

# EAR

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## Retirement Leaders Scrutinize Pension Playbook

**W**ITH THE FAILURES IN the U.S. financial industry and their economic effects fresh in the rearview mirror, the pain felt by pension plan sponsors and participants provided a point of reflection for attendees at the sixth annual Pension Symposium. The two-day discussion immediately following the 2009 Enrolled Actuaries Meeting in Washington focused on the past several decades of retirement policy in the U.S., with an eye toward evaluating its performance, projecting alternative outcomes and guiding future decision-making.

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Academy Pension Practice Council Vice President Tom Terry, right, and Pension Practice Council member Lawrence Sher talk prior to an EA Meeting general session. Terry was a moderator for the Pension Symposium.

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### RON GEBHARDTSBAUER

## How Would I Fix PPA?

*Editor's Note: In light of the discussion at the 2009 Pension Symposium, the EAR asked former Academy Senior Pension Fellow Ron Gebhardtsbauer to offer his recommendations for what he'd do to help fix U.S. pension law. The views expressed in this column are solely the author's and do not necessarily reflect those of the Academy.*

**S**OME MEMBERS OF CONGRESS MAY WONDER why they need to fix the Pension Protection Act (PPA) when the ink on it is barely dry. Actually, the Academy's Pension Committee told Congress that PPA had problems long before it was passed. In a March 2006 [letter](#), the committee suggested an anti-volatility mechanism (AVM) that would eliminate the need for smoothing assets or liabilities. The Senate put it into its bill, but the House Republican majority leadership deleted it and adjourned for the summer, forcing the Senate to pass the House version (or have no bill).

The Academy's AVM proposal was designed to keep contributions from increasing (or decreasing) in any one year by more than 25 percent. We substituted a floor on that maximum increase equal to 2 percent of the plan's accrued liability, so that plans with no prior-year contribution, or relatively large retiree liabilities, couldn't take advantage of the AVM rule. We were flexible on the 25 percent and 2 percent numbers, leaving them up to the policymakers.

This past November, Mercer wrote a letter to then-Treasury Secretary Henry Paulson suggesting the idea again. One of the Academy's difficulties back in 2005 and 2006 was that employer groups weren't comfortable with our new AVM idea (because they preferred keeping the four-year smoothing rules from prior law). On

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## Letter to the Editor

### Refocus the Conversation

**T**HAT THE ACADEMY IS ENCOURAGING A DIALOGUE on public plans is a good thing. However, what's being discussed (based on the Winter 2008 *EAR* article "Academy Encourages Public Plans Dialogue") is not. The debate over valuing assets and liabilities at market is not only wrongheaded but ignores the real scandal in public pension funding: Politicians get to make up their own rules.

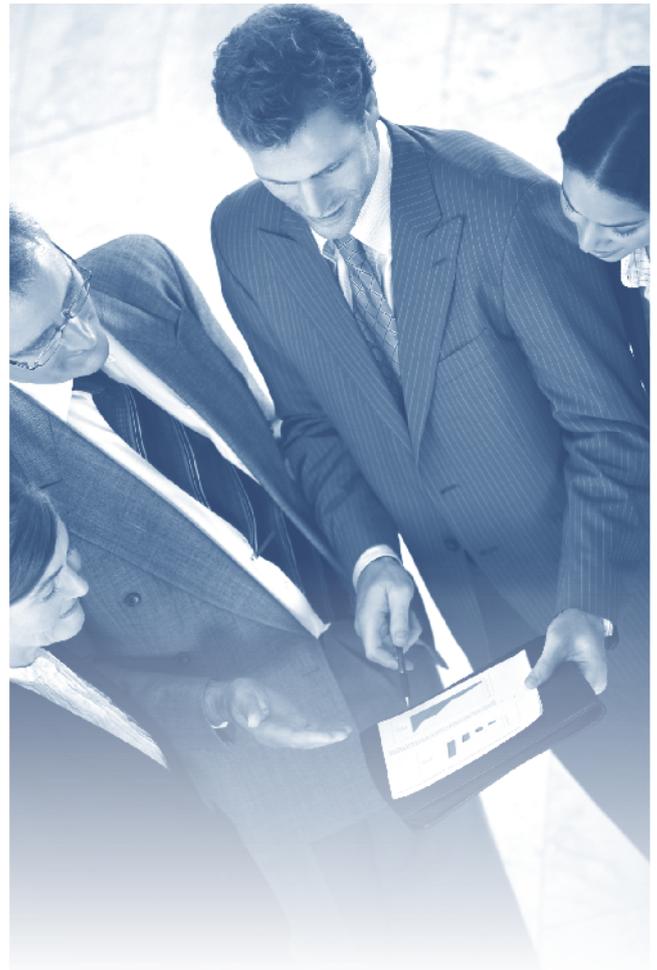
In New Jersey, Gov. Jon Corzine went on YouTube and proposed to slash the state's contribution in half to balance his next budget. A contribution based on an 8.25 percent interest rate and suspect mortality assumptions that has left the plan with at best a 50 percent funded level was too onerous. What will happen with future accruals of generous benefits, COLAs, longer life expectancies and continued poor investment returns? The New Jersey plan is in grave danger of going bankrupt within five years, and actuaries will just be abetting the process unless we get an ERISA (or preferably a PPA) for public plans, and quickly.

