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ENROLLED ACTUARIES REPORT

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TOM TERRY

Retirement Leaders Air Views at Pension Symposium

GATHER SOME OF THE BEST thinkers in our profession, mix in leaders from labor and other retirement advocacy groups, and create an environment conducive to open dialogue. The result? The fourth annual Pension Symposium, held March 28-29, immediately following the 2007 Enrolled Actuaries Meeting in Washington.

The ground rules are simple:

- Recruit panelists who are leaders in their fields.
- Limit opening comments to just a couple of minutes for each panelist.
- Encourage open dialogue among all participants.
- Enforce a strict limit on attendance: No more than 100 allowed; first come, first served.

This format gives attendees a unique opportunity to both listen and discuss. It's the pension actuary's

VIEWS AIRED, PAGE 6

Actuaries filled the corners of the room at the crowded final session of the 2007 Enrolled Actuaries Meeting.

Inside this issue

BRUCE GAFFNEY

Advanced Topics in Pension Reform

THE CENTERPIECE OF THE 2007 Enrolled Actuaries Meeting was a series of linked sessions addressing the sweeping changes made by the Pension Protection Act of 2006. Session 501, the third breakout segment of this extended seminar, addressed the alternative funding requirements that will apply to underfunded plans starting in 2008. Session 701, fourth in the series, explored contribution strategies available to plan sponsors under the new rules.

In the third session, speakers discussed the myriad of new definitions brought to us by funding reform, such as "carryover balance" and "prefunding balance" (the new, bifurcated credit balance), and the differing measures of funded percentage under the new rules. There are new funding-based benefit restrictions provided that apply if the funded status of a plan dips below certain thresholds:

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Senate Finance Committee staffer Judy Miller speaks at a general EA Meeting session on the potential for further pension reform.

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ENROLLED ACTUARIES REPORT

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The 2007 Gray Book

EACH YEAR, members of the Enrolled Actuaries Program Committee meet with representatives of the Treasury Department and the Internal Revenue Service (IRS) to discuss questions raised by the actuarial community on a variety of issues. The Gray Book is the annual compilation of these questions coupled with answers provided by IRS and Treasury employees. While Gray Book responses reflect only the personal views of government employees and cannot be relied on as formal guidance, they still can shed light on a difficult question or a confusing area of practice.

The distribution of the Gray Book at the Enrolled Actuaries Meeting is accompanied each year by concurrent sessions where the questions and responses are discussed. Leading one of the sessions this year were committee members Bruce Cadenhead, a principal with Mercer Human Resource Consulting in New York, and Marjorie Martin, a consulting actuary with Aon Consulting in Somerset, N.J.

The session started with discussion about the determination of the gateway percentage under Sec. 412(l) in a spinoff situation. Under the scenario posed in the question, a de minimis spinoff from a larger plan with a calendar plan year occurred as of Oct. 1, 2005. The larger plan's gateway percentage exceeded 90 percent for 2003 and 2002, and 80 percent for 2004 and 2005. What look-back period should be used to determine the applicability of 412(l)? The response was that the current liability-funded percentage had to be considered as of Oct. 1, 2005, for the short plan year and that the 2005, 2004, and 2003 plan years were considered the look-back period. In this case, the spun-off plan would be exempt from the additional funding charge of Sec. 412(l) only if its funded share exceeded 90 percent as of Oct. 1, 2005.

Also discussed was the ability to amend Schedule B to reflect additional contributions made after the date of original filing. In its response, the IRS indicated this was allowable, as long as an amended Form 5500 (first page only) and amended Schedule B were filed. Cadenhead and Miller noted that the assumptions and methods used in the original filing couldn't be changed, only the amount of contributions recognized for that plan year.

With respect to a question on the 25 percent of pay deductible limit of Sec. 404(a)(7), the IRS described the includable group: The pay of participants who make elective deferrals to a profit-sharing plan but receive no other benefits or contributions to either plan can be included in the total compensation. This determination can presumably also be considered when weighing the compensation for recent changes to the 25 percent of pay limit for 2006 and 2007, when certain defined contribution benefits (below 6 percent of pay) aren't included in the limit.

