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ERISA UPDATE—NONINSURED PENSION PLANS

Moderator: JOSEPH MUSHER. Panelists: NORMAN W. CLAUSEN, DONALD S. GRUBBS, JR., LEROY B. PARKS, JR., ROBERT H. SMITH.

1. Enrolled actuary status
2. Valuation and certification problems
3. Compliance procedures and practices
4. Relationship with other professionals
5. Miscellaneous related topics

MR. DONALD S. GRUBBS, JR.: I talked to Blackburn H. (Gee) Hazlehurst yesterday about the Academy meeting in Washington for which Mr. Hazlehurst had prepared a paper. The paper, called Actuarial Reports Under ERISA "Full and Fair Disclosure of Actuarial Position of the Plan," was not distributed due to an error at that meeting. The paper is worth reading though I do not agree with much that is said in it. We have copies here which I encourage you to pick up. It is a very well-done paper.

I am going to discuss several subjects briefly.

First, regarding the Joint Board and pending court action, there are two groups of claimants--one involving a class action suit and another involving two individuals.* The Joint Board filed a motion for summary judgment and motioned for a dismissal of the suit. There have been a number of extensions but the plaintiffs in the suit were to have filed their final answer yesterday. The case should come before the judge very shortly. At that time, the judge will rule on the motion to dismiss and the motion for summary judgment.

Summary judgment means that it is apparent, based on the facts presented, that the plaintiffs do not have a case which justifies delving into the issues in more detail.

Secondly, the Regulations concerning qualification for people enrolling after 1975 were published this week in the Federal Register. Here are the three requirements for enrollment:

1. An experience requirement requires a minimum of three years of pension actuarial experience or, as an alternative, one and one-half years of responsible pension actuarial experience if one has at least five years of total responsible actuarial experience including experience in the nonpension area.

*The second suit has been withdrawn since both individuals have passed the Joint Board examination given on April 1 and are now enrolled actuaries.

2. The second requirement concerns basic actuarial knowledge. The basic actuarial knowledge requirement can be met by one of three routes:

   a. By passing an exam given by the Joint Board. This exam should essentially cover the same material covered in Parts 3 and 4 of the Society's exams.

   b. By passing certain exams found by the Joint Board to be equivalent to its own exam. The Board has not yet designated any exams as equivalent.

   c. By having a degree in actuarial science from a college or university or the equivalent courses.

3. The third requirement, a requirement related to pension actuarial knowledge, would be to pass an exam given by the Board in pension actuarial knowledge or, as an alternative, pass an exam given by another actuarial organization which the Board determines to be equivalent.

The proposed Regulations are now open for comment for 30 days. If someone requests a hearing, there will be a hearing on the subject after which the Board will adopt the final Regulations. Then, they will begin actually taking applications for enrollment in 1976.

There are several open questions concerning these Regulations. One question is, "How do you determine what are equivalent examinations?" The introduction to those Regulations indicates that the Board will first ask whether the examinations cover the same subject material. Equivalence in difficulty and passing level should be ascertained. My own feeling is that the Board should first give its own exams. Based on information about exams sponsored by other organizations, the Board could determine the relative difficulty of such other exams. If the Board found, for example, that three-fourths of those who passed Part 3 and Part 4 of the Society's examinations passed the Board's own examination, then that would be an indication that the Society's examinations were equivalent. If it found the majority of those who passed Part 3 and Part 4 had failed the Board's examination, that would be an indication that the Society's examinations are not equivalent.

Since everyone knows that the Society's exams are equivalent to any that the Board will give, why do we go through this? If the Board did not have any objective basis for determining what were equivalent examinations, any organization might propose to have examinations which were equivalent. The Board did not want to discourage any organization from having other examinations which are truly equivalent. However, I want to be in a position to say, "We are not going to recognize any examinations unless we can objectively prove that they are equivalent." This is a different approach than was taken in 1975 when there was an expressed intent of Congress to have a grandfather clause. Similarly, with regard to the post-1975 period, the same approach might be taken, though the Board may decide not to recognize any other examination in the pension area. Legally, it is required under the law to recognize an alternative examination and doing this in the area of basic actuarial knowledge should meet that requirement. The Board has had differences of opinion concerning whether it would be advisable to give its own exam or whether to recognize other exams in the pension area. We would welcome ideas from different people on that subject.

As to degrees from colleges, again a requirement of the law is that these be recognized. As to what will be considered an equivalent degree, the Board has gathered curriculum information from a wide variety of colleges. If one claims to have an equivalent education, transcripts should be produced to determine if the course content is equivalent to the content of actuarial science programs at other schools.

