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ENROLLED ACTUARIES REPORT

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Shaping the Future of Retirement

THE LEGISLATIVE AND REGULATORY ENVIRONMENT GOVERNING PRIVATE DEFINED BENEFIT (DB) pension plans continues to evolve, characterized by implementation of Pension Protection Act (PPA) provisions, modifications courtesy of the Worker, Retiree, and Employer Recovery Act, and a comprehensive discussion of funding relief on Capitol Hill that culminated in President Obama signing the final bill into law on June 25. But it was with an eye to the horizon that the Academy and the Conference of Consulting Actuaries hosted the seventh annual Pension Symposium April 14–15 in Washington immediately following the Enrolled Actuaries Meeting. The symposium sought to look beyond both current law and the DB system, tapping into actuarial and retirement system expertise to address policy challenges of the future. It brought together a diverse group of panelists and participants, including employers, union groups, lobbyists, congressional staff, think tanks, the Obama administration, and consulting firms.

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Judy Miller, chief of actuarial issues at ASPPA, leads the discussion of the Pension Symposium with Academy Senior Pension Fellow Frank Todisco and Social Security Administration Chief Actuary Steve Goss.

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Multiemployer Subcommittee Comments on Funding Relief Provisions

THE ACADEMY'S PENSION COMMITTEE and Multiemployer Plans Subcommittee sent comments on May 4 to Sen. Johnny Isakson (R-Ga.) and Sen. Benjamin Cardin (D-Md.) on the multiemployer pension plan relief provisions contained in their amendment to H.R. 4213. In addition to providing pension funding relief for multiemployer plans, H.R. 4213 contained a number of tax and benefits extensions on which both houses of Congress recently had been working intensely.

In their letter, the Academy committees sought to clarify some of the relief provisions in the proposed legislative language, including the manner in which net investment loss is determined, verification of the number of years utilized in extended amortization periods, and the impact of the relief as it relates to previously issued certifications. The letter underscores certain aspects of the multiemployer pension plan provisions that could be misinterpreted and offered suggestions as to how they might be clarified.

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JAMES KENNEY

The 2010 Gray Book

ALTHOUGH IT CAN MAKE FOR DIFFICULT READING, the 2010 Gray Book is a potential treasure trove of information. The questions are often multipronged, with as many as five sub-questions under the general topic being reviewed. The government's answers are generally short, but occasionally they are as complicated as the questions.

Not surprisingly, this year's Gray Book focuses on the final regulations regarding Internal Revenue Code Sections 430 and 436 released in 2009. Many of the questions revolve around employer elections and shed considerable light on this tricky topic. Some of the most challenging questions, however, concern adjusted funding target attainment percentage (AFTAP) certifications. These include when they must (or may) be revised, a matter that often turns on the issue of materiality, and how that interacts with the new presumption rules, especially when a plan amendment is adopted.

Plan amendments that increase plan liabilities can lead to complex situations, especially depending on the timing of the amendment and even the wording of the amendment itself. The plan's presumed funded status can determine whether the employer can simply make the amendment, whether the employer can make the amendment only in combination with payment of a Section 436 contribution equal to the full increase in liability, or whether the employer can make the amendment with a 436 contribution sufficient to bring the plan to a presumed 80 percent funded status. The presumption rules frequently will affect the proper outcome.

Question 18 is an important illustration of how these various rules interact and the counterintuitive results that may follow. It is a four-part question with a complex fact pattern. Ironically, a prior-year contribution made during the current year allows a plan with a 79 percent AFTAP to make a valid amendment because the inclusive presumed AFTAP is 83.6 percent. After this takes place, however, the presumed AFTAP remains at 79 percent rather than increasing to 83.6 percent. When the plan sponsor makes a second amendment, it is the presumed AFTAP rather than the inclusive presumed AFTAP that governs, and since the presumed AFTAP is below 80 percent, the sponsor must make a contribution that fully funds the increase in the funding target.

This question is a wonderful—if confusing—guide to the new rules that apply to plan amendments and, in particular, to how to calculate the amount that must be contributed to allow such amendments to take effect.

