EAR

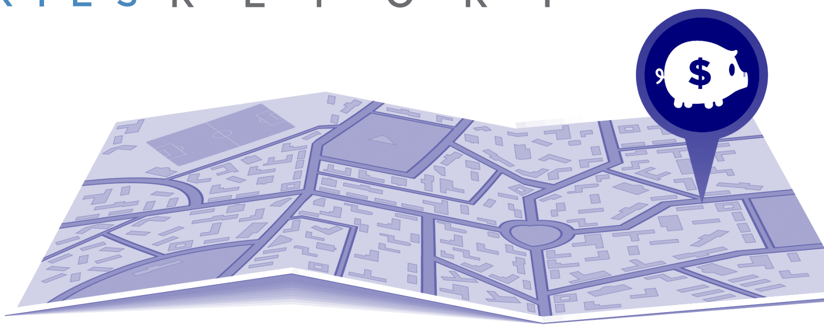
ENROLLED ACTUARIES REPORT

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

VOL.37 NO.4 WINTER 2012

JAMES KENNEY

Mapping the Future



THE MOVING AHEAD FOR PROGRESS IN THE 21ST CENTURY ACT (MAP-21 or MAP), which was signed into law on July 6, 2012, specifies interest rates to be used in pension plan calculations for plan years beginning in 2012 and later. Initially MAP-21 appeared to be another Band-Aid for the Pension Protection Act of 2006 (PPA) intended to ease the burden of high contributions to underfunded plans. Close review of IRS Notices 2012-55 and especially 2012-61, however, show that MAP-21 is much more revolutionary, even though it missed July 4 by two days.

There are two primary ways to look at MAP: tactically and strategically. As is often the case with rescue legislation, the tactical takes precedence.

Tactical Considerations

Most of MAP-21's tactical considerations revolve around two decisions that a plan sponsor can make:

- ➜ Whether to apply MAP-21 in the 2012 plan year (and if so, how);
- ➜ Whether to use segment rates instead of the yield curve to determine plan liabilities.

To be clear, the use of the new interest rate restrictions (for that is what they are) is mandatory for plan years beginning after 2012. It is only 2012 that is up for grabs.

But 2012 is almost over, so why would a plan sponsor want to forgo the opportunity to have a lower minimum required contribution—especially when a special provision of MAP preserves the prior maximum deduction the employer can take if it wants to put in more? A lower minimum, the same maximum—it's a no-brainer, right? Not exactly.

In the first place, most 2012 valuations were already done by the time MAP was passed; electing not to defer MAP until 2013 means higher actuarial fees to redo that valuation. In addition, the 2012 adjusted funding target attainment percentage (AFTAP) will be different—not just a little bit different, but *quite* different. Changes could include:

- ➜ Whether lump sums can be (or could have been) paid;
- ➜ Whether new benefits accrued in 2012 or could accrue for the part of 2012 after making the election described

MAP-21, PAGE 5 ⇢

Inside this issue

MARJORIE MARTIN

Fiscal Cliff and Retirement Plan Limits

WHAT ARE THE IMPLICATIONS for retirement plans if Congress and the president allow the economy to go over the "fiscal cliff" by allowing the Bush-era tax cuts to expire at the end of the year? The answer is nothing, aside from changing the relative tax advantage of plan benefits compared with the taxation of income from investments outside of the plan as a result of changes in tax rates for capital gains and dividends.

The implications of going off the fiscal cliff encompass a broad array of federal tax and spending issues. But for retirement plans, the Bush-era tax cuts included changes to the Internal Revenue Code (Code) in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). EGTRRA is the source of many benefit plan changes, including specific increases in the dollar limits used for plans. Other changes to retirement plans made by EGTRRA include:

- ➜ **Compensation limit**—The limit on annual compensation allowed to be taken into

FISCAL CLIFF, PAGE 6 ⇢

Top 10 Reasons You Should Attend the 2013 EA Meeting

THE 2013 ENROLLED ACTUARIES MEETING will be held April 8–10 at the Marriott Wardman Park Hotel in Washington. Hosted by the American Academy of Actuaries and the Conference of Consulting Actuaries, this annual meeting is the largest gathering of enrolled actuaries in the country. Here are the top 10 reasons you should join them:

1. Earn continuing education (CE) credits—2013 is the last year of the three-year enrollment cycle. The EA Meeting is a great opportunity to earn missing credit and fulfill the ethics and core credit requirements.