It was also confirmed that rounding of values in the 95 percent to 105 percent grouping of the relative value wasn't permitted and that relative-value information involving multiple annuity starting dates had to show the relative-value impact at each starting date.

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JOINT BOARD GOES ELECTRONIC

IT WAS ANNOUNCED AT THE 2007 Enrolled Actuaries Meeting that the Joint Board for the Enrollment of Actuaries will not be mailing out hard copies of renewal forms for the next cycle, slated to begin April 1, 2008. Instead, the forms will be available online on the Joint Board's website, www.irs.gov/taxpros/actuaries/index.html.

To renew your enrollment, you will need to download the form, print it out, and mail it in. Look on the Joint Board website this fall for forms and complete instructions.

ANGELA SCHIEBOUT

Lump Sums Under PPA

THE PENSION PROTECTION Act of 2006 (PPA) changes how lump sums are calculated under Sec. 417(e) and Sec. 415. In a session at the 2007 Enrolled Actuaries meeting, Jerry Allen, a principal with Mercer Human Resource Consulting in Chicago, and attorney Emily Mao, a partner in the Washington office of Alston & Bird, discussed these and other changes resulting from the new law.

Sec. 417(e) Minimum Lump Sum

The 417(e) minimum lump sum is calculated as the present value of the accrued benefit payable at normal retirement age. PPA updated the interest and mortality basis for calculating this minimum lump sum. Generally, lump sums will be lower under PPA for plans where the payment is defined as the 417(e) lump sum.

Effective Jan.1, 2008, the 417(e) lump sum must be calculated using the adjusted first, second, and third segment rates as applied under the minimum funding rules and using the mortality table required for minimum funding purposes. The 417(e) lump sum is calculated by discounting each expected payment back to the cash-out date using the segment rate. The segmented rate periods are determined from the cash-out date, not from the annuity commencement date.

There is a phase-in schedule for calculating the 417(e) lump sum from 2008 to 2011, with the new law completely phased in by 2012. It's not clear exactly how the phase-in will work. PPA language requires the 417(e) lump sum to be determined by using the weighted average of the old and new interest rates. A report by the Joint Committee on Taxation appears to require that the actual lump-sum values be weighted. These two approaches are not mathematically equivalent.

The applicable mortality table for funding purposes is based on a projection of RP-2000 male and female tables, with no collar adjustment. There are separate tables for retirees and active workers, with an option to use a blended table instead. An employer may also apply to use a different table based on the plan's mortality experience. Session speakers discussed several unresolved issues regarding the mortality table to be used for determining 417(e) lump sums: how to create a unisex table, and whether a plan-specific mortality used for funding purposes should also be used for 417(e) lump sums.

Lump-Sum Benefit Limits Under Sec. 415

PPA retroactively changed the interest rate assumption used for determining a lump-sum benefit under Sec. 415 for plan years beginning after Dec. 31, 2005. The interest rate is not less than the greater of (a) 5.5 percent (same as under prior law), (b) the plan's interest rate (same as under prior law), or (c) the rate that provides a benefit of not more than 105 percent of the benefit provided if the interest rate applicable to determining minimum lump sums under Sec. 417(e)(3) were used (added by PPA). If the interest rate in (c) is greater than the interest rate in (a) and (b), it is possible that the plan may have paid lump sums in 2006 that exceed the new modified limit. Any overpayments are considered Sec. 303 excess distributions and need to be corrected.

Restrictions on Lump-Sum Payments

For plan years beginning after Dec. 31, 2007, prohibited payments (which include lump-sum payments or any other accelerated distributions greater than the amount paid under a single life annuity) may be restricted if the plan's adjusted funding target attainment percentage (FTAP) is below or is presumed to be below certain thresholds. For this purpose, FTAP equals actuarial value of assets (AVA) minus prefunding balance (PFB) minus carryover balance (COB), divided by the not-at-risk funding target. If there were any annuity purchases for non-highly compensated employees, the amount of these purchases is also added to both the numerator and the denominator. PFB and COB are ignored if the AVA is at least 100 percent of the funding target (92 percent in 2008, 94 percent in 2009, and 96 percent in 2010).

