EAR

ENROLLED ACTUARIES REPORT

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

VOL.38 NO.3 FALL 2013

BY DAVID GOLDFARB

Is the PBGC Deficit Real?

IN NOVEMBER 2012, the single-employer program of the Pension Benefit Guaranty Corp. (PBGC) reported a $29.1 billion gap between its assets and its liabilities. The implication: At some future point, PBGC risks being unable to pay the benefits it has guaranteed.

At least one group took issue with the deficit claim, calling it a nonevent and a misleading number. The controversy led the Academy's Pension Committee to investigate the methods and assumptions PBGC used to calculate its liability. In August, the committee published its analysis in its issue brief ***Perspectives on the PBGC Single-Employer Deficit***. It found PBGC's methodology reasonable.

The existence of the deficit matters because 33 million workers and retirees in 24,000 pensions rely on PBGC insurance. The program currently pays benefits to 836,000 retirees.

The single-employer program funds itself through insurance premiums, assets acquired from failed plans, investment earnings, and recoveries during bankruptcy. In 2012, PBGC paid out $5.4 billion but collected only $2.2 billion in premiums.

More than 98 percent of the program's current $112 billion liability comes from the agency's calculation of the present value of benefits from plans already taken over by the PBGC. Groups opposing the deficit primarily argue that the "deficit" results from the low discount rate the PBGC applies when computing its liabilities.

The PBGC uses an American Council on Life Insurance (ACLI) survey to determine the rate with which it discounts its liability. The survey provides currently available annuity rates, and PBGC calculates a discount rate based on this survey. In fiscal year (FY) 2012, that rate was 3.28 percent.

In the issue brief, the Pension Committee finds this approach reasonable and explores the outcomes based on

PBGC DEFICIT, PAGE 4

Inside this issue

BY JAMES A. KENNEY

The 2013 Gray Book
Commentary

AFTER YEARS OF GRAY BOOKS that contained baffling questions and surprising answers, it is almost disconcerting that the 2013 Gray Book is so tame—disconcerting but also a relief. It is a sign that the massive confusion that followed the passage of the Pension Protection Act of 2006 (PPA) is finally yielding to logic, analysis, and occasionally, corrective legislation.

As usual, by its very nature, the Gray Book is a grab bag of questions that don't lend themselves to easy exposition, because it is intended to explore the outer limits of our understanding of current laws and regulations. It's not called the Gray Book for the color of its cover (although it is gray).

A number of questions in the Gray Book deal with prohibited payments, primarily lump sum distributions, and this area of the law clearly is not yet fully rationalized. Questions 17, 18, 19, 28, and 31 all deal with this knotty issue. Generally speaking, the PPA requires that under certain funded conditions, a lump

GRAY BOOK, PAGE 5

EAR

ENROLLED ACTUARIES REPORT

COMMUNICATIONS REVIEW COMMITTEE
Steve Rosen, Chairperson
Jenna Fariss
Paul Fleischacker
John Gleba
Kenneth Hohman
Gareth Kennedy
Barbara Lautzenheiser
Tonya Manning
Robert Meilander
Geoffrey Sandler
Debbie Schwab
Chester Szczepanski

MANAGING EDITOR
Julia Goodwin
(editor@actuary.org)

DESIGN AND PRODUCTION
BonoTom Studio Inc.

DESIGNER
Paul Philpott

AMERICAN ACADEMY OF ACTUARIES

PRESIDENT
Cecil Bykerk

PRESIDENT-ELECT
Tom Terry

SECRETARY
Stephen Rosen

TREASURER
Art Panighetti

VICE PRESIDENTS
Mike Angelina
Maryellen Coggins
John Moore
Cande Olsen
David Shea
Karen Terry

EXECUTIVE DIRECTOR
Mary Downs

DIRECTOR OF COMMUNICATIONS
Charity Sack

ASSISTANT DIRECTOR FOR PUBLICATIONS
Linda Mallon

Academy Educates on Implications of Longer Life Spans

IN A SERIES OF EFFORTS over the past several months, the Academy continued its public policy mission by considering the longevity challenges posed to Social Security and individual retirement planning. Americans living longer poses two problems that policymakers need to address: ensuring sufficient levels of income in old age and recognizing the additional costs of entitlement programs.