What is the status of the enrolled actuary within our firms? How are we going to treat the people who have been recently enrolled and what about their relationship to the American Academy of Actuaries? Has the Academy done the right thing--the wrong thing? I know there are sharp differences of opinion that you might want to discuss.

In the area of funding, Regulations should be issued soon concerning asset valuation and the six-month extension of the period during which contributions may be made after the end of the plan year. According to the Act, contributions may be made during two and one-half months after the end of the plan year. That two and one-half month period is subject to a six-month extension under Regulations to be issued. We have yet no Regulations and do not know under what conditions a six-month extension will be granted. Employers certainly need to know about the extension. I am taking the cautious viewpoint by saying we are just not sure and that a corporation should not count on an extension at this point.

Form 5500 is out and there are various questions as to its content and when it should be filed. What are the relative responsibilities of the accountant, the actuary, and the plan administrator? Are they in conflict? Just briefly, the actuary has sole responsibility for Schedule B; the plan administrator has responsibility for Form 5500 itself; and, in plans covering over 100 participants, an attached accountant's statement is required for which the accountant has responsibility. So the accountant does not have responsibility for the statement of assets or statements of receipts and disbursements as found in Form 5500 itself. Alternatively, the plan sponsor may want to delegate to the accountant or to the actuary or to someone else the responsibility of filling out Form 5500.

On plan qualification, there are many uncertainties and it may be desirable to take a wait-and-see attitude. The special reliance procedure is not a big carrot after all, and there are several areas where, before amending a plan, it would pay to wait and see what the final rules will be, particularly the years-of-service rules of the Department of Labor. We can anticipate that the final Regulations are going to be different than the Regulations initially issued. Someone who amends their plan now to comply with the temporary Department of Labor Regulations may be disappointed when they see that they could have written a better plan under the final Regulations.

Another area where we can expect improvement is in the notification of interested parties. At present, when a plan is submitted for approval, one must notify all interested parties. The term "interested parties" includes all plan participants and every employee of the employer. Every employee of the employer includes all employees of every employer under common control, and, in the case of a collectively-bargained plan or a multiemployer plan, every employee of every employer who contributes to the plan and every employee of any employer under common control with any employer who contributes to the plan. When put into the context of the Western Conference of Teamsters, a mindboggling situation could develop. The final Regulation should provide some clarification. It should solve the problems of the multiemployer plans. Whether it will solve problems with plans of companies under common control, I am not sure.

We may also expect a revision of Revenue Ruling 69-502, which deals with combination pension and profit-sharing plans. Basically, the old Revenue Ruling prevented a company from qualifying a pension plan in which the benefits were offset by benefits provided under a profit-sharing plan. The Regulations said neither plan will qualify. Because of this ruling, many employers have maintained a qualified profit-sharing plan and an unfunded, nonqualified pension plan. ERISA now requires that the pension plan be funded which is in conflict with the situation produced by the Revenue Ruling.

We have in Revenue Ruling 71-446 the outdated integration tables. Prior to joining IRS, I was sharply critical of their failure to update the covered compensation in the published tables. After two years with IRS, I did not succeed in publishing revised tables. It is satisfactory to have a definition of covered compensation which will comply with the definition of covered compensation in Revenue Ruling 71-446 and which produces larger numbers than those in the printed tables. The actuarial division of IRS recognizes this but, of course, not all of our district offices recognize this. If you should have approval problems with a district office, ask them to informally contact the actuarial division of the national office. An informal contact with the national office will usually solve the problem.

I have always taken the view that where there are uncertainties, it pays to write a plan document like you want it and then submit the document to IRS. If a favorable determination letter is issued, you are home free. If not, they will tell you how you have to change the document. That is a practical way to handle the many uncertainties we face with ERISA rather than worrying too much about the problems.

There are other problems in integration. One of these relates to the required joint-and-survivor option prior to retirement. There are questions as to whether the preretirement survivor annuity is a preretirement death benefit reducing integration. This question should be answered.

MR. LEROY B. PARKS, JR.: I would like to comment briefly on three subjects relating to ERISA. First, a quick review of the purpose of ERISA and the likelihood of the Act fulfilling its intended objectives. Secondly, a discussion of certain actuarial valuation problems that practitioners are presently experiencing. Thirdly, a prognostication of the broad, long-range impact of ERISA on private pension plans.

