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FUNDING REQUIREMENTS UNDER ERISA

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(For list of discussion topics, see Page 691)

CHAIRMAN RICHARD C. KEATING:* Much of what we've been talking about for the last two days has to do with funding in its broader aspects, actuarial methods, assumptions, asset valuation, investment. We, in this session, will be talking about funding requirements as prescribed by law. We do not wish to rule out any discussion of the other items but we shall try to concentrate on the law itself and of course that's all we have at the moment. We know that there are some regulations out, but many more are forthcoming.

I would like to introduce the members of the panel to you. The gentleman on my immediate left is Russ Mueller, formerly in consulting practice with Hewitt Associates, formerly actuary in the Social Security Department and for sometime now, actuary for the Pension Task Force of the House Labor Committee. He has been quite involved in the development of ERISA and we expect that he will be able to talk to us on the law itself, some of the legislative history and maybe some of the things that the language was intended to mean.

On my right is Mr. Jack Elkin, who is Chief Actuary for Martin Segal and Company. Among his other talents, he is well known for his broad experience in multiemployer plans. He will be able to talk about the funding problems that they may have. On the far left, Mr. Harrington, who is actuary for AT&T. We expect that he will be able to address us on the problems of funding as presented to the large corporation. Our recorder is Mr. Ted Sweeney from A. S. Hansen. Each of the panel members has a presentation to make, at the end of which we shall entertain comments, suggestions, criticisms, or what have you, from the floor and try to do the best we can. The first member I should like to present to you is Mr. Russ Mueller.

MR. RUSSELL J. MUELLER: It has been almost 9 months since the enactment of ERISA (Employee Retirement Income Security Act of 1974) and the number of questions about the Act still seems to be growing. Until regulations are issued, there will continue to be more questions than answers, and this is especially true in the funding area.

Before we get into some of the thorny problems of exactly which plans are required to fund, I would like to comment on some areas which impact heavily on the actuary and his duties under ERISA.

Perhaps the most distressing question facing actuaries (and accountants and attorneys alike) is whether they will be considered fiduciaries under the Act while performing their normal professional activities. A good case can be made that actuaries are fiduciaries, especially in light of a statement to that effect in the House Committee on Education and Labor report explaining H.R. 12906.[1] (See Page 680 for footnotes.)

Perhaps a better case can be made, however, that it is not necessary to impose fiduciary duties on the actuary in order to carry out the intent of the Act. The reason is that ERISA expects the actuary to act "like" a fiduciary, if not "as" a fiduciary.

*Mr. Keating, not a member of the Society, is a Fellow of the Conference of Actuaries in Public Practice.

To explain the former statement, the Act requires that the enrolled actuary be engaged "on behalf of all plan participants" (ERISA, Section 103(a)(4)). This requirement is analogous to the one for the fiduciary to act "solely in the interest of the participants and beneficiaries" (ERISA, Section 404(a)). The actuary is also to exercise independent judgment in the selection of actuarial assumptions and methods in order to give his best estimate of anticipated experience under the plan. This could be interpreted to vest in the actuary "discretionary authority or discretionary responsibility in the administration of the Plan." This phraseology is contained in the last of the three clauses defining "fiduciary" (ERISA, Section 3(21)). The positive duty of the actuary to use "reasonable" assumptions and methods is again comparable to and consistent with the requirement of the fiduciary to exercise "prudence" in carrying out his duties (ERISA, Section 404(a)(1)(B)).

Numerous requirements, protective of plan participants, apply directly to the enrolled actuary of a defined benefit pension plan.[2]

1. He must perform an actuarial valuation of the plan at least once every three years (or more frequently if necessary to support his opinion under (6) below), and also in the event of a plan merger or consolidation.

2. He must state that to the best of his knowledge the actuarial report (for both Labor Department and IRS purposes) is complete and accurate.

3. He must certify as to the plan contributions necessary to reduce any accumulated funding deficiency to zero.

4. He must justify any changes made in the actuarial assumptions or cost methods.

5. He must make a statement that all costs and liabilities are determined on the basis of actuarial assumptions and methods which, in the aggregate, are reasonable (taking into account the experience of the plan and reasonable expectations) and which, in combination, offer his best estimate of anticipated experience under the plan.

6. He must offer an opinion that the "contents of the matters" in the actuarial report meet the criteria in (5) above.

7. He must report all information necessary to fully and fairly disclose the actuarial position of the plan.

This extensive list of responsibilities would appear to raise the accountability of the actuary to the highest level possible. The Act goes even farther to ensure that the actuary's independent judgment as to the appropriate actuarial methods and assumptions to be used is not compromised by the plan sponsor or others who might exert influence on the actuary.[3] Before the actuary gains the "privilege" of assuming all of these responsibilities, he must meet the new enrollment standards established by the Joint Board for the Enrollment of Actuaries.

By virtue of these extensive duties imposed on the actuary by the Act, it would appear that the interests of participants and beneficiaries are more than adequately safeguarded. If this does not convince you that the actuary need not be a fiduciary, let me explain to you the clincher.

In order to understand my conclusion on this point, you must also understand a basic principle which is offered in only half jest. This principle of regulatory construction is that "one refers to the language of the Act only when the Statement of Managers of the Conference Committee is unclear."

The Joint Statement of Managers of the Conference clearly states that the ordinary functions of consultants and advisers (e.g., actuaries) may not be considered as fiduciary functions except in extraordinary circumstances.[4] I would hope that, if the Department of Labor has already reached this conclusion, they would soon end the current state of confusion and anxiety by issuing clarifying regulations. While such regulations may prove helpful, they may only offer a brief moment of respite for many actuaries. The reason is that where the actuary offers any form of investment advice for a fee, the actuary again would be considered a fiduciary to the extent of the advice given.

Let us turn our attention briefly to a requirement which can have considerable influence on the actuary's determination of minimum funding levels. The Act places a number of constraints on the actuary's choice of actuarial assumptions and methods. The issue giving rise to the greatest amount of speculation, and perhaps a good deal of misleading speculation, is the requirement for the actuary to utilize "his best estimate of anticipated experience under the plan."[5]

A close reading of the legislative history of this provision is instructive in arriving at a reasonable interpretation of the meaning of "best estimate." First, the question might be asked, "What ultimate result did the Act intend to achieve by requiring the actuary to use <u>his</u> best estimate?"

The answer to this question is twofold. First, by requiring the actuary to use <u>his</u> (own) best estimate, it is clear that the Act intends that the actuary's independent judgment not be compromised. The committee reports in the House make this point crystal clear. (The provision originated in H.R. 2 as passed by the Committee on Education and Labor on October 2, 1973.)