Question 17 is also an important guide to the methodology of determining presumed values, such as the amount of the presumed funding target. In this case, prior-year contributions are made between Jan. 1 and April 1. The answer to this question appears to contradict the answer to a similar question in last year's Gray Book, indicating the extent to which our understanding of the Pension Protection Act of 2006 is evolving. The answer also seems quite counterintuitive, so the question is worth studying. Based on the government's response, it may be that, had the sponsor chosen to delay the contribution until April 1, the outcome would have been different.

It is issues such as these that make the difference between consulting and expert consulting. When matters of timing of contributions and amendments—and, as will be discussed below, even the structuring of amendments—can make a substantive difference in the outcome of the intended event, then it behooves actuaries who are on the front lines of providing client advice to study the guidance given us by the Internal Revenue Service.

Question 38 shows how far this *Through the Looking-Glass* world can go. The question concerns flat-dollar plans that may increase benefits without making 436 contributions, if those increases do not exceed the rate of increase in average wages of the affected participants. In this hypothetical question, an employer with an AFTAP below 80 percent adopts an amendment providing for an increase greater than the increase in average wages. The second part of the question makes it clear that if this amendment is broken into two pieces—one that increases benefits to the level equal to the increase in average wages and a second one that increases benefits to a higher level—only the second piece would require a 436 contribution. But if the amendment were adopted as a single amendment, the employer would have to fund the entire increase in liability.

This year's Gray Book deserves serious study by any actuary whose responsibility involves advising clients on making amendments or drafting elections.

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TOM SCHRYER

PBGC Issues from the 2010 Enrolled Actuaries Meeting

This article relies heavily on the Blue Book from the 2010 Enrolled Actuaries Meeting, in which the Pension Benefit Guarantee Corp. (PBGC) informally answers certain questions raised by various enrolled actuaries.

Questions 8–10: Alternative Premium Funding Target Election

The subject of faulty PBGC premium filings was addressed in Questions 8-10 from the Blue Book. Most notably, Question 9 stated that faulty PBGC premium filings would need to be amended, and interest would be assessed on any shortfall. The PBGC indicated that the election in Box 5 of the PBGC premium filing form (which regards usage of the alternative premium funding target) governs and that the filing would need to be amended if the choice made in Box 7(d)(1) was inconsistent with Box 5. This position would have affected about 5 percent of plans that intended to use the full yield curve or segment rates averaged over 24 months (with or without transition) but did not elect to use the alternative approach in Box 5 concurrently or for 2008. The American Benefits Council and a bipartisan group of Senate leaders asked the PBGC to reconsider the position expressed in the Blue Book. Subsequently, PBGC Technical Update 10-2 was issued on June 16, 2010, and offers important relief for these plans—but only if requested by July 16, 2010, with some exceptions. The notification process in the technical update requires some careful review. For example, Footnote 2 indicates that if the spot interest rates are shown in the filing, then the PBGC assumes that the "standard" liability was used and that relief should be unavailable. So, review those interest rates. Footnote 3 refers to plans requesting relief for 2008, so the second sentence points out that some 2009 filings can become invalid.

Question 4: Valuing Social Security Supplements

Some plans have benefits that are not related to the accrued benefit (e.g., $500 supplements and $1,000 post-retirement death benefits). Question 4 says that the PBGC will accept only the Pension Protection Act (PPA) methodology for prorating such benefits. Such methodology differs significantly from Accounting Standards Codification 960-20-25-4(a) (formerly Financial Accounting Standard No. 35), which has provided guidance on calculating the value of vested benefits for many years. Valuation results for these plans, therefore, should be reviewed for compliance before completing 2010 premium filings.

Question 19: Reportable Events

Question 19 gives sponsors welcome relief when a mandated credit balance reduction retroactively triggers a missed quarterly contribution. The events are reportable only after the events have actually happened.

Question 23: Enforcement Policy for 4062(e) Events

After closing or selling a facility, some struggling plan sponsors find the PBGC asking them to purchase a substantial bond (coverage from an acceptable corporate surety company) or to put funds in escrow accounts. After a plan has had a reportable event relating to a 20 to 25 percent decrease in its workforce, the PBGC considers its options under Employee Retirement Income Security Act (ERISA) Section 4062(e). 4062(e) and 4063(a) combine to make many downsizings and sales of facilities reportable separately (within 60 days)—even if disclosure of the reportable event due to reduced employment is waived. Question 23 concludes by stating that the PBGC tries to find "settlements that fit the parameters of their business plans."