Addressing Social Security's Demographic Problem

Increasing life spans combined with lower fertility rates threaten the long-term solvency of Social Security. How to properly evaluate longevity increases was the key aspect of three questions sent to Senior Pension Fellow Donald Fuerst after his May 23 **testimony** before the House Ways and Means Subcommittee on Social Security. Chairman Sam Johnson (R-Texas) and Ranking Member Xavier Becerra (D-Calif.) sought further analysis on changing the benefit formula of Social Security and modifying the program's early and full retirement ages. Fuerst responded on July 31.

The first question focused on strategies to better address longevity: What is Fuerst's view on increasing the retirement age versus changing the benefit? Fuerst noted the significance of retirement ages as milestones for workers, an influence that is difficult to override despite benefit changes. "Changing the formula but not the earliest and full retirement ages would have less influence on the retirement age selected by workers because of the signal that the eligibility ages provide," he wrote. Despite benefit cuts, workers would still claim as soon as they could and then face reduced payments and overall financial insecurity.

The question of financial insecurity came into sharper relief when Johnson and Becerra asked about the effects of increasing the early eligibility age (EEA) or letting it remain at 62 even if the full retirement age increased. Fuerst pointed out that keeping the EEA at 62 if the full retirement age increased would lead to deeper cuts in benefits. First, workers would see the EEA as a retirement milestone worth choosing, despite the hits they would take to their ability to earn and save and to their overall retirement benefit.

Additionally, the roughly 30 percent reduction attached to early retirement would be even greater.

"If the EEA is not changed, initial claims at age 62 (currently about 44 percent) will continue to be high," Fuerst wrote. "If the EEA is increased, more individuals will work longer and ultimately receive larger benefits."

To analyze this increased benefit reduction from an increased full retirement and a static EEA, the subcommittee asked if it made sense to change the factors so they are not actuarially neutral. Fuerst indicated that doing so would increase the costs to Social Security. He also underscored the importance of the messages that various retirement ages send to those workers contemplating retirement. If the EEA and the full retirement ages are increased, workers will start to see that they need longer careers to achieve a stable retirement.

Longer Lives and Lifetime Income

The Lifetime Income Initiative continued in full force throughout the summer as Academy experts educated policymakers, regulators, and the public about longevity risk and ways to secure income that lasts a lifetime. Efforts kicked off in June with the Lifetime Income Risk Joint Task Force's release of the **discussion paper** *Risky Business: Living Longer Without Income for Life* and with a June 27 **briefing** for policymakers on Capitol Hill.

NAIC Summer Meeting

In addition to policymakers, the Academy reached out to regulators on the lifetime income issue. Senior Life Fellow Nancy Bennett **presented** the *Risky Business* paper to the National Association of Insurance Commissioners' (NAIC) ERISA Retirement Income Work-

LONGEVITY, PAGE 3 ⇢

Pension-Related ASOPs Under Review

RECENT ACTIVITY by the Actuarial Standards Board (ASB) has prompted several comments from Academy committees. The actuarial standards of practice (ASOPs) currently under development by the ASB review include ASOP No. 4, ***Measuring Pension Obligations and Determining Pension Plan Costs or Contributions***; ASOP No. 6, ***Measuring Retiree Group Benefits Obligations and Determining Retiree Group Benefits Program Periodic Costs or Prefunding Contributions***; and a new **ASOP** on modeling.

ASOP No. 4

Both the **Pension Committee** and the **Pension Finance Task Force** submitted comments on revisions to ASOP No. 4.

The Pension Committee said the current draft addresses many of its previous suggestions, and it suggested additional changes involving output smoothing, disclosures, definitions, and other terminology and formatting issues.

