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ERISA UPDATE—INSURED PENSION PLANS

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(See opposite page for topics discussed.)

MR. ROWLAND E. CROSS: We have felt that the most effective way of conducting this particular program is to take one-by-one the individual topics that are listed on the agenda, and have the three panel members express their comments on it. Although I am not going to say very much, any comments that I do make will have to be understood as not necessarily being representative of either the IRS or the Joint Board for the Enrollment of Actuaries. This first topic does pick up with this area of enrollment, and certainly has elicited a great deal of comment as to the position that the Society bears with respect to the professional training of actuaries now that the enrollment status is an accomplished fact. I know there are some who feel that the enrollment status will have an impact upon the operations of the Society and upon the extent to which students and prospective actuaries will regard enrollment status as some kind of an alternative to going the Society route.

MR. E. TOM HUGHES: The opinions I am about to express are certainly my own, and not necessarily those of my employer. In dealing with the question: "Enrolled Actuary - More Valuable than FSA?", I thought, "Let us ask a few questions or put a few more criteria on the statement and see if we can get a handle on it." The questions I asked included: (1) Who is making the determination of value?, and How might they make that determination? (2) What does "enrolled actuary" mean? It means that an individual has met the government's requirements to do pension actuarial work under ERISA. (3) What does FSA mean? FSA means that competence and perseverance have been demonstrated, in passing a series of examinations covering all aspects of actuarial science with a good deal of exposure to some other disciplines, for example, economics, law, demography. (4) What can be done with a particular designation? In order to be in the pension business today, by legislative mandate one must be enrolled. As an FSA on the other hand the list of pursuits is boundless: practice actuarial science for all manner of insurance schemes and products and pension plans, for governmental agencies, for corporations, for investment media, and so on. (5) "What are the applicable responsibilities?" Responsibilities under ERISA to an enrolled actuary, basically stated, are to act in the interest of plan participants. An insurance company actuary is responsible for the solvency of the company and assuring that funds on hand are sufficient to pay claims.

From an actuary's point of view, I realize that if I want to be in the pension business these days, I must be enrolled. Certainly that has a value, but it does seem apparent to me that from an actuary's personal point of view, the FSA designation denotes a much broader scope, more diverse challenges and responsibilities than that of an enrolled actuary, while the responsibilities and rewards to an FSA are at least equivalent to those of an enrolled actuary.

Any comments made here make no distinction or statement as to relative competence between bearers of these two designations other than what can be inferred from their respective definitions. Value, finally, is derived from substance, not appearance, and that value is obtained through performance, and not alphabetical appendages to one's name.

MR. DANIEL M. ARNOLD: The main distinction between the enrolled actuary and the FSA is for whom they are working. The enrolled actuary works for and is responsible to the participants while the FSA is responsible to his employer, so the outlook of the two are different in terms of what they are trying to accomplish. From the point of view of a potential actuarial student, the enrolled actuary designation now appears to involve about two exams, or perhaps something in the neighborhood of an associate level of the Society, (although this is debatable) as opposed to the fellowship requirements. However, other factors should be taken into account such as a return on investment, the needs or interest of the particular student, available resources, and the requisite time and the energy to go through the ten exams. From the point of view of a consulting actuary, the enrollment designation for the clients is simply taken for granted. The FSA title helped me get a position with a consulting firm, but in general the clients do not know what FSA means. They just presume from my position that I understand what's going on. Each individual has to look at the situation from his own vantage point to determine which is more important. There is no question that in order to be in the pension area, the enrolled actuary designation will become extremely important, but an enrolled actuary is not in a position to evaluate the profitability of an insurance contract from the insurance company's point of view or get into the pricing of that contract in general, the way an FSA is through his formal training.

MR. HERBERT J. BOOTHROYD: The enrolled designation is a necessary but not sufficient condition for the broader area in which most pension actuaries operate. All the "enrolled" designation means is that your signature on a valuation will be acceptable to the Government and I think most of us perform in a much broader area for policyholders or clients, than just producing a valuation.

The FSA or ASA has never been required by law. People with FSA designations have gotten into the pension field because the training and so forth has given them some qualifications which are very useful to policyholders or pension clients, and the introduction of this new designation does not change those qualifications at all. I do not think that there is that much prestige associated with being an enrolled actuary, considering the grandfathering process that has gone on. Now, as time goes on, if the post-'75 enrollment requirements are as tough as they appear likely to be, that situation may change and there may be a good deal of prestige associated with the designation. I would assume, though, the Society would in due course take steps to restructure the employee benefit exams in such a way that they could convince the Government that this was an acceptable alternate education route to enrollment.

Insurance companies with their careful programs for educating an actuary and his study time allowances have a few interesting questions facing them. If you have your eye on somebody you want to become an enrolled actuary, and the new tougher post-'75 exams come along, do you encourage him to write those in lieu of part 4 or part 5 and are you going to start giving bonuses or salary differentials for passing the enrolled actuarial exam? Some of our people have expressed a little concern that, if they are viewed as an enrolled actuary, they will be locked into that as a career path then by their company and not have the latitude to move into a variety of other functions as the typical new FSA does? I would also mention that, in the future, the new actuary is going to need 36 months of pension experience unless you are moving him in and he has already had 60 months elsewhere, and it seems to me, this may impact a lot of these formal rotation programs where people only stay one year in a particular place. So, you are going to have to do a little thinking on your company's philosophy as far as career paths and whom you want to identify to become the enrolled actuary.

