

## Academy Says Cash Balance Report Is Flawed

**WRITE TO YOU ON BEHALF** of the American Academy of Actuaries' Pension Practice Council (PPC) regarding your recent report, "Private Pensions: Information on Cash Balance Pension Plans." Based on our review, we respectfully recommend that you amend or supplement the report to reflect the considerations enumerated below.

The study compares a typical cash balance (CB) plan based on actual sampling of conversions with a hypothetical typical final average pay (FAP) plan that the GAO indicates was developed from Bureau of Labor Statistics (BLS) data. The derived "typical" final average pay plan has a step-up integrated formula of 1.50 percent /1.95 percent. Our chief concern with the study is that, based on the best data available and the considerable experience of our council members, we typically do not find formulas that high, particularly among plans that were converted to cash balance plans.

In fact, Tables 112 and 122 of the Department of Labor (DOL) paper cited on page 59 (footnote 2) of the GAO report provide data that does not correspond with the GAO typical

plan. It also uses the BLS database and reveals a mean base rate of 1.07 percent<sup>1</sup>, not 1.5 percent (and a step up of 0.52 percent). A base rate much closer to 1.07 is corroborated by a Hewitt survey of plan provisions<sup>2</sup> and by a Towers Perrin survey<sup>3</sup>. Thus, the GAO typical final pay benefit formula is far more generous than prevailing FAP formulas—by about 40 percent for workers with earnings under the breakpoint (and 30 percent to 40 percent for workers above the breakpoint).

Part of the overstatement of the derived FAP benefit formula in the GAO report can be attributed to the lack of early retirement subsidies assumed for the typical plan. Plans that convert are more likely to have larger early retirement subsidies. We see

**EDITOR'S NOTE:** This is the full text of comments the Academy sent to the Government Accountability Office (GAO) on data used in its November report on cash balance plans. The Nov. 28 letter signed by Donald Segal, the Academy's vice president for pension issues, was sent to David M. Walker, the GAO's comptroller general.

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## DONALD SEGAL

## Calm Before the Storm

**A**S I ASSUME my responsibilities as vice president for pension issues at the Academy, I am taking a deep breath. The near future can only be characterized as interesting and challenging, and I expect that the Academy staff and I will be kept busy on behalf of pension actuaries in the months to come.

Pension funding reform is a very hot topic. As of this writing, we don't know whether Con-

gress will take any action this year. If nothing happens in 2005, it will have to act next year (that sounds familiar). The Academy's Pension Practice Council and all of its constituent committees and task forces have been very busy commenting upon various proposals and public statements and, I expect, will continue to do so. As the nonpartisan experts, we shall strive to provide comments that consider all sides of an issue, both pro and con.



**Donald Segal**

At the same time, the Financial Accounting Standards Board (FASB) is undertaking a major study of pension accounting.

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no justification for understating prevailing early retirement subsidies, especially since by doing so it probably introduced distortions into the analysis.

Page 67 of your report notes that Table 9 of a Watson Wyatt report, "The Unfolding of a Predictable Surprise" (page 19), showed that the median converting FAP plan reduced costs by 19 percent. It was noted that such reduction is not much different from the levels the GAO derived by comparing the typical FAP and cash balance benefits. However, that Watson Wyatt figure was heavily affected by the results from the small number of plans in deciles 5 and 6 (as is evidenced by the 12 percent increase in costs in decile 7). In fact, page 18 of the Watson Wyatt report shows that average defined benefit costs dropped by 10.3 percent and, more important, by only 1.4 percent when including contemporaneous changes to employers' defined contribution plans. Moreover, we note that a more recent Watson Wyatt study<sup>4</sup> revealed that the average cost of 55 plans that converted to hybrid plans since 1999 actually increased by 2.2 percent (5.9 percent when excluding companies that were at or near bankruptcy when they converted).