2. Attend sessions targeted to your specialty. This year practitioners who focus on public plans, multiemployer plans, or small plans can attend at least five sessions designed for their specific areas of practice.

3. Interact with actuaries from the IRS, the Social Security Administration, the Department of Labor, the Department of the Treasury, and the Pension Benefit Guaranty Corp. You'll have a number of opportunities to ask questions and share your concerns with these government representatives.

4. Find out about new rulings and regulations.

5. Hear experts discuss possible changes the new Congress will make to employee benefits and pensions.

Early Bird Registration

Academy and CCA members can save $580 off the walk-in registration fee if they register by Dec. 31.

Writers Wanted

IF YOU ARE PLANNING TO ATTEND THE 2013 EA MEETING AND WOULD BE WILLING TO WRITE A RECAP OF A SESSION FOR THE *ENROLLED ACTUARIES REPORT*, PLEASE CONTACT MARSHALL@ACTUARY.ORG.

6. Learn about new actuarial standards of practice and how they may change the way you practice.

7. Network with experienced practitioners who are passionate about their work and eager to share their expertise.

8. Catch up with old friends and colleagues during the Monday evening reception and during breaks between sessions.

9. Attend seminars before and after the meeting for additional learning and CE credits.

10. Visit Washington during the 2013 National Cherry Blossom Festival (March 20-April 14, 2013).

Click here for more information and to register for the 2013 EA Meeting.

Joint Board Advisory Group to Meet in January

THE JOINT BOARD FOR THE ENROLLMENT OF ACTUARIES' ADVISORY COMMITTEE ON ACTUARIAL EXAMINATIONS will meet Jan. 10–11, 2013, to discuss topics and questions for inclusion on future joint board examinations. According to a Dec. 4 announcement in the *Federal Register*, the committee will discuss the joint board's examinations in actuarial mathematics and methodology and make recommendations concerning the November 2012 Pension (EA-2A) Joint Board Examination, including a recommendation on a minimum acceptable passing score.

A portion of the meeting, scheduled for Jan. 11 from 1 p.m. to 3 p.m., will be open to the public. Members of the public who wish to make oral statements at the meeting should notify the board's executive director in writing and submit text or an outline of their proposed comments. Notifications of intent to make an oral statement or to attend must be faxed to 202-622-8300, Attn: Executive Director, no later than Jan. 4, 2013.

The meeting will be held at the IRS headquarters, 1111 Constitution Ave. N.W., in Washington. Anyone planning to attend the public session should notify the executive director in writing to obtain entry to the building.

Written statements for consideration by the joint board and the committee can be sent to:

Internal Revenue Service
Attn: Patrick W. McDonough, Executive Director
Joint Board for the Enrollment of Actuaries SE: RPO
Room 7550
1111 Constitution Avenue NW
Washington, DC 20224–0002

Updated Social Security and IRS Amounts for 2013

These four tables list updated figures for IRS pension limits, Social Security amounts, covered compensation, and PBGC premiums for 2013.

Andrew Eisner of Buck Consultants Knowledge Resources Group compiled the tables.