The idea that states and local governments are not at risk of going bankrupt is deceptive. Vallejo, Calif., went bankrupt, and Montgomery County in Alabama is likely to. When recent asset declines get factored into valuations, either numbers will need to be massaged or massive tax increases will need to be made—increases that taxpayers going through a depression will not be able to afford.

Finally, there is the matter of equity. A public worker gets promised a pension. If the correct value, based on best assumptions, is not set aside to fund that pension, then we have the equivalent of a theft of services. Future taxpayers will have to make up for past underfunding, a Ponzi scheme will ensue, or those promises will not be kept despite whatever laws (which politicians have a way of interpreting to their advantage as necessary) are on the books.

Unless the actuarial establishment can get past those feel-good numbers (both on ledgers and invoices) and work aggressively to overhaul a flawed system of funding public plans, this debate might wind up being held in other courts.

— JOHN BURY  
*Montclair, N.J.*



ANDREW EISNER

## IRS, Actuaries Exchange Their Two Cents

**S**ESSION 403 AT THE 2009 Enrolled Actuaries Meeting featured a candid discussion between the Internal Revenue Service (IRS) and enrolled actuaries. This session was framed as a process session (not a question-and-answer session)—a chance for practitioners to tell the IRS what guidance they are looking for and for the IRS to let practitioners know what it is working on. The session, which was moderated by Donald Segal, featured the following panelists from the IRS: Andrew Zuckerman, director of employee plans, rulings and agreements; James Holland, assistant director for employee plans, rulings and agreements; and Martin Pippins, manager for employee plans, technical guidance and quality assurance.

Zuckerman began the session by discussing the determination letter program, saying that the IRS is looking at overhauling it—including hiring staff and revising the process to speed things up. He said the agency is expecting a huge volume of submissions and wants to be prepared. The audience was reminded that in order to get relief for PPA amendments from the anti-cutback rules under 411(d)(6), such amendments must be adopted during the 2009 plan year. In addition, consideration is being given to opening a 403(b) pre-approved program, followed by an individually designed 403(b) program.

The IRS is considering expanding the information on its website for governmental sponsors and practitioners, acknowledging that information currently available is scarce and that some plans may have not been amended properly for years. Zuckerman said that initiatives may start providing more information on international plans and examination of 401(k) plans. Finally, Zuckerman indicated that the number of voluntary correction program filings has doubled over the past three years and that the program will be expanded to include 403(b) plans.

An audience member asked for more information on church plans, since some

rules are unclear and many different things are going on in practice. The IRS response was that some information is available and that the IRS ruling program is on hold. Guidance in this area requires decisions from three agencies.

Pippins discussed guidance that was being worked on: Worker, Retiree and Employer Recovery Act of 2008 (WRE-RA) required minimum distributions for 2009; comprehensive 401(k), 403(b) and 457 guidance relating to the Heroes Earnings Assistance and Relief Tax Act of 2008 (which includes provisions related to death, disability and pension benefits for those in the military); and multiemployer plan guidance (finalizing some proposed regulations and re-proposing some to conform to WRE-RA).

Many comments were received regarding single-employer PPA guidance to Sections 430 and 436. Holland said that the IRS is going to consolidate and finalize as much proposed guidance as possible, while issuing new proposed guidance where needed (e.g., on WRE-RA issues, mergers and spinoffs). The agency was hoping for a spring or summer 2009 release. The IRS is also looking to issue regulations on hybrid plans—both proposed (on market