The PFB and COB may not be known until the Schedule SB is filed 9½ months after the end of the plan year, which creates problems for certifying the plan's FTAP and for applying the presumed underfunding rules. For a calendar-year plan, the FTAP is presumed to decrease by 10 percent from the prior year FTAP at April 1 and is presumed to be less than 60 percent as of Oct. 1, unless the current year's FTAP has been certified by the actuary.

If the FTAP is less than 60 percent, no lump sums are permitted. If the FTAP is at least 60 percent but less than 80 percent, lump-sum payments may not exceed the lesser of 50 percent of the lump sum or the present value of the participant's maximum guaranteed benefit from the Pension Benefit Guaranty Corp. Only one prohibited payment can be made to a participant during consecutive plan years in which the restrictions apply. Since participant and beneficiary are considered to be one person, if a participant receives a partial lump sum and dies the next year, the beneficiary could not receive a lump sum of the death benefit. The restrictions appear to apply to all lump sums, including de minimis lump sums of less than $5,000. The restrictions don't apply to plans that were hard frozen as of Sept. 1, 2005.

Finally, the plan sponsor is required to notify participants within 30 days of the date the plan becomes subject to the distribution restrictions. A penalty of up to $1,000 per day could apply if the notices are not distributed.

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BRENDA MAJDIC

Multiemployer Provisions of PPA

The Pension Protection Act of 2006 (PPA) contains several funding changes and transparency provisions that affect multiemployer plans, including shorter amortization periods, increases in deduction limits, requirements for providing employers with access to plan financial information and actuarial reports, interest-rate changes, zone funding, and modifications to certain withdrawal rules. In addition, while the determination of the funding interest rate has not changed for multiemployer plans, the interest rate used in calculating lump sums will be based on the yield curve, just as with single-employer plans.

Speaker Ron Gebhardtsbauer, right, greets Paul Angelo before a session.

Most of these changes will take effect in 2008 and will require plan trustees and bargaining parties to be forward in their thinking.

Two key areas actuaries should focus on are projections and disclosures. Within 90 days after the end of the plan year, the plan actuary must provide an annual actuarial certification. For 2008, that means by March 30. This certifies the status of the plan each year, taking into account projections of contributions, benefit payments, and liabilities and assets, and determining how actual experience has affected the projections. If the plan is endangered, there are additional notifications that must occur within 30 days of issuing the certification. Failure to comply with the deadline triggers penalties of up to $1,100 per day.

PPA attempts to provide greater transparency by requiring additional information on the annual funding notice, expanded requirements on Form 5500, and the ability of contributing employers and participants to request plan financial information and actuarial reports. The notice will now be due on April 30 and must include the number of participants in pay status, plan funding and asset allocation policy, events that could have a material

PENSION REFORM, FROM PAGE 1

➜ The payout of lump sums and the adoption of benefit improvements may be limited if a plan's adjusted funding target attainment percentage (AFTAP) is less than 80 percent; and

➜ Benefit accrual may be automatically curtailed, lump-sum payouts prohibited entirely, and shutdown benefits precluded if a plan's AFTAP drops below 60 percent.

Presenters discussed the special rules surrounding the applicability of benefit restrictions, including a blanket exception and some transition rules for 2008 through 2010. There are also complicated rules regarding when the components of the new credit balance can be included in plan assets in determining funded status, as well as when the plan sponsor can affirmatively elect to waive (or "burn") some or all of the credit balance, in order to have it counted in plan assets.

Another new concept in the law is the presumed-funded status. The applicability of funding-based restrictions will at times operate predicated on a presumption that the prior year's funded status has deteriorated, making the timing of the actual determination of funded status (and thus the timing of completion of annual valuations) very important. For example, a plan that is 85 percent funded in a given plan year (and thus with no applicable restrictions) will be presumed to be only 75 percent funded after April 1 of the following plan year (with restrictions kicking in), if the plan's actuary cannot certify the plan's actual funded status prior to that date.

There are also new funding rules for at-risk plans. A plan is considered at risk if its funded status dips below 80 percent and its funded status, calculated using special, more stringent at-risk assumptions, dips below 60 percent. Plans determined to be at risk have their liabilities and cor-

impact on plan liabilities, and funded ratio and plan assets/liabilities for the current and last two plan years. Form 5500 requirements, which include providing this information to employers and unions representing participants, will include contribution/benefit schedules, the number of contributing employers and those contributing more than 5 percent, the impact of plan mergers on funded percentage, the number of employer withdrawals in the year and total withdrawal liability billed, and assumptions and methods used to project retirements and payment forms. This information must be submitted in Internet-ready format and posted on the plan's intranet if one exists.