"Your committee recognizes that frequently there is a range of actuarial assumptions which may be appropriate for determining the costs of a defined benefit pension plan, and the choice of the appropriate assumptions is very much a matter of judgment. In this circumstance, an employer may attempt to substitute his judgment for that of his actuary, which may lead to situations where plan costs are not being independently determined by an actuary. Your committee believes that it is inappropriate for an employer to substitute his judgment in these matters for that of a qualified actuary, and it is contemplated that, if such a circumstance were to arise, an actuary would have to refuse giving his favorable opinion with regard to the plan."[6]

The second part of the answer goes to the issue of eliminating confusion on the part of the public who must rely on the actuary's figures. The statement by the Committee of the Conference makes clear what is intended to be achieved by requiring the actuary to use "his best estimate."

"The conferees intend that under this provision a single set of actuarial assumptions will be required for all purposes (e.g., for the minimum funding standard, reporting to the Department of Labor and to participants and beneficiaries, financial reporting to stockholders, etc.)."[7]

(See Page 680 for footnotes)

Given the above legislative history of this provision, the intent of the requirement for the actuary to use "his best estimate of anticipated experience under the plan" can be interpreted as follows:

The actuary is to use his own independent judgment to select a single set of actuarial assumptions, such that the single set of assumptions reflects anticipated experience for each particular plan, and is in the actuary's own judgment the most appropriate (best) under the circumstances to use for reporting to all interested parties (e.g., participants and stockholders).

Of course, this requirement must be read in conjunction with the duty of the enrolled actuary to act "on behalf of all plan participants." Equally important is the requirement that the actuary utilize assumptions and techniques which are in the aggregate reasonably related to the experience of the Plan and to reasonable expectations.

What then are the implications of the "best estimate" standard? First of all, the enrolled actuary for the plan is to act in an independent and unbiased manner. He is not to act as an advocate of management (or of a labor union) which might seek to minimize (or maximize) pension costs. Secondly, the terms "anticipated experience" and "reasonable expectations" suggest that those factors which have affected plan costs in the past and which the actuary knows will be operative in the future must be reflected in the actuary's estimates. Certainly, increases in wages and salaries due to inflation fall into this category. Thirdly, the actuary must decide which set of assumptions (among several sets that may meet the first test of being reasonable in the aggregate) is most appropriate (his best) for all reporting and disclosure purposes, giving due regard to his duty to act on behalf of all plan participants. There is nothing in the legislative history of the "best estimate" provision which would seem to automatically prevent the actuary from choosing a set of assumptions which contains a margin for error. In fact, the House Committee reports indicate that the actuary may make a choice of assumptions from within a suitable <u>range</u>.[8] The "best estimate" clause cannot be read so as to reduce to meaninglessness the requirement of the preceding clause that all assumptions be reasonable in the aggregate. In summary, the legislative history does not support a view that the intent of the "best estimate" clause was to introduce some narrow mathematical concept of "best." Finally, logic would dictate that the required single set of assumptions is applicable to all instances where a valuation of a plan on an "ongoing basis" is performed. In a similar manner, a single set of assumptions would be required in all instances where a valuation of a plan is made on a "termination basis."

I believe that a careful reading of the legislative history and the Act can quickly dispel far-out interpretations like the following. Some have suggested that the actuary must now come up with a single set of assumptions to be used for all the plans the actuary services. The legislative history makes clear that assumptions are to be established separately for each plan and that putting the plan actuary in such a straightjacket would, in fact, be undesirable.

Let's go on to some of the other questions that the other panelists have posed to me.

The funding standards of the new law seek to achieve the dual purpose of protecting the plan participant and, from a tax standpoint, of establishing a reasonable basis for allocating and allowing pension costs. Some persons maintain that, because of the imposition of plan termination insurance on defined benefit pension plans, the only reason left for funding is to protect the solvency of the Pension Benefit Guaranty

Corporation (PBGC). Additional reasons for funding go far beyond this narrow point of view.

First, to the extent that a funding "cushion" is built up, the Plan sponsor is protected against potential excise tax levies at times when contribution deadlines cannot be met. Secondly, it is not PBGC but the solvent employer's net worth and good credit standing that is at risk in the event of underfunding. Thirdly, participants who are not vested and even some who are can stand to lose substantial accrued benefits that are not insured in the event of the termination of an underfunded plan. Finally, as a result of the socialization of the private pension system, it is the employers continuing their defined benefit pension plans who may suffer the fate of having to pay higher premiums if other plan sponsors go bankrupt and terminate underfunded plans.

The most severe penalties, excise taxes and employer liability, are imposed by the IRS and PBGC on tax-qualified defined benefit pension plans. In light of this fact, perhaps we should focus in on exactly which plans can continue to exist in a less perilous environment.

The Act's funding provisions are set out in parallel fashion in both Title I (Labor Title) and Title II (IRC amendments). For the most part, the funding provisions of the two titles are identical. However, certain plans may be subject to only Title I provisions (principally non-IRS-qualified plans) and others subject to only Title II provisions (for example, qualified plans for nonresident aliens).

Excluded from both Title I and Title II are:

1. Government plans (including plans financed by contributions required under the Railroad Retirement Act).

2. Church plans. Qualified church plans must continue to meet certain requirements of prior law. But church plans which elect to be covered under the participation, vesting, and plan termination insurance provisions of the Act are also subject to the new funding requirements (ERISA, Sec. 4(b); IRC, Sec. 112(h)(4)). Some persons have questioned whether a plan for employees of a church-affiliated hospital is exempt from ERISA. Generally, the answer is no. Hospital plans, as well as plans established by other nonprofit or tax-exempt organizations, such as universities, are covered under the Title I funding standards. Coverage under Title I is deferred until plan years beginning after December 31, 1982, if the hospital is a church agency exempt from tax under Section 501 of the Internal Revenue Code and if the hospital plan is part of a plan also covering employees of a church.

3. Plans funded exclusively by the purchase of qualified level premium individual insurance contracts (or an equivalent group contract) (ERISA, Sec. 301(a)(2); IRC, Sec. 412(h)(2)). Splitfunded plans (ordinary life insurance or annuity contract with a "side" investment fund) are not excluded from the funding requirements.

4. Fraternal beneficiary society plans (established by IRC Sec. 501(c)(8) organizations) or voluntary employees' beneficiary association plans (established by IRC Sec. 501(c)(9) organizations) if no part of the contributions to the plan are made by employers.

(See Page 680 for footnotes)

5. Plans which do not at any time after September 2, 1974 provide for employer contributions.

Title I excludes the following plans:

1. Workmen's compensation, unemployment compensation, and disability plans required by law.

2. Unfunded plans maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees (ERISA, Sec. 301(a)(3)). This exemption applies to consultant contracts for retired management employees.

3. Unfunded "excess benefit" plans -- plans maintained solely for the purpose of providing benefits for employees in excess of the limits on contributions and benefits imposed by IRC Section 415 (ERISA, Secs. 3(36), 301(a)(9)).