At the recent meeting for enrolled actuaries in Washington, jointly sponsored by the American Academy of Actuaries and the Conference of Actuaries in Public Practice, one of the government representatives noted eight objectives hoped for by ERISA. Those goals were:

1. Better <u>disclosure</u> of information
2. More liberal <u>participation</u> requirements
3. Earlier <u>vesting</u> of benefits
4. Stronger <u>funding</u>
5. Higher <u>fiduciary standards</u>

6. More equitable distribution of <u>tax benefits</u>
7. Greater <u>plan termination protection</u>
8. Further <u>growth</u> of private pension plans

I wish to submit to you that some of the inherent features of ERISA will preclude the possibility of the Act ever achieving certain of these objectives.

Item 1 - As far as disclosure is concerned, the only accomplishment of ERISA up until this point in time is the requirement of the distribution of a somewhat confusing "special notice" to all participants of pension plans; this little announcement does not aid any participant in understanding his plan. In the long term, I believe that the greatly increased complexities of pension plans, brought about by ERISA, will largely offset any legislative attempts to provide better disclosure to plan participants.

Item 2 - I am led to believe that there have actually been some restrictions in participation requirements for many plans (from no requirements to age 25 and one year of service) and that these restrictions have probably more than offset the cases where a plan's participation requirements have been forced to be liberalized in order to comply with ERISA.

Item 4 - It now appears likely that, as a result of ERISA, many pension plans will be funded at a slower rate than was the case in the past. This unanticipated consequence is due to the ERISA-mandated switch from conservative to reasonable assumptions and due to the tendency for plan sponsors to adopt the minimum funding level allowed by the Act.

Item 7 - The anticipated plan termination protection for participants may be accomplished in the aggregate in the long run, although the application of the 20% phase-in rule for even those on pension will deny some retired employees a portion of their benefit that they would have received if ERISA did not exist. In the short run, the existence of ERISA and the PBGC has, in some cases, meant a prohibition on payment of benefits to employees who have retired, which seems quite contrary to the concept of benefit protection.

Item 8 - I do not believe that many people sincerely feel that ERISA will promote the growth of private pension plans. Such a viewpoint is contrary to logic and is inconsistent with the surprisingly large rate of plan terminations that has been experienced since ERISA was enacted.

The second area I wish to briefly discuss, which is also Item 2 of the program, relates to actuarial valuation problems. Some of the difficulties we are experiencing in performing valuations that must comply with the minimum funding standards of ERISA are the following:

1. Determination of valuation assets - As we all are aware, ERISA requires that plan assets be determined on any reasonable basis which "takes into account fair market value." My historical preference in determining contributions has been to value assets on a cost basis, provided that cost is reasonably close to market. I am continuing to employ this convention, although the procedure does not seem to dovetail with the technical requirements of ERISA.

2. Application of interest charge on late contributions - ERISA indicates that interest must be applied to the Funding Standard Account

minimum if the required contribution is not made as of the first day of the plan year. However, the Act seems to further suggest that interest need not be considered beyond the end of the company's fiscal year, even if contributions are actually deposited as late as eight and one-half months after the year has actually ended. Hopefully, Regulations will clarify the intent of the law in this area.

3. Appropriate funding period for plan amendments - ERISA allows for the amortization of the unfunded past-service liability in existence on January 1, 1976 over a 40-year period, whereas increases in the liability after that date must be funded over new 30-year periods. A couple of technical points surface in applying this general principle. First, is 40-year funding permissible when a plan amendment in 1975 increases the benefit unit in 1976. Secondly, do the ERISA-mandated improvements that become effective on January 1, 1976 have to be funded over a 30-year period if the amendment making those improvements is not executed prior to 1976?

4. Selection of actuarial assumptions - Much consideration has already been given to the question of what constitutes appropriate assumptions under ERISA. I would anticipate that Regulations will tread very softly in this area. My own personal observation is that the concepts of "taking into account the experience of the plan" and "taking into account reasonable expectations" are frequently inconsistent and cannot be utilized as a standard for the actuary's judgment in selecting appropriate assumptions.

Finally, I would like to venture some thoughts as to what this practitioner feels will be the long-range impact of ERISA.

1. Fewer new pension plans and more plan terminations - Added administrative cost and red tape will discourage some employers from establishing or maintaining plans.

2. Less variability and flexibility in plan specifications - Greater uniformity due to ERISA requirements regarding participation, crediting service, benefit accrual, vesting, etc.