Covered Compensation, 2013

(Advanced calculation—pending IRS release of amounts)

2013 WAGE BASE $113,700

YEAR OF BIRTH	AGE IN 2013	SSRA	YEAR OF SSRA	COVERED COMPENSATION ROUNDED TO			
				$1*	$12	$600**	$3,000
1946	67	66	2012	64,566	64,560	64,800	66,000
1947	66	66	2013	67,309	67,308	67,200	66,000
1948	65	66	2014	69,903	69,900	70,200	69,000
1949	64	66	2015	72,411	72,408	72,600	72,000
1950	63	66	2016	74,811	74,808	75,000	75,000
1951	62	66	2017	77,134	77,124	77,400	78,000
1952	61	66	2018	79,363	79,356	79,200	78,000
1953	60	66	2019	81,531	81,528	81,600	81,000
1954	59	66	2020	83,649	83,640	83,400	84,000
1955	58	67	2022	87,694	87,684	87,600	87,000
1956	57	67	2023	89,657	89,652	89,400	90,000
1957	56	67	2024	91,534	91,524	91,800	93,000
1958	55	67	2025	93,317	93,312	93,600	93,000
1959	54	67	2026	95,040	95,040	94,800	96,000
1960	53	67	2027	96,703	96,696	96,600	96,000
1961	52	67	2028	98,306	98,304	98,400	99,000
1962	51	67	2029	99,823	99,816	99,600	99,000
1963	50	67	2030	101,323	101,316	101,400	102,000
1964	49	67	2031	102,780	102,780	102,600	102,000
1965	48	67	2032	104,160	104,160	104,400	105,000
1966	47	67	2033	105,454	105,444	105,600	105,000
1967	46	67	2034	106,629	106,620	106,800	108,000
1968	45	67	2035	107,700	107,700	108,000	108,000
1969	44	67	2036	108,651	108,648	108,600	108,000
1970	43	67	2037	109,474	109,464	109,200	108,000
1971	42	67	2038	110,237	110,232	110,400	111,000
1972	41	67	2039	110,974	110,964	111,000	111,000
1973	40	67	2040	111,651	111,648	111,600	111,000
1974	39	67	2041	112,209	112,200	112,200	111,000
1975	38	67	2042	112,671	112,668	112,800	113,700
1976	37	67	2043	113,006	113,004	112,800	113,700
1977	36	67	2044	113,203	113,196	113,400	113,700
1978	35	67	2045	113,400	113,400	113,400	113,700
1979	34	67	2046	113,597	113,592	113,700	113,700
1980	33	67	2047	113,700	113,700	113,700	113,700

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

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

PBGC Premiums

	2013	2012
Single-Employer Plans:		
Flat-rate premium (per participant)	$42	$35
Variable-rate premium	$9 per $1,000 of unfunded vested benefits Maximum of $400 per participant	$9 per $1,000 of unfunded vested benefits
Multiemployer Plans:		
Flat-rate premium (per participant)	$12	$9

Social Security—2013 Factors

Wage Base The maximum amount of earnings taxable in 2013 is $113,700 for Social Security purposes.

COLA The cost-of-living increase in benefits is 1.7 percent, first applicable to December 2012 benefits, payable in January 2013.

Wage Index The Average Annual Wage figure of $42,979.61 will be used in computing benefits for workers who become eligible in 2013. This figure is based on data for the last complete year (2011) and was used to determine other wage-indexed numbers given in the table below.

FACTOR		2013	2012
Wage base:			
	for Social Security	$ 113,700	$ 110,100
	for Medicare	No Limit	No Limit
	old-law wage base, for indexing PBGC maximum, etc.	$ 84,300	$ 81,900
Cost-of-living increase (applies to December benefits, payable in January)		1.7%	3.6%
Average annual wage (based on data two years earlier)		$42,979.61	$41,673.83
PIA formula, first bend point		$ 791	$ 767
PIA formula, second bend point		$ 4,768	$ 4,624
Maximum family benefit, first bend point		$ 1,011	$ 980
Maximum family benefit, second bend point		$ 1,459	$ 1,415
Maximum family benefit, third bend point		$ 1,903	$ 1,845
Retirement test exempt amount (annual)			
	below SSNRA	$ 15,120	$ 14,640
	year of SSNRA	$ 40,080	$ 38,880
Wages needed for one quarter of coverage		$ 1,160	$ 1,130
FICA (employee) tax rate*:			
	Social Security (OASDI)	6.20%	4.20%
	Medicare (HI)	1.45%	1.45%
	Total	7.65%	5.65%
SECA (self-employed) tax rate, total		15.30%	13.30%

* Beginning in 2013, an additional .9 percent Medicare tax rate will apply on wages over $200,000 for single filers, $250,000 for joint filers, or $125,000 for married filing separately. The 6.20 percent tax rate for employees was reduced by law for 2011 and 2012 to 4.20 percent. Currently, no reduction is in place for 2013.