With respect to smoothing, the committee noted that ASOP No. 4 is silent on the issue. "While it may be premature to provide any significant guidance on output smoothing methods, we believe ASOP No. 4 should at least include them within the discussion of 'allocation procedures' and the related required disclosures," the committee said. When it comes to the "contribution allocation procedure," it suggested that the definition "is probably broad enough to include output smoothing methods without specifically mentioning them."

The committee commented extensively on disclosure requirements in Paragraph 4, especially those related to unfunded actuarial accrued liability during the amortization period, the impact of the plan's contribution allocation procedure on future plan contributions and funded status, and changes in assumptions and methods.

Remaining comments addressed definitions of "plan," "actuarial present value," "actuarial present value of projected benefits," "contribution allocation procedure," "cost allocation procedure," and "market-consistent present value."

The committee also pointed out the need for consistency among ASOPs. "Finally, we support the ASB's efforts to coordinate ASOPs No. 4 and No. 6," the committee said. "Consequently, we encourage the ASB not to finalize ASOP No. 4 before considering any related comments on ASOP No. 6."

The Pension Finance Task Force noted that its "primary concern continues to be with just one of those topics, the proper measurement of pension obligations." To that end, the task force focused its comments on the use of the term "market-consistent present value" versus "market liability." The task force recommended that "market liability" be used instead for greater consistency and clarity and suggested the ASB review ASOP No. 6 for this terminology as well.

ASOP No. 6

On Aug. 30, the Joint Committee on Retiree Health sent **comments** to the ASB on a second exposure draft of ASOP No. 6.

The committee responded to six questions on which the ASB asked for

ASOPS, PAGE 4

‹LONGEVITY, FROM PAGE 2

ing Group at the NAIC Summer National Meeting on Aug. 24.

She explored the paper's focus on longevity risk and inadequate lifetime income as well as potential solutions.

"The problem cannot be solved with a single solution, but rather with a number of approaches that address lifetime income from different directions," she told regulators.

Some of those solutions include emphasizing financial literacy, reworking plan designs, and instituting policy changes such as increasing the Social Security maximum age and increasing the age for required minimum distributions.

Bennett also showcased the Academy's overall **Lifetime Income Initiative** and its work to raise awareness of the actuarial and public policy aspects of the issue.

Department of Labor

On Aug. 7, the Pension Committee **commented** on the Department of Labor's (DOL) Employee Benefits Security Administration **proposed regulations** for ERISA pension benefit statement requirements.

Specifically, the rule would require pension benefit statements to express a participant's accrued benefits as an estimated lifetime stream of payments as well as an account balance. Additionally, these accrued benefits would be projected to the participant's retirement date and then expressed as an estimated lifetime stream of payments.

In asking for comments, the DOL notes that it "intends to consider all reasonable alternatives to direct regulation, including whether there is a way short of a regulatory mandate that will ensure that participants and beneficiaries get constructive and helpful lifetime income illustrations."

The committee commended the DOL for developing the proposed regulations and commented on several topics, including inflation-adjusted annuity conversions, projected retirement ages, and assumed rate of investment return.

‹PBGC DEFICIT, FROM PAGE 1

several other commonly held views: a settlement-basis approach, a financial-economics approach, and an expected-return-on-assets approach. The issue brief determines that with all three alternative approaches, a PBGC deficit would still exist.

The settlement-basis approach would use high-quality corporate bond yields to derive a discount rate for PBGC calculations. The Citigroup Pension Liability Index (CPLI), a common measure, would place the discount rate around 3.9 percent on Sept. 30, 2012. A 78-basis-point change is not irrelevant. A 103-basis-point decline from FY 2011 increased the deficit by $10 billion.

But the duration of the CPLI is 20 years, compared with the PBGC liability's duration of 11 years. According to the Pension Committee, when properly accounting for duration, the interest rate equals about 3.5 percent, closer to the reported 3.28 percent rate. Additionally, corporate bond rate yields contain some degree of credit risk, which a PBGC annuity would not have. This lends credence to the notion that the ACLI survey method leads to a reasonable discount rate.