4. Plans or arrangements for retired partners pursuant to IRC Section 736 (ERISA, Sec. 301(a)(6)).

5. Plans maintained outside of the United States primarily for the benefit of nonresident aliens (ERISA, Sec. 4(b)(4)).

6. Certain pension plans created before 1959 and described in IRC Section 501(c)(18).

While individual account plans of the profit-sharing and stock-bonus type are not covered, money-purchase pension plans are subject to the dual funding requirements.

What Is a Pension Plan? Almost 9 months have elapsed since the Pension Reform Law was enacted, and the Department of Labor is still struggling to define "pension plan." The job is not an easy one, however, given the breadth of the language in the Act.

The Act (Section 3(2)) defines a pension plan to be any plan, fund, or program which, by its express terms or as a result of surrounding circumstances, provides retirement income to employees, or results in a deferral of income by employees for periods extending to the termination of covered employment or beyond, regardless of the method of calculating the contributions made to the Plan, the method of calculating the benefits under the plan, or the method of distributing benefits from the plan.

The potentially broad reach of this definition could sweep all sorts of presently unfunded formal and informal arrangements under the funding and other provisions of Title I. At one extreme, an arrangement by an employer to pay retirement income to a single individual on an ad hoc basis could conceivably be interpreted to be a covered "plan." It is clear that such unfunded arrangements (whether formal or informal) for one or more management or highly compensated employees is excluded from the funding requirements. A strong argument can be made that to subject such an arrangement for a single individual (who is not a management or highly compensated individual) to the provisions of ERISA would offer little, if any, extra benefit protection to the individual. If the arrangement is established at or after termination or retirement, the funding provisions would be irrelevant. Of course, it may be possible for the arrangement or contract to be described in terms which would meet the definition of "individual account Plan" (ERISA, Sec. 3(34)). In this case, the arrangement would be exempt from the funding standards altogether. Whether the Department of Labor will effectively "kill" such arrangements by subjecting them to the reporting, disclosure, trust, fiduciary, and vesting requirements of the Act remains to be seen.

The status of severance pay plans will also remain under a cloud until regulations are issued. Such plans offering substantial benefits may be indistinguishable from pension plans in their actual operation. A current review of the terms of existing severance pay plans may be helpful in heading off problems that regulations may later cause in this area.

Beyond the one man "pension plan" considered above exists a whole host of pay-as-you-go arrangements covering retired employees and, in some cases, active employees. Under one type of arrangement, an employer will provide a group of retirees cost-of-living or other supplemental benefits on a pay-as-you-go basis. Under another type of arrangement, sometimes referred to as a minimum pension guarantee program, an employer will supplement defined contribution plan accumulations in order to guarantee the participant a certain minimum pension benefit at retirement. Sometimes these arrangements take the form of a guarantee of principle and a fixed rate of interest on profit-sharing accounts. At one time in the past the Department of Labor reported that about 600,000 employees were covered under formal pay-as-you-go pension plans.

Because of the scope of these arrangements, it is doubtful that the Department of Labor will see fit to exclude them from the definition of "pension plan." An unfortunate consequence of this inevitability is that some plan sponsors are being advised that the only alternatives are to seek tax qualification (and some by their terms cannot be qualified) for such plans or to terminate them. Emphatically, these are not the only alternatives. Although the Senate version of H.R. 2 would have required this result, the House version which prevailed in Conference did not.

In the case of a nonqualified plan presently paying benefits to a closed group of pensioners, there would appear to be no need to either terminate or qualify the plan. As a "pension plan," this arrangement would be subject to the reporting, disclosure, trust, fiduciary, and vesting requirements of Title I. However, Title I does not require that new participants be brought into the plan nor that the plan be nondiscriminatory in operation. Since past service liabilities may be funded over 30 or 40 years, the funding standards of Title I would be met by merely continuing to pay benefits to the retirees. Hopefully, plan sponsors will be made aware of these facts before retired persons are needlessly cut off from their benefit payments. I think this would be unfortunate and I think some of this interpretation came from an agency that still hasn't understood the scope or purpose of Title I.

In the case of nonqualified plans presently covering a broad range of active employees, the situation does become more precarious. A decision could always be made to redefine and limit the coverage of the plan to a closed group of retirees and active employees nearing retirement age and to continue the plan in the nonqualified status described above. If the plan covers a substantial number of retirees, it might very well be that the plan could be continued for several years for both actives and retireds. Of course, the time will come when the benefit payments to the retirees will not be sufficient to meet the funding standards of Title I. Under these circumstances, the only alternative may be to establish a qualified plan for the remaining active employees. It should be noted that nonqualified pension plans are not subject to the plan termination insurance provisions of the Act (ERISA, Title IV) unless they would meet all qualification requirements in actual practice over a period of 5 years. There is another area where nonqualified plans could be granted some relief at the regulatory level. Hopefully, in light of ERISA, the Internal Revenue Service will reassess its present policy on so-called "feeder plans," and permit such plans to be qualified where adequate safeguards are introduced.

Once the coverage hurdle has been cleared, the actuary comes face to face with the accounting namesake to the F.S.A. and the A.S.A. That is, the Funding Standard Account (FSA) and the Alternative Minimum Funding Standard Account (ASA). A number of concerns have been raised as to the accounting treatment of actuarial gains and losses under minimum funding standards (ERISA, Part III; IRC, Sec. 412) and the maximum tax deduction limits (ERISA, Sec. 1013(c); IRC Sec. 404(a)).

Generally, the Act requires that actuarial determinations for both the minimum funding standards and maximum deductible limits be made in a parallel and consistent fashion. The Statement of Managers of the Conference Committee says that "deductible limits are to be determined under the funding method and actuarial assumptions used for the minimum funding rules."[9] The legislative history makes clear that, under certain actuarial cost methods (e.g., aggregate, frozen initial liability), actuarial gains and losses need not be separately identified.

"However, the bill provides that experience gains and losses are to be determined under the funding method used to determine costs under the plan. It is understood that some funding methods, such as the "aggregate method," do not provide experience gains or losses, but differences between anticipated and actual experience are subsumed in the basic funding requirements of the method. If a Plan were to use such a funding method, it is anticipated that the Plan would not need to separately amortize experience gains or losses."[10]

Under such methods the normal costs, and therefore the "actuarial gains" and "actuarial losses" reflected in such normal costs, are treated in a parallel fashion in the determination of minimum standards and maximum tax deductible limits. In a similar manner, a consistent treatment of actuarial gains and actuarial losses can be expected to apply when actuarial cost methods which separately identify such gains and losses are used. A House Committee report states that the intent is "to put the minimum contribution requirements and maximum deduction limitations on a comparable basis."[11] Under the minimum funding standards, actuarial losses as well as actuarial gains are amortizable over 15 years. It would seem to follow that, if actuarial losses are to be amortized over 10 years in determining the tax deduction limits, actuarial gains would also be amortized over 10 years for this purpose.