MR. CROSS: The board has been very concerned about the outreach of the regulations which we have published. I am sure you also appreciate that we did not write the law. We are under congressional mandate to interpret the phrases which are there, and implementation of them, and I think it is extremely important to make clear that all we are certifying to is the right of this particular individual to sign a valuation statement in certain circumstances. It does not say that this individual knows anything about integration; it does not say this fellow knows anything about what kind of a plan is a good plan to put in; it does not say that this individual is technically proficient in investment monitoring or any of the wide variety of functions which consulting actuaries or insurance company actuaries engage in. We are constantly bothered by statements that we read in publications and hear people make, implying that once a person is enrolled, he/she has got it made. It should be understood for exactly what it is and no more, namely, an authorization to sign off on certain types of statements.

I was bothered to read in the papers a while ago that in connection with some bill for national health insurance, currently under discussion in Congress, a legislator was saying, "Well, we will need to have national health insurance overseen by actuaries, and, of course, the actuaries will be those recognized by the Employee Retirement Income Security Act." I say this bothered us because the qualifications that we are concerned with have nothing whatever to do with health insurance. All of you can serve a good cause by pointing out to your customers, clients and associates exactly what the enrolled actuary status does and does not mean, because the term is going to be used in a great many senses for which it was not originally intended.

Let us move on now to the next topic, which is the position of the Academy. I take this to refer to where does the Academy stand relative to the Society and, more particularly, relative to the enrollment situation, but it may also get into the question of how the Academy stands vis-a-vis the American Society for Pension Actuaries.

MR. BOOTHROYD: There is a very definite role that does need filling, either by the Academy or some actuarial body, in two areas. The first one would be the development of opinions or guidelines as to what are commonly accepted actuarial principles. Examples of that would be (1) the meaning of the "best estimate" provision in the law, (2) how much weight should be given to past investment performance, (3) interpretation of the ban on advertising, and (4) circumstances under which it is appropriate to ignore inflation perhaps through the use of implicit assumptions. Many actuaries would welcome some way of thinking it out on a group basis and getting some guidelines or help in a variety of areas. The second role would be a consultation or a sounding board where complaints on actuarial practice arise. Such a committee of the Academy could be very useful as a sounding board, useful both to somebody who thought he might have a legitimate complaint against an enrolled actuary, as well as to some enrolled actuary against whom some complaint had been filed, and conceivably could also be useful as a sounding board or even a peer review function for the Government.

There are many actuarial organizations with a good deal of overlap and some of them without any clearly defined purpose. I think the Society and the Canadian Institute have a clear mission and role that everybody recognizes, but that is about the end of that statement. The Academy, up to now, has not had the initiative. Say what you will about the qualifications of members of ASPA, they have run circles around the rest of us in their ability and effectiveness to get their point of view across to the Government. We, as actuaries, have had trouble with our grandfathers, and when the Academy was formed, some of us were reluctant to grandfather in everybody who was practicing, which is one reason that ASPA was formed.

Today I think the Academy is attempting to serve all enrolled actuaries since they have invited all of them to come in, not as Members, but merely as Affiliates. It understandably rankles those people a good deal to be brought in only on a grudging basis. What we have got to do is sort out whether the prestige of belonging to a particular organization because it has been tough to get into it, and being a member of an exclusive organization is what you really value, or whether you want that organization to accomplish some particular objective, such as effectiveness in representing actuaries with the Government and so forth. To date, our history has been that we have tried to have both, and have often ended up with a little less than half of either one, and, if that is not resolved, I myself do not see the Academy as being very effective in these fields.

MR. ARNOLD: I would hope that the Academy would take a very aggressive stance. They have made some moves in this direction. ASPA's existence has been very healthy, I think, just as competition in general in this country has been very healthy, and forced the reexamination of the entire structure of the Academy and the Society and what they are doing and whether they are meeting the needs of the people, be it actuaries or the general public. The Academy's exposure draft of April 1975, "Determination of Actuarial Present Values under Pension Plans and the Recognition of Inflation in Determining Actuarial Present Values under Pension Plans", as well as the guides to professional conduct, the opinions of professional conduct, and the Society's work on actuarial terminology for pension plans are examples of some movement in the last few years to develop material dealing specifically with the needs of professionals in the pension field.

A further area where I feel they should move aggressively would be to discipline any members of their organizations who get out of line and then take every opportunity to make sure that the regulation of the operation of pension plans from the point of view where actuaries are involved is controlled by the private sector through independent non-profit organizations and not let the Government step in. I think if the private organizations, such as the Academy and Society take action, then the Government will tend not to involved. This seems to have happened in the legal profession and the medical profession and I hope it will happen here. So, I am very encouraged by the existence of ASPA, and I think it has had a very stimulating effect on the actuarial profession, and hope that the result will be very positive for all of us and for our public.

MR. HUGHES: I tend to agree that the Academy has taken a number of steps in the right direction. Opening the membership in the Academy to all enrolled actuaries gives the enrolled actuary exposure to the most expert individuals in this country on pension-related matters. It gives them an opportunity to meet, communicate and discuss matters of current interest to them (enrolled actuaries) to present their problems, and to meet the Government officials involved.