The centerpiece of PPA for multiemployer plans is the funding reform section that divides multiemployer plans into green, yellow, or red zones. A plan is in the green zone if the funded ratio is 80 percent or more and the plan has no projected funding deficiency in the next seven years. A plan is in the yellow zone and considered endangered if the funded ratio is less than 80 percent or there is a projected funding deficiency in the next six years. A plan in the yellow zone is considered seriously endangered if the funded ratio is less than 80 percent and there is a projected deficiency in the next seven years. A plan is in the red zone if it meets one of several triggers, including a funded share of less than 65 percent and assets and projected contributions that are insufficient to pay projected benefits during the next four to seven years. If a plan falls into the yellow or red zone, a funding improvement plan is required, limitations are placed on the plan and trustees, and certain benchmarks are set.

Donald Segal and Tonya Manning confer before the start of the third general session.

Overwhelmed? Just keep these six key thoughts in mind:

- There is plenty of work to do.
- Not much of it involves yield curves.
- The actuary's best estimate prevails.
- Funding ratio and credit balance sufficiency need to be monitored—and projected.
- Lots of folks may have access to your work.
- Bad timing can be expensive.

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responding contribution requirements calculated under different, short-term assumptions. The idea is to close any potential gap between funding levels for ongoing plans and the amount needed to fully fund the plan in the event of plan termination.

Other issues that underfunded plans now face include limitations on lump-sum payments to the top-25 highest-paid employees (an area where there are many unanswered questions), as well as special determinations related to Pension Benefit Guaranty Corp. variable premiums and the applicability of the participant notice under ERISA Sec. 4010.

The fourth breakout session built on concepts learned in the earlier sessions on regular and at-risk funding rules. Speakers laid out an overview of what plan sponsors can expect when the new rules become effective in 2008.

There are a number of ways that a plan sponsor can manage a plan's contribution requirements by "burning the credit balance" (when a carryover balance or prefunded balance is voluntarily waived), and there are situations where a small contribution can result in a significant change in the funding requirement or in the avoidance of troubling developments (such as benefit restrictions). Session speakers pointed out instances where certain actions may yield counter-intuitive results because of the new rules, and stressed the importance of using projections and modeling to determine the best course of action.

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version of Speaker's Corner in London's Hyde Park.

This year's symposium followed on the heels of the passage, last August, of the Pension Protection Act (PPA) of 2006. And it occurred in the midst of massive effort and uncertainty related to the law's implementation—all of which was covered in depth at the Enrolled Actuaries Meeting.

Yet the discussion was forward-looking (and thought-provoking). Attendees came not to convince others that they were right but rather to air their views, have them challenged, and invite alternative perspectives. The collective learning was significant.

A fly on the wall might have heard the following comments during the course of the symposium.

On pensions and the three-legged stool:

"What people want is portability, flexibility, and security. Hmm … sounds like Social Security, doesn't it?"

"The administration's theme of an ownership society is not a shared vision."

"How did it happen that retirement security has come to be translated to wealth preservation/transfer upon death?"

"We live in a society consumed by consumption! Yes, we consume a lot—and funded pension and savings plans are effective antidotes. "

"Retiree medical is the real retirement security dilemma in the United States."

"Hybrids are the future of pension plans."

"Retirement age is the key factor in retirement security."

"Portability is not achieved by lump-sum payouts—so let's stop the charade!"

On the subject of pension risk:

"Pension risks aren't new—but we sure understand them better today!"

"Sponsors are OK with risks if they're seen as manageable."

"Shifting risks to employees has been shown as ineffective. Bear markets hit both defined benefit (DB) and defined contribution (DC) plans!"

"Employees do not understand long-term risk."

"Variable-benefit plans allow sponsors to transfer investment risk while keeping mortality risk. The result is more stable costs."

"Actuaries do a good job of focusing on costs, but we can do a better job of measuring the value of DB plans."