Proponents of the financial economics approach would argue that neither the annuity rate nor the settlement rate reflects a proper discount rate. In their view, the ACLI price quotes likely include a credit-risk premium. Instead, the discount rate should be based on a risk-free security, such as Treasury bonds. This would make the deficit larger than reported, but not by much.

Groups that claim the single-employer deficit does not exist argue the PBGC should discount the present value of benefits using an expected return on assets. According to the Pension Committee's calculations, raising the discount rates by 300 basis points would decrease the reported liabilities by $26.5 billion. An expected return of 6.6 percent would seemingly make the entire deficit disappear.

But the Pension Committee states that applying an expected return rate to the liabilities alone does not account for the changes interest rates could have on PBGC's assets. The agency currently invests its assets in 70 percent fixed income and 30 percent non-fixed income. If interest rates were to increase, the price of its assets would fall, and a deficit would still exist.

So the PBGC deficit is real, following the Pension Committee's analysis. But what does this suggest for future PBGC policy? The implication by some was that this means that PBGC could run out of money at some point. At first glance, it might appear to imply a need to raise premiums, something plan sponsors hope to avoid. Not so, according to the issue brief.

To assess whether PBGC should raise premiums, according to the Pension Practice Council issue brief ***Examining the PBGC Premium Structure***, it's important to break down the program's costs into going-forward costs and legacy costs. The legacy costs represent the "deficit." Going-forward costs represent the costs associated with ongoing coverage.

In the issue brief, the council applies insurance principles to assessing the premium structure. According to these principles, the cost of the insurance should be borne by members of that group. This implies that premiums should account for going-forward costs only, not legacy costs.

The brief acknowledges that unlike regular insurance, PBGC is mandatory and assessed only on viable, ongoing plan sponsors. However, existing legacy costs come primarily from plans already taken over by the PBGC. According to the brief, this implies that the costs represent entities no longer carrying the insurance and that past premiums were inadequate.

If using premiums to solve the entire problem is inappropriate, then funding must come from somewhere else. Several models exist, according to the brief. For instance, some state insurance funds and the Federal Deposit Insurance Corp.

PBGC DEFICIT, PAGE 6 ⇢

‹ASOPS, FROM PAGE 3

specific guidance and then went on to address additional areas in the ASOP. A year ago, the committee had commented at length on the exposure draft of ASOP No. 6, and it said that many of its initial concerns have been addressed in the revised version. However, the committee did point out remaining concerns surrounding terminology and other issues.

"There are fundamental differences between pension and retiree health, and our comments focus on the need for ASOPs to recognize those differences," the committee said. "We continue to have concerns that ASOP No. 4 language regarding pensions is used more than is needed within ASOP No. 6 and that the problem of implicit subsidies (and age-specific costs for groups in pooled health plans) is not sufficiently addressed."

In section-by-section comments, the committee noted needed distinctions between defined contribution and defined benefit retirement plans. It also emphasized the use of definitions such as "cost" versus "periodic cost," "implicit subsidy," "obligations," and "participating dependents."

The committee also stressed that revisions to both ASOP No. 4 and ASOP No. 6 should be consistent where necessary.

Modeling ASOP

The Pension Committee believes the ASOP exposure draft on modeling needs extensive rewriting to focus precisely on the issues the ASB wants to address. In its Sept. 27 **comments**, the committee states that the exposure draft defines "model" too broadly and would apply to straightforward calculations, such as setting a deterministic present value. According to the letter, in situations with straightforward calculations, "the exposure draft does not seem to have any positive effect and might instead add cost and exposure to routine work."

Pension Committee Comments on Form 5500

THE MANDATED ELECTRONIC FILING of Form 5500 has many advantages but raises concerns, particularly over transmission errors, according to a recent Pension Committee letter to the IRS. The letter focuses on Schedules SB and MB, which contain the actuarial information for single-employer and multi-employer plans and are prepared and signed by a pension plan's enrolled actuary. The letter cites advantages that electronic filing provides, including reduced error rates, reduced burden of correspondence, and fewer resubmissions. Mandatory electronic filing has also increased the speed and completeness with which data become publicly available.