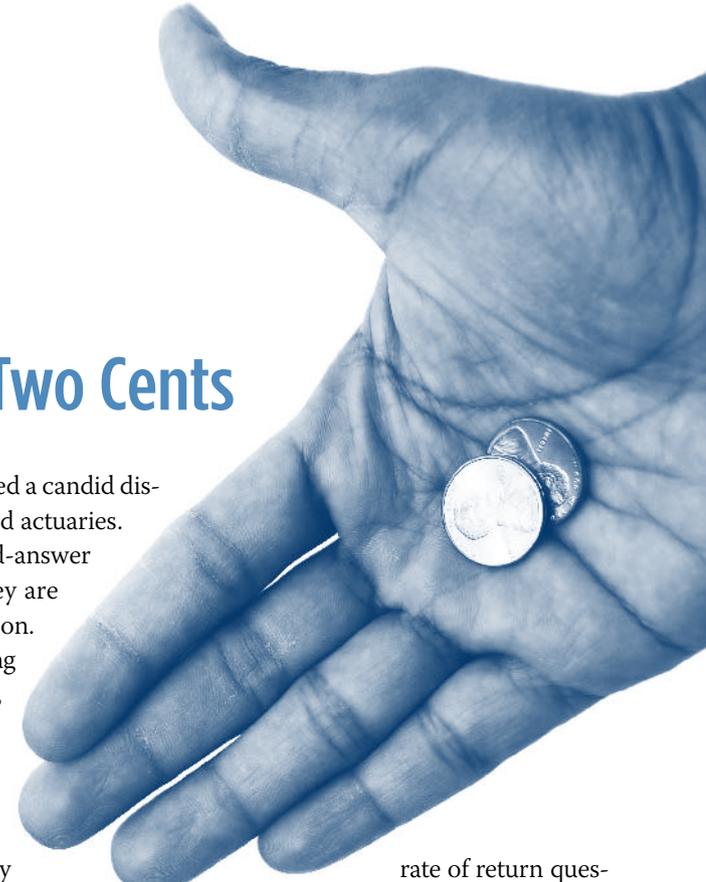
rate of return questions) and final. It may be difficult, however, to address certain issues due to pending litigation.

Regarding other guidance: Final regulations on the 411(b) accrual rules are expected to be issued without any major changes to the proposed regulations; regulations under 404(o) were not included in the guidance plan for the year ending June 30, 2009 (the plan for the year ending June 30, 2010, should be released in August 2009); the Joint Board's proposed regulations have been drafted and were expected to be released in "a few months"; and a notice of intent to issue proposed regulations under 414(x) regarding defined benefit and 401(k) plans will probably be released.

The IRS representatives stressed that they are always eager to hear from practitioners on what issues should be addressed—all comments and suggestions are looked at. It is helpful if such suggestions include an assessment of the timing necessary for the release of guidance in order to meet the needs of practitioners.

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## Actuaries Armed with Strategies for PPA Compliance

The **Enrolled Actuaries Meeting** is an excellent source of information about the technicalities and minutiae of regulations and restrictions facing the profession. As the current crisis reminds us, regulation can be a good thing, or perhaps it is more accurate to say that the lack of regulation can be a bad thing. Nevertheless, regulations are often frustrating and confining, so it was refreshing to enjoy a session devoted not to what we can't do, but to how we can do what we want to do: help our clients deal with their ever-threatened defined benefit plans.

Session 502 at the EA Meeting, presented by Ellen Kleinstuber and Gloria Lesmeister, was a welcome discussion that delved into the mysterious realm of creative PPA compliance. The session explored many strategies related to carryover balances and prefunding balances, including whether to preserve your carryover balance, whether to establish a prefunding balance, how to get the most use out of your prefunding balance in managing minimum-funding requirements, and tactics for waiving a portion of the prefunding balance in order to preserve the carryover balance. Also discussed was the interaction of all this with the Internal Revenue Code Section 436 benefit restrictions, requirements to issue a Section 101(j) notice, the possible need to file a Pension Benefit Guaranty Corp. (PBGC) 4010 form and whether an employer can fund its non-qualified deferred compensation plan.

In her presentation, Kleinstuber, a managing consultant with the Savitz Organization Inc. in Philadelphia, focused on the investment strategy of immunization as a means of controlling volatility in contribution requirements and accounting hits to the balance sheet and shareholder equity. She referred numerous times to the disastrous effects on plan sponsors caused by the plunge in equity values. Her comments were timely and interesting—especially her discussion of the materiality of this decline as a percent of shareholder equity, bringing to mind John Wooddy's old study note on Ruin Theory: It is to nobody's advantage if the hit to shareholder equity or the need to contribute desperately hoarded cash essentially wipes out the plan sponsor.