The GAO research approach was discussed in a footnote on page 60 of the report. The report further acknowledges that another approach would have been to obtain data on the plans that elected to convert to cash balance, but the report dismissed that as "outside the scope of our study." We don't view this as an alternate approach but as the best approach. We believe that to capture accurately what has transpired in actual conversions is appropriately in the scope of this project, especially in light of the overstated FAP plan used to represent traditional plans. Even if the typical FAP plan had properly reflected actual practice, comparing two average plans does not capture the wide range of real-world outcomes. For example, Table 9 of the earlier Watson Wyatt report shows the reader a more comprehensive picture. Employers with less costly FAP plans often increased their costs when they converted to cash balance plans, while employers with more costly FAP plans more often decreased their costs when they converted. In addition, as we note above, employers often improve other benefits in connection with conversions. Watson Wyatt and Mellon<sup>5</sup> studies observed this in their reports. The fact that these changes are

not reflected in the GAO report causes additional concern about the reliability of the conclusions drawn.

We note that just because some employers combined their conversion to the cash balance plan with a reduction in their pension costs (e.g., Delta), it does not follow that cash balance plans are inherently less valuable than traditional final average pay DB plans. It simply means that those companies reduced their costs. It seems logical to conclude that had those companies not changed to a cash balance plan, they would have reduced costs in some other way, in many instances by reducing benefit levels or making other changes to their DB plans. Thus, we feel that the preferred way to compare traditional FAP plans with CB plans is on a cost-neutral basis, similar to the Society of Actuaries study in the October 1998 Pension Forum ([library.soa.org/library/sectionnews/pension/PFN9810.pdf](http://soa.org/library/sectionnews/pension/PFN9810.pdf)). The GAO report also puts forth cost-neutral comparisons. However, due to the problems with the FAP formula, the cash balance benefit credits are much higher than the ongoing benefit credits that employers provide. Therefore, the report's cost-neutral analysis can be misleading as well.

On page 30, the report states that in developing the FAP plan, the GAO reflected "discussions with pension actuaries, consultants knowledgeable about DB plans..." We are aware of at least two members of the Academy who discussed with GAO staff their concern regarding the level of benefits under the (at the time) proposed FAP formula before the report was issued.

We have some other concerns regarding the GAO report:

**1** Pages 2 and 3 of the report (including footnotes 6 and 9) cite the need for better disclosure of a conversion's effect on a participant's benefits. While the report notes that this issue was discussed in more detail in a 2000 GAO report, the report never mentions that Congress already amended the law to address this concern in 2001.<sup>6</sup>

**2** The report mentions the "wear-away" effect on page 2 and implies that it is a cash balance related phenomenon. It would have been appropriate to also mention that the wear-away concept was first suggested by the IRS in the late 1970s and is codified in Treasury regulation 1.401(a)(4)-13(c) as an acceptable approach for amending any DB plan.

**3** We are not sure why the GAO looked just at the demographics of the 1955 birth cohort, but it would have been helpful to have a discussion on how that may have affected results.

**4** Conversions to cash balance plans can improve benefits for workers above the age for unreduced benefits, but we did not see that pointed out anywhere in your report.

**5** We agree that it is difficult to get good transition benefit information from Form 5500. The plan summaries often miss details that can have a major effect on the value of transition benefits. One example is how starting balances are determined, which often reflects enhancements that are not captured in summaries. Without more detailed information, one cannot be confident that all of the important elements are reflected.

For all of the above reasons, but especially our concern regarding the derivation of the typical final pay formula, we urge the GAO to revise or supplement its report to reflect the concerns addressed in this letter in order to provide the best information available in the important public policy debate on cash balance plans.

The Academy, and specifically the Pension Practice Council, has had good experiences working with the GAO over the years to raise our collective understanding of a broad range of issues and mutually to enhance the outcomes of our analysis.

We look forward to continuing this relationship and welcome any questions you may have about the issues outlined in this letter. Please contact Heather Jerbi, the Academy's senior pension policy analyst ([Jerbi@actuary.org](mailto:Jerbi@actuary.org); 202.785.7869), if you would like to discuss this further.