"Semiannual" Yield Curve Interest Rates

Slide 28, "Yield Curve—Tips on Use," from Session 302 ("Caution—Yield Curve 101") characterizes the yield curve's interest rates as "semiannual." It should be noted that an employee of the Treasury Department who is familiar with the derivation of these rates was one of the presenters. Subsequent comments from others suggest that rates supplied for PPA liability measurement, including segment rates, pre-PPA rates used for current liability measurement, and presumably pre-PPA PBGC purposes may have been developed as nominal annual rates for bonds paying semiannual coupons.

Nominal annual interest rates generally would need to be compounded [(1 + rate/2)2 -1] before being used as annual effective rates of interest. A "semiannual" rate published as 6.00 percent would translate to an effective rate of about 6.09 percent. A plan with assets equal to 90 percent of liabilities could have its variable PBGC premium and minimum funding requirement reduced by roughly 15 percent due to a 1 to 2 percent reduction in gross PBGC and funding liabilities. Until the Internal Revenue Service (IRS) makes any further pronouncements, however, it is suggested that published rates be used as annual effective rates.

Posing Questions

Actuaries start the process of assembling questions for the EA Meeting's general sessions and the Gray (IRS), Blue (PBGC), and Green (Employee Benefits Security Administration) books each year by posing questions. The practice in which I work accumulates issues as they arise. We then send them to Matt Noncek, the CCA's IT manager/registrar (mnoncek@ccactuaries.org), in early November. This year many of the questions we posed were addressed in the Blue and Gray books, in general session slides, and in greatly expanded instructions to Form 5500 Schedule R's Line 19a. We find the process helpful and one in which you may wish to participate.

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As is customary, the opening session of the symposium was structured as a continuation of the closing general session of the EA Meeting, titled "The Future of Retirement (or Where Will We Be in 2030?)." (See the May issue of ***Actuarial Update*** for a summary of the 2010 EA Meeting.) Over the course of the two-day symposium, sessions focused on private-sector solutions, government-based solutions, and the public role of the actuarial profession in informing these developments well into the future.

"If we think in terms of current law, we won't get anywhere," said Academy Pension Committee member and Society of Actuaries President-elect Donald Segal. "We need to think, 'What should it be? What changes should be made?' "

The symposium continued in its traditional interactive format, featuring panelists who provided background and context for an open discussion of topics with session participants to further develop ideas and responses.

The role of mandates versus incentives in the distribution phase of retirement was examined in detail during the opening discussions. Panelist Judy Miller, chief of actuarial issues at the American Society of Pension Professionals and Actuaries, and others questioned whether the individual mandate contained in the new health insurance reform law indicated a political shift in a collective willingness to entertain mandates. In the realm of retirement security, such a shift could have important implications for the decision to receive pension benefits as lump sums or as annuities. From the behavioral finance perspective, symposium participants suggested setting annuities as the default distribution—or even imposing penalties on lump sum distribution. The Obama administration's proposed auto-individual retirement account (IRA) program is an example of an increased interest in mandates, but participants wondered whether, in light of the health care mandate, another proposed mandate would cause workers to recoil from the idea of an even larger government nose under the proverbial tent.

One challenge to consider when discussing the role of mandates is a lack of agreement on what standard of living is sufficient to constitute adequacy in retirement, as the need to sustain that standard could influence retirees in choosing lump sums up front. This is complicated by current personal savings practices in the U.S., which continue to lag behind other countries with growing economies such as China, where the average rate of savings of disposable income is nearly twice that as in the U.S.

Several participants suggested that pre-tax incentives through auto-IRAs can help influence savings, and others proposed introducing or increasing employee contributions to existing employer-sponsored retirement programs. The Ontario Teachers Pension Plan was highlighted by Andrew Peterson, Society of Actuaries (SOA) staff fellow for retirement systems, as one example in which the teachers pay about 12 percent of their salary to the DB pension plan—and, as a result, have a significant interest in the plan. While sometimes a feature of public plans, employee contributions are a tool used much less frequently in private pension plans.

