

EAAR

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

ENROLLED ACTUARIES REPORT

VOL. 37 NO. 1 SPRING 2012

New EA Exam Structure Effective in 2013

THE JOINT BOARD FOR THE ENROLLMENT OF ACTUARIES (JBEA) is restructuring the enrolled actuaries' examinations to allow for more thorough testing of the interaction between the legal aspects of pensions and the funding rules. The restructured exams will reverse the normal sequence currently assumed for taking the two segments of the EA-2 examination.

Beginning in 2013:

- EA-1 remains unchanged. It will continue to cover the mathematics of compound interest and practical financial analysis and the mathematics of life contingencies and practical demographic analysis. This examination will continue to be given in May each year.
- EA-2 (Segment B) will be renamed EA-2 (Segment L). This "Law" section will cover relevant pension laws—in particular the provisions of the Employee Retirement Income Security Act (ERISA) and related laws, regulations, and rulings—as they affect pension actuarial practice. The exam will presume knowledge of topics covered in the EA-1 exam; it will still be given in May each year.

→ EA-2 (Segment A) will be renamed EA-2 (Segment F). This "Funding" section will cover the selection of actuarial assumptions and calculation of minimum required and maximum tax-deductible contributions under current pension law, along with the related actuarial mathematics. The exam will presume knowledge of topics covered in the EA-1 and EA-2 (Segment L) exams; it will continue to be given in November each year.

While the assumed normal sequence for taking the exams will be EA-1 → EA-2 (Segment L) → EA-2 (Segment F), candidates may take the examinations in any sequence desired. When deciding the for order sitting for the examinations, candidates should consider the knowledge that will be presumed for each of the exams.

The topics covered in each of the segments generally will be unchanged, but there may be changes to the suggested reading lists to reflect that the legal aspects of pensions will be emphasized in EA-2 (Segment L) and that the funding and tax-deduction aspects of pensions will be emphasized in EA-2 (Segment F).

Additional information is available on the JBEA [website](#).▲

GORDON ENDERLE

Revised ASOPs Exposed for Comment

THE ACTUARIAL STANDARDS BOARD (ASB) in January issued a new exposure draft of Actuarial Standard of Practice (ASOP) No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*, and a second exposure draft of ASOP No. 27, *Selection of Economic Assumptions for Measuring Pension Obligations*. Actuaries should take time to review the drafts because they contain significant new material. Comments on both exposure drafts are due by May 31, 2012.

One of the new features of the ASOP No. 27 second exposure draft is the revised definition of a reasonable assumption. An assumption was considered reasonable in the first exposure draft

if it was not expected to produce gains or losses (similar to the approach taken in ASOP No. 35, *Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations*, which also is pending revision). In the second exposure draft, a reasonable assumption is defined qualitatively rather than quantitatively and relies on the actuary's professional judgment. In another change, the second exposure draft has reordered the sections to improve the flow of the statement.

Many of the new features in the first exposure draft were retained in the second exposure draft. The proposed standard, for example, still requires actuaries to disclose the rationale behind

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MARTHA L. TEJERA

Treasury Proposes Changes to Retirement Income Rules

Taking Small Steps in the Right Direction

THE DEPARTMENT OF THE TREASURY released a package of proposed regulations and revenue rulings on Feb. 2 that are intended to encourage broader utilization of annuity distribution options for both defined benefit (DB) and defined contribution (DC) plans. While the rule changes—which are the result of deliberations by Treasury and the Department of Labor that began in 2010—are welcome, they are limited to a narrow set of issues that are relatively easy to resolve. Much bigger and more significant challenges remain to be tackled if the retirement security of America’s aging workforce is to be improved significantly.

The Problem

As corporate America has abandoned traditional DB plans in favor of DC plans, individuals have been exposed to a variety of risks, including market, interest rate, longevity, inflation, sequencing, and behavior.

More and more individuals, as a result, face greater uncertainty in retirement. Those exercising caution may continue to work beyond their point of productivity, which results in unsatisfactory working conditions for the employee and creates workforce-management challenges for the employer. Others may enter retirement only to run out of money and be forced to subsist on Social Security and rely on the generosity of others. This puts more pressure on an already stressed entitlement program and on the “sandwich generation” of people who care for their aging parents while supporting their own children.