## Footnotes

1. While the most common percentages in Table 71 of the 2002 National Compensation Survey were in the category of 1.50 percent to 1.75 percent, we have confirmed, based on conversations with BLS, that the flat-rate category does not include step-rate plans. However, the BLS informed us that the category does include offset plans (where the percentage recorded is the gross rate on all pay and was not reduced to reflect the offset based on Social Security benefits). That helps explain why the 1.50 to 1.75 percent range was the most common. Another reason that the most common range seems high is that plans of smaller employers are more likely to have higher formulas, but these plans are less likely to convert to cash balance.

2. The Hewitt survey uses techniques to ensure that the typical plan (which has subsidized early retirement benefits) has a value equal to all of their plans using a standard workforce.

3. The Towers Perrin survey noted that GAO's typical plan was more valuable than 3/4 of plans in its survey.

4. "Hybrid Pension Conversions Post-1999: Meeting the Needs of a Mobile Workforce"

5. The "2004 Survey of Cash Balance Plans" by Mellon Financial (Secaucus, NJ)—also mentioned in the GAO report (footnote 9).

6. Economic Growth and Tax Reconciliation Relief Act (EGTRRA) Section 659 amended Employee Retirement Income Security Act (ERISA) Section 204(h) in 2001.

## •••CALM, FROM PAGE 1

Our mission will be to establish a solid working relationship with FASB so that its members look to us for input on the actuarial aspects of their study. When funding reform is finally passed, pension actuaries and plan sponsors will be getting new guidance from the agencies. Here again, the Academy will strive to provide meaningful input so that the result is something that all parties can live with and that enables full compliance with both the spirit and the letter of the new law.

From the outset, I would like to express my appreciation to Senior Pension Fellow Ron Gebhardtsbauer, Senior Pension Policy Analyst Heather Jerbi, General Counsel Lauren Bloom, and all of the other Academy staff who have provided leadership to us pension practitioners over the past years. We will continue to support your efforts on our behalf.

In a similar vein, I have had numerous opportunities in the past few years to interact with people at various government agencies who work in the area of qualified pension plans. I

have found them to be dedicated, knowledgeable individuals who have the same goal the Academy does—compliance with the law. Things have changed. These regulators don't view us as the enemy, and we return the favor. We are all working together to solve the many problems that crop up in the administration and maintenance of pension plans. In my opinion, we are fortunate to be working with the group of regulators we now have.

Finally, it is the mission of the Pension Practice Council to advocate the continuous advancement of pension actuarial practice. Toward that end, we will be ramping up efforts to create practice notes and other advice to help pension practitioners as they navigate these interesting and challenging times.

**DONALD SEGAL**, a consultant with CCA Strategies in New York, is the new editor of the EAR and the Academy's vice president for pension issues.