The exposure draft on guides to determining actuarial present values is significant and I hope it will soon be put in final form. They faced up to some very tough issues on inflation, how it should be handled, on explicit and implicit assumptions, and on how one reacts and acts when using a particular method or approach. It dealt even with how to handle unit credit funding method with a final average salary plan.

Finally, the establishment of the Washington office and the Executive Director of the Academy to interface with those in Washington should give perhaps a much clearer means for the largest body of actuarial organizations in the country to voice their opinions.

MR. ARNOLD: Another area to touch on would be the area of establishment by the Academy or the Society, or a combination of the two, of a study or survey to give some information on what is the common practice and experience of plans. Especially for small pension plans, this is extremely important in my view because the particular plan itself may not have any credible experience. However, if we could, through the Society or Academy, combine the experience of thousands and thousands of samll pension plans, look at them in regard to the professions involved and the type of funding and type of benefits involved and so forth, we may be able to come up with some patterns which would be helpful for actuaries in evaluating what would be appropriate in terms of best estimate assumptions. This is quite in keeping with what the Society has done with the mortality, the morbidity, and turnover studies. In other words, I would like to see the Society carry on what it has done before with insurance companies, but this time apply their efforts to pension plans, and in particular, small pension plans.

MR. CROSS: I would like to make a comment or two about the relationship of ASPA to the Society or Academy. You can appreciate, I am sure, that we in Government have to treat this entire situation at arm's length. There is nothing in ERISA that sanctifies any single organization as being the unique spokesman for the actuarial profession. I think that, realistically, it is time to recognize that the ASPA organization is not going to go away. They are not as big as the Society or the Academy but they still have about 1500 members, many of them doing responsible work in the pension field. The challenge to us all is to establish a basis upon which we can work together productively.

One area that has come to our attention very currently is the possibility of having an actuarial advisory body to the Joint Board or the Internal Revenue Service or the Department of Labor or PBGC or whatever. If that is the case, under Federal law it would be necessary to have members of the Academy and members of ASPA and probably representatives of the unaffiliated enrolled actuaries, all sit down as equals in such a body. I am told many Academy members would refuse to participate on that basis. All I can say is that refusal to participate is not going to prevent its happening.

There is one final comment I would offer on this subject, namely, that the Society over the years has maintained, rather generally, a heavy bias, if you want to call it that, for middle and large size plans. A number of people who founded ASPA did so, because the Society was of so little help to those working in the small plan area. There was absolutely nothing in the Society's syllabus and there was virtually nothing in the Society literature on the unique actuarial problems of small plans. I suggest it might be a practical situation for these people who are interested in concentrating their professional activities on small plans, to follow the route of the ASPA education and examination program instead of the Society's and maybe let the Society handle the training of actuaries who will work on large size cases. In my own organization, I have in fact advised certain of our staff actuaries to go the ASPA route rather than the Society route.

We move now to the question on funding assumptions. I take this to relate somewhat to the area of the reasonableness of assumptions. This existed in the prior law determinations of Internal Revenue, but we now have the phrase "best estimate" added to the lexicon of terms which the pension actuary is going to have to deal with, and now we need to discuss what criteria are appropriate in establishing what a best estimate is. Let me comment that the position of the IRS at this point is by no means final. And both Vince Amoroso and I, and many of our other IRS people here are very anxious to elicit the opinions and considered conclusions of those of you who are practicing in this field as to what our regulations should say about this.

MR. HUGHES: Let me approach the question on best estimate tangentially, by saying there are three issues of importance in funding assumptions. These are (1) explicit versus implicit assumptions, (2) the participation in assumption setting by non-actuaries, and (3) what I have labelled the problem of "credibility."

On explicit and implicit assumptions, most pension-writing insurance companies have by now established their approaches with respect to these assumptions. As might have been expected there's anything but a consensus. Most group-writing companies have adopted the explicit approach. The net result, based on what I have seen in practice, is a range of interest assumptions, I suppose, between 5 and 7 percent, and a salary scale that typically is below the interest assumption by a range between ½ percent and 3 percent. If I had to come out with a set of "typical" standard assumptions, it would be 6 percent interest and 4½ percent salary scale.

Now, depending upon which economist you are listening to, the preponderance of evidence would say that that is not complete explicit recognition of inflation. That's probably a practical reality in that you do not want to face the plan sponsor and tell him you expect him to hand out salary increases of 8 to 10 percent over the next "umteen" years, tagged with an interest assumption of 9 to 10 percent, which you would rather not go back 5 years hence and have to lower, a step which he may perceive to be an index of your company's subpar investment performance. Under our typical set of assumptions here, the pre and post-retirement assumptions are equivalent.

That was not always the case before; there are a few exceptions to this, but normally, if you have got a 6 percent assumption, it is both pre and post. A salary scale is typically a flat, level annual equivalent salary scale. Most companies have dropped the old age-specific scale, probably on some rationale about age discrimination, etc., but more probably as a result of the practical difficulties in dealing with it and explaining it to clients. Also, very few companies are now distinguishing salary scales between males and females. Mortality is usually on some current table, with a few companies adopting a unisex table. The best estimate requirements have been translated by a lot of companies into a noticeable increase in turnover assumptions relative to what we might have seen pre-ERISA. A few of the larger pension writers either used or are gearing up to use select and ultimate turnover.