Academy Pension Committee member and SOA President-elect Don Segal moderates discussion at the Pension Symposium.

The advantages of an annuity as a vehicle for hedging a retiree's longevity risk are well known, but participants speculated that a common fear persists among many that by choosing an annuity one might end up leaving money on the table. Barbara Bovbjerg, director for education, workforce, and income security issues at the Government Accountability Office, suggested that this perspective stems from the same attitude that induces many people to claim Social Security benefits as soon they are eligible—despite the fact that they could receive a higher benefit over time by forestalling their benefits claim.

Participants acknowledged that the future of retirement faces interesting implications from the private sector. An employer's capability and interest in taking on both investment and longevity risks reflect the debate about the social contract and a balancing of priorities between providing for employees' retirement while at the same time answering to corporate shareholder interests.

Some participants acknowledged possible futility in spending time and effort to force employers to offer what new generations of a more mobile workforce may not want or value. Whereas long tenures were common years ago because of promised pensions, newer generations see mobility not just as a freedom but as an investment, argued Henry Eickelberg, vice president for human resources and shared services for General Dynamics in Falls Church, Va.

"That's a more critical method of success," Eickelberg said. "You typically get a pretty good raise when changing jobs, which drives them to move forward into different positions."

Part of this growing preference for increased current compensation, Eickelberg speculated, may be a result of a greater desire to control one's future decisions, which requires a greater appetite for taking on risks, such as retirement risks. In light of rising health care costs, others speculated that employees also may be prioritizing the security of higher health care benefits at the expense of retirement security.

In relation to participants' discussion of public pension plans and

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TOM SABLAK

Plan Design for the Future

LONGEVITY RISK and aggressive strategies to reduce—rather than shift—pension plan risks dominated a lively panel discussion during Session 504 at the 2010 Enrolled Actuaries Meeting. Panelists Ellen Kleinstuber of the Savitz Organization, Evan Inglis of the Vanguard Group, and Mike Clark of the Principal Financial Group offered attendees a detailed examination of some of today's most challenging issues in pension plan design. Attendees had the opportunity to listen and react to the panelists' comments on the current risk environment for defined benefit plans, methods for managing certain risks, and barriers preventing effective pension plan designs for today's workforce.

Kleinstuber set the stage for the session by discussing recently released results from the 2010 MetLife U.S. Pension Risk Behavior Index. This study indicates that sponsors are no longer narrowly focused on asset-based risks and return benchmarks but are increasingly concerned about longevity risk. One also could infer from the study that sponsors' concerns are now equally distributed across the spectrum of risks they face, with no single risk standing out. Kleinstuber emphasized that recent financial turmoil, coupled with demographic shifts and changes to funding and accounting rules, calls for a re-evaluation of investment strategies, funding policies, and plan designs. She closed by asking if sponsors have viable alternatives to freezing their pension plans.

The session shifted to strategies for managing pension plan risks, and Inglis suggested that sponsors should look for actual ways to reduce various risks, rather than simply reallocating them. First, he argued that sponsors should take advantage of longevity pooling and make annuities mandatory, which would allow retirement programs to be more cost-efficient and minimize losses arising from adverse selection. Second, he noted that high levels of guaranteed income, such as overly generous replacement ratios and early retirement subsidies, are very expensive and even have a decreasing level of utility to participants as the guarantee increases. Finally, he suggested that employees generally have longer investment time-frames and therefore may be better equipped to take on investment risk compared to companies that face significant short-term financial pressures from shareholders. Responding to questions from the audience on this last point, Inglis explained that while individuals may not always possess the knowledge and discipline to make the best investment decisions, they generally have investment time-frames measured in decades rather than fiscal quarters. Therefore, individuals can, in theory, customize their investment strategies over time to make up shortfalls, whereas companies often resort to plan freezes and terminations in response to short-term financial stress.