# Updated Social Security and IRS Amounts for 2006

## Covered Compensation, 2006

2006 Wage Base \$94,200

YEAR OF BIRTH	AGE IN 2006	SSRA	SSRA	YEAR OF COVERED COMPENSATION \$1*	\$12	COMPENSATION ROUNDED TO \$600**	TO \$3,000
1939	67	66	2005	46,351	46,344	46,200	45,000
1940	66	66	2006	48,820	48,816	48,600	48,000
1941	65	66	2007	51,254	51,252	51,000	51,000
1942	64	66	2008	53,637	53,628	53,400	54,000
1943	63	66	2009	55,951	55,944	55,800	57,000
1944	62	66	2010	58,240	58,236	58,200	57,000
1945	61	66	2011	60,494	60,492	60,600	60,000
1946	60	66	2012	62,714	62,712	63,000	63,000
1947	59	66	2013	64,900	64,896	64,800	66,000
1948	58	66	2014	66,937	66,936	67,200	66,000
1949	57	66	2015	68,889	68,880	69,000	69,000
1950	56	66	2016	70,731	70,728	70,800	72,000
1951	55	66	2017	72,497	72,492	72,600	72,000
1952	54	66	2018	74,169	74,160	74,400	75,000
1953	53	66	2019	75,780	75,780	75,600	75,000
1954	52	66	2020	77,340	77,340	77,400	78,000
1955	51	67	2022	80,271	80,268	80,400	81,000
1956	50	67	2023	81,677	81,672	81,600	81,000
1957	49	67	2024	82,997	82,992	82,800	84,000
1958	48	67	2025	84,223	84,216	84,000	84,000
1959	47	67	2026	85,389	85,380	85,200	84,000
1960	46	67	2027	86,494	86,484	86,400	87,000
1961	45	67	2028	87,540	87,540	87,600	87,000
1962	44	67	2029	88,500	88,500	88,800	90,000
1963	43	67	2030	89,443	89,436	89,400	90,000
1964	42	67	2031	90,343	90,336	90,600	90,000
1965	41	67	2032	91,166	91,164	91,200	90,000
1966	40	67	2033	91,903	91,896	91,800	93,000
1967	39	67	2034	92,520	92,520	92,400	93,000
1968	38	67	2035	93,034	93,024	93,000	93,000
1969	37	67	2036	93,429	93,420	93,600	93,000
1970	36	67	2037	93,694	93,684	93,600	94,200
1971	35	67	2038	93,900	93,900	94,200	94,200
1972	34	67	2039	94,080	94,080	94,200	94,200
1973	33	67	2040	94,200	94,200	94,200	94,200

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

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

These three tables list updated figures for IRS pension limits, Social Security amounts, and covered compensation for 2006.

Andrew Eisner of Buck Consultants Research Department compiled the tables.

# Social Security – 2006 Factors

**On Oct. 14, the Social Security Administration announced updated factors for 2006.**

**Wage Base** The maximum amount of earnings taxable in 2006 is \$94,200 for Social Security purposes.

**COLA** The cost-of-living increase in benefits is 4.1% first applicable to December 2005 benefits, payable in January 2006.

**Wage Index** The average annual wage figure of \$35,648.55 will be used in computing benefits for workers who become eligible in 2006. This figure is based on data for the last complete year (2004) and was used to determine other wage-indexed numbers given in the table below.

FACTOR	2005	2006
Wage base:		
for Social Security	\$90,000	\$94,200
for Medicare	No limit	No limit
old-law wage base, for indexing PBGC maximum, etc.	\$66,900	\$69,900
Cost-of-living increase (applies to December benefits, payable in January)	2.7%	4.1%
Average annual wage (based on data two years earlier)	\$34,064.95	\$35,648.55
PIA formula, 1st bend point	\$627	\$656
PIA formula, 2nd bend point	\$3,779	\$3,955
Maximum family benefit, 1st bend point	\$801	\$838
Maximum family benefit, 2nd bend point	\$1,156	\$1,210
Maximum family benefit, 3rd bend point	\$1,508	\$1,578
Retirement test exempt amount (annual)		
below SSNRA	\$12,000	\$12,480
year of SSNRA	\$31,800	\$33,240
Wages needed for one quarter of coverage	\$920	\$970
FICA (employee) tax rate:		
Social Security (OASDI)	6.20%	6.20%
Medicare (HI)	1.45%	1.45%
Total	7.65%	7.65%
SECA (self-employed) tax rate, total	15.30%	15.30%

# IRS Pension Limits for 2006

## Principal Limits

IRC	LIMIT	2005 ROUNDED	2006 ROUNDED	2006 UNROUNDED	NEXT INCREMENT	\$ INCREASE NEEDED
415(b)(1)	Defined benefit plan limit	\$170,000	\$175,000	\$177,184	\$180,000	1.6%
415(c)(1)	Defined contribution plan limit	42,000	44,000	44,296	45,000	1.6%
401(a)(17)	Limit on includible compensation *	210,000	220,000	221,480	225,000	1.6%
402(g)(1)	Limit on 401(k)/403(b) elective deferrals **	14,000	15,000	15,000	15,500	3.3%
414(q)	HCE definition	95,000	100,000	100,080	105,000	4.9%
414(v)(2)	401(k)/403(b)/457(b) Catch-up deferral limit **	4,000	5,000	5,000	5,500	10.0%