Encouraging retirees to annuitize their savings will not solve the problem of *adequacy*, but it will address the issue of *certainty*. In this context, adequacy means sufficient income, while certainty means a guaranteed income for life, e.g., an annuity.

The Initial Fix

The Treasury Department addresses four areas that currently discourage plan sponsors from offering greater access to annuities and retirees from selecting options with annuity features. Treasury’s proposal would:

- **Allow participants to access longevity insurance through a DC plan.** Longevity insurance is a deferred annuity that makes payments if and when a retiree reaches a predetermined age, such as 85. Retirees may find this more attractive than an immediate annuity because it allows them to retain control of the bulk of their savings, manage the draw-down to a set point in time, and be assured of a steady income stream to supplement Social Security late in life. For tax reasons, it is preferable to purchase longevity insurance through a DC plan or IRA, but current minimum required distribution rules make this difficult. As the retiree draws down the account balance, at some point assets will be insufficient to make the minimum required distributions without cashing in the longevity insurance. This is because the value of the longevity insurance is included in the total account balance. The proposed regulations address this by allowing the value of the longevity insurance to be excluded from the account balance when minimum required distributions are calculated. This is an admirably simple solution, but it will only support the ultimate goal of increasing use of annuities if plan sponsors are encouraged to make longevity insurance available and if they help educate employees about how it can help them protect their standard of living during old age. (IRC 401(a)(9))
- **Clarify spousal consent rules in DC plans.** Plan sponsors were reluctant to take on the burden of obtaining spousal consent for pre-retirement and post-retirement survivor benefits if deferred annuities were offered in a profit-sharing plan. Under this proposal, the plan sponsor does not have to obtain spousal consent at the time the participant elects to invest in a deferred annuity if the annuity meets certain requirements. It becomes the insurance company’s responsibility to ensure the appropriate disclosures are made and consents obtained before the annuity begins. This is just one of several

RETIREMENT INCOME RULES, PAGE 5 →

Asymmetric Risk in OPEB Liabilities

THE TERM ASYMMETRIC RISK is used primarily in investments to describe when an asset experiences a gain after a determinative factor moves in one direction but experiences a loss of a significantly different magnitude after the factor moves the same amount in the other direction. The same principles, however, can apply in analyzing liabilities.

The analysis of a recent loss by a retiree medical other post-employment benefits (OPEB) plan revealed an asymmetric risk when setting liabilities for OPEB plans. The determinative factor for the loss was the distribution of spousal ages for the new retirees. The plan's liabilities were related strongly to coverage before age 65 since sponsor support is greatly reduced after retirees are eligible for Medicare.

The analysis showed that benefits for active employees in an OPEB plan may be undervalued if a uniform spousal age difference of three years is assumed—even if the actual spousal average age difference is exactly three years. To appreciate the dynamics involved, consider the following examples of two married employees retiring at age 65 for which the average age difference is three years:

Example 1: Both of the retired employees have a spouse who is three years younger than they are. The average age difference is three years, and there are six years of pre-65 coverage.

Example 2: One retired employee's spouse is four years older than the retiree, and the other retired employee's spouse is 10 years younger than the retiree. The average age difference is still three years, but there are 10 years of pre-65 coverage.

In each case, the average difference in spousal age is three years. The second case displays asymmetry since the younger spouse triggers a significant loss and the older spouse triggers a much less significant gain.

To incorporate this asymmetry in OPEB valuations we first broke data for the plan's retirees into quartiles of age differences (spouse's age minus the employee's age) and took averages:

Quartile	Age Difference (Male)	Age Difference (Female)
1	-7.7	-1.5
2	-3.4	1.1
3	-1.4	3.1
4	1.1	7.7
All	-2.9 (Std. Dev. of 4.3)	2.6 (Std. Dev. of 3.9)

We then did valuations for active participants by employee gender, using the above quartile average age differences. Next,

we averaged the results for each gender and interpolated the liability/age difference function to match that average.

The employer-paid OPEB coverage costs before age 65 vary widely between 1.5 and 20 times those for later ages. The suggested age differences, adjusted for asymmetry, are as follows:

Multiple	Husband Age Minus Wife Age		Youngest Retirement Age
	Male Employee	Female Employee	
1.5	2.9	2.5	55
2	3.0	2.0	55
3	3.1	1.0	55
4	3.1	.9	55
7	3.1	.9	55
12	3.2	1.1	55
20	3.2	1.0	55
1.5	3.0	2.5	62
2	3.1	2.0	62
3	3.2	1.6	62
4	3.0	1.4	62
7	3.0	.9	62
12	3.0	.8	62
20	3.3	.7	62

Actuaries valuing active employees in OPEB plans should consider assuming that husbands of future female retirees will be only one or two years older than the retirees. The customary three-year difference still seems appropriate when valuing male employees.