With smaller plans, implicit assumptions are more common. This reflects the practical realities of the additional expense in putting together a valuation system that can handle all these various parameters, but, on the other hand, it probably reflects actuaries' reluctance to use population statistics on such a small sample, whose experience is likely to fluctuate enormously from year to year. Playing it by the book, obviously only the actuary can set assumptions, but practical reality says, there are some assumptions the actuary is not really equipped to set without talking to plan sponsors. Typically, I have limited this so far to turnover, and (let us say) hours-worked, assumptions, or any parameter on which contributions are likely to be based. Even though I ask the plan sponsor to give me his best guess as to what is likely to obtain in the future, I would like to see past historical data on all such situations.

The problem of credibility is not so much in the mathematical sense in small plans, but it is rather our credibility as insurance company actuaries. I find myself having my funding assumptions disseminated to all kinds of people, such as, for instance, prospective buyers and, when bidding in competition, one sees one's colleagues at other companies in the same situation. So, here we have a prospective buyer who sees funding estimates for the same plan conceivably with a very wide divergence in cost estimates, and each of these is readily certifiable by the respective insurance company's actuary.

So, the credibility problem lies with us as a profession. I am not one to advocate a standard set of assumptions for the entire industry, but I would think that we certainly owe a prospective buyer an explanation of the rationale that we have used in setting these assumptions, setting our cost methods, the implication of those assumptions and methods, not only on his current pension expenditures, but on what is likely to happen over the next 15 or 20 years.

I find this problem to be most acute when a company using explicit assumptions runs into one using the implicit approach. A most recent example was on a case that was a final average excess plan, integrated with a frozen social security level, and the "explicit" company was showing costs in the neighborhood of four times that of the "implicit" company. So it behooves us to accompany each of our cost estimates with some description of our thinking as to how we are approaching the funding of a particular plan and its likely implications for future pension contributions.

MR. ARNOLD: I look at the question of best estimate from two points of view, the individual pension trust side and the group side, and I take into consideration when they say "funding assumptions," both the method and the actuarial assumptions involved. For instance, from the group (or large-case) point of view, you can be very open in your time and efforts spent whether you are an insurance company actuary or a consulting actuarial firm. You can put together a 15 to 20-page valuation report, and maybe have a face-to-face meeting with the client involved to discuss all the explicit assumptions. There are thousands of these large plans covering millions of workers, and there's a good deal of money available to pay the fee for the services of the actuary. Those fee dollars relative to the pension contribution are very small on a percentage basis, and looking at the two absolute numbers, it really doesn't bother the plan administrator who is normally a knowledgeable person, and who thus understands that, to get good advice, he has to pay for it and maybe can even understand some of what you are talking about.

The questions of inflation factors in social security's automatic increases with the 1972 amendments, experience review, and so forth, all fit into conversations with larger clients. The main problem with plans is in experience reviews, getting the computer output straightened out and making sure that the charges are correct.

I see a revolution in the individual policy pension trust area and small case area. For many small plans, determining the plan cost will now have to be done by an enrolled actuary rather than the insurance agent. Some of these one-time practitioners may manage to become enrolled and pray that the Government, the Society, Academy or ASPA will come up with computer programs or methods for them to continue in business, or they are going to have to find other jobs. With the onset of individual retirement accounts, which are not under the same contraints that split-funded plans are, there will be major changes in the individual and small plan area.

As to the money involved in a large case a reasonable percentage of contribution is enough to pay for a 15 or 20-page report, but to have an enrolled actuary, or FSA or ASA sit down and explain to a three-life case or a ten-life case what is going on here and what this means in explicit assumptions and how it applies to them, and entry age normal, minimum contributions, maximum contributions - all this is just not within their means in general. A consulting actuary is generally able to do this and the client is generally willing to pay for the time spent. But if he says "No, I do not want to pay for all that service," and he goes to the insurance company and he sees a $500 charge, he may well turn to IRA's or the insurance agent may well be able to convince him that it is in his best interest to go fully insured.

We also may see a strong movement to IRA's, and the split-funded individual policy pension trust plan may disappear. To go a little further on these small plans, for insurance companies there has been a big question mark hanging over the split-funded business as to whether the insurance company is making any money. A Fellow of the Society trained in what is the insurance company going to offer as its products and what is the profitability return on investment, exposure to risk, requirements of the various states in terms of reserves and so forth, should be able to analyze whether or not the investment in that line of business was returning a profit. A really serious problem is experience review on these small plans, and this is where there is a need for the Academy and Society to help out the enrolled actuaries and other actuaries by pooling their experience together.

MR. BOOTHROYD: As my company is very active both in the small case individual policy and in the large case group markets, it might be of interest to note that we have taken steps to try to assure that we are using the same professional actuarial approach to the funding work on all cases regardless of size. We want to be able to defend the assumptions and the results on the basis, for example, that this is a small case and experience is not significant, or there are a lot of old people in it, or there is an unusual turnover situation, or something like that.