The problem is that plan sponsors often use a separate firm instead of the enrolled actuary's firm to file electronically. The committee expressed serious concern over this process, because a manual input error can occur and the enrolled actuary cannot review the transcription before it gets submitted electronically.

Plan sponsors only become aware of an error at a later date when the IRS sends a letter that the actuarial valuation results are nonsensical or corrupt. Correcting these mistakes requires significant time and expense, according to the committee.

The potential for transmittal error calls into question the validity of the information contained in the electronically filed Schedules SB/MB, according to the committee. The letter proposes comparing a sample of the electronic filings with the PDF versions of the Schedules SB/MB forms in the filing packet.

If the sample review demonstrates an uncomfortable degree of discrepancies, the committee suggests creating a system that allows an enrolled actuary to directly submit those scheduled forms.

‹GRAY BOOK, FROM PAGE 1

sum exceeding $5,000 either must be split in half (with the second half available only as an annuity) or cannot be paid at all.

Question 17 makes it clear that a plan may provide that if its funded status later improves above 80 percent—enabling a full lump sum payment—participants who had previously chosen to take half of their benefit in a lump sum form may elect to take the present value of remaining annuity payments in a lump sum within 90 days of the adjusted funding target attainment percentage (AFTAP) certified above 80 percent (or within 30 days of their notification of this right, if later). This second event represents a second annuity starting date (ASD), and the participant must be offered the various other options (qualified joint and survivor annuity [QJSA], qualified optional survivor annuity [QOSA], and so forth) as well as a lump sum. The wording of this question is a bit confusing, but it appears that it may even apply to participants who did not elect to receive the one-half lump sum on their original ASD.

This means that a plan may be drafted to suggest that if a participant retires while the funded status of the plan is below 80 percent, he or she gets a completely new "bite at the apple" of the plan's full panoply of optional forms. This conclusion was certainly a surprise to me, but at least (or so it seems from the phraseology of the question and answer) it only applies if the plan is deliberately drafted to permit this second choice. The possible complications and drawbacks of this are mind-boggling if the participant has changed his or her marital status or if, for example, the original election was in a joint and survivor form, and the spouse has died in the interim.

It also seems to make it less desirable for plans to allow a "second bite" at the lump sum, once the funded status has improved, because of potential adverse selection by participants whose health or marital status has changed since their original ASD. It would have been much more helpful if the IRS had simply allowed the participant to choose to commute the remaining value of his or her annuity into a lump sum. One can only imagine the programming changes that benefit calculation companies would have to introduce if a plan were to adopt the language suggested by Question 17.

Question 18 is another variation on Question 17 and deals with the issue of whether a new spousal consent must be obtained at the second ASD if the participant's spouse had signed a "general consent" (as described in Q&A-31(c) of 1.401(a)-20), including language consenting to any future election the participant might make with respect to the restricted portion of the benefit. Surprisingly, the answer to this is yes, the participant must obtain a new spousal consent, because the first election applies only to the original ASD, not to the second ASD. This would seem to vitiate the value of such a supposed "general consent." Again, this answer surprised me. While I am sure the IRS has valid arguments based on prior regulations, the answer seems to fly in the face of common sense.

If the answers to Questions 17 and 18 are surprising, the answer to Question 19 is simply astonishing. The posited facts involve a plan with an AFTAP of 75 percent, in which some participants have elected to receive their half lump sum and some have elected to take another form of the full benefit. A year later the AFTAP rises to 82 percent. The sponsor wants to amend the plan to allow payment of the "lost half" lump sum. The question is: Can the sponsor restrict this amendment to those who

GRAY BOOK, PAGE 6 ›

Material Events and Current Plan Year Discussed

ON OCT. 3, the Pension Committee asked the Department of Labor (DOL) to revisit its interpretation of "current plan year," because confusion leads to some material events not being disclosed on the annual funding notice (AFN). The lack of disclosure could mislead or confuse participants who read the AFN, according to the **letter**.