3. Retarded rate of improvements in plans - A certain amount of apprehension now exists on the part of plan sponsors concerning pension plans and the cost of these plans, and these fears will likely dampen the rate of plan improvements.

4. Poorer funding of pension plans - This will occur as a result of the movement toward reasonable assumptions and the likely adopting of the minimum allowable funding basis under ERISA.

5. Higher levels of company management becoming involved in pension plan matters - Pensions are no longer considered as a rather trivial administrative detail.

6. Less attractive nature of pension consulting - Our role as advisors to plan sponsors has come to involve a greater emphasis on detail and less on general policy matters.

7. Assurance of continuation of private pension industry - Some people have felt that ERISA might signal the beginning of the end of the private pension industry. However, I believe that, on the contrary, ERISA has effectively secured the future of private pension plans by creating a large bureaucracy to regulate plans which Congress will never be willing to dismantle.

MR. ROBERT H. SMITH: I would like to offer several comments, first about enrolled actuaries, then about relations with other professionals, and then comments about plan termination which may come either under Topic III, "Compliance Procedures and Practices," or under V, "Miscellaneous Related Topics." I would like to offer some comments about the discussions we have had in the firm with which I am associated in connection with enrolled actuaries with the thought that others will offer similar comments. We have had several employees whom we consider to be paraprofessionals who took and passed the examination for enrolled actuaries and have been accepted as enrolled actuaries. We were then faced with the problem whether they should be treated as actuaries in our firm and given all the privileges and responsibility of professional status. These individuals are not members of any other actuarial organization. We were also concerned as to whether we should permit them to sign actuarial valuation reports. While we have not finalized our conclusions, at least tentatively, we have decided that only actuaries who are either Members of the American Academy of Actuaries or who are Associates in the Society of Actuaries will be permitted to sign valuation reports. Enrolled actuaries who are Affiliates of the American Academy of Actuaries will be given a title such as Actuarial Supervisor, which carries Officer status, but not at the elective level. Enrolled actuaries who are not Affiliates of the Academy would have no special status. For enrolled actuaries who become Affiliates of the Academy, we will probably pay the dues and permit them to attend meetings on a rotating basis.

Next, in connection with relationships with other professionals, again I would like to invite comment regarding relations or, more precisely, responsibilities of accountants and actuaries in connection with multiemployer plans. It is my impression that most actuaries have difficulty obtaining complete and accurate data from the so-called Taft-Hartley Plans, so that a certain amount of judgment is involved in determining what contributions are required to support current benefit levels. My concern here is not with any friction that might develop with the accountants, but rather what are the responsibilities of each. In Section 103 of ERISA, the qualified public accountant is charged with the responsibility of making such tests of books and records of a plan as he deems necessary. Section 103 also requires the administrator to furnish the number of employees. This section also charges the actuary with including in the actuarial statement information about the number of participants and beneficiaries. He also must certify that the report is complete and accurate. Since we, as consulting actuaries, are engaged by the administrator on behalf of plan participants, it would seem to me that, if the accountant has not audited records of participants' credited service to date, hours or days, and of contributions and similar material, we would have to qualify our statement to indicate that we have relied upon information furnished by the administrator, but this information is not audited.

I would like to offer most of my comments in the area of plan termination. We were awarded a contract to write a manual for the employees of Pension Benefit Guaranty Corporation who are responsible for processing the plan terminations. We commenced February 2 and are scheduled to be completed by the end of July. I assume that all of you can read the law dealing with plan termination, but it may be helpful if I mention some of the points we have had to focus on in the preparation of the manual. Obviously, in making any such comments, I am offering my own interpretations and not those of PBGC.

First, by way of general comment, I would say that our contacts with personnel at PBGC have been quite encouraging. PBGC has had to recruit personnel from other branches of the government, many of whom are completely unfamiliar with pension plans. Obviously, these personnel have made mistakes and have not made the progress in processing plan terminations that would be desired. However, we have found top level personnel at PBGC to be quite conscientious and eager to discharge their duties. They are not anxious to build an empire and did not at all present a picture of the typical (or the picture that most of us think as typical) government bureaucrat.

One of the primary questions relates to when a termination has occurred or may occur. In this area, PBGC has been guided by three objectives: (1) minimal disruption of the private pension system; (2) protection of participants; (3) avoiding unreasonable risks. It is the objective of PBGC to minimize their involvement in the private pension system consistent with protecting the interest of plan participants and preventing exposure of PBGC to unreasonable risks.