"Does risk reduction mean eliminating volatility? No."

"We must repackage DB plans."

"Can the multiemployer pension concept be replicated outside the collective bargaining environment?"

On the subject of pension finance:

"We can kill DB plans, but the equity risk will just be shifted to DC plans—so we haven't eliminated it."

"Longevity risk is huge for the individual but easily pooled in true pension arrangements."

"Can new capital be brought into the pension system?"

"Can this be effectively regulated?"

"Will public-policy goals be fostered by the emergence of new players in the pension-financing field?"

"All things being equal, the Pension Benefit Guaranty Corp. (PBGC) would probably prefer that pension risks be in the hands of stronger rather than weaker sponsors."

"The landscape for pension finance will be entirely different in 10 years."

"The PBGC's role will be important."

"Society still needs to deal with the PBGC's legacy problems. They weren't addressed by PPA."

"The reversion tax is the single most important pension plan barrier to be removed."

On the subject of retirement policy:

"It's sad that we fail to push good ideas just because we think they lack support in Congress."

"Our retirement system has been geared to the benefits of the provider, not to the beneficiaries' best interests."

"Social Security is the most successful DB plan in our country."

"Employees must understand that they need income in retirement. Who will do this education? Actuaries?"

"This education should start before employment."

"Annuitization will be the most important policy challenge of the next 10 years."

"The marketplace needs more catalysts."

"Whatever happened to contributory pension plans?"

"There is often a big gap between what employees want and what's good for them. Which way should policy take us?"

At the risk of oversimplifying a full day's discussion, here's what I learned: The three-legged stool is a bit wobbly, and there is work to do to correct this. Actuaries are well equipped to address retirement risks in new and creative ways. These risks aren't new, but we understand them better today. And we have an opportunity—maybe even an obligation—to help shape new financial solutions to these old but ever more urgent retirement challenges.

Many thanks to my fellow organizers of the 2007 symposium: Don Fuerst, Ron Gebhardtsbauer, Ken Kent, and Don Segal.

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JAMES TURPIN

PPA Influences on Small Plan Design

WHILE THE PRESS has devoted most of its attention to the impact of the Pension Protection Act of 2006 (PPA) on larger pension plans, panelists at a session on small-plan design at this year's Enrolled Actuaries Meeting identified a number of PPA-related changes that will permit increased funding for small plans, as well as a wider array of small-plan designs.

Congress' clarification of the status of cash-balance plans, for instance, allows small-plan sponsors an opportunity to use hybrid designs. These are especially beneficial when there are multiple owners with different ages and varying financial goals. In traditional defined benefit (DB) plans, the ability to provide comparable benefits and funding requirements for two owners with a 20-year difference in their ages was more limited. However, a hybrid plan design can minimize the impact of that age disparity.

The ability to incorporate a hybrid design into a DB plan without worrying about potential cash-balance litigation is also enhanced by the change in the deductible contribution limits for multiple plans. Historically, an employer sponsoring both a defined contribution (DC) and a DB plan was limited to contributing the greater of the minimum required contribution to the DB plan or 25 percent of compensation. Under the new rules, plan sponsors who are exempt from Pension Benefit Guaranty Corp. (PBGC) coverage can contribute up to 6 percent of compensation to a DC plan and still fully fund their DB plan. This means that combining a 401(k) safe-harbor plan with a DB plan will no longer limit most contributions to the DB plan.

The owner of a small business will be able to make maximum 401(k) salary deferrals that won't be limited if other employees decide not to contribute to the plan. In addition to the 3 percent safe-harbor contribution, the owner may also receive a discretionary employer contribution in the 401(k) plan. For an owner who is at the Sec. 401(a)(17) compensation limit and more than 50 years old, contributions to the 401(k) plan on his or her behalf may be $34,000 or more. These contributions to the 401(k) plan can be made in addition to funding for the maximum permitted benefit in a DB plan. (Since the contribution permitted for the DB plan is the minimum required contribution, a judicious selection of funding method may be necessary to assure that the contribution still will be deductible under multiple-plan rules. For plans that are subject to PBGC coverage, the limitations for multiple plans will not apply beginning next year.)