Under the Act, as in the House bill, experience gains and losses are generally to be determined at least every 3 years (ERISA, Sec. 302(c)(9); IRC, Sec. 412(c)(9)). This requirement coincides with the requirement that an actuarial valuation be made at least every 3 years. By permitting actuarial gains and losses to be determined at least every 3 years, the Act intends to permit plans "to smooth fluctuations in funding."[12] It would seem to follow that, where plans would in fact experience greater fluctuations in funding (rather than a smoothing), regulations would permit such plans to determine gains and losses more frequently than every 3 years.

Under the Act, the definition of experience loss under certain collectively-bargained pension plans is to include the difference between the reasonably anticipated contributions and the actual contributions.[13] That the Conferees intended this result is clearly stated on page 285 of the Joint Explanatory Statement of the Committee of the Conference (House Report 93-1280). I think Jack Elkin will probably cover this situation as far as multiemployer plans are concerned.

Moving to the issue of Valuation Methods, the funding standards are specific as to the number of years over which plan liabilities arising from various sources are to be amortized. Net gains or losses resulting from changes in actuarial assumptions must be amortized over 30 years. The legislative history of ERISA would seem to indicate that net gains or losses resulting from changes in actuarial cost methods must also be amortized over 30 years. Although H.R. 2 as passed by the House overlooked the gains and losses resulting from changes in actuarial assumptions and actuarial cost methods, both the Education and Labor Committee and the Senate-passed versions of H.R. 2 required gains and losses from both sources to be amortized over an identical period. The Senate bill would have required such changes to be amortized over 15 or fewer years, while the House Education and Labor Committee bill would have set the amortization period at 30 years. As to the amortization period relating to changes in actuarial assumptions, the Act follows the House rule of 30 years. Presumably, the Act will be interpreted to follow the House rule of 30 years as the period for amortizing net gains and losses resulting from changes in actuarial cost methods.

The actuary's choice of method to value assets is critical to the level and incidence of charges and credits to be made to the Funding Standard Account of a pension plan. For example, if the method chosen were to recognize abnormally large fluctuations, large gains in a single year could wipe out any difference between the accrued liability of the plan and the value of plan assets. This would mean that the so-called "full funding limitation" had been met and that all unamortized liabilities of the plan (whether they had 20, 30, or 40 years to go) would be considered to be fully amortized. A subsequent drop in the value of assets to the original (more normal) level could create at that time a substantial experience loss which would then have to be amortized over 15 years (and not the original 20, 30, or 40-year period).

This raises the question of just what the requirements of the Act are as to the valuation of assets. Under the Act, plan assets are to be valued on the basis of any reasonable actuarial method of valuation which takes into account fair market value and which is permitted under regulation prescribed by the Secretary of the Treasury. It should be emphasized that the actuary is not restricted to using only fair market value. The Act generally recognizes the long-term nature of pension plan funding and, in this regard, permits the use of actuarial valuation methods which produce asset values which are lower than market value in some years and greater than market value in other years. The actuarial value of the assets must bear a reasonable relationship to fair market value. If the fair market value and the value used under the actuarial method differ significantly over several years then the asset value under the plan must be adjusted accordingly.[14]

The House Committee reports signal the direction the regulations are to take in defining acceptable asset valuation methods.

(See Page 680 for footnotes)

"It is contemplated that using cost or book value without taking account of changes in fair market value would not be an acceptable valuation method. However, in a case where fair market value tended to fluctuate around cost, a reasonable actuarial method may determine that cost is the appropriate value."[15]

The latest SEC report shows the market value of all private noninsured pension plan assets to be $22 billion below book value at the end of 1974 (and $6 billion above book value at the end of 1973). It may be that book value will not disappear overnight as a reasonable and accepted asset valuation method.

The actuary has always had to deal with uncertainty. As a result perhaps he is better able than most to cope with the "slow but deliberate" pace being taken by the agencies in issuing regulations. On the whole, most of the provisions of ERISA are reasonable, and forward progress can be made by making reasonable interpretations of those provisions.

Footnotes

1. Congressional Record, 2/25/74, H 1100 (Material Explaining H.R. 12906).

2. ERISA, Sections 103(a)(4), 104(d), 302(c)(3) and (9). IRC, Sections 412(c)(3) and (9), 6058(b), and 6059.

3. House Report No. 93-807, 93rd Congress, 2d Session, 94; Congressional Record, 2/25/74, H 1116 (Material Explaining H.R. 12906).

4. House Report No. 93-1280, 93rd Congress, 2d Session, 323 (Conference Report).

5. ERISA, Section 103(a)(4)(B)(ii). IRC, Section 412(c)(3).

6. House Report No. 93-807, supra note 3 at 95. Congressional Record, 2/25/74, supra note 3 at H 1116.

7. House Report No. 93-1280, 93rd Congress, 2d Session, 285 (Conference Report).

8. House Report No. 93-807, supra note 3 at 27. Congressional Record, 2/25/74, supra note 3 at H 1104.

9. House Report No. 93-1280, supra note 7 at 293.

10. House Report No. 93-807, supra note 3 at 80. Congressional Record, 2/25/74, supra note 3 at H 1113.

11. House Report No. 93-807, supra note 3 at 100.

12. House Report No. 93-807, supra note 3 at 81. Congressional Record, 2/25/74, supra note 3 at H 1113.

13. House Report No. 93-1280, supra note 7 at 285.

14. House Report No. 93-807, supra note 3 at 97. Congressional Record, 2/25/74, supra note 3 at H 1116.

15. Ibid.

MR. KEATING: Thank you very much, Russ. I believe Russ has made some excellent points here in bringing out the need for an investigation of the committee reports, several committees, and the statement of managers as to what was really intended. Now we have to remember than a lot of the regulations and so forth of ERISA are not for something but they're against something. They're to correct abuses, real or alleged. I think we can maybe get too tangled up in technique, whereas going back to the original design and purpose of a particular provision could lead to a more rational working out of exactly what we have to do.

I'd like to go ahead now, and the next panel member is Jack Elkin.

MR. JACK M. ELKIN: A multiemployer plan, for the purpose of the law, is defined as one maintained pursuant to one or more collective bargaining agreements between an employee organization and more than one employer, with no single employer accounting for more than 50% of the total contributions, and under which benefits are payable to each participant (at least to the extent that they accrued while his employer was contributing to the plan) without regard to the cessation of contributions by his employer. By regulation, new plans established after the enactment of ERISA must show that they were established for a substantial business purpose.