It is our understanding that PBGC will consider a plan to be terminated for purposes of termination insurance when there is a permanent discontinuance of contributions. A situation in which contributions cease under a plan because it has been replaced by a comparable plan, however, does not constitute a termination. In general, the mere cessation of benefit accrual under a plan does not necessarily mean that it has terminated for purposes of termination insurance. If, for example, a plant or facility is closed so that no additional benefits will accrue but funding, to the extent required, continues, then, in many cases, the plan has not terminated for purposes of termination insurance. In all except the obvious cases of plan termination, it may be well to explore whether the events that have occurred are reportable events rather than a plan termination.

As you know, Section 401(a)(4) of the Internal Revenue Code imposes certain restrictions on benefits for the top 25 employees in case of termination within the first 10 years of the inception of a plan or a substantial amendment. This provision of the Internal Revenue Code at least raises questions of ambiguity, if not conflict, with Section 4044(a) of ERISA as far as priority for allocating assets in case of plan termination. Section 4044(b)(4) states that, if the Secretary of Treasury determines that an allocation is discriminatory, as judged by Section 401(a)(4) of the Code, then the assets allocated under categories 4B, 5 and 6 shall be reallocated to the extent necessary to avoid the discrimination. By implication then, any assets allocated under categories 1 through 4A will not be considered discriminatory. Mr. Alvin D. Lurie sent to Regional Commissioners and District Directors in November of 1975 a notice bearing on this subject. It is our understanding that the Secretary of Treasury and the PBGC are working on Regulations dealing with this subject.

MR. NORMAN W. CLAUSEN: I have come across a few specific problems that to my knowledge have not been widely discussed in forums such as these. I would like to talk about these problems and several possible solutions.

Problem 1: Many contributory defined benefit plans pay benefits on a modified cash refund basis. If the employee elects a refund of his contributions with interest, presumably we can determine the employer-purchased part of the pension by reference to Revenue Ruling 76-47. That ruling tells one to (a) select the number of years which the modified cash refund, in effect, guarantees (for example, you might determine the modified cash refund feature is equivalent to a five-year certain guarantee), (b) convert the contribution refund to a pension which would have been guaranteed for that number of years, and (c) subtract the pension so determined from the total accrued pension. This net amount would then be the employer-paid part of the pension. The problem is that the actuarial principles behind this method presume that the employer-paid part of the pension will carry some level of death benefits (for example, a five-year certain guarantee) when, in fact, there would never be any contributions to refund.

Answer: We believe the best approach is to first increase the total pension to the actuarial equivalent on a life only basis and then determine the two pieces on that basis.

Problem 2: The allocation of accrued benefits in a contributory plan between the employer part and the employee part is only done at normal retirement age. If earlier retirement benefits are subsidized, how does the actuary reflect that?

Answer: If such subsidization is not subject to the minimum vesting standards, and I do not think it is, then a plan is free to provide that an employee electing a refund of his own contributions will forfeit any subsidization.

Problem 3: With respect to the alternative minimum funding standard, what does the term "accrued benefits" mean?

Answer: Our best guess is that "accrued benefits" are those which would be paid if all employees were forced to retire on the valuation date with immediate commencement of benefits. This, of course, will produce a reserve which may be much greater than the traditional "actuarially computed value of vested benefits" if the plan subsidizes benefits for early retirees.

Problem 4: With respect to the alternative minimum funding standard, what is the meaning of the phrase "normal cost...under the unit-credit method"?

Answer: Our best guess is that for purposes of the alternative standard, this normal cost must be computed as the excess of (a) the present value of benefits assuming all employees retire a year from the valuation date over (b) the present value of accrued benefits just discussed.

Problem 5: If an actuary's "best estimate" is that wages will only grow slightly faster than the cost of living, it follows that he must project mushrooming Social Security benefits. This has the effect of dramatically reducing costs for new entrants under offset plans. Is this proper?

Answer: It seems very reasonable to assume that Congress will act to "decouple" Social Security benefits at some time in the not-too-distant future. Therefore, it seems proper to in some way anticipate some amendment to the Social Security Act. Since the present Act would work well if national wages rise at twice the rate of inflation, one way to anticipate changes in the Social Security Act would be to project Social Security benefits on the basis that the Consumer Price Index will increase at one-half the assumed rate of wage increase. For example, if plan benefits are computed assuming 5% inflation and 6% economic pay increases, Social Security benefits might be projected assuming 6% increases in national wages and 3% inflation.