We have, actually, in the organization combined into one department what heretofore had been quite independent and uncoordinated funding operations, and we have formed a working committee of enrolled actuaries, who will be working on individual policies or group funding, and they have developed a common body of funding guidelines which are based on the characteristics of the people covered rather than on the funding vehicle. In all cases, the enrolled actuary is free to modify or interpret these guidelines based on anything exceptional he finds in that particular case, but we are starting from the same philosophy and approach regardless of how it is funded.

With a small case there is considerably less credibility and significance of experience, and I think the Academy or the Society could be helpful in developing this theory. That would help a little bit on the cost problem too, because to the extent a case is small and the experience is not too significant the cost of the analysis can be spread over a good many little cases that all happen to be in the same category, and no one will get involved in a lot of explanations of the significance of individual experience and how that bore on the assumptions. One also should be a little more conservative on smaller cases because their cash flows are generally so uneven, and they probably need greater liquidity.

We have a preference for explicit assumptions in both individual and group on the grounds that they are easier to explain and, secondly, that it is difficult to be sure that the implicit package comes out to the right result except on the basis of some explicit calculations. One last question is whether the actuary should vary his interest assumption, depending either on the past performance of the particular plan or what the policyholder tells you his expectations are for the future. Personally, I would be very cautious about modifying my interest assumption for either of those reasons, as I am on dangerous ground if I appear to be setting up my assumption as a measure of investment performance, which carries me into the business of evaluating investment performance, the risk of being held de facto an investment advisor to the plan, and perhaps a fiduciary, with all that that entails.

MR. CROSS: We will start the question period at this point and resume presentations on the other two topics on the program later on.

MR. ROBERT MURPHY: I have heard an estimate that for plan years beginning in 1976, 500,000 Schedule B's had to be filed and if there are in the neighborhood of 2000 enrolled actuaries, is it going to be physically possible for these to act in a responsible manner as the law calls for?

MR. CROSS: At the time that we started on the enrollment work, we asked various organizations to give us an idea of how many enrolled actuaries they thought were needed. Nobody would give us an answer, actuarial or non-actuarial, even though we were prepared to accept rather more than the usual actuarial error. We asked, was it in the range from 500 to 5,000, but they still would not say. We currently have about 2,350 enrolled actuaries. We have received about 4,000 applications, and so we could not have more than 4,000 enrolled actuaries even if we wanted to. We are not consciously trying to limit the supply of enrolled actuaries, but we think we have a mandate to insure a minimum degree of competence.

MR. ARNOLD: As I recall, Form 5500 is required to be filed at the end of the first year that you are covered by the funding standards. So, for the vast majority of plans, this would be in 1977 or 7 months after the end of the anniversary in 1977. From my own point of view, I would not be too pleased about the prospect of spending the rest of my working life filling out 5500 forms, so that I think there is no question, there have to be methods found to handle large volumes of forms, be they 5500 or any other kind.

There is certainly evidence that a number of insurance companies have found ways of handling their thousands of plans so that there appears to be developing a two-tier system within an insurance company, whereby the FSA or ASA, who may be in a better position to handle the more difficult plans, handles those plans, and those easier plans that fit into a pattern would go to an enrolled actuary who maybe does not have the experience or the background that another enrolled actuary had.

MR. BOOTHROYD: Ultimately the enrolled actuaries are responsible for assuring that the proper funding assumptions have been applied to a particular case, and that the work has been done accurately, but that involves delegation in putting in the right people and appropriate checks; it does not involve his doing every last case from start to finish. Then you need some exception procedures to highlight and throw out of the routine handling cases that give off some danger signals for some interpretive work by the actuary.

MR. NORMAN R. MINOR: Do you have an opinion as to the selection of funding assumptions and the certification of an evaluation on a new corporate case by an enrolled actuary whose employer is the insurance company that reports the pension income as new business? Somewhat along the same line, is it contemplated that the Joint Board will promulgate some type of a code of ethics similar, say, to the Academy and the Society?

MR. CROSS: The actuary to the plan (who is selected by the plan administrator) is the one who, in signing Schedule B of Form 5500, certifies that the method and assumptions represent <u>his</u> best estimate. He alone (not the insurance company he works for) is responsible for the appropriateness of the basis. If there is a conflict between him and the insurance company on what a proper basis is, ultimately the actuary must prevail.

As to the other question there is a standards-of-conduct section in the regulations already, which to some extent is patterned after the rules for practice before the IRS, to some extent reflecting standards of the code of ethics of the Society, Academy and ASPA as well, incidentally. I am not presently aware of any plans to issue supplementary statements, but forthcoming regulations for suspension and disenrollment of an enrolled actuary are still to be issued, and presumably those will indicate a number of the things which will be grounds for disenrollment by the Board.

MR. CHARLES E. WILSON: Who is going to look at all these reports after they are prepared?

MR. HUGHES: I think one of the significant changes that ERISA put on us is disclosure to the participants. That is quite important now, and, although this form must be coincidentally filed with the Government, this information is now open to all plan participants. So, I think we are going to see a great deal more involvement by the actual plan members in all these documents. For instance, my company just prepared the short ERISA notice in lieu of summary plan description, and at the same time made available copies of the plan document on a come-one-come-all basis at some incredibly cheap rate. Within the first two weeks 200 people out of 1,300 have requested to see copies of the pension plan. So, it is not only the Government that is looking at this; it is participants who are now aware that they can.