Multiemployer plans account for about one-third of the coverage of the private pension plans; some of them are small with only a few hundred participants but some are national in scope, embracing hundreds of thousands of employees. Although properly classified as defined benefit rather than defined contribution plans, they are characterized by defined contributions fixed by collective bargaining and by benefit levels so designed that they can be financed by these contributions.

By their very nature, multiemployer plans have to a great extent always embodied some of the basic objectives of ERISA. Almost always, participation rights are granted from the first day of employment, regardless of age. An employee may work for numerous employers in the course of his career, but so long as he remains under the coverage of the plan -- which in some cases means so long as he works at his trade or craft anywhere in the country -- it can be said with substantial truth that he is always fully vested and fully insured in the event his employer goes out of business.

Congress attempted in a number of ways to recognize the special features of multiemployer plans, one way being through special funding requirements. Not only existing but new plans may amortize their liabilities over a 40- instead of a 30-year period. Also, increases in unfunded liabilities resulting from plan amendments may be amortized in 40 years instead of 30 and net experience losses in 20 years instead of 15. This is no less than fair in consideration of the obvious fact that, in general, multiemployer plans have a safer life expectancy than single employer plans. The special treatment also has its practical side since many multiemployer plans have adopted benefit programs which are being supported by fixed contributions on a minimum or close to minimum schedule and it is not a simple matter for a union to bargain for a higher contribution for the sole purpose of strengthening the funding of a pension plan with no increase in benefits to show for it.

Under the heading of funding, mention should be made of several other provisions that are applicable specifically to multiemployer plans.

One states that, if it is necessary in order to meet the funding standards to reduce liabilities, a multiemployer plan has time to adopt a retroactive amendment up to 2 years instead of 2-1/2 months after the close of the plan year to which it will apply. Another eases the requirement that liabilities be amortized by level annual payments in the case of a plan that was in existence on January 1, 1974, and is financed by contributions based on a percentage of pay. There are not many such plans but one of them covers over 400,000 employees. Such a plan may elect to fund the unfunded past service liability existing as of the end of the first year to which the funding provisions apply, as well as subsequent increases resulting from plan amendments, by contributions that are a level annual percentage of participant payroll, provided that they are at least equal to the interest on the unfunded liability. Of course, the assumptions as to interest and future payrolls must be reasonable. For practical purposes, the provision means that a plan to which it applies may, for a few years at least, proceed with interest-only funding.

The maintenance of the funding standard account will present certain problems for multiemployer plans. While an employer maintaining a pension plan can be required to make additional contributions to cover funding deficiencies, it is not practical to impose this requirement in the case of a plan maintained pursuant to a collectively-bargained agreement providing for a predetermined level of contributions for the duration of the contract period. Most such plans are of the Taft-Hartley multiemployer type, where contributions are usually dependent on the number of hours worked and benefit levels are so designed that they can be financed by the negotiated contributions, with the calculations based not only on the usual actuarial assumptions but also on an assumption as to the level of employment. In some plans, contributions are related to the number of tons of coal mined or tons of fish caught or on aggregate payroll,and corresponding assumptions must be made.

There is no explicit provision in the law dealing differently with these plans in the matter of funding deficiencies, but the Conference Committee Joint Explanation describes the special rules that will be applied. If, at the beginning of a contract period, the actuarial assumptions were reasonable and the actuarial calculations correct, and if the agreed-on contributions were made as required, no funding deficiency would be declared in the event contributions failed to match the funding requirement. If the plan has experienced losses (and a shortfall of contributions would be treated as an experience loss) the next contract, the report states, can provide for them by increasing contributions or decreasing benefits.

Not only is the statute not explicit on this matter but the Conference Committee's report can be read to mean that the entire loss during one contract period must be made up within the next period. This would be a wholly unrealistic requirement incompatible with the pattern of collective bargaining. The only realistic approach, of course, would be to allow the loss to be amortized like any other experience loss.

There is a possibility, of course, although the Explanation does not consider it, that,with a reassessment of projected income and reasonable changes in actuarial assumptions, the actuary could certify that the standard can be met in the course of the next contract period without making any adjustments in contributions or benefits. Obviously, adjustments should not be required when this is the case. There is a possibility also that, even though an honest good-faith effort is made through reasonable adjustments to ensure that no deficiency will be created over the next contract, new unforeseen economic difficulties in the industry may result in a deficiency. In such circumstances, a fund should be given still another opportunity to make necessary adjustments for the future without the imposition of an excise tax.

Another funding problem unique to multiemployer plans is illustrated by the following: A union negotiates a 30¢ contribution in 3 steps, 10¢ the first year, 20¢ the second, and 30¢ the third. A pension plan is then designed that can be supported by the 30¢ contribution on the assumption that it will be continued into the future. If the level annual actuarial cost is determined by the entry age normal cost method, and experience during the 3-year contract period conforms to the assumptions, there will obviously be an actuarial deficiency at the end of the period. In the past, we would report to the plan sponsors that the "loss" was expected, that the deficiency is only apparent and had been taken into account in the original actuarial certification, and that future contributions were still expected to support the expected benefits. What is needed now is recognition of a sort of modified entry age normal cost method of determining cost in a case like this -- a method which produces a level annual cost except that it is one-third of level the first year and two-thirds of level the second.

A particularly difficult funding problem is presented by those plans, often national in scope, that embrace units covered by different collective bargaining agreements, independently negotiated, expiring at different times, and providing different levels of contributions. The contribution rate automatically determines the benefit rate. In some cases, an employee's pension is based on his "career-average" contribution rate, but more commonly it is based on his final rate. In the latter case, substantial new past service liabilities are created each time a contract is renegotiated to increase the contribution rate. It is impossible to introduce a satisfactory actuarial assumption to forecast the rate at which such increases will be negotiated and the actuary may try to deal with the problem by loading the cost with a sufficient margin of conservatism to absorb the increases in liabilities as they occur. Such an approach will, of course, have to be reconciled with the requirement that the actuary utilize assumptions that will give him a "best estimate."

I must say, I received a great deal of comfort from Russ' remark that the best estimate does not mean a central mathematical figure with the maximum probability attached to it, that a best estimate could, taking into consideration the needs of the participants, etc., include an element for conservatism that will enable you to manage the plan without running into deficiencies. Now while I've given you a few of the special problems of multiemployer plans, I might give you also some of the relief that multiemployer plans have, some of the problems they don't have to worry about. Multiemployer plans do not have to worry about maximum deductible limits because none of them ever go on an amortization schedule that would even come within smelling distance of the maximum deductible limits. They don't have to worry about an alternative minimum funding standard account. They don't have to worry about the full funding limitations because, as soon as the trustees of a plan find that the amortization is proceeding at a nice clip and shows some promise of being amortized in something less than say, 30 years, the benefit is quickly increased and they move back to a forty or a forty-five or fifty year amortization schedule, getting the full benefit of the contribution and the experience that the fund has gained.