Problem 6: Some companies have made payments to the plan's trust fund in excess of the amounts charged to profit and loss, with such excess being set up as an asset item on the books of the company. Can such "assets" be used to satisfy the minimum contribution requirements of ERISA?

Answer: Our best guess is that such prepayments cannot be used to satisfy the minimum requirements, to the extent they were deducted before the effective date of the minimum funding standards. Similarly, reserves on the books of the company--which result from a company contributing less than the charge to profit and loss--need not be treated as assets for purposes of this minimum.

I would emphasize that although these asset and liability items probably cannot be reflected in reporting to the IRS, we think they should continue to be used in reporting to stockholders.

Problem 7: We have wondered whether or not the PBGC would go after the assets of a parent company if one of the parent's subsidiary companies terminated its plan and was unable to reimburse the PBGC for unfunded insurance benefits. If not, companies might avoid their contingent employer liability whenever they had to terminate part or all of the plan by setting up a corporation covering the plant or location to be terminated.

Answer: I have heard that the PBGC would not "pierce the corporate veil" if the parent never had anything to do with the subsidiary's plan--such as is often the case with plans for represented employees.

Problem 8: How do you treat the required payments under the minimum funding standard account when, several years after its establishment, the interest assumption is changed?

Answer: One possible solution is to take the amortization payments in effect for the old plan liabilities and discount them back to the valuation date at the revised interest rate. The difference between that unfunded reserve and the unfunded reserve based on the revised interest assumption would be amortized based on the revised interest rate.

MR. JOSEPH MUSHER: Now is our chance to ask questions of the recorder and the audience on the subject of the independence of actuaries, an area in which we may spend some uncomfortable moments over a period of time. Comments are solicited especially in connection with the relationship of actuaries with lawyers and accountants.

MR. DENNIS M. MORRIS: Here in Houston, the relationship between actuaries and lawyers is certainly different from the relationship in other parts of the country. In Houston, we are blessed with five big law firms, each having one and several having three or more attorneys who draft plan documents. The companies which employ these big firms employ them primarily because they feel the firm can offer legal assistance in all areas. This includes the employee benefit area and, more precisely, retirement plans.

We view their work in two parts. One part would be the actual consulting involved with a plan and the second part would be the plan drafting. We generally try to use our documents, but in many instances the attorney will want to use his own documents for one reason or another--either he has previously qualified similar documents or just because of his own personal preference. This is a point which is negotiable with the attorney and is really dependent on the particular circumstances.

Where we have found a problem is when the attorney steps into a consulting role. Many times we are called into a conference where the attorney is present and professes to be the company's pension consultant. We have to take a back seat to the attorney's desires. It is a very critical relationship, one of which you must be careful since, with the big firms, the lawyer charged with providing legal services carries far more weight with the corporation than does the actuary. The actuary is viewed as the person who generates the actuarial costing of the plan and he is not viewed here in a way that he might be viewed in other parts of the country. I know from working in Dallas that we had very little intercourse with attorneys for corporations. We would normally prepare the documents for the attorneys who would review them and pass them on to the company.

MR. ED FRIEND: It is worth noting that the Joint Committee on Independence met for the final time on April 23. We hope that the report which flowed from that particular meeting will be published soon and presented to the presidents of the various actuarial bodies. The Joint Committee did embrace and reaffirm its position that an actuary and an accountant who are affiliated may not review the work of the other and still satisfy our view of the professional conduct requirements. There is an ethics ruling which the American Institute of Certified Public Accountants has embraced saying that, if the client is prepared to accept as his judgment the promulgations of the actuary or the findings of the actuary, then the accountant is auditing management and not the actuary. Our Committee disavows this particular ethics ruling. It is a direct confrontation of the Committee's position that management may make an actuary's determinations their own judgment. It would be unlikely that the auditor would be auditing management's decisions. The auditor should really be auditing the actuary.

MR. MUSHER: I would now like to call on a distinguished actuary of a consulting firm which employes in-house lawyers. Mr. Borton, would you have something to say about a lawyer's relations within such a consulting firm?

MR. DOUGLAS C. BORTON: We get along with each other very well in New York as is the case throughout the country. A lawyer associated with a consulting firm is not allowed to practice law; therefore, we take the position that the lawyers on our staff are actually serving as employee benefit consultants.