MR. CROSS: The Internal Revenue Service has always audited corporate tax returns. As to pension deductions, this involved audit of the old Form 4848 and IRS representatives have reviewed that form for most, if not all, plans. I am not prepared to say what special procedures they are going to follow with respect to this new form, but we plan to provide our local District Offices with guidelines for spotting potential trouble areas. Schedule B's will be reviewed in the field, (i.e., in IRS District Offices), and referred to the National Office only when they need our technical advice.

MR. BOOTHROYD: I understand the Government is putting on tape all the information that is coming in on these various forms and the intent is to draw off information for analysis.

MR. CROSS: I have become aware in the course of reviewing enrollment applications of the not insignificant number of ASPA members who work for relatively large insurance companies. And there are in your companies many enrolled actuaries who have no professional affiliation at all. Are the insurance companies going to treat them somewhat analogously to actuarial students? In the case of people taking the ASPA examinations, are you going to give them some kind of recognition for ASPA or enrollment examinations passed the way I believe is common with respect to Society examinations?

MR. HUGHES: My company has adopted a policy of a cash bonus and a level salary increase for any individuals in a "non-actuarial classification" who becomes an enrolled actuary. That is the compensation, but they are not considered to be in the actuarial program. They are simply pension specialists working at that time in that area.

MR. BOOTHROYD: Our company has taken the position that enrollment is a professional status, and it is the Joint Board that makes that judgment. What we do have a role in, however, is in deciding who is authorized to certify the plans on which we are providing the actuarial service. That has been limited to four designated enrolled actuaries and they are the only ones that the corporation would back up in case of any financial or other claims arising from the practice. For others, it is between them and the client. Three of the four are Fellows of the Society. There are some other FSA's, including myself, who were enrolled, but are not among the designated four. I do not know of any ban on an ASPA member qualifying.

MR. CROSS: Are those companies which have on their staffs enrolled, but otherwise unaffiliated, actuaries urging these people to avail themselves of the offer to become Affiliates of the Academy or Members of ASPA, or just to forget the whole thing. At the enrolled actuary's meeting in Washington a couple of weeks ago, I met a number of insurance company actuaries in this category who told me that although they were permitted to come and were given time off with pay, they had to pay their own expenses.

MR. YUAN CHANG: We have encouraged our nonaffiliated actuaries who have been doing valuations to take the Board exam. Now, we find that at least some of those who have passed do not really want the responsibility of an enrolled actuary. In the future we may have more enrolled actuaries than we need, but if the company requires a person to be an enrolled actuary to perform the particular job, then such a person will be treated differently from those others who are not performing as enrolled actuaries. However, their treatment is not going to be the same as the regular actuarial student program.

MR. RICHARD DASKAIS: If the IRS determines that an actuary has used assumptions which are not reasonable, would action be taken against the plan sponsor or against the actuary, and who would take this action?

MR. CROSS: The Joint Board's rules of conduct reflect certain ethical considerations. Where there has been a breach of trust, or where an actuary gave an opinion in an area for which he does not have competence, the Board would have to consider whether continued enrollment is appropriate. It is not presently in our contemplation to revoke enrollment status simply for having made an error, even an error of judgment unless of course this clearly evidences incompetence. Our disenrollment and suspension standards are not yet published, but I expect that suspension or disenrollment will be predicated primarily upon positive acts which are clearly in violation of the trust which is believed to rest in the enrolled actuary.

As to the action which the IRS may take, if by whatever means and for whatever reason it is determined that the particular actuarial basis, be it assumptions, actuarial cost method, asset valuation standard, or whatever, is unacceptable or does not properly represent the best estimate standard mandated by the statute, the remedy there would be to require a recalculation on a proper basis, with whatever consequences that might have for deductions or minimum funding.

We now turn to the last two topics on the agenda, which have to do with actuarial certification and special valuation problems. By "actuarial certification" in this particular context, I understand the reference to be to the content of the actuarial report, which to some degree is prescribed by the terms of ERISA, and also the extent to which it is made available to others, i.e. the kind of information that will be provided to participants and so on about the funding status of the plan. The topic, "special valuation problems" is one that I think is left intentionally open because, for example, we in IRS have had a number of rather unusual situations presented to us as to how certain things should be dealt with, what constitutes an appropriate standard, and so on. This will provide an opportunity to raise any questions on matters of that type.

MR. HUGHES: The actuarial certification requirement has caused a number of actuaries, especially those of us in insurance companies, to review their entire valuation process right from scratch. The first question you might ask the next time you sign an actuarial valuation report is, "How do I know I am the enrolled actuary for this plan?" Have all your companies gone out and had your clients designate you to be the enrolled actuary, or are you implicitly assuming that is going to happen simply because signed group contracts of long standing remain in effect? Several companies have actually contacted all their clients and asked for that designation which, of course, is prescribed in the law.

Secondly, there can well be a problem with census data. In the past some actuaries have always done valuations based on census data in hand. Now, it may be appropriate (a lot of companies have done this) to receive a certification of the census data from the plan administrator. You set down the specifications by which you want to do the valuations with respect to census data, send the plan administrator a clear and specific letter as to what is to be included, and have him certify that he has complied, or, if not, where he has not.