These results might not be appropriate for every OPEB plan. Results will vary by retirement age pattern and benefit structure. An actuary could do a similar set of eight valuation runs (male and female employees, each at four different spousal age differences) and more confidently tailor the gender's spousal age assumption for each plan. A stochastic analysis very likely would provide better results, but software is not yet readily available to perform such an analysis.

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the selection of non-prescribed assumptions. The discussion of geometric and arithmetic investment returns without promoting one over the other also was retained. (For more on the first exposure draft, see the spring 2011 *EAR*.)

Like the second exposure draft of ASOP No. 27, the sections of the ASOP No. 4 exposure draft have been reordered to improve the flow of the statement. The exposure draft also refines some of the concepts in the current standard and introduces several new concepts. The changes include:

- Differentiation between actuarial present values that are based on expected asset returns and present values that are based on fixed-income yields;
- Definition of a market-consistent present value;
- Definition of funded status and a disclosure requirement for plans that are described as fully funded;
- Increased disclosure regarding gain sharing or other asymmetric plan provisions;
- Expanded assessment of a plan sponsor's contribution allocation procedure;
- Inclusion of an asset valuation method as part of the cost or allocation procedure; and
- Increased disclosure regarding the rationale for any changes in a cost or contribution allocation procedure.

The changes to ASOP No. 4 are significant and can have far-reaching effects in our work as pension actuaries. Actuaries should keep in mind that ASOP No. 4 is considered the umbrella standard for pension obligation measurements. If ASOP No. 4 conflicts with another standard, ASOP No. 4 will govern.

More Changes to Come

The ASB's Pension Committee plans to update ASOP No. 35 after ASOP No. 27 is finalized so that the two standards provide consistent guidance. The definition of a reasonable assumption in ASOP No. 35 and the disclosure requirement for assumption selection are two areas on which the committee plans to focus.

The Pension Committee also is drafting a new standard that

will provide guidance on the assessment and disclosure of pension risk. The committee expects to bring a proposed standard to the ASB for consideration later this year. ▲

GORDON ENDERLE, a consulting actuary at Towers Watson in Milwaukee, is the chairperson of the ASB's Pension Committee.

Submitting Comments

Thoughtful comments from the actuarial community play a vital role in ensuring the quality of our standards of practice. Enrolled actuaries are encouraged to review the ASOP No. 4 and ASOP No. 27 exposure drafts and submit comments to the ASB by May 31, 2012. You may send your comments by email (comments@actuary.org) either in the body of the message or in an attached Word document. You must include the phrase "ASB COMMENTS" in the subject line of your message. Any email message not containing this exact phrase in the subject line will be deleted by the ASB's spam filter.

While email is the preferred method, the ASB also will accept comments by conventional mail sent to:

ASOP No. 4 Revision or ASOP No. 27 Revision
Actuarial Standards Board
1850 M Street NW, Suite 300
Washington, DC 20036

The ASB posts all signed comments received to its website to encourage transparency and dialogue. Unsigned or anonymous comments will not be considered by the ASB or posted to the website. The comments will not be edited, amended, or truncated in any way. The ASB website is a public website, and all comments will be available to the general public.

Learn More at the EA Meeting

Don't miss Session 604, New ASOPs for Setting Actuarial Assumptions, at the Enrolled Actuaries Meeting in March. Join panelists Sheila Kalkunte, James Verlutz, and Gordon Enderle as they discuss the proposed changes to ASOP No. 4 and ASOP No. 27, and other changes being considered by the ASB. Find out how setting actuarial assumptions for valuing pension obligations has changed and what it means for actuarial practice.

2012 Enrolled Actuaries Meeting

March 25-28

Marriott Wardman Park Hotel in Washington

It's not too late to register for the largest meeting of enrolled actuaries in the world! The 37th annual Enrolled Actuaries Meeting will feature more than 60 sessions on various aspects of pension plan funding and administration, new rulings and regulations, and professionalism issues.

