition, favorable investment performance in the DC plan can substantially reduce the need to contribute to the DC plan in order for the combined plans to meet the minimum benefit level provided in the DB plan component.

In some instances, combined plans were designed based on an average contribution rate to the DC plan of 3 percent per year, and the DB plan benefit formula may also be modest, such as a benefit that is 0.5 percent to 1 percent of annual compensation. In this example, the DB component does not represent more than half the total benefit provided by the combined plans for at least 50 percent of the NHCEs, nor would the DB component satisfy the nondiscrimination requirements without being aggregated with the DC plan.

Unless the proposed regulation is modified, there may be many floor offset plans like this that will no longer comply. While the intent of the proposed regulation is to assure a reasonable relationship between contribution rates for NHCEs and HCEs in new comparability plans, the inclusion of special rules for combination plans creates the potential for significant unintended problems on plans that weren't the original target of the regulation. The apparent goal of including the combination plans in the proposed regulation is to prevent the use of combination plans as a means of avoiding the proposed limitation on cross-tested DC plans.

Discussions continue between Treasury officials and representatives of various employer and professional groups about revising the gateway testing requirements for DB/DC combination plans. The Academy is continuing to monitor the process and is expected to offer additional input. In the absence of any change, however, actuaries should be prepared to redesign or terminate combination plans before Jan. 1, 2002—the effective date of the regulation.

JAMES TURPIN, president and consulting actuary for Turpin & Associates, is the editor of *EAR* and the Academy's vice president for pension issues.

AOC or the extent to which a prior plan's benefit level should be disclosed.

The ASB's Pension Committee decided it needs more input from the profession. Through this and other articles in various actuarial publications, as well as through discussions at actuarial organization meetings, the committee hopes to garner more comments. The committee hopes a consensus will emerge and the standard can be re-exposed and finalized.

Comments can be sent to the committee via e-mail, at **comments@actuary.org** (please include the phrase "Benefit Illustrations" in the subject line of your message), or by writing to the following address:

Benefit Illustrations
Actuarial Standards Board
1100 Seventeenth Street, NW, Seventh Floor
Washington, DC 20036-4601

Additional copies of the proposed standard can be requested from the Academy at 202-223-8196, or can be downloaded from the Academy's website, **www.actuary.org/pdf/asb/benefit.pdf**.

BRUCE GAFFNEY is a consulting actuary with Ropes & Gray in Boston and a member of the Pension Committee of the Actuarial Standards Board.

Your Comments, Please

The Actuarial Standards Board welcomes comments on any aspect of the exposure draft of the actuarial standard of practice, *Projected Benefit Illustrations in Connection with Retirement Plan Amendments*. But it would particularly like to hear responses to the questions posed in the memo that accompanies the draft, including:

- Is the concept of an AOC feasible?
- Should the scope of the standard be expanded to include all projected benefit illustrations in connection with plan amendments, regardless of whether an AOC is issued?
- Should the scope of the standard be expanded to include all routine projected benefit illustrations (regardless of whether they relate to a plan amendment)?
- How should "wear-away" be defined? How should it be treated?
- To what extent should benefits under a prior plan formula (which is no longer in effect) be disclosed or illustrated?

AMERICAN ACADEMY of ACTUARIES

Washington Forum

May 2, 2001 – Washington, D.C. – Renaissance Hotel Downtown

The Impact of the Financial Services Revolution

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"Long-range planning does not deal with future decisions, but with the future of present decisions."

—Peter Drucker

Renaissance Hotel Downtown

SCHEDULE OF EVENTS

TUESDAY, MAY 1

4:00–7:00 pm
Registration

4:00–8:00 pm
Washington Forum Hospitality Suite

WEDNESDAY, MAY 2

7:00am–1:00 pm
Registration

8:00–9:15 am
Opening Breakfast

Welcome
Larry Johansen, President, American Academy of Actuaries

Keynote Address
"The Financial Services/Political Nexus"
Jeffrey Birnbaum, Washington Bureau Chief, *Fortune* magazine, Fox News analyst, and author of *Showdown at Gucci Gulch*

9:30–10:50 am
Concurrent Workshops

Workshop 1A
Brave New World: The Financial Services Revolution

Workshop 1B
Federal Regulation: The Experience of the Employee Benefits Community

11:00am –12:15 pm
Concurrent Workshops

Workshop 2A
New Products, New Practices: New Visions for the Profession

Workshop 2B
Actuaries in a Global Profession

12:30–2:00 pm
American Academy of Actuaries Washington Luncheon
"Business Ethics for Modern Times"
Rabbi Harold Kushner, author of *When Bad Things Happen to Good People*

Presentation of the 2001 Robert J. Myers Public Service Award

2:15–3:30 pm
Plenary Session

Workshop 3
Professionalism after the Revolution

3:40–5:00 pm
Plenary Session—Academy Members Only

Workshop 4
Academy Open Forum: Developing an Agenda for the Future
Washington Forum Registration Fees

Washington Forum Registration Fees

	EARLY BIRD April 6	REGULAR April 7-27	LATE Apr 28-May 2
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Government/Nonprofit Think Tank/ Educator	$400	$500	$550
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