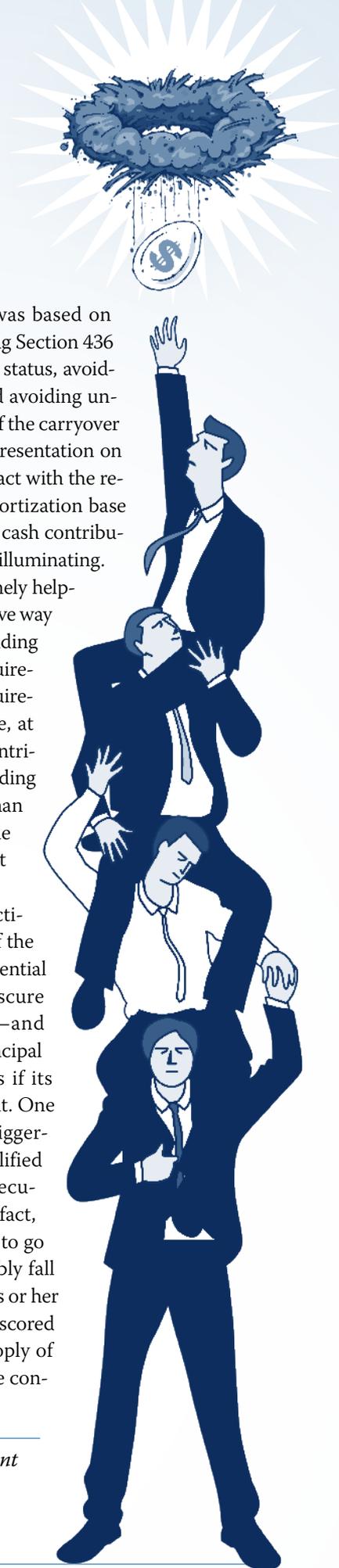
Lesmeister, an actuary with Buck Consultants in Houston, focused primarily on the creative use of the carryover balance, but even more importantly, the new

prefunding balance. Her approach was based on tactical considerations such as avoiding Section 436 benefit restrictions, avoiding "at-risk" status, avoiding the need to file a PBGC 4010 and avoiding unintentional elimination or reduction of the carryover balance or prefunding balance. Her presentation on how the prefunding balance can interact with the requirement to establish a shortfall amortization base when a sponsor is trying to minimize cash contribution requirements was masterful and illuminating. The charts she presented were extremely helpful in understanding the counterintuitive way in which attempting to use the prefunding balance to reduce a contribution requirement can result in *increasing* that requirement instead. It became clear (to me, at least) that the strategy of managing contributions through the use of the prefunding balance is much more complicated than the strategies associated with use of the carryover balance, something I had not appreciated before.

Both presenters pointed out practical pitfalls as they went along. One of the most significant seemed to be the potential for a small plan belonging to an obscure member of the controlled group—and which is unknown to the client's principal actuary—to cause serious problems if its funded ratio were less than 80 percent. One major consequence could be the triggering of rules against funding non-qualified deferred compensation plans for executives. If this were discovered after the fact, there would be no shortage of blame to go around, and most of it could inevitably fall on the hapless actuary who advised his or her client in good faith. The session underscored the need to understand the full panoply of benefits offered by all members of the controlled group.

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



The four-part symposium, dubbed “Monday Morning Quarterback,” examined what has and hasn’t worked, discussed the resulting impact on employees and retirees, evaluated the effect on employers and generated suggestions for topics to focus future policy discussions. Tom Terry, Academy vice president for pension issues, and Ken Kent, Academy Pension Practice Council member, moderated the event. In each session, discussion leaders introduced issues before throwing them to participating attendees for open dialogue. Participants analyzed topics such as the durability of defined benefit (DB) plans, the health of defined contribution (DC) plans and the impact of the Pension Protection Act and other retirement regulations.

### What Worked, What Didn’t

In the first part of the symposium, discussion leaders identified some of the problems facing the DB system and discussed whether they are exacerbated by any federal regulations. One major issue was the unpredictability of costs required to maintain a DB plan and its potential growing inconsistency with a successful business model. Since required contribution levels change as market values of assets and liabilities fluctuate, companies are forced to make their highest contributions when the economy is foundering, presumably at a time when a company is most hesitant to spend its cash reserves.

“You can’t make business plans to be clobbered when you can least afford it,” said Kent Mason, a partner at Davis and Harmon LLP in Washington, who said he’d like to find ways to encourage more pro-cyclical contributions.

One proposal that generated a large reaction was relaxing restrictions on the reversion of surplus pension assets when a company faces budgeting and cash flow problems. While some asserted that the company can keep the money in a separate trust to use in the future as it would like, discussion leaders also pointed out that a publicly owned company is answerable to its shareholders, and holding those funds can appear to be wasting a corporate asset that could go to other uses. On the other hand, if the sponsor adds money to a plan that already appears well funded (according to PPA benchmarks that rely on market-value accounting), shareholders could take action against the company’s employees for what would appear to be a similar waste of corporate assets.