We are, as are all sizeable consulting firms, involved in work which is of a legal nature. I am referring to drafting of documents primarily. We may also prepare employee booklets, forms for use in plan operation, and also forms to be filed with the government. In the case of plan documents, it is incumbent on the employer to have these reviewed by counsel, preferably outside counsel and, in some cases, inside counsel. Booklets are in a little grayer area--but again, the employer should utilize the services of counsel. Generally, forms which are filed with the government are the responsibility of the employer himself, except for several forms, such as Schedule B of Form 5500, which are in the province of the actuary. We try to bend over backwards to cooperate with the legal profession in these matters.

MR. JAMES C. LASTINGER: I have a question as to the relationship between the actuary and the attorney. When drafting the plan text, is the actuary working with the in-house counsel or outside counsel, or does he ignore the attorney completely?

MR. BORTON: It usually depends upon the expertise of the client's counsel. In many cases, the client's counsel is not equipped to write a pension plan. He may not be an expert in the employee benefits area and is usually perfectly willing to accept a plan draft from the actuary. In other cases, the lawyers are quite jealous of their prerogative to draft these documents. In these cases, we have taken the position that the documents should be drafted by the attorney. We like to look at the draft particularly from an actuarial viewpoint to make sure the benefits are correct and integration requirements are met.

MR. PARKS: In Cleveland, there are large prestigious law firms which are indeed quite capable of generating pension plan documents that hopefully some day will comply with ERISA. We have many clients that do not use these law firms and, therefore, we are involved quite regularly in the drafting process. I think our most awkward moments come when a client directs us to draft a document and transmit it directly to them, bypassing the lawyer. The client does not want the lawyer involved because he will just keep the draft for a month and charge $1,000. In these instances, we make sure that plan documents flow through the outside legal counsel for review.

MR. CLAUSEN: In the past, the standard argument has been that the actuary should draft the plan since it usually takes an actuary to sit down and make the plan understandable to both the plan sponsor and the participant. If a lawyer writes the plan, it is not understandable. I think we will see the demise of those plans the actuary writes which are comprehensible to everyone.

MR. SAMUEL J. LYONS: I am employed by an accounting firm and may give everyone an idea of what we are now doing in our firm. We are closer to this legal situation than perhaps others and are more sensitive to it. When a client wants us to draft a plan document, we require that his attorney provide us with a letter requesting that we provide sample wording for his document. The attorney understands fully that he will be responsible for the legal interpretation of that document. Furthermore, we must provide the document directly to him although we may at the same time provide a copy to the client. We hope that this procedure will keep us from practicing law without a license.

MR. MUSHER: How about your relationship with accountants--either in your company or outside? How do you manage?

MR. LYONS: I do not agree with Mr. Friend's point of view. I feel that the actuary's independence can be maintained. I am probably more independent than the accountants and I have never been under any pressure from the accountants' side of the house. If anything, the accountant has had to accept what I said rather than I having to accept their position. In general, our firm will not request any more or any less information from another actuary than they would from us. We generally try to maintain that position as much as possible. It may be that the view from the outside is that there is no independence; in fact, from the inside, we think there is.

MR. LASTINGER: I am interested in what the other firms are doing with their paraprofessionals who have passed the enrolled actuary exams but who are not members of the Academy or Society.

MR. PARKS: We are starting by praying that they are not raided by other firms. In our Cleveland office, we have less than forty employees in total. We now have nineteen enrolled actuaries. Nine of our associates took the exam and all of them passed the exam. I would expect that some of those newly enrolled via the exam route are going to be itching for greater responsibility and probably larger paychecks. The Board of Directors of The Wyatt Company is meeting this weekend in New England to resolve this matter so we do not have a final answer at the present time.

MR. GRUBBS: We had quite a few for the Academy meeting in Washington, D. C. We arranged to have our own railroad car and took 30 people to the meeting. Aside from this, I am not aware of what our firm is doing.

MR. BORTON: This a problem which our Board has wrestled with. I am not sure that we have all of the answers. We have the same embarrassment of riches which The Wyatt Company seems to have. We had 30 people who took the exam, some more than once, and all 30 passed. Several were turned down on the experience requirements. I am aware of a situation where one of our long-serviced employees received a pass notice and was offered a job by a small consulting firm at purportedly a higher salary. This individual showed good judgment by staying with us. I am not sure that we can count on that all the way down the line. Our official position is that we are not going to delegate any more responsibility than in the past as far as signing reports because an individual is an enrolled actuary. A number of these people have reached a stage in their career with us where they probably would have more responsibilities irrespective of whether they are enrolled or not. You must maintain standards obviously and yet, on the other hand, you do not want any employees raided by other firms. We do not want our reports signed by individuals who are not a member of a recognized actuarial body--the Academy, the Conference, or the Society. That is our proposition as of right now.