## Other Limits

IRC	LIMIT	2005 ROUNDED	2006 ROUNDED	2006 UNROUNDED	NEXT INCREMENT	\$ INCREASE NEEDED
457(b)	Limit on nonqualified deferrals **	14,000	15,000	15,000	15,500	3.3%
409(o)(1)(C)	ESOP payouts, 5-year limit	850,000	885,000	885,920	890,000	0.5%
409(o)(1)(C)	ESOP payouts, additional 1-year limit	170,000	175,000	177,184	180,000	1.6%
408(k)(2)(C)	SEP pay threshold	450	450	498	500	0.4%

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

\*\*The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) prescribed \$1,000 annual increases in the Sections 401(k), 403(b), and 457(b) limits and the Section 414(v) catch-up deferral limit through 2006. Thereafter, these limits will be adjusted for inflation.

# Tweaking Pension Reform

**EDITOR'S NOTE:** *The following are highlights from the executive summary of the Academy's recent analysis of pension funding legislation under consideration by Congress. While commending legislators for incorporating many of the Academy's reform principles into proposed legislation, the Academy had some further suggestions. To read the complete report, go to [www.actuary.org/pdf/pension/reform\\_nov05.pdf](http://www.actuary.org/pdf/pension/reform_nov05.pdf).*

**T**HE LEGISLATION PASSED by the various committees reflects many of the funding reform principles discussed in our published report *Pension Funding Reform for Single Employer Plans*, namely: solvency, predictability, transparency, incentives for funding, flexibility, avoidance of moral hazards, and simplicity. In particular, these bills improve solvency by setting a funding target of 100 percent and using an amortization period of seven years.

In addition to one of our top principles that is not adequately addressed by either of the primary House and Senate bills—the incentive to fund plans more than beyond 100 percent of current

liabilities—we provide the following suggestions for consideration by members of Congress:

- ▶ **ECONOMIC VALUE FROM SUPER-SURPLUS:** Allowing transfers of pension surpluses to the employees' health plan, above a threshold set in consultation with the PBGC, would remove the current disincentive to increase contributions, to the advantage of both employees and employers.
- ▶ **SMOOTHING:** Volatile contributions are not optimal for achieving adequately funded plans. Concerns about volatility in the Senate bill can be addressed by gradual amortization or capping increases and decreases in minimum contributions.

## Some Suggestions for Multiemployer Plans

**While most are pondering the effect of pension funding reform on single-employer plans, the Academy's Multiemployer Plans Task Force has been looking at how it will affect multiemployer plans. In a recent analysis, available online at [www.actuary.org/pdf/pension/multi\\_nov05.pdf](http://www.actuary.org/pdf/pension/multi_nov05.pdf), the task force had comments in a number of areas, including:**

- ▶ The minimum accrual provided in the Senate bill for plans in critical status
- ▶ Non-core benefit reductions
- ▶ The funding improvement period
- ▶ Funding ratios and the methods by which both the House and Senate bills base the liability
- ▶ Amortization extensions under Sec. 412(e)
- ▶ Actuarial certifications for the status of improvement plans
- ▶ The potential for challenges to actions based on actuarial calculations
- ▶ Actuarial projections about contribution increases for purposes of funding improvement and rehabilitation plans.

—HEATHER JERBI

DAVID GODOFSKY

## Circular 230 Applies to You!

**N**EW STANDARDS FOR COVERED OPINIONS and "other written advice" that went into effect June 30 apply to enrolled actuaries and may well apply to things you do in your everyday practice.