Inglis discussed how three specific pension plan designs might address these risks. A cash balance plan may reduce some investment risk when compared to a traditional final-average-pay plan, but it doesn't take advantage of longevity pooling since participants have access to lump sum distributions in this plan design. A Green DB plan (based on a design put forth by Vanguard) may help mitigate investment risk for the plan sponsor through a lower promised level of guaranteed income. This design also takes advantage of longevity pooling through the elimination of lump sum benefits. The third option, a variable annuity plan (VAP), eliminates investment risk for the sponsor and pools longevity risk. While it has not been widely adopted, a VAP is a design that has been around for a while and might be worth another look, Inglis said.

Clark predicted that the next pension crisis will not involve solvency issues but likely will center on longevity risk. He said that properly designed defined benefit plans offer the solution to this challenge—but suggested that decades-old Employee Retirement Income Security Act (ERISA) rules have discouraged sponsorship of pension plans and have led to a short list of viable plan designs. Specifically, he listed three ERISA-based hurdles that hinder efficient plan designs for today's employees. First, he noted the required normal retirement age of 65 has not changed since the passage of ERISA in 1974 and ignores mortality improvements since then. Second, he suggested that a low mandatory participation age (generally age 21 with one year of service) incorrectly focuses on extending eligibility to younger employees who may not have been in the workforce long enough to value a pension benefit. Third, he observed that regulatory priority has shifted from protecting the accrued benefits of participants via PBGC insurance to protecting the financial stability of the PBGC itself.

For each of these issues, Clark proposed a solution, each of which would require a change in current law. Raising the normal retirement age from 65 to 70, he said, would require individuals to work longer to get their full pensions but would be consistent with increased life expectancies and would lower longevity risk. He then argued that the mandatory participation age should be increased to age 40, which would be more efficient in directing a limited supply of benefit dollars toward the provision of retirement income. An age-40 participation requirement also aligns with the approximate point when the average individual begins to think about the retirement years. (Both of these solutions would also lower pension liabilities.) Finally, he proposed that eliminating PBGC protection of accrued benefits might provide incentive for employers to sponsor defined benefit plans and allow for a better balance of risk sharing between employees and employers. (For more information on Clark's proposal, see his cover story, "Pension Alteration—Fashioning an ERISA Makeover," in the May/June issue of ***Contingencies***.)

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Defined Benefit Pension Relief Signed Into Law

FUNDING RELIEF for defined benefit pension plans was signed into law by President Obama on June 25. The funding relief provisions were part of H.R. 3962, the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act.

The pension relief provisions, originally part of H.R. 4213, the "tax extenders" bill, were removed and incorporated into H.R. 3962, a six-month Medicare doctor-payment extension. The bill was approved by the House on June 24 by a vote of 417-1 and on June 18 by the Senate.

The relief grants pension plan sponsors an extended period to account for investment losses incurred during the economic decline. Sponsors may elect an extended nine-year amortization period for up to two plan years during the four-year period from 2008-2011, paying interest only in the first two years of that nine-year election. This represents a change from the seven-year amortization period under current law. For pension plans not yet subject to the funding rules of current law under the Pension Protection Act of 2006, a 15-year amortization schedule for one plan year is available.

Plan sponsors that elect to extend their amortization periods would be required to make additional contributions to their pension funds if they pay employees in excess of $1 million a year, pay out extraordinary dividends to shareholders, or redeem in excess of 10 percent of the market capitalization of their stock.

Additional Section 4010 disclosure requirements, an active plan requirement, and maintenance-of-effort provisions were not included in the bill. For multiemployer pension plans, the option of a 30-year amortization schedule is now available, a change from the current 15-year period available under current law.

The text of H.R. 3962 can be found at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h3962eas.txt.pdf or by contacting Justin Edwards, the Academy's legislative assistant (edwards@actuary.org).

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The multiemployer pension plan provisions of the amendment by Sen. Isakson and Sen. Cardin have since been modified, and similar language was included in H.R. 4213, the American Jobs and Closing Tax Loopholes Act of 2010. This legislation passed the House on May 28 and was sent to the Senate, which took out the pension funding relief and Medicare reimbursement provisions of the bill and inserted them into H.R. 3962, the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act. H.R. 3962 passed the Senate June 18 by a voice vote and passed the House on June 24 by a 417-1 vote before being signed into law by President Obama on June 25.