Section 101(F) of ERISA requires that the annual funding notice disclose events that have a material effect on a plan's assets or liabilities during the current plan year. The DOL has interpreted "current plan year" to mean the year in which the notice is distributed, not the year to which the notice relates. To fix this disclosure gap, the committee recommends that the DOL interpret "current plan year" to mean the year to which the AFN relates.

‹PBGC DEFICIT, FROM PAGE 4

(FDIC) charge the industry to support failures. The council believes assigning the entire cost to defined benefit (DB) plan sponsors similar to this model could drive plan sponsors away from DB plans.

The council argues that only a portion of the legacy costs should be funded through premiums and the remaining through some other method. The brief offers several suggestions, including charging industries that most contributed to the PBGC deficit; assigning costs to all employers based on an allocation method, such as per employee; taxing the beneficiaries of qualified plans; or using general revenues.

PBGC's 2012 exposure report modeling showed no signs of failure in the next 10 years for the single-employer program. So regardless of the method, immediate funding is not required, according to the council. But stabilizing the deficit is. For going-forward costs, the council suggests adequate risk-based premiums. If done correctly, this could limit the growth of the deficit and assess plans in a way that limits legacy costs by requiring plans that are most likely to fail to pay the most.

DAVID GOLDFARB *is the pension policy analyst at the American Academy of Actuaries.*

‹GRAY BOOK, FROM PAGE 5

originally elected to bifurcate their benefits, or must the sponsor offer the new option to all participants who had an ASD when the plan was subject to the Section 436 benefit restrictions?

I would have thought that simple equity would lead to the conclusion that the amendment should be offered to all participants, but the Gray Book response states that "it would be acceptable" to offer this only to those who originally had taken the half lump sum. This seems inequitable to me because some of the participants who elected to take an annuity form may have done so to avoid the bizarre situation of receiving half their money in one form and half in another. It also seems a bit contradictory when compared to the answer to Question 17. An important little caveat is offered at the end of the answer, "as long as the requirements of 401(a)(4) are satisfied." Translated, this means that if most of the participants who chose the bifurcated benefit were highly compensated employees, the amendment would be or could be discriminatory in favor of the higher paid, which raises the specter of non-discrimination testing to adopt such an amendment.

Perhaps all of these questions are "angels dancing on the head of a pin" speculations, because it is hard to imagine when a plan sponsor would want to do such a thing. The matter of bifurcating benefits when a plan's AFTAP is below 80 percent is a messy one, and it is not hard to imagine that a sponsor would want to do the right thing and let participants have the other half of their lump sum once the funded status has improved. On a more practical level, it is also easy to imagine that the plan sponsor would want to get such participants off the books when it comes to paying PBGC premiums, which have become increasingly expensive. This is especially true since half the benefit already has been paid and the residual annuity might be so low that the present value of the annuity is less than the present value of expected PBGC premiums to be paid in the future.

Question 28 also concerns benefit restrictions based on an AFTAP. In this scenario, the prior year's AFTAP is 80 percent and would drop to 70 percent if the actuary does not issue a new AFTAP by or on April 1. The answer is that since the prior year's AFTAP is presumed to apply until April 1, and the new AFTAP (90 percent in this question) is issued on April 1, all the bad things that could occur are avoided. This just confirms that it is fine to sign your new AFTAP on April 1 (not March 31) to comply with the PPA restrictions. What is intriguing about this question (which otherwise seems fairly mundane) arises from Part (d) of the original question: "Is there a similar result for an Oct. 1 certification?"

No, says the IRS. "A certification must be issued no later than September 30 to avoid the AFTAP being conclusively presumed to be below 60 percent for the remainder of the plan year." What is interesting about this is the difference in treatment of the two AFTAP certification dates. For one, the first of the following month is acceptable; for the second, the first of the following month is not.

GRAY BOOK, PAGE 7 ›

Premium Filing Comments

THE PENSION COMMITTEE expressed strong **support** for proposed Pension Benefit Guaranty Corp. (PBGC) rules intended to reduce regulatory burdens related to premium filings. The new approach "simplifies and streamlines due dates, coordinates the due date for terminating plans with the termination process, makes conforming changes to the variable-rate premium rules, clarifies the computation of the premium funding target, reduces the maximum penalty for delinquent filers that self-correct, and expands premium penalty relief," **according** to the PBGC.