Attention was also brought to efforts to improve policy since the Employee Retirement Security Income Act of 1974. Some charged that attempts to fine-tune ERISA were revenue driven and not done in the best long-term interests of DB plans and secure retirement.

On the other hand, several attendees focused on the perceived inability of the Pension Benefit Guaranty Corp. (PBGC) to raise enough money to cover its risks. However, David Gustafson, chief policy actuary for the PBGC, pointed out that proposals to

increase the agency’s rate-setting autonomy were dismissed by employers when they were presented in January 2005.

### Impact on Employees/Retirees

The second portion of the symposium focused on the impact the economic recession has had from the perspective of employees and retirees. Representatives from AARP and the Pension Rights Center highlighted the changing attitudes toward DC plans (such as 401(k) plans) that became so popular amid the stock market successes of the 1990s.

“The ‘90s were a road to riches, but now we’ve learned our lessons,” said Karen Friedman from the Pension Rights Center. Although she supported efforts to strengthen DC plans, she also asserted that the market collapses of the past year prove that the personal-responsibility philosophy of retirement investment and savings isn’t working anymore.

Shaun O’Brien of AARP speculated on the future of retirement in the U.S. as workers approaching retirement are scared, angry and “don’t know who to trust” in the current economic atmosphere. He also expressed surprise at the amount of time that was devoted to discussing pension reversion, both in the earlier session and in the third general session of the EA Meeting that introduced the themes of the symposium. AARP and the Pension Rights Center both took the position that earned retirement benefits should be untouchable, and they also opposed a suggestion to allow employers the ability to transfer surplus funds specifically to pay 420 retiree health care benefits or to fund active employee health benefits.

However, many countered that providing that flexibility to the employer to transfer surplus pension funds into other uses increased the likelihood that companies will carry DB plans—which are in the employee’s interests—in the first place. Otherwise, they said, plan providers will increasingly freeze their DB plans and simply restructure 401(k) plans because they are less volatile.

Friedman also expressed openness to new ideas, including the possibility of an involuntary retirement system. She touted the Pension Rights Center’s Retirement USA project, which seeks to create a system that provides universal, secure and adequate retirement income to supplement Social Security.

### Impact on Employers

While prior discussions approached the issues from the employee perspective, Kenneth Porter, chief actuary and senior vice president for international affairs for the American Benefits Council, provided a different vantage point. In addition to the effect the market turmoil has had on an employer’s PPA funding status, Porter stressed the severe strain those unfunded liabilities can put on a business trying to position itself for economic

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## Small-plan Gotchas

**W**ITH ALL OF THE ADDED REQUIREMENTS from the 2006 Pension Protection Act (PPA), it is easy to miss some issues that can cause problems for your clients. Presented by Richard Hochman, president of McKay Hochman Co. in Butler, N.J., and Howard Rosenfeld, president of Rosenfeld/Tortu Retirement Planning in White Plains, N.Y., Session 704 of the Enrolled Actuaries Meeting identified several things that small plans in particular need to look out for.

While most small-plan practitioners are familiar with the top-heavy rules, it is easy to overlook what happens when we make changes to plans. For example, the combination of a defined contribution (DC) plan and a defined benefit (DB) plan may specify that the top-heavy minimum benefit/contribution will be provided through the DC plan. What happens when you discontinue contributions to the DC plan? Or, what about the last-day rule in a DC plan for being eligible for a contribution when a participant terminates with more than 1,000 hours (500 hours for a standard prototype plan) but is not employed on the last day? In both of these cases, the top-heavy obligation shifts to the DB plan, but often that requirement is missed.

Similarly, in a 401(k) plan the employer may want to eliminate the 3 percent safe harbor contribution. However, as long as key employees are making salary deferrals, the minimum top-heavy contribution may still apply. So, the effect is to replace the safe harbor contribution with the top-heavy contribution. In addition, the safe harbor contribution applies only while an employee is a participant, but the top-heavy contribution applies to the entire plan year (troublesome for new midyear entrants).

For highly compensated employees, key employees and required minimum distributions, one criterion to determine whether the top-heavy minimum benefit/contribution will be provided is 5 percent ownership. Remember, this requirement is based on ownership of *more* than 5 percent; so, an owner with exactly 5 percent does not fit in this group (but may be included for other reasons). Also, you need to ask the plan sponsor if someone with 5 percent or less ownership has an agreement to purchase additional shares or ownership interests. If so, that agreement means the less-than-5 percent owner may actually be a greater-than-5 percent owner for purposes of the regulation.

You also have to watch when the employer is owned by multiple entities; for example, each owner has its ownership in the employer through an individual limited liability com-



pany (LLC). While each of the individual ownership interests may represent under 5 percent of the employer, owning 100 percent of the LLC means the owner of the LLC is a 5 percent owner of the employer.