Obviously, if multiemployer plans are to continue to perform their valuable function without having to contend with unmanageable technical obstacles, their special character and the exigencies created by the collective-bargaining process will have to be recognized in regulations or technical amendments.

MR. KEATING: Thank you, Jack, for mentioning some of the peculiar problems of multiemployer plans that must be faced as a result of ERISA. It doesn't come as any great surprise to us that particular problems also can apply to large corporations. And our next speaker will talk on that area. I'd like to present Mr. Donald Harrington.

MR. DONALD P. HARRINGTON: It's difficult to speak for a particular management, much less all managements. The decision-making process and the rationale inherent in that process is too complex. However, there is a tangible connection in that certain considerations that affect the decisions of one corporate management have a high probability of affecting the decisions of other corporate managements.

Any change with respect to the pension plan that affects the design, administration, or financing should cause management to reconsider its policies. Usually an informed management will consider a series of questions that tend to reduce much of the confusion surrounding the change. A partial listing of the more important questions might be the following:

(1) What is the increase in both the normal cost and the amortization of additional accrued liabilities resulting from the new proposals, or, more simply, how much more must we contribute to the fund?

(2) What will be the effect on present and near-term corporate earnings? These two questions are basic and should be expected. Obviously, the question of corporate solvency is always at issue. While it's nice to have the actuarial liabilities of the pension plan secured by the off-balance sheet assets, it is even nicer to have a solid earnings statement and a comfortable corporate surplus position.

(3) Will it be necessary to alter the financial policy to take into account this change?

   Future financial burdens which are not properly taken into account can place an inordinate strain on all aspects of the business. Accordingly, management likes to be in the position of anticipating, within certain limits, the problems it will encounter. Management does not like surprises and, in this respect, is no different than most people. A constant state of alarm is not the way to run the business.

(4) Finally, what considerations should be given to the interested parties? Primarily, this relates to the shareholders and the employees. The interests of these parties are not always parallel. Often management will have to perform a balancing act if each category is to be properly treated.

<u>Effect of ERISA in Relation to Above Questions</u>

The enactment of ERISA and the financial aspects of the funding requirements would necessarily cause management to review its policies. No doubt the primary focus was placed upon the period over which the pension plan assets were to theoretically equal the pension plan liabilities.

I personally recall a survey of management about two years ago in one of the leading business magazines where a large portion of management felt that periods in excess of 30-year funding (of the unfunded accrued liability) were excessive. The question of whether such unfunded had to be amortized was not fully covered. (See Frank Griffin's article in the Transactions, TSA-Vol. XVIII, entitled "Concepts of Adequacy in Pension Plan Funding" and the related discussion.) Apparently, the management of most of these corporations felt that (1) any additional cost resulting from this change was within the bounds of reasonableness, and (2) that this effect on earnings could be absorbed. Of course, this article did not consider the effect of further aspects of the law, namely, (1) that the assets must be determined by a reasonable actuarial method which takes into account fair market value, and

(2) that the assumptions must be reasonable in the aggregate and take into account the experience of the plan and reasonable expectations. To the extent that these items increase the cost, management may wish it had been more careful in eliminating the flexibility associated with the amortization of the unfunded accrued liability.

The funding provisions of ERISA will probably have some effect on financial policies since most managements like to smooth out the costs associated with the budgeting of pension expense. Accordingly, when actuarial gains and losses are experienced, management often likes to spread such costs over the future payrolls of the covered participants. To the extent that such costs are not part of the normal cost, they now must be amortized in level annual amounts over a 15-year period. If the weighted average temporary annuity used in the spread adjustment has a value that is substantially greater than the 15-year annuity certain, there can be quite a few surprises -- especially in a heavily-integrated final pay plan! Therefore, some managements may wish to change their method of accruing pension costs so that corporate financial policy can be planned with a reasonable degree of accuracy.

In the past, the actuarial cost method and the actuarial assumptions have been generally sympathetic to the pressures of the parties-at-interest. There was a range of reasonableness in these areas where competing interests might be balanced. It is doubtful that this flexibility will still exist in the future. The following requirements of ERISA will impact directly on this flexibility: (1) the enrolled actuary, engaged by the administrator of the Plan, is required to act "on behalf of all the plan participants," (2) the range of reasonableness of the actuarial assumptions will be narrowed considerably since they must "reflect his best estimate of anticipated experience of the plan," and (3) finally, any change in the funding method will require approval by the Secretary of the Treasury.

In short, it is going to be a lot more difficult in the future to balance the competing interests of the employees and shareholders.

MR. KEATING: Thank you, Don. We have time for comments and questions and I would ask that, even though we may all know you, you go to the microphone and identify yourself before the question or comment.

MR. GORDON W. CLARKE, JR: The speakers generated, I think, fifty or sixty questions but I'll stick to two short ones. The funding standard account allows for 40-year amortization of the liability in effect on the date that the funding standard account first applies. Can somebody help me out with whether you include in that liability, the liability that's created by the ERISA-complying amendment that is coincident on that date?

MR. MUELLER: The legislative history, I believe, is clear and any additional costs that arise because of the ERISA requirements could be spread over 40 years.

MR. CLARKE: The other matter, that doesn't appear to be addressed in the law in terms of telling you what period to deal with it on, is the matter of making a single adjustment for an unanticipated event. The report indicates an adjustment should be made for this, the law doesn't help us out here. Is there any help that anyone up there can offer?

MR. MUELLER: I think here we can focus on the duties of the actuary and whether or not the act would, in fact, prohibit special adjustment. The fact that you say adjustment is required would seem to mean, at least to me, that you feel that it's reasonable and that it should be done. Now certainly this could raise a situation where that adjustment might be tested by the Service as to whether it would violate any of the standards, such as that assumptions must be reasonable in the aggregate. So I think here again, instead of the act controlling necessarily, we have the attitude of the regulators controlling; will they be reasonable or will they be sticky?

MR. PAUL C. COWAN: In the typical multiple employer plan you have cents per hour, so many dollars per week, or however the contribution level is expressed. You turn that into a benefit structure and publish a plan with defined benefits in it, and so on. Is it clear yet as to whether this is a defined contribution plan or a defined benefit plan, and the second question is, is it covered by PBGC or not?

MR. ELKIN: This is a defined benefit plan and is covered. As far as being covered by PBGC, the termination provisions will apply to multiemployer plans beginning 1-1-78. Before that time, it is subject to the discretion of the benefit guarantee corporation, with a further restriction that the amount of money that can be paid in the case of terminated plans under the discretionary authority of the corporation is limited to the premiums collected. The guarantee corporation may not have any recourse to the 15 million dollar loan that it got from the Treasury Department. Right now the guarantee corporation has two plans on which it's holding hearings under its discretionary authority. It hasn't decided yet whether to consider the terminated plans subject to the insurance provisions.