IRS Qualified Plan Limits for 2013

Principal Limits

IRC	LIMIT	2013 ROUNDED	2012 ROUNDED	2013 UNROUNDED	NEXT INCREMENT	% INCREASE NEEDED
415(b)(1)	Defined benefit plan limit	$ 205,000	$ 200,000	$ 207,280	$ 210,000	1.4%
415(c)(1)	Defined contribution plan limit	51,000	50,000	51,820	52,000	0.4%
401(a)(17)	Limit on includable compensation*	255,000	250,000	259,100	260,000	0.4%
402(g)(1)	Limit on 401(k)/403(b) elective deferrals	17,500	17,000	17,547	18,000	2.6%
414(q)	HCE definition	115,000	115,000	117,072	120,000	2.6%
414(v)(2)	401(k)/403(b)/457(b) catch-up deferral limit	5,500	5,500	5,849	6,000	2.6%

Other Limits

IRC	LIMIT	2013 ROUNDED	2012 ROUNDED	2013 UNROUNDED	NEXT INCREMENT	% INCREASE NEEDED
457(b)	Limit on deferrals	$ 17,500	$ 17,000	$ 17,547	$ 18,000	2.6%
416(i)	Top-heavy key employee definition	165,000	165,000	168,415	170,000	1.0%
409(o)(1)(C)	ESOP payouts, five-year limit	1,035,000	1,015,000	1,036,400	1,040,000	0.4%
409(o)(1)(C)	ESOP payouts, additional one-year limit	205,000	200,000	207,280	210,000	1.4%
408(k)(2)(C)	SEP pay threshold	550	550	583	600	3.0%
132(f)(2)(A)	Commuter/transit limit (monthly)**	130	125	130	135	3.9%
132(f)(2)(B)	Parking limit (monthly)	245	240	246	250	1.7%

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

** Advance calculation—pending IRS release of amount (amounts shown may change because of IRS rounding interpretation).

in Notice 2012-61 Q&A T-3 (there are a number of elections that may be made under MAP, and Notice 2012-61 is the best source to learn about them);

- Whether unexpected contingent event benefits were triggered or could be triggered after the date of the election referred to above.

These are weighty issues, especially for severely underfunded plans. If your plan offers unlimited (or very large) lump sums, and your old AFTAP was under 60 percent, do you really want a new AFTAP of 72 percent, or even worse, 82 percent? In Notice 2012-61, Q&A T-3 details special rules you must follow if your new AFTAP was certified after Sept. 30, 2012. But even if it was certified before that date, the change in benefits restrictions can be applied either prospectively or retroactively. Be careful because the language in this Q&A is extremely complicated and hard to follow.

Applying a threshold-changing AFTAP retroactively is inherently tricky, but Notice 2012-61 gives it a superb try. The notice details exactly how to clean up any failures in plan operations, e.g., a failure to pay a special early retirement benefit due to a plant closing (and whether the closing happened during the three-month presumption period at the beginning of the year, or whether it happened after the initial AFTAP was issued by April 1, 2012). This is messy stuff that deals with the voluntary compliance program, and Notice 2012-61 is a valiant effort to resolve these issues.

The notice does not solve concerns about prohibited payments. Q&A T-4(f) deals, somewhat obliquely, with this issue: "If…a participant…is entitled to…benefits payable in a different form of payment (and who elects such different form of payment, with spousal consent, if applicable), the required correction is to provide the benefit payments in the increased amount or other form of payment…"

For those who would like to receive a retroactive lump sum, the notice continues ominously: "However, if payments have already commenced, the correction is to provide the participant with (1) the future benefit payments in the same manner and amount…and (2) a make-up for past underpayments."