The modified multiemployer pension plan relief provisions address many of the issues raised by the Academy committees, including an improved definition of net investment losses that provides for scheduled recognition of the losses and the establishment of a transition rule for certifications with operational procedures for changes in plan status resulting from application of the relief. In addition, relief provisions include:

- The option of incorporating longer recovery periods into funding improvement or rehabilitation plans;
- Extended asset smoothing for investment losses incurred in 2008 and 2009;
- Relief for plans operating under pre-PPA amortization extensions.

The relief also establishes an alternative default schedule that plan sponsors may utilize if certain adoption criteria are met. You can view the final text of H.R. 4213 here.

—JESSICA THOMAS

JOANNE MOONEY

Late-Breaking Developments

Speakers in Session 104 of the Enrolled Actuaries Meeting reviewed late-breaking developments related to new legislation, regulations, and court decisions from the past year. Panelists were Eric Keener from Hewitt Associates, Kent Mason from the American Benefits Council, and Heidi Rackley from Mercer. One of the bigger-ticket items they discussed was potential pension funding relief being considered by Congress. At the time of the meeting, the Senate had already passed a bill that includes funding relief, while the House was still considering its own version. (For updated information on the final legislation, see Page 6.)

Nondiscrimination Testing Proposals

H.R. 4126, introduced last year by Rep. Lloyd Doggett (D-Texas), would change testing dramatically, including prohibiting inclusion of nonvested benefits for non-highly compensated employees, prohibiting cross-testing, and requiring contribution-based testing for cash balance plans. Due to retirement community concerns, the Doggett staff separated the proposed legislation into two phases. The first phase, possibly included with funding relief, deals with major abuses (e.g., plans providing large benefits to short-serviced participants to avoid providing benefits to non-highly compensated employees), and the second phase would later revisit concerns about current test rules.

FBAR Reporting

Foreign bank and financial accounts (FBAR) reporting is required for trusts with foreign asset holdings and for anyone with trust signature authority. Reporting for a calendar year is due the following year. In August 2009, the filing was extended to June 30, 2010, for those with signature authority, due to confusion over the requirement. In February 2010, the Internal Revenue Service issued proposed regulations further clarifying that a U.S. pension trust is required to file if it has assets in a foreign mutual fund. The regulations also would provide additional reporting relief for those with signature authority. Guidance regarding investments in a foreign private fund was deferred.

Investment-Related Developments

Proposed regulations indicate that a computer model provided to defined contribution plan participants for financial modeling may not reflect return differences for active vs. passive managers unless there is confidence that differences will persist. The comment period for these proposed regulations was still open.

Legislation, expected this year, will regulate those selling swaps (including interest rate, equity, credit default, and currency swaps). Dealers may have capital requirements and clearing requirements. Pension plans that use swaps heavily may be swept into dealer regulations, making the use of swaps prohibitive for pension plans. Work on the Senate side was underway to extract these rules included in the House bill.

Recent Court Activity

Battoni v. IBEW Local Union No. 102, which was decided by the 3rd U.S. Circuit Court on Feb. 5, 2010, held that a welfare plan change triggered a pension plan anticutback violation. Both plans' funds have the same trustees, and meeting minutes showed an intent to discourage participants from taking lump sums. Citing the 2004 Supreme Court decision in *Central Laborers' Pension Fund v. Thomas E. Heinz et al.*, which provided that the addition of any condition to a benefit that has already accrued violates anticutback rules when the condition results in a further restriction on the benefit, the circuit court found that the welfare amendment constructively affected pension plans by adding the condition that retiree medical benefits were forfeited if a lump sum was taken.

In *Overby v. National Association of Letter Carriers*, decided by the D.C. U.S. Circuit Court on Feb. 26, 2010, the court found that a departure from the written procedure for the amendment process voids the amendment.

Multiemployer Plan Developments

The Department of Labor's final multiemployer plan regulations provide for disclosure of funding documents to interested parties and guidance on timing for delivery. The Financial Accounting Standards Board announced a project for multiemployer plans regarding standards for disclosure of risks for participating employers in 2010 year-end financial statements. Sen. Robert Casey (D-Pa.) introduced legislation to promote solvency by allowing formation of alliances between allied frozen and ongoing multiemployer plans; it also would create a process for some financing through general tax revenues.