MR. COWAN: Can an argument be made, in your judgment at all, that, since the primary establishment is the contribution, this is a defined contribution plan, regardless of the fact it's backed up by an instrument?

MR. ELKIN: No, it's still a defined benefit plan.

MR. COWAN: Well, is this a judgment or an opinion or a fact. What is it? I'd like to have a basis of authority on something like this. I'm reaching here specifically for some authority.

MR. ELKIN: Well, where the employer enters into the determination of contributions or determinations of benefits, the law treats it as a defined benefit plan.

MR. HERBERT L. FEAY: Mr. Mueller indicated that Title I covered benefits beyond just dollar pensions after retirement. Does it extend to substantial amounts of paid-up life insurance, or paid-up health insurance for retired lives, because if you put that in with the active lives, you'll get a terribly high average premium.

MR. KEATING: You have another good point on another funding problem. However, maybe you might want to speak about this, Russ. A plan, and Russ did say something about a pension plan, is a bit undefined as yet but is some instrument or scheme or device to provide retirement benefits. Do you know if what was mentioned would fall under that category?

MR. MUELLER: Well, if the contracts are still under the plan, then I would expect that the regulations would require both the benefits to be valued and the assets to be valued and the appropriate charges and credits be made to the funding standard account. If they are not part of the plan but are spun off in some manner, I would expect that these contracts would not constitute a plan. At least for the Service purposes, there is no plan. Whether it will constitute a plan for Title I is unclear but I don't believe it would. It really depends on the continuing relationship between the employer and the payment of those benefits.

MR. BOYD S. MAST: I'd like to get a clarification on an interpretation that Mr. Mueller made relative to the necessity, or the lack of same, for establishing a trust to cover pension benefits currently being paid to a frozen pension population, those benefits being benefits that were paid under an unfunded plan prior to the establishment of the currently funded plan.

MR. MUELLER: As I said, I believe that this plan would only be covered under Title I but, since it is covered under Title I, it would come under the trust requirements. Whether an application made to the Labor Department for a waiver of that requirement would be acceptable, I don't know. I would certainly forward to the Labor Department such a request because it would seem to me that in essence it would be a dry trust. There wouldn't be any necessity for its establishment and I would think that where certain safeguards are provided, Labor Department would grant such an exemption. If it doesn't and there's a technical amendments bill, I think that's one area that might be addressed.

MR. RALPH J. BRASKETT: Russ, am I correct in assuming then, that you're saying that a pay-as-you-go scheme, for retirees only, of either the supplemental or past service nature would be acceptable currently, as it stands?

MR. MUELLER: Well, there isn't any plan that's acceptable.

MR. BRASKETT: Okay, these are nontrusteed, being paid on a current budget basis by the employer. Usually it's a closed group, generally now all retirees or, say, 90% retirees.

MR. MUELLER: That's the type of plan I was addressing myself to and my point is that it is a plan covered under Title I and that it must meet disclosure and fiduciary and reporting standards.

MR. BRASKETT: Well, now would the fiduciary standards prevent the employer from running a pay-as-you-go scheme?

MR. MUELLER: The prohibited transactions area is certainly one that has to be explored, but I would think that, in any event, this would be one area where there would be an exemption. Hopefully, to echo Congressman Erlenborn's remarks, individuals will inform the Senate as to the harshness of that provision and hopefully there can be a bill that would remove from the act this restriction.

MR. BRASKETT: However, these plans would not have PBGC coverage.

MR. MUELLER: They would not be covered by PBGC.

MR. BRASKETT: Another question. I've been told again and again that the aggregate method and possibly also the attained age normal method will not be acceptable for the funding standard account because the amortization of gains and losses is not done. Now you've just said the contrary, can you tell me where citations would be for that?

MR. MUELLER: This is in House Report #93-807, page 285.

MR. BRASKETT: It's not in the conference report then.

MR. MUELLER: No, it's not in the conference report.

MR. JOHN E. CHAMPE: Because the law didn't require that the act be written in terms that could be understood by all actuaries, myself included, I find myself in need of an understandable paraphrase of the workings of the alternative funding standard account.

MR. KEATING: Before someone else might answer that more clearly, I would like to speak about the motivation and the rationale of the alternative funding standard account. The rationale is contained in a paper by Frank Griffin with the assistance of John Hanson,I believe. The motivation for the alternative funding standard account might be paraphrased as "save the entry age normal method." What it means is that, if we set up an entry age normal past service liability, for purposes of orderly funding, then we are not in a position of telling the sponsor that he must completely fund the entry age normal reserve which, of course, would be redundant in case the plan terminated. We would anticipate in most circumstances that, if the plan is being funded on an entry age normal basis, let us say over 40 years, and one reaches the point where the value of all accrued benefits is covered, then the funding of payments on the principal can cease. Let us suppose that, in the usual circumstance, the sponsor would continue to pay the entry age normal cost and interest only on the remaining unfunded reserve. Of course, the law doesn't come out that way. The law says that we need not pay even that much, but that once this security line is reached, it must be maintained, and in order to maintain it, at least the provision for a unit credit normal cost must be made year by year. Russ might want to speak a little further about the problems and discussions that went into this.

MR. MUELLER: Well, the approach originally taken by the Education and Labor Committee was essentially related to a solvency test, and the approach taken by the Senate Labor and Senate Finance Committee and Ways and Means Committee was the type of approach that was originally adopted in the act. The solvency test that is now called the alternative minimum funding standard account is really a vestige of the original Education and Labor committee approach,and essentially what it says is that the employer need not contribute to a plan at all if, on a termination valuation basis, the assets at their fair market value would equal or exceed the present value of the accrued benefits on a termination basis. If there was a slight difference, they could also meet the funding standard by paying that amount. However, if you choose to use the ASA in a particular year, and then subsequently incur a substantial experience loss or have a large liability produced because of a plan amendment, then you may switch back to the FSA method if the contribution required would be less. Under this circumstance any deficit in the funding standard account would have to be amortized over a five-year period. Where did five years come from? God knows. I think Don explained. The five-year approach was rather an uninformed way of treating actuarial gains and losses in the Senate, in the S-4 Senate Labor Committee Bill; and they thought this was a good idea because this was the approach used in the Canadian solvency test. They never quite figured out the difference between the two arrangements, but this is where it came from.

MR. HARRINGTON: There are two problems that I see here. The first is the definition of accrued benefits that are to be used under this unit credit method, whether or not they're vested. Second, I wish the fund was at some stabliized value. It is not. It is at market value. The problem here is that you have to deal with swings in the market and you're going to have this value bouncing around day to day over short periods of time. This is likely to be a highly volatile account unless you can play the contrary part of the game that allows you to say, well the market is down and interest rates are up so I'll value at a higher rate. We can have a yo-yo effect that can cause a lot of difficulty.