This would seem to preclude lump sum payments, as in this hypothetical case:

Maria Chavez retired on June 1, 2012, at age 62. Her plan provided for unlimited lump sums, but its 2012 AFTAP was 57 percent. Maria was told she could receive only monthly payments, not a lump sum. She needed money because of her financial circumstances, so, with her husband's consent, she elected a single-life early retirement benefit.

Because the plan sponsor did not elect to defer MAP until 2013, the plan's AFTAP is now 80 percent. Can Maria get the lump sum that she had been promised under the plan?

A careful reading of Q&A T-4(f) would suggest that the answer is no. By initiating payment of a monthly benefit, Maria has no remedy under the MAP transition correction provisions. (She may have a legal remedy however, which MAP-21 does not address.) If Maria's colleague, Charles, had retired on the same day, but had delayed making up his mind about what benefit to take, under Q&A T-4(f) it appears that Charles would be eligible to receive a lump sum.

Procrastination never looked so good.

Of course, the plan sponsor could apply to the IRS for an alternative approach (and may want to if challenged) and it seems likely that the IRS would find some way to avoid a difficult situation for all concerned.

Not that the authors of Notice 2012-61 have it wrong. Changing the form of a benefit once it has gone into pay status is generally forbidden. But there have been cases involving terminating pension plans, where retirees were offered Internal Revenue Code 417(e)(3)-compliant lump sums with appropriate spousal consent, that show that this prohibition is not all inclusive.

Strategic Implications

Fascinating, and pressing, as the tactical considerations about MAP-21 are, the strategic implications are even more compelling.

It's fair to say that the PPA was based on a philosophical scaffolding of what we might call "a Polaroid moment." Both asset values and interest rates used to determine pension liabilities were to be "marked to market" on the valuation date, and the pension plan measured as if it were just another corporate asset or liability. Accountants had long urged this position, wanting, as accountants tend to want, a definite measurement of the corporate enterprise at a definite point in time. It was the fuzziness of actuarial judgment that led first to regulation of mortality tables, then to interest rates, and finally, to actuarial methodology itself.

This conceptual framework of the PPA was reasonable in a world in which almost everything worth owning (except real estate) could be valued at a moment's notice. But that was before the 2008 market crash, which revealed that instantaneously determined market values, especially of interest rates, were largely illusory. PPA's inner logic fit very well with the brave new world of immediate valuation promoted by high-frequency trading and the globalization of commerce. Actuaries had long given up the fight to control the mortality assumptions they could use; that battle was lost 20 years ago. The fight over interest rates took longer and was not definitively resolved until the passage of the PPA.

What most non-actuaries don't realize, though, is that present values aren't driven mostly by mortality tables; they're driven by interest rates. That's why nearly every year since the passage of the PPA, it's been necessary to apply one more Band-Aid to the "interest rate problem." But MAP is anything but a Band-Aid. Instead, it is a frontal assault on the idea that marking interest rates to market is sensible. Instead of a 24-month average, MAP uses a 300-month average of interest rates to measure pension liabilities. This is a *fundamental* change.

The 300-month average will change very slowly. What will change quickly is the percent of the MAP rates that will be used in the new calculations: 90 percent in 2012, 85 percent in 2013, 80 percent in 2014, 75 percent in 2015, and 70 percent thereafter. One of the problems with giving clients good advice after the passage of

MAP-21, PAGE 6 ⋯›

‹MAP-21, FROM PAGE 5

the PPA was that it just wasn't possible to tell what next year's segment rates would be and, therefore what their liabilities would be.

Now MAP-21 puts a floor under those interest rates. There is still a lack of transparency in Notice 2012-55's description of how the 2012 rates were determined, and the notice includes a caveat that they may be determined differently in future years. But the basic parameters are laid out, and it is now possible to estimate the maximum accrued liabilities for a frozen plan with a fair degree of accuracy for at least the next three years, and possibly for much longer.