PPA also increased the maximum deduction for DB plans to 150 percent of current liability. In the small-plan context, this increased funding does not represent added cost for benefits attributable to non-owners, merely an advance on contributions that would otherwise be contributed in later years. When advising plan sponsors of this option, it's important to stress that the plan needs to stay in place for a number of years after it appears to be fully funded to allow the accrual of benefits to catch up with assets.

Unfortunately, PPA made permanent, retroactive to the beginning of 2006, the increase in the interest rate used to determine maximum lump-sum benefits under Sec. 415. The changes to the interest rate used to determine minimum lump-sum distributions also may have an effect on the maximum lump-sum benefit as the changes in Sec. 417(e) are phased in over the next five years. As a result, small-plan design needs to reflect that the maximum paid in a lump-sum distribution will be slightly lower in the future.

In many respects, plan design opportunities after PPA are similar to those available before but with wider latitude to fund those options or to combine plans. Previously, minimum funding requirements and the maximum deductible contribution for small plans were often the same amount. Now it will be necessary to plan for a new minimum funding requirement and what is likely to be a much larger maximum deductible amount. You may want to consider providing the employer with a third option: a contribution from what some have called a "regular" valuation under the current rules that represents your recommendation as to what should be contributed on a recurring basis to adequately fund benefits. It may be easier to just call this option the recommended contribution.

To many actuaries, there doesn't appear to be much discretion in the development of the new minimum funding requirements. However, the actuary has to determine when benefits are likely to be paid. As a result, it's important to consider the rate at which benefits accrued and when those benefits might become payable. In a small plan, the failure to consider the rate of benefit accrual can lead to underfunding of some benefits and a disgruntled client.

There are a number of different ways to achieve a favorable plan design. Whenever considering a plan design, you should remember several things: Someone else (your client) has to understand the plan, you have to keep it in compliance going forward, and a more complex design doesn't always produce a better result.

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AMY SULLIVAN

Dialogue With the Joint Board

ANOTHER GOOD REASON to file your taxes: There was much discussion on the importance of filing accurate and timely personal tax returns at this year's Enrolled Actuaries Meeting dialogue with members of the Joint Board for the Enrollment of Actuaries.

Circular 230, to which all enrolled actuaries are bound, provides for disciplinary action for tax evasion or the willful failure to file a return in a timely manner, said Patrick McDonough, executive director of the Joint Board. Every year, the Joint Board selects a random group of approximately 250 individuals (not all enrolled actuaries) and reviews whether their personal tax return filing was made on time and if any penalties were assessed. Of these 250 individuals, about 50 are flagged for problems, precipitating a follow-up from the Joint Board. McDonough said that knowing you would be receiving a refund doesn't excuse you from missing the deadline. Disciplinary action could result in reprimand, suspension, or worse. Although McDonough didn't provide information as to how many delinquent filers are enrolled actuaries, he did say that enrolled actuaries, as a group, are praiseworthy in the timing of their filings.

David Godofsky addresses EA Meeting attendees.

Zenaida Samaniego, chairperson of the Joint Board, began the session with an update on changes in the organization and information on the examinations. She said that the fall EA2 examination would most likely cover the basics of the Pension Protection Act of 2006 (PPA). When asked if the EA2 exam would cover both old and new rules, Samaniego said that it would depend on what regulations are released. Samaniego also said that the Joint Board currently has no intention of moving to a computer-based testing system. Samaniego urged actuaries to notify Lawrence Isaacs, secretary of the Joint Board, if they have an interest in providing pretesting assistance. (To reach Isaacs, and for any other questions for the Joint Board, send an e-mail to nhqjbea@irs.gov.) It is possible to earn continuing professional education (CPE) credit for helping with the administration of examinations.

From left, Judy Miller, Ron Gebhardtsbauer, James Delaplane, and Donald Segal debate the effect of recent pension reform.

In a related matter, if the Joint Board selects you for an audit of CPE credits, McDonough said, you are no longer required to present handouts from the Enrolled Actuaries Meeting or meetings of the American Society of Pension Professionals and Actuaries that are attended by members of the Joint Board. All other credits that you claim will still require backup information to confirm content.

Finally, McDonough said that enrolled actuary renewal forms will not be mailed out this year but instead will be available for download in an online form (see box, Page 2).

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