MR. KEATING: I believe that the act requires that the present value of accrued benefits under the plan be used for the alternative minimum funding standard account, so that it would not be just insured vested benefits, it would be all accrued benefits.

MR. CHAMPE: If I understand it then, if the assets climb to the level of the value of the accrued benefits, there need not be more contributions. But it may be that the value is less than the value of the accrued liability under the entry age normal method. Therefore, if that's the case, may the employer continue to make contributions and claim them as a deduction on his tax return?

MR. MUELLER: This ASA only goes to the requirement for minimum funding. It's independent of the maximum tax deductible limits; they would be the same.

The full funding is a little bit different on the other extreme,and you make various tests under full funding. Full funding in effect wipes out your funding deficiencies,which really says that minimum is a minimum until it becomes greater than the maximum, at which time the minimum has to be reduced. Now if that makes sense to people, it doesn't to me; there are some problems with that maximum, of course, too. But at least in the full funding concept, you do take the actuarial value of the assets on the full funding side. So you have a ceiling and, hopefully, you'll be able to have a more stable value there than you can on the alternative standard account.

MR. EDWARD H. FRIEND: I have two questions, one for Russ. If an employer has two plans, one qualified closed plan with retirees only, and one with actives, can the employer aggregate the funding requirements under both plans, utilizing the excess, that is the pay-as-you-go over 40 years funding, under the closed plan to offset the funding requirement on the other plan?

MR. MUELLER: I hesitate to answer questions just offhand, but I believe that the funding requirements go to the issue of a plan. So what you have is two plans and funding standards would apply separately to each plan so that offhand I would think there would be no offset available.

MR. FRIEND: The second question was to the gentleman who just left but maybe one of the other panel members can answer it. For a multiemployer plan with benefit bands, would it not be appropriate, rather than utilizing actuarial assumptions which are loaded for expectations as to actuarial loss, to introduce a concept paralleling the use of a salary scale for salaried plans, wherein an assumption as to participants' rates of movement upward to higher bands is made part of the overall set of assumptions?

MR. KEATING: Jack, where are you when we need you? Jack did not leave because he didn't like the questions, he has a plane to catch. Ed, I think that is a worthy suggestion and I don't want to answer it, but I think that it is a suggestion that should be entertained.

MR. MICHAEL MUDRY: Is there any more insight into how the various items that must be amortized may be combined into one period?

MR. MUELLER: Well, there are some examples given in the applicable committee reports. Beyond that I see Don Grubbs back there and he'll be working on that in the next couple of years.

MR. CHAMPE. Could I ask a question about the maximum deductible again. The minimum contribution is based on the then-outstanding unfunded past service at the time the act applied. Now, is the maximum deductible based on that same unfunded or on something else? And the reason I ask is in connection with an employer who has been attempting to fully fund this past service liability using the maximum 10% deduction. Maybe he's got only one more payment to go. Is the IRS likely to say you can't make just one more payment and finish it up; you've got to take 10 years to finish it.

MR. MUELLER: Interesting question. The act generally requires a new start. This is generally the intent of the act but, where there are areas that are not addressed, and it might be interpreted that this is an area that is not addressed by the act, past practices would continue to be acceptable.

Don maybe has an answer.

MR. DONALD GRUBBS, JR. You're right that the minimum amortization is related to the unfunded. However, the maximum 10-year funding is related to the initial unfunded liability, the same base as you have now as I understand it, and unless you changed your assumptions there wouldn't be a need to change that base. Of course, if you change your assumptions, then you'll have to readjust your initial unfunded liability.

MR. KEATING: Yes, it seems along that line that it would be ironic that an act that is supposed to improve benefit security, could result in a smaller payment to the fund by reason of this change. I agree with the concept that, even though the act may be a bit silent on it, the initial base, as adjusted, would be allowable, to speed amortization, and 10 years instead of 10% would be permitted as a tax deduction.

MR. MICHAEL R. GREENSTEIN: I have a question for Russ. You mentioned that the funding standard account deficiency would be amortized over five years when the alternative account is used. Can you illustrate how this deficiency would arise?

MR. MUELLER: Well, if you're going to use the alternative minimum funding standard account, you must keep two accounts. So, if there is a contribution that would be required under the funding standard account, but not under the alternative standard account, then obviously there would be a debit balance in the funding standard account, and therefore, let's say in the next year, if you switched back, that debit would then have to be amortized over 5 years.

MR. GREENSTEIN: That is, the funding standard account would set a contribution level at one amount and the alternative account at some lower amount, and then the actual contribution being credited to both accounts would not quite make up what was necessary in the funding standard account, is that it?

MR. MUELLER: Right.

MR. KEATING: For a step-by-step example of that, let us say there's a 30 year funding in the funding standard account and the situation develops where the alternative could be used. When the alternative is used, suppose the sponsor stops amortizing his reserve but continues on with normal cost and interest. That means each year in the regular funding standard account, he is falling behind by the principal payment that should have been made. Somewhere down the line something happens, a severe market drop, for example, so that the alternative funding standard no longer applies, or to make it apply would require a significantly larger contribution. Then the sponsor can fall back to the funding standard account which was being maintained on sort of a phantom basis all along. But the deficiency, which now consists of the principal payments that had not been made, in accordance with the law must be amortized in five years.

MR. GREENSTEIN: Another question along these lines. The language of the alternative minimum standard accounts speaks in terms of all previous credits and all previous debits to the account and it's totally incomprehensible to me. Can you explain that?

MR. MUELLER: What it's saying is, when you switch from the FSA to the ASA, if that's possible, that you start with a zero balance, in essence, in the ASA, and if you were to switch back to the FSA and subsequently go back to the ASA again, you start with another zero balance.

MR. KEATING: As an alternative response to your question, it seems quite clear that in the regular funding standard account one can get ahead of the game by putting in more than the 40 or 30-year funding and the additional contributions would act as a reserve in meeting the funding standards. Such reserves are not permissible in the alternative minimum. It's a very roundabout way of phrasing, but I think that's what it means; you cannot build up a reserve in the alternative account.

MR. CHAMPE: I think it's curious that an employer can gain some flexibility under this funding standard account. If, in 1975, he made no contribution, let the unfunded build up a little bit and spread it over 40 years and then, in the following year, made the 1975 and 1976 contribution which gets him ahead in the unfunded, he still has a little flexibility left.

Discussion topics include:

1. Funding Standard Account

2. New deductible maximums

3. Gains and losses

4. Amendments

5. Change in funding method

6. Alternative Minimum Funding Standard