Even though Congress granted a moratorium on minimum required distributions for 2009, it applies only to DC plans, 403(b) plans and individual retirement accounts (IRA), not to DB plans. There are a number of techniques available to lower the required minimum distribution (RMD) for a DB plan, such as taking a lump-sum distribution and transferring it to an IRA or 414(k) account, selecting the RMD based on 100 percent joint and survivor annuity, or converting to an installment payment with a cost-of-living adjustment that is less than 5 percent per year.

For self-employed plan sponsors, remember that even though PPA expanded the deduction for contributions (Internal Revenue Code Section 404(o)) to DB plans, the old rule that limits contributions to net self-employment income still applies.

For 2009, the Pension Benefit Guaranty Corp. (PBGC) rescinded its waiver for reporting missed quarterly contributions for small plans. Subsequently, it provided some relief (PBGC Technical Update 09-3), but that relief is limited to situations where the missed quarterly contributions are not due to financial problems. The technical update provides a waiver on reporting for plans with fewer than 25 participants and simplified reporting for plans between 25 and 100 participants, as long as the missed contributions were due to reasons other than financial problems.

For the most part, the use of a prototype or word-for-word volume submitter document allows the plan sponsor to rely on the opinion letter issued by the IRS to the document's sponsoring organization. Despite the ability to rely on the master plan opinion letter for most purposes, without an individual determination letter, the IRS may require the plan sponsor to prove that the plan was always in compliance since its origin if the sponsor ever seeks an individual determination letter for the plan in the future. Thus, you may want to obtain individual determination letters on all prototype documents now, while you can control the time frame during which you have to gather this historical information—rather than have a limited period mandated by the IRS reviewer during a subsequent determination letter application.

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# The 2009 Gray Book

**R**EADING A NEW GRAY BOOK is like choosing a new restaurant: you never quite know what you'll be eating. Will the chicken curry be too spicy? The prawns too garlicky? The lamb ragout heavenly? As always, Donald Segal and Ken Steiner, in their presentation at this year's Enrolled Actuaries Meeting, made wonderful guides to the perils and pleasures of the Gray Book. Segal is extremely forthright in his opinions, while Ken Steiner's wry one-liners can be very amusing. The Gray Book always has a number of things in it that grant a little bit here while taking away something else there, and the 2009 edition is no exception—containing some new approaches and inspiring ideas discussed at the session.

Question No. 33 of the Gray Book, for instance, deals with the interplay between plan amendments and the benefit restrictions of Internal Revenue Code Section 436. The answer parenthetically offers a wonderful drafting suggestion: "The proposed regulations do not specify what happens if the amendment cannot take effect, so it is recommended that the amendment itself state what happens in that case." Suppose a plan sponsor adopts an amendment effective in 2009 to raise benefits based on past service. This amendment cannot take effect in 2009 because the adjusted funding target attainment percentage (AFTAP) is below 80 percent and the sponsor doesn't make a special contribution to enable the amendment to take effect. What happens in 2010, when the AFTAP is above 80 percent? Does the amendment take effect then—or not? This is a frightening question, fraught with peril regardless of the answer. Suppose the answer is "yes" and someone retired during 2009 after the amendment's intended effective date. Should such a retiree's benefit be increased? Yet the former employee retired before the actual effective date of the amendment. On the other hand, the sponsor may face potential legal challenges if the benefit is *not* increased. Likewise, suppose the amendment never takes effect because on the effective date stated in the amendment, the Section 436 restrictions prevented it from taking effect, and the amendment was silent on the crucial question of what happens later. Accordingly, the government suggested adding language indicating which amendment would take precedence in the event that not all the amendments could take effect under Section 436.

It is probably fair to say that the rules regarding the Section 436 benefit restrictions and regarding reductions to the "credit balance" (I just can't get used to calling it a "carryover balance") dominate the confusion created by the Pension Protection Act of 2006 and exacerbated by the Worker, Retiree and Employer Recovery Act of 2008. Question No. 10 states that the proposed regulations require that an election to reduce the credit balance must include the "specific dollar amount" of the reduction and that an election containing a formula (such as "the amount necessary to achieve an AFTAP of 80 percent") is *not* a valid reduction election. An amusing discussion followed about whether "the entire amount" could be regarded as a specific dollar amount.

Steiner's opinion was that such an election would be legitimate. Segal thought otherwise, adding: "Again, it just doesn't make sense, but it's part of the war on credit balances!"

Question No. 9 was an especially tasty appetizer: "Can the sponsor of a plan that has used the segment rates to determine minimum funding...elect to switch to the full yield curve without the consent of the secretary?" Amazingly enough, the answer is "yes"!