This makes determining contribution cash flow much more reliable, which will help companies budget more accurately. It also makes deciding whether to implement a "term-vested lump sum window" much more cost focused. (The actual lump sums paid will exceed the MAP-21 funding targets by a considerable margin, thereby causing either actuarial losses or Section 436 contributions.)

Since not all products of a valuation are based on the MAP-restricted interest rates, it will be necessary to carry out two valuations each year. Pension Benefit Guaranty Corp. variable rate premiums will not be lowered by this change, even under the alternate method that uses liabilities determined in the Section 430 valuation.

What is fairly obvious is that unless short-term interest rates rise significantly in the next five years, the first segment rate will always be the applicable percentage of the 25-year MAP-21 rate. This will have the greatest impact on plans that are heavily weighted towards retirees, since the five years of payments after the valuation date will be discounted at an artificially high 70 percent MAP rate, rather than the PPA's "Polaroid rate."

In the short term, the liability reduction will come from active employees and terminated-vested participants, but in the long run, the real reductions will be associated with retirees, especially older retirees. For this reason, frozen plans will be affected the most, and employers may want to think twice before offering a "term-vested cash-out window" in response to the dramatic increase in per-participant premiums.

It's tempting, but the math just isn't there.

Decision Deadline

Notices 2012-55 and 2012-61 are full of information too voluminous to summarize completely here. If your client wants to elect out of MAP for 2012, he or she has until the due date (with extensions) of the Form 5500 to make a valid election. If your client wants to apply the MAP rates for 2012 and this causes the AFTAP to cross a threshold, 2012-61 Q&A T-4 is essential reading, and an election on how to handle the lifting of the 436-benefit restrictions is either required or a very good idea.

JAMES KENNEY *is a pension consultant in Berkeley, Calif.*

‹FISCAL CLIFF, FROM PAGE 1

account in determining benefits in qualified plans rose from $170,000 in 2001 to $200,000 for 2002.

- **Allocation limits for defined contribution plans**—Code Section 415 annual addition limits rose from $35,000 to $40,000 in 2002, and the 25 percent of compensation limit was reset at 100 percent. Limits on elective deferrals rose to $11,000 in 2002 (from $10,500 in 2001), faster $1,000 annual increases were put in place through 2006, and the various catch-up contribution opportunities were added.
- **Roth contributions**—The option to allow elective deferrals to be made on a Roth basis was added.
- **Vesting**—A faster vesting rule for matching contributions (100 percent after three years or a six-year graded schedule) was mandated.
- **Multiple use test**—This onerous test, which combined actual deferral percentage and actual contribution percentage test results for elective deferrals and matching contributions, was repealed.
- **Portability for eligible rollover distributions**—The rollover rules across various types of plans were harmonized so that, for example, qualified plan money could be rolled over into a participant's 403(b) annuities and governmental 457(b) plans.

Permanence in PPA for Retirement Plans

As with other tax changes in EGTRRA, the benefit plan changes were set to sunset at the end of 2010, but the Pension Protection Act of 2006 removed the sunset provisions for retirement plans and individual retirement accounts. Unless and until Congress revisits and specifically revises these retirement plan rules by future legislation, plan administrators need not fret that falling off the fiscal cliff will automatically change plan operations that stem from the EGTRRA changes. As a result, the 2013 cost-of-living adjusted plan limits announced by the IRS in October will apply as planned.

Looking Ahead

As the *Enrolled Actuaries Report* goes to press, the debate over how to raise revenue and cut spending continues, and it seems unlikely that Congress will pass changes during the lame-duck session that will rein in current benefit plan limits. Until actual changes are enacted, plan sponsors should aim to implement the 2013 benefit thresholds and assume business as usual for limits that the IRS specifically has announced. It is expected that any future changes that are not automatically triggered by the fiscal cliff will have prospective effect and offer a reasonable time frame for implementation.

MARJORIE MARTIN *is director of knowledge resources for Buck Consultants in Washington.*