The general sessions will cover:

- Pension Funding to Avoid Ruin
- Social Security Financial Situation and Options
- Measuring and Managing Longevity Risk

Additional sessions are available before and after the meeting, including:

- Professional Standards Seminar on March 25
- Business Development and Relationship Management Skills Seminar on March 25
- Public Plans Update on March 28
- 2012 Pension Symposium on March 28 and 29

The EA Meeting is sponsored by the Academy and the Conference of Consulting Actuaries. For more information and to register, go to <http://enrolledactuaries.org/>.

perceived administrative burdens associated with offering annuities. It very likely will not have a significant impact if other critical issues also are not addressed. (Revenue Ruling 2012–3)

→ **Allow retirees to use DC account balances to purchase DB credits.** This proposal achieves the goal of giving participants access to a low-cost and convenient annuity. It would be low cost because DB plans do not have the same overhead, sales costs, and profit goals that traditional insurance companies have. If the employee already is entitled to an annuity from the DB plan, it would be convenient because the payments could be combined. It would be an option for employees, however, only if their employer sponsors a DB plan, if their employer is interested in expanding the liabilities of its DB plan, and if retirees want an annuity in the first place. These are some pretty big “ifs.” (Revenue Ruling 2012–4)

→ **Make it easier to allow partial annuities in DB plans.** The proposed regulations would allow a partial annuity to be calculated as a pro rata portion of the full annuity instead of having to be recalculated using the statutorily prescribed assumptions. This should be less confusing for participants already overwhelmed with deciphering “relative values,” which most likely contributes to more retirees taking the full lump sum because at least that they can understand. While this may encourage plan sponsors to offer partial annuities, unless more is done to make the entire benefit distribution election

process easier for employees to understand and assess, it may not achieve the ultimate goal of seeing more retirees opt for annuities. (IRC 417(e))

Are Bigger Steps to Come?

Treasury’s proposed regulations are a welcome indicator that government wants to help address the need for greater retirement security. While the proposed changes do mitigate some regulatory barriers to higher utilization of annuities by retirees, they will have only a marginal effect.

To improve retirement security significantly, much bigger steps are needed. Employers need help overcoming both real and perceived fiduciary liability associated with offering annuities through DC plans. Employers also need help educating their employees so they make good choices in preparing for retirement. Additional steps are needed to help individuals appreciate and address the multiple risks associated with managing their savings during retirement.

The goal is for more working Americans to achieve a secure retirement. Annuities are uniquely suited to play an important role in making that happen. ▲

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Treasury/White House Issue Lifetime Income Guidance

Editor’s Note: The following is taken from an Academy Alert sent to Academy members on Feb. 9, 2012.

ON FEB. 2, the Treasury Department issued proposed regulations and revenue rulings relating to providing lifetime income through qualified retirement plans. The rules and rulings address defined benefit and defined contribution plans, as well as individual retirement accounts (IRAs).

Proposed Regulations

→ [Longevity Annuity Contracts](#)

Longevity annuities, or deeply deferred annuities, would be permitted in defined contribution plans and IRAs subject to certain restrictions through new regulations related to IRC 401(a)(9) – minimum distributions.

→ [Modifications to Minimum Present Value Requirements for Partial Annuity Distribution Options Under Defined Benefit Pension Plans](#)

Partial lump sums and partial annuities would be simplified through proposed regulations to IRC 417(e).

A public hearing is scheduled on the proposed rules on

June 1. Comments are due by May 3. Requests to testify should be filed by May 11.

Revenue Rulings

→ [Application of Survivor Annuity Requirements to Deferred Annuity Contracts Under a Defined Contribution Plan](#)

Revenue Ruling 2012-3 offers guidance to the Qualified Joint and Survivor Annuities and Qualified Pre-Retirement Survivor Annuity rules for deferred annuities provided through a defined contribution plan.

→ [Rollover From Qualified Defined Contribution Plan to Qualified Defined Benefit Plan to Obtain Additional Annuity](#)

Revenue Ruling 2012-4 provides guidance regarding rollovers from a defined contribution plan to a defined benefit plan to obtain additional annuity.

Additional Documents

→ [Helping American Families Achieve Retirement Security By Expanding Lifetime Income Choices](#), Treasury Department Fact Sheet

→ [Supporting Retirement for American Families](#), Council of Economic Advisors report