For example, consider other written advice, which includes advice concerning "the Federal tax treatment of an item of income, gain, loss, deduction or credit..." In providing other written advice, practitioners should consider the following:

*A practitioner must not give written advice (including electronic communications) concerning one or more Federal tax issues if the practitioner bases the written advice on unreasonable factual or legal assumptions (including assumptions as to future events), unreasonably relies upon representations, statements, findings or agreements of the taxpayer or any other person, does not consider all relevant facts that the practitioner knows or should know,*

*or, in evaluating a Federal tax issue, takes into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be resolved through settlement if raised.*

Wow! Let's take just three parts of that sentence. First, you can't base your tax advice on "unreasonable" factual assumptions, which, by definition (theirs, not mine) include any facts you know or should know are incorrect or incomplete. Question: Does that include employee data? There is no materiality requirement to the rule, but perhaps materiality is assumed.

Second, you cannot rely on advice given by another tax professional (such as your client's attorney) if you know or should know the advice is incorrect or incomplete or if the other practitioner is not qualified to render the opinion. (And no, just being an attorney isn't enough to make someone qualified.) So if you know or should know that your client's pension plan is not a qualified plan,

- **YIELD CURVE AND PHASE-INS:** Plan sponsors that use bonds to protect against market risks should have the option to use the market value of liabilities without smoothing, segmentation, or phase-in, just as they can now opt to use the market value of assets.
- **TRANSITION:** Three years of transition may not be adequate for some plans.
- **MORTALITY:** Projection of additional mortality improvement should be required for some pension plans.
- **EARLY RETIREMENT ASSUMPTIONS:** Requiring the use of earliest retirement date or most subsidized retirement date for all employees in at-risk plans is not a good predictor of what can happen. Specifying an objective in law for actuaries to follow could produce more accurate results.
- **CREDIT RATINGS:** Credit ratings may be difficult to determine for not-for-profits and private corporations that do not want to disclose their financial results.
- **SUBTRACTING CREDIT BALANCES:** The pros and cons of subtracting credit balances are outlined [in the full report]. We also discuss a number of solutions to various concerns.
- **HYBRID PLANS:** Concerns that hybrid legislation could jeopardize the provision of defined benefit pensions are discussed [in the full report].
- **REORGANIZATION FOR SINGLE-EMPLOYER PLANS:** When a company faces financial distress, one option it has is to terminate its underfunded pension plan and have the PBGC assume the plan. We discuss an alternative that would allow single-employer plans to enter a special status, similar to the reorganization status for multiemployer plans, which would serve as an alternative to a PBGC takeover.



then you are prohibited from relying on another professional's judgment that it is a qualified plan when rendering advice on, for instance, the deductibility of pension contributions.

Third, you cannot take into account the possibility that your client will not be audited or that the auditor will not discover the issue.

You may have heard that there is an exception for advice relating to the qualified status of a qualified plan. Unfortunately, that exception applies only to covered opinions—not to other written advice. And all the issues discussed above relate to other advice, not to covered opinions. Also, you may have seen the Circular 230 disclaimers that are appearing at the bottom of e-mails and think that those give you some help. Sorry. The disclaimer applies only to prevent an opinion from being a marketing opinion—it will not save you from any of the rules discussed above.

So what happens if you violate Circular 230? The IRS can suspend or permanently revoke your enrollment. Oops!

Circular 230 is 60 pages long, and in addition, you should know about listed transactions and reportable transactions under Section 6011 of the Internal Revenue Code. (By my count, seven of the 31 listed transactions—which are deemed by the IRS to be aggressive

## **Restoring the Employee Benefits Connection**

**H**URRICANE KATRINA swept away a lot more than buildings. In the post-storm diaspora, affected workers, retirees, and their employers have lost contact with each other. As a result, people are not receiving retirement checks, don't know where to send premium payments for their health benefits, and don't know how to reach plan administrators to request a hardship loan, COBRA information, or an update on the status of their employment or benefits.

To help, the Labor Department's Employee Benefits Security Administration (EBSA) has created a searchable database on the Labor Department website for employers and employee benefit plan sponsors whose operations were disrupted by Hurricane Katrina.