ASOPs and Academy Practice Notes

Several actuarial standards of practice (ASOPs) and Academy practice notes were mentioned as valuable reading for additional professional continuing education credit. ASOP No. 35, *Selection of Demographic and other Non-economic Assumptions for Measuring Pension Obligations*, requires an actuary to include an assumption for future mortality improvement effective for disclosures on or after June 30, 2011.

ASOP No. 41, *Actuarial Communications*, clarifies that an actuary is responsible for assumptions and methods unless the actuary discloses otherwise; the ASOP also requires the actuary to disclose if an assumption conflicts with the actuary's assessment of a reasonable assumption for the assignment.

Several Academy practice notes were mentioned, including one on assumption setting released in October 2009; one on AFTAP certification released in August 2009, which suggested that a plan administrator should direct an enrolled actuary as to when to issue an AFTAP; and one regarding selecting and documenting investment return from May 2001, which is still helpful for investment return assumption setting.

JOANNE MOONEY *is an actuary and consultant with Towers Watson in Boston.*

KEITH SARTAIN

Health Care Reform and the Retiree Medical Market

With the Patient Protection and Affordable Care Act and accompanying Health Care and Education Reconciliation Act having just been signed into law at the end of March, attendees of Session 607 of the 2010 Enrolled Actuaries Meeting met to discuss health care reform's impact on retiree medical benefits and valuations. Health care actuaries and retirement actuaries were working diligently to understand the implications for employer group health plans covering active employees and retirees. The session focused on Medicare retirees and retirees younger than 65 years old. Its expert panel—Mac McCarthy of McCarthy Actuarial Consulting, Bob Tate of Hewitt Associates, and Dale Yamamoto of Red Quill Consulting—discussed key provisions directly affecting retiree health care strategy and valuation results.

Medicare

Panelists explained changes in the retiree drug subsidy (RDS), including the elimination of the Medicare Part D coverage gap between the initial limit and the catastrophe coverage trigger—in other words, closing the doughnut hole—and the actuarial equivalence standard, which specifically remained unchanged under the new law and therefore does not affect attestation. Part D improvements increased subsidies from pharmaceutical companies (for brand-name drugs) and from the federal government (for generics), which will eliminate the current coverage gap by 2020. A more valuable Part D benefit may encourage retirees and employers to take advantage of many available prescription drug plans in the market.

At the time of the EA Meeting, many employers were in the midst of recognizing the taxation of RDS programs for quarterly accounting under Financial Accounting Standard (FAS) No. 109. The impact depends on the employer tax rate and expected value of future RDS payments reflected in the valuation according to FAS No. 106. The original goal of RDS was to keep employers involved in retiree coverage. Elimination of tax-exempt status reduces the value of RDS and may make other alternatives more attractive. One such example may be employer contracts with a group prescription drug plan, such as an employer group waiver plan, with the savings from Part D built into the premium cost. It's worth noting, however, that administration can be challenging with the new premium structure. Another alternative is for an employer to move to a defined contribution approach to leverage the individual market.

Income-related Medicare premiums would apply to more retirees because the Part B income thresholds will be frozen for 2011 through 2019, and new income-related premiums will apply to Part D reflecting the same thresholds. This change may create administrative challenges for some plans. In addition, Medicare Advantage reimbursement will be restructured and could materially affect plans. Medicare Advantage plans had been providing extra benefits to retirees using the higher reimbursement payments—which had been about 114 percent and will move toward 100 percent. Retirees may see a \$50 to \$75 per month increase in premiums for 2011 and/or a reduction in benefits provided.

Non-Medicare Reforms

The excise tax on high-cost insurance would not be effective until 2018, but at that point it is likely to affect many plans of those younger than 65 years old. Several adjustments to the specified dollar thresholds may apply. Plans may be able to aggregate costs with Medicare retirees and thereby delay application of the excise tax. Employers also may be able to delay accounting recognition until more guidance is issued.

The reinsurance program for early retirees will be effective soon, but funds may not last more than two years, so employers would need to apply soon if it makes sense for them. It is expected that reinsurance will cover approximately 25 to 30 percent of gross charges. It is not clear whether the reimbursement can be used to reduce employer cost or just to reduce cost to retirees. (The Department of Health and Human Services issued guidance on May 4 that seems to provide flexibility for employers and retirees to share the reimbursement.)