"Because that's what the law says!" Segal explained. Steiner felt this represented a backing off from the proposed regulations. Whatever the reason, since the yield curve approach often results in lower liabilities, it is good to know that clients can switch to it without a messy application to the IRS.

Question No. 23 discusses just what *does* a "change in accrued benefits" mean? Segal took the position that a change to an "accrued benefit" is defined as a change in the benefit payable at normal retirement, and Steiner countered with, "What if we're changing the early retirement factors? Is this an additional accrual? It increases the funding target." Segal admitted that he didn't know. The government's response to the actual amendments proposed in the question was that none of the changes would be considered as providing additional accruals under the plan.

Sometimes I have to wonder at the creativity of actuaries. Question No. 32 posited that a sponsor has two plans: one with an AFTAP of 70 percent and another of 90 percent. No lump sums could be paid under the first plan. Could the sponsor transfer people from the first plan to the second plan and then pay them lump sums? The answer was, "Transfers should not be used as an 'end-run' around the Section 436 restrictions." (I am not sure whether to be appalled at the cleverness of the ideas or marvel at the need for an answer, since the law itself appears to permit this.)

There are so many other Q-and-As worthy of attention. This is a particularly valuable Gray Book, and in many places it is obvious that the IRS is trying to make the PPA work while giving actuaries and plan sponsors a break. Unfortunately, the opacity of the PPA often makes this difficult. As a profession, we should be grateful to Don Segal and Ken Steiner for their long-standing role of Gray Book interpreters extraordinaire.

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

a positive note, I see that employer groups are now suggesting something similar. One proposal would limit 2009 and 2010 contributions to a 5 percent or 10 percent increase over 2008. (They also propose changes in the following areas: widening the asset corridor back to 80 percent to 120 percent of market value of assets in prior law; a two-year delay in amortizing the 2008 loss as long as the interest on the loss is paid; and delay of benefit freezes.) They would need to require something for companies with no contribution requirement in 2008 (e.g., something like our override using the 2 percent of liabilities floor). Of course, that could mean a hefty contribution increase in some cases, so this will need to be debated.

The Pension Committee's AVM wasn't perfect either. Back in 2005, we realized that the details would be complex. For example, the proposal could limit contribution increases caused by benefit improvements (or mergers and acquisitions) instigated by employers. It shouldn't. In addition, the Bush administration—and perhaps the Pension Benefit Guaranty Corp. (PBGC) as well—was concerned that the AVM could delay funding beyond the seven-year amortization period on which lawmakers had already agreed. So the Pension Committee suggested an alternative, based on an idea originally suggested by Mercer's Eric Friedman, to address those two concerns. The plan sponsor would fund experience losses over the same seven-year amortization period in the law, but if the amortization payment were greater than 25 percent of the prior year's contribution (and the 2 percent of liability floor), then the amortization payments would increase each year only by that amount. For example, if the first amortization payment was reduced by \$10 million due to the cap, then that \$10 million would be amortized over the remaining six years. If the stock market came back within seven years, the total contribution would not get too large. Of course, if the stock market were like Japan's, then the later amortization payments could become quite large.

Thus, there would still be incentives for employers to limit their exposure to equities. If those incentives were not enough, other rules could affect asset allocations. For example, if needed, a PBGC risk-related premium could be charged, based on a plan's equities in excess of an "acceptable" percentage. More direct rules might be needed for pension plans sponsored by weak employers that had huge retiree liabilities backed with equities. (For example, when the Bethlehem Steel plan's stock returns were better than the plan's discount rate, the sponsor could continue to afford the plan; but when the stock return was worse, it had a big enough hole to justify "putting" the plan's underfunding to the PBGC as unaffordable.) To address this abuse, the law could require a minimum allocation to bonds in these situations.

Other fixes to pension laws are needed. While working at Senate Finance in 2008, my colleagues and I tried to move the following ideas:

- (1) **Encourage employers to contribute more to their underfunded plans by giving economic value to the surpluses in their pension plans.** We wanted to allow sponsors to use super pension surpluses to pay for retiree *and employee* health benefits. Unfortunately, a lobby for retiree groups that already had retiree medical didn't want "their" surplus used to help active employees (even if we required employers to maintain their retiree medical plan and/or pension plan for a few more years). On a related issue, we found that the side fund idea (allowing future contributions in excess of the minimum to be placed in side funds eligible for asset transfers) wouldn't work, since it wouldn't help plans already way overfunded (or plans that became overfunded even though only the minimum was contributed).
- (2) **Keep employers responsible for their pension promises (unlike in the United Airlines termination).** We liked Section 402 of the Senate version of PPA (S. 1783), where the PBGC, in consultation with Treasury, could work out an alternative funding agreement with sponsors to prevent distress terminations when a company is in reorganization. (This is similar to a bank working out a revised loan for companies in distress.) In addition to freezing guarantees, the PBGC could freeze 4044 priority categories (so that future accruals have little priority) and, if necessary, temporarily reduce benefits in pay status, but to no less than the benefit levels the PBGC would pay if the plan were terminated. Lump sums were already restricted. The heads of the PBGC, Northwest Airlines and the Air Line Pilots Association all supported this back when PPA was being debated.
- (3) **Tie the benefits of non-qualified deferred compensation (NQDC) plans to the benefits in the employee plans.** PPA already ties the funding, but without this addition, management could terminate the company DB plan and then no longer worry about the funding restriction on the non-qualified plan. If the NQDC benefits had to use the same formula as the company pension plan, management would care again about what the company plan provides. If top management wanted more compensation, they would have to pay it through cash, which is more transparent.
- (4) **Return to past congressional policy, which gave DB plans greater advantages than 401(k)s.** Since 401(k)s don't have to benefit all employees and don't have to provide lifetime incomes and other guarantees, etc., they shouldn't get more advantages than DB plans. For example, DB rules could be applied to 401(k)s, such as requiring that generally all employees get a uniform benefit from the 401(k).
- (5) **Build up the PBGC funds** with a fee of \$1 per person for each commercial flight (domestic or international) that

recovery. Overnight, what now appears as unfunded pension obligations show up as balance sheet debt that hurts a company's credit appraisal from rating agencies—making it much harder to borrow money needed for repositioning.

Porter advocated returning to politically unpopular but, in his opinion, more effective funding rules that allowed smoothing to calculate long-term funding strategies, as opposed to snapshot calculations of unfunded liabilities. Others also pointed out that some of the biggest beneficiaries of the Worker Retiree and Employer Recovery Act's relaxed PPA implementation dates were highly rated companies that weren't among those facing the heaviest burdens under PPA.

### Future of Retirement

The symposium closed by discussing how the actuarial profession can bring attention to waning retirement security for future generations of Americans and what else can be done to repair the system. One source of wide agreement was the need to change behavior in 401(k) plans. Discussion leaders—including Terry and Academy Senior Pension Fellow Frank Todisco—pointed to the problem of using 401(k) plans as a fund for spending unrelated to retirement, such as buying houses, and encouraged mechanisms to promote annuity distributions from 401(k) plans. Other suggestions included promoting variable annuity designs to help plan sponsors manage retirement income risk without having to bear the costs, a bifurcated retirement system that

On June 9, a House bill was introduced that provides tax incentives for workers to annuitize part of their retirement savings. The proposed Retirement Security Needs Lifetime Pay Act would, among other things, provide a 50 percent tax exclusion for up to \$10,000 of lifetime annuity payments annually and a 25 percent tax exclusion of lifetime income payments from individual retirement accounts, qualified plans and other employer-sponsored DC plans.

provides DB plans to older workers and DC plans to younger workers, and phased retirement.

Several attendees also brought up governance changes in U.K. union plans that have established training for pension plan trustees, protocol to replace trustees if they don't act in the best interests of participants or the employer (whichever they are designated to represent), and the power of trustees to negotiate in place of the employer.

Society of Actuaries (SOA) Staff Fellow for Retirement Systems Andrew Peterson also discussed the SOA's Retirement 20/20 initiative to design a new retirement system from the ground up. Peterson told attendees to be on the lookout for a call for models (released in late June), to present new ideas for reshaping retirement. Winners will be announced at a Retirement 20/20 conference planned for 2010. ▲

takes off or lands at a U.S. airport, and a fee of \$1 for every ton of raw steel sold in or imported into the U.S. That way, the customers of the industries that abused the PBGC will get charged for those underfunded pension plans, not the industries that didn't abuse the PBGC.

**(6) Change U.S. budget rules to reflect tax income from pension distributions beyond the 10-year budget window.** This would show that legislation encouraging retirement savings would increase taxable income in the future (not just lose tax revenue up front). Several high-level staff of the Joint Committee on Taxation felt this made sense. The Obama administration would find this idea could help its individual retirement account-payroll deduction proposal. There are many other changes in pension law that are needed. What would you suggest?

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## Let Us Know What You Think!

*EAR* readers: Do you have any other specific suggestions for fixing U.S. pension law that you'd like to offer? If so, feel free to email your ideas to [editor@actuary.org](mailto:editor@actuary.org). Space permitting, the *EAR* will select some of them to run in the fall issue.