‹GRAY BOOK, FROM PAGE 6

But it also hints at a devious and devilish strategy: Suppose last year's AFTAP is 82 percent, and the departing president of the company takes an unlimited lump sum on March 28. This is perfectly acceptable under the PPA rules. The lump sum is quite large and alarms the new president, who tells the actuary, "I don't want to pay any more lump sums. Find me a way to accomplish that." The actuary, being clever, decides, "Well, I just won't issue any AFTAP this year." On April 1, only half lump sums can be paid, because the presumed AFTAP is now 72 percent, and on Oct. 1, the AFTAP will be conclusively presumed to be below 60 percent and no lump sums may be paid.

Interestingly, Question 20 posits that "pursuant to the sponsor's direction, the actuary has not issued an AFTAP certification since the plan was frozen," and then asks, "Are there any adverse consequences resulting from the lack of an AFTAP certification?" The response is, "No, as long as the plan remains frozen, does not pay UCEBs, (unpredictable contigent event benefits) and benefits are not improved." Reading this answer, the clever actuary decides, "Well, if the sponsor doesn't want to pay any more lump sums, I just won't issue any more AFTAPs. The plan will be deemed to have an AFTAP under 60 percent, and no lump sums can be paid."

Lump sums, especially in today's low interest rate environment, can be expensive. A plan burdened with a provision that allows unlimited lump sums cannot remove the provision from the plan without violating Section 411(d)(6).

In such circumstances, the last person to receive a lump sum payment would have been the former president of the plan sponsor, and one wonders about the potential for violation of the nondiscrimination rules, as well as the possibility for lawsuits by disgruntled participants who terminate employment in the future. But the strategy would seem to be airtight under the current rules as described in this year's Gray Book.

Lump sums, especially in today's low interest rate environment, can be expensive. A plan burdened with a provision that allows unlimited lump sums cannot remove the provision from the plan without violating Section 411(d)(6). The answers to Questions 20 and 28, when considered together, however, show that as long as the plan is frozen and doesn't pay UCEBs, the lump sum feature can effectively be removed by the sponsor, simply by directing the actuary never to issue an AFTAP. There is no requirement to issue one, and the only penalty is that the plan will be deemed to be below 60 percent funded, regardless of how well funded the plan actually is. It could be 100 percent funded, and this strategy would still allow the sponsor to effectively eliminate a troublesome benefit formerly protected by 411(d)(6), something I would have thought impossible. (The same logic would apply to a "Social Security level income" option, which is also protected by 411(d)(6).)

A number of other questions are worth a look, such as Question 36, in which the response frankly states that benefits that provide for annual CPI adjustments are not protected by 411(d)(6). This response surprised me quite a bit, because it seems to contradict answers in previous Gray Books. Instead, the annual increase is to be treated as "a current-year accrual," which leads to the unanswered question of whether these accruals should be valued as part of the target normal cost rather than as part of the funding target, which would require them to be fully funded when they occur, rather than amortized over seven years.

Another interesting question is 31, which considers a plan that requires distributions to begin at age 65, but where a participant cannot be located until age 67. Are the back payments between 65 and 67 (with interest) subject to the prohibited payments rules as a lump sum? The response is, "Although this is considered a prohibited payment, it is also a corrective distribution." It goes on to say that the plan administrator could make the back payments but that the plan sponsor would have to make a contribution equal to the restricted portion (see Rev. Proc. 2013-12, Section 6.02(4)(e)). This may be another possible quagmire for actuaries to avoid.

Other than the questions that deal with prohibited payments under Section 436, the answers in the Gray Book demonstrate that the fog created by the PPA's passage is beginning to dissipate and that clarity is gradually returning to pension actuarial work, a very welcome development.

JAMES A. KENNEY, *a pension consultant in Berkeley, Calif., is a contributing writer to the* EAR.