Thirdly, the best estimate requirement plus utilizing the explicit method rather leads one to the conclusion that every benefit in that plan ought to be at least considered, if not actually valued. This position has led to much debate on 1-year term versus level premium funding, etc., but it is all for a good cause; nobody wants included in Schedule B a laundry list of benefits that the actuary did not price.

I still foresee some technical problems with Schedule B itself. When do I sign it and when do I sign an attachment to it? If 100 percent of the plan assets are held by the insurance company, actuaries are tending to sign Schedule B rather than the attachment thereto. On the other hand, on split-funded plans, especially under 100 lives where there is no accountant required, they are simply signing the attachment saying, "I certify to the estimates giving plan provisions and all the other relevant actuarial factors." If you sign the attachment, you must certify to the minimum funding standard amount also. The revised Schedule B that came out in early April contained an item called "Value of vested benefits (if calculated)." For years, we have been giving an estimate, which may not coincide with valuation census data. Is it advisable to put in what now becomes a very approximate figure as to what vested benefits are worth?

One general comment on actuarial certification with respect to plan sponsors, especially those who seem to feel that with the certification as to compliance with minimum funding requirements their plan surely must be in fine physical fettle. This is of course not necessarily the case, and we must get this message across as strongly as possible.

MR. ARNOLD: An important consideration for a plan with less than 100 lives is that an accountant may not be involved. So, if no lawyer is involved either, because perhaps it is a split-funded insured contract with a prototype (supplied by the insurance company) being used, the enrolled actuary is left as the only professional on the case. Furthermore if the plan administrator is also the principal of the firm, he is probably also the custodian and the investment advisor as well, which means the enrolled actuary may well have some additional responsibilities which he had not contemplated since he is the only professional on the case. Let us say that the principal were to exit with most of the cash so that there are very few assets left and then the six remaining participants in the plan, (even though their benefits may be very small because, if the principal was older or had a higher salary or both, most of the money goes to him anyway) start looking around for somebody to sue. The PBGC quickly gets involved here because there are some vested liabilities and too little money, and the enrolled actuary is going to be particularly vulnerable. For that reason, if the assets are not held by an insurance company or a bank, the enrolled actuary should recommend that they be held by a third-party custodian, and maybe even require that that be done as a pre-condition before he will sign the actuarial certification.

There is one other school of thought that says, "Let us get the plan administrator to submit a list of the assets and have him sign that these assets exist and that they are as listed." Let us say that that is done and that on the list of assets are some stocks of blue chip companies and some stocks of companies which are over-the-counter issues that have not been traded in the last few weeks, or that the enrolled actuary would find it difficult, if not impossible, to place a value on. What does he do with a stock or other security which is not known to him? Does he demand auditors or appraiser statements for these items? That is a serious problem for the enrolled actuary, where he is the only professional on the case.

Handling the reflection of market value as required by the new pension law is a serious problem for the insurance companies in particular, but for non-insured plans as well. The emerging liabilities question is another special valuation problem. If you are using an aggregate funding method because you want to spread your gains and losses on a 10-life case where Mr. Big is 55 years old, and if you propose to spread the liability over 30 years, you may have some real cash flow problems. A display of the emerging liabilities over the next 10 years or so is something that the enrolled actuary should make in the normal course if he is using some kind of an aggregate approach.

The question of whether to express costs as a level percentage of pay or as a level dollar amount and how you communicate your thoughts on the subject to the client so that he understands what is going on is another special problem worth mentioning. If you explain to him that it should be a percentage of pay, and his payroll doubles over a period of years so that his dollar contribution doubles even assuming no gains or losses in the experience, are you going to be able to communicate directly with him, or will the agent (if you are in an insurance company situation) be able to communicate this to him? The really serious problem is what kind of relationship does the enrolled actuary have with the client company, or, for that matter, with the participants for whom he is hired by the plan administrator.

Finally, the question of basic data. Do the people actually exist that the plan administrator says exist? Are their salaries correct, their dates of birth, and so forth? How far does the enrolled actuary go to verify that? These are all special problems which have to be dealt with and the solutions to them will often depend on the size of the case and the relationship of the enrolled actuary to the plan participants or to the employer.

MR. BOOTHROYD: When the actuary certifies the report, he should not be obliged to make a review of, or comment on, the actual investment results achieved, the plan design itself, or the question as to whether the employer has really adopted the appropriate funding vehicle (this is particularly touchy in some situations such as the choice of individual policies versus group funding). Certification is merely a statement that for the plan and benefits selected and the kind of investment results achieved, these are the appropriate contributions to fund the plan under the terms of ERISA. Now, if we were confronted with a really bizarre situation, we would either decline to be involved as enrolled actuary or suggest that they do something about it, but, in general, we do not consider the certification as covering those matters.

As to the ability of an actuary as an individual professional to provide a certification under the law while concurrently being an employee or an officer of a large corporation, we have done everything possible to preserve the professional aspects and the independence of the individual actuary. In our situation, we started out by making it clear that we don't require plan administrators to get their enrolled actuarial reports from our company just because they are funding the plan there. They are perfectly free to engage anyone that appeals to them. However, if they want us to provide the enrolled actuarial service, our objective is to provide a top-quality and purely professional service, and under such conditions the actuary must have the final say in these matters. It is a personal certification he is giving, but the corporation is backing him up as far as any liability that arises from it. At the same time, we recognize that it is the insurance company that is bringing the clients to the actuaries. So, it is a two-way street, and the company has a right to make the judgment whether, indeed, this service is one that it wants to provide as part of an optional package of services. Thus the company is entitled to know how these enrolled actuaries propose to operate so they can decide whether they really want to provide this kind of service or not.