The panelists explained that insurance reforms may not have as much impact on self-funded plans, and existing plans may be grandfathered. However, even grandfathered plans are required to provide coverage to adult children up to age 26 and have no lifetime limits or restrictive annual limits. High-deductible plans, on the other hand, may require some adjustments to meet requirements.

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Other Key Provisions

Additional items were discussed that indirectly affect retiree health care strategy and valuation results.

- Health insurance exchanges and individual market reforms should encourage individual market growth and may allow employers to move away from providing group coverage.
- The individual mandate and related plan design considerations may influence retiree plan designs.
- Low-income premium credits and cost-sharing subsidies may cause more employees to opt out of employer plans. Credits are based on household income, which an employer does not know.
- New fees and taxes on segments of the health care sector could affect health care trends given that the cost will be passed along in administrative load.
- Expanded Medicaid eligibility may cover more retirees.

Actuarial Assumptions

- Participation rates for retiree medical plans and COBRA plans (created by the Consolidated Omnibus Budget Reconciliation Act of 1985) may trend lower as more and better options become available in the market or through Medicaid. The 3-to-1 age rating limitation of the insurance exchanges may help retirees obtain subsidized coverage.
- Adding dependent children to age 26 should increase younger workers' participation in retiree plans.
- Retirement rates may change as "job lock" resulting from health insurance need is eliminated. It should be easier to move to another job or choose to retire prior to age 65.
- Termination rates may trend higher with universal elimination of pre-existing conditions.
- Claim costs may be affected by insurance reform enhancements. There are potential adverse selection issues for retirees dropping coverage.
- Health care cost trend rates may be affected more in the short term than in the long term. While the goal was to reduce cost increases, maybe even flatten them to the level of general inflation, long-term trend rates are expected to be comparable to current projections.

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government solutions, opinions inevitably turned to the familiar challenges related to funding rules. Andrew Biggs, resident scholar at the American Enterprise Institute in Washington, argued that regardless of funding method or asset and liability calculation methods, the target numbers still will be inadequate. By definition, a plan that is fully funded based on an average expected return, regardless of the discount rate, will still have only a 50 percent chance that its assets will match its liabilities at the projected date in the future. Some, in discussing this, cited features of the Dutch retirement system, which Peterson said is being looked at as part of the SOA's Retirement 20/20 project. For example, those regulations require 110 percent funding in order to allow benefit increases such as cost-of-living adjustments.

Social Security is another potential vehicle for changes to retirement policy. In a discussion of ways to avert impending shortfalls, one suggestion was to lower cost-of-living adjustments. That change would shift a potential benefit cut onto higher-paid workers, who tend to live longer, instead of hitting the lower-paid workers who, on average, would face a benefit cut based on a raised retirement age. It is important to note that any change will unavoidably result in one sector benefiting more than another, a point emphasized by discussion leader and Academy volunteer Sven Sinclair, an economist for the Social Security Administration. While different proposals can seek to pick specific relative winners and losers, the Academy's 2008 public interest advocacy statement supporting raising Social Security's retirement age as part of comprehensive reform directly responds to the demographic causes for the program's impending shortfall based on actuaries' unique training.

As the actuaries in attendance discussed ways the profession can provide unique leadership to shape the future of retirement in the U.S., David Gustafson, chief actuary for the Pension Benefit Guaranty Corp., highlighted the request for comment issued by the Departments of Labor and the Treasury on ways to increase lifetime income streams in retirement. The Academy's Pension Practice Council and Life Practice Council sent joint comments on May 4 in response to that request. (For a summary of those comments, see the story in the June *Actuarial Update*.)

Participants discussed the importance for the profession to continue to seek ways to educate the public about all aspects of retirement security. For example, Academy Senior Pension Fellow Frank Todisco pointed out the popularity of the Social Security Game on the Academy's website. The game has garnered a significant amount of media attention over the years, helping it become a simple way that many consumers have learned more about the trade-offs necessary to return Social Security to long-term solvency.