MR. SMITH: A point which disturbs us is maintenance of standards. We want to discourage an attitude like, "Well, what is the point of going through all the labor of becoming a Fellow of the Society?" For the last 10 or 15 years, we have hired associates who would hopefully achieve Fellowship status within a reasonable period of time. Now, if we place too much importance or prestige on the enrolled actuary status, we would undermine the future of the Society. Most of us are proud of the Fellows of the Society and we should not do anything to undermine that status.

MR. LASTINGER: That is a very real problem because how can a client understand the difference between Fellowship in the Society and enrollment? We recently had a client receive a quotation from an enrolled actuary who could perform work that we were doing substantially cheaper. You really have a selling job to point out that enrolled actuaries do not all have the same training and background.

MR. MUSHER: It is dangerous to ignore the problem raised by not giving people some sort of recognition. If you do not give recognition to them in terms of money, you should give it to them in terms of prestige. I received a letter from the American Society of Pension Actuaries (ASPA) offering me a pretty title, MSPA-Member, Society of Pension Actuaries, upon application. When you have four letters instead of the usual three after your name, you can impress lots of people.

MR. BORTON: This is a very real problem and, in fact, I have been asked by several people in our firm whether to join ASPA. The only official position we have taken is to pay the dues for Affiliate membership in the Academy. We have indicated that we would not pay the ASPA dues. However, we want to play fair with our employees. If an individual does have an opportunity for increased status or to make himself more marketable, I am not sure what fair advice to give him.

MR. MUSHER: Let us get back to a question that has not been answered and happens to be involved in a real live court situation. Mr. Clausen expressed the thought that the PBGC position is one which is not designed to "pierce the corporate veil" so easily. Does the contingent liability for vested benefits extend beyond a corporate shell to its parent corporation?

MR. PARKS: We have had dealings with PBGC on this subject and, frankly, came away with a different reading. It depends on who you talk to at PBGC. We had a situation in Cleveland where two large companies were merging and the acquiring company wanted assurance in the event that the company being acquired did not make the grade. It was a failing operation in which the acquiring company did not want to be left holding the bag for pension liabilities. This question was asked of PBGC and we were advised that the liability would flow back to the acquiring company. I also asked this question of George Chadwick, chief actuary for PBGC, last week in Washington. He gave the same answer. However, to the best of my knowledge, they do not have an official written position. They must still be trying to formulate the final answer.

MR. GRUBBS: Contingent liability insurance may solve the problem.

MR. MUSHER: Earlier, Mr. Grubbs made a comment concerning the required joint-and-survivor option. Don, would you care to comment further?

MR. GRUBBS: If the joint-and-survivor benefit is provided at the expense of the employee, clearly it does not affect integration. If provided at employer expense, is it a preretirement death benefit affecting integration? It is my expectation it will not affect integration but there are contrary voices on the subject. It should not affect integration since otherwise an employer maintaining a fully integrated plan might tend to make its employees pay for the protection. The Internal Revenue Service does not want to force employers to make this protection contributory.

MR. MUSHER: Do you see anything wrong with the employer picking up the additional cost for the benefit if that is what he wants to do?

MR. GRUBBS: From a plan design viewpoint, it certainly makes sense. You do not have the administrative, communication or equity problems. For example, two employees age 55 have a choice of the benefit. One takes the coverage and the other does not. The one who takes the coverage has his benefit permanently reduced by 7/10% per year of coverage or whatever reduction is used. Suppose the one who rejects the coverage reaches age 64 and his doctor tells him he is in poor health. He immediately elects early retirement under the joint-and-survivor option and has the benefit of that protection and an unreduced benefit. The person who took the coverage, upon retirement, will have a permanently reduced benefit. The costs for the benefit are minor and, although you can calculate an actuarial cost difference, that is not entirely the true cost difference. There is a fair amount of antiselection involved with the benefit.

MR. MUSHER: How about the option as it concerns disabled employees?

MR. GRUBBS: If disability benefits are provided before age 55, I recommend that employees disabled before age 55 be given an option to elect a joint-and-survivor benefit. Most plans use healthy mortality to compute actuarial equivalence so that the employer actually pays a portion of the cost. I would suggest to most clients that the easiest solution is to eliminate the pre-65 disability benefit from the pension plan. Pre-65 benefits should be provided under long-term disability, and the pension plan should provide post-65 benefits.