The database, located at [www.dol.gov/ebsa](http://www.dol.gov/ebsa), is populated with contact information from the Forms 5500 and annual reports filed previously with EBSA by employee benefit plans located in the affected disaster areas. The information includes the employer name, pre-hurricane address, and phone number. As plans report new or updated contact information to the administration's benefits advisers, the information will be entered into the database.

Plan sponsors are encouraged to call the administration's toll-free number, 1-866-444-EBSA (3272), to report changes. To prevent fraudulent or unauthorized information from being entered onto the database, the EBSA will then require plan sponsors to fill out an updated contact information form that can be downloaded from the website. All forms should be faxed to 202-219-8141 or mailed to EBSA, Attn: Contact Verification, Room N5623, 200 Constitution Avenue N.W., Washington, D.C. 20210.

► Questions? Contact EBSA's office of participant assistance at 202-693-8630.

and illegal tax shelters—relate to advice given by actuaries.)

There will be a session at the 2006 Enrolled Actuaries Meeting, March 27-29 in Washington, on Circular 230, listed transactions, and reportable transactions. The Joint Program Committee for the Enrolled Actuaries Meeting considers this topic so important the session will be held twice so that everyone who wants to can attend.

**DAVID GODOFSKY** is an actuary and an attorney. A partner in the law firm of Alston & Bird in Washington, Godofsky represents both actuarial firms and sponsors of qualified plans. He is a member of the Joint Program Committee for the Enrolled Actuaries Meeting.

## Convergence: The Future of U.S. Pension Accounting

**T**HERE'S A MOVEMENT IN ALL COUNTRIES to make the securities markets more transparent," said Mark Beilke at the 2005 Enrolled Actuaries Meeting, pointing to an anticipated convergence toward "one accounting standard worldwide."

Beilke, the late chairperson of the Academy's Committee on Pension Accounting, warned meeting attendees that convergence was a matter of "when, not if." And he said the likely result would be pension accounting standards that look more like where international standards are headed than like where U.S. rules have been.

Statement of Financial Accounting Standards (SFAS) No. 87, the key U.S. pension accounting standard, and International Accounting Standard (IAS) No. 19, the comparable international standard, both establish principles based on a projected unit-credit method. Key differences that indicate likely future directions for U.S. pension accounting include:

► **MEASUREMENT DATE**—IAS No.19 requires measurement on the financial statement date, whereas the U.S. standard permits a measurement date as much as three months earlier.

► **ASSET VALUATION**—For cost determination, IAS No.19 prescribes use of the market value of assets, whereas the U.S. standard permits a smoothed market-related value.

► **PLAN AMENDMENTS**—IAS No.19 prescribes amortization only of the non-vested portion of any prior service cost of plan amendments.

► **DISCLOSURES**—Among other differences, IAS No.19 requires disclosure of expected asset returns for each major class of investment.

Certain benefit accrual patterns may be treated differently under the two standards, with IAS No.19 attributing amounts

to the vesting date that SFAS No. 87 would spread over expected service periods. IAS No. 19 also suggests that the assumption for expected return on assets should be established more frequently and that the expected return should reflect actual cash flow during the year, although for those aspects current practice is typically the same under both accounting standards.

But U.S. actuaries with an eye toward accounting convergence need to look not only at current distinctions but also at the direction in which IAS No. 19 is headed. A good example of this future direction is a December 2004 amendment to IAS No. 19 that permits employers to recognize gains or losses immediately and in full during the period when they occurred, instead of delaying and spreading net gains or losses. The option for now, designed mainly to permit coordination with the U.K. pension accounting standard, would carry the recognized gains or losses outside operating profit or loss in a separate statement of recognized income or expense. Although employers are not yet required to use the option, any decision to do so would require them to apply international accounting for all employee defined benefit plans (including non-pension postemployment benefits).

Ultimately, the international standard is expected to evolve toward the U.K. standard, which essentially recognizes all pension liabilities on an immediate non-smoothed current market basis. Although it may be some years before the standard for U.S. accounting is similarly structured, U.S. actuaries should be preparing already for significant changes in pension reporting when the inevitable convergence occurs.

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