We have a funding committee set up, which consists of our practicing, enrolled actuaries who reviewed these guidelines, compared notes with some other group writers and consultants, and found them very much in the ballpark. We also went to some of our large general agencies who have their own inhouse FSA's who are operating as enrolled actuaries, and, if anything, we found them ahead of us in taking a more conservative view as to what would be appropriate under ERISA. So, by having satisfied the company that this was a service that they could be proud of and would be viewed as a quality service, we have reinforced the independence of the particular actuaries. If there are complaints or appeals, it goes to this funding committee of practicing actuaries for a peer review among colleagues, but again, the enrolled actuary will be responsible, in the last analysis, for standing by or electing to change any of his assumptions or his comments.

One other problem in the certification area is a plan that has had a practice for some years of making ad hoc cost-of-living adjustments to retirees, but only on a year-to-year basis with the legal right to stop these at any time. Yet, in practice, probably most of the people expect this is going to continue, and the fact that these annual adjustments have been made so regularly is what makes the whole plan viable and acceptable to the participants. The dilemma I have on that is that you cannot really fund for these benefits, because they are not part of the formal plan (although Labor Department regulations may dispute this), whereas, if you do not fund for them, you have sort of gone along with their splitting the plan into two parts and really doing a piece of the total plan on a pay-as-you-go basis.

MR. CROSS: In the situations where there is no accountant to certify to the data or to the value of assets, it seems to me that the actuary has an obligation to satisfy himself that reasonable efforts have been made to get reliable information. If he simply takes and uses whatever information is handed over to him, I wonder how he can put much reliance on the results which his actuarial calculations produce. I am not prepared to say exactly what a "reasonable effort" is, but it is clearly something more than no effort, and the person who simply takes whatever somebody or other may send him as the value of the trust, plugs that into the valuation formula, and grinds out the answer is certainly taking his responsibilities rather casually. The actuary has got to sign his statement, and before he can do that he has to satisfy himself that the information he is putting into the calculation process has some degree of reliability, consistency with previous years, and so on. I should think that that would be the case even if he did have an accountant in that he ought at least to talk to the accountant or get some assurance that the accountant is using reasonable techniques. The responsibility is very personal, and the enrolled actuary has to take that extremely seriously.

The second point I would like to mention is a question that was raised at the Enrolled Actuaries meeting a couple of weeks ago, namely, "Can assumptions be established in the framework of collective bargaining?" I guess anyone who has ever worked in collective bargaining is aware that cost estimates upon which the settlement will turn frequently vary rather substantially from one actuary to another and that it has been not uncommon for the actuaries on the two sides to get together and trade off along the lines of, "I will give you the interest, you will give me the turnover," etc., and finally they come up with a common basis that produces a set of figures that the actuaries at least "agree" on. Then if the other parties go along with it (I do not know what choice they have) that becomes the basis; now the question is, "Is that acceptable under ERISA?" I submit that the answer is clearly "No!" The collective bargaining process cannot be a substitute for the judgment of the enrolled actuary who must sign that statement. The collective bargaining process cannot determine what the generally accepted accounting principles are. The collective bargaining process cannot make legal interpretations. The final decision has got to be reached by the actuary who is going to put his name to it, and, if he is not satisfied that that represents his best estimate, he had better not sign it.

That brings me to the responsibility of the actuary to the client. First, who is the client? One might say that the client is the plan sponsor since that is who pays the bills, but still the actuary is retained on behalf of the participants, and what are the interests of the participants? Are they, for example, best served by using the most conservative basis possible? That standard could be used to justify very meager benefits, very richly funded, whereas a more "realistic" standard would produce larger benefits with less rich but perhaps still adequate funding. The traditional viewpoint that the "better" the funding is (meaning the more conservative the assumptions are) the better off the plan is, seems to me to be open to question under the new rules, which makes the actuary clearly responsible to the interests of the participants.

MR. ARNOLD: One problem here is the frequency of valuation for a small pension plan. If there is no accountant involved in the case, you may well find the data to be in such a disastrous condition after 3 years, that you will want to do a valuation every year. Also, it has been typical in the past to supply breakdowns of cost per participant. If we are now going to change (whether by choice or otherwise) the valuation method from what has been done in the past, will you still be able to provide these breakdowns? There is a problem as to crediting interest in the funding standard account; where you are dealing with thousands of plans, finding out exactly when the contributions were made in each case and getting the right amount of interest credited, with possibly many little deficiencies, can be an administrative headache. Finally, a word about profit centers within an insurance company. The individual policy pension trust operation is quite commonly not in the same profit center as the group pension operation, and, as a result, they may be competing with each other. It has been quite common for the group pension actuary to use a full set of assumptions, including salary scales, but the individual policy pension trust actuary uses an interest-only assumption basis. Sometimes they even compete on the same case, and there is no communication between the two of them.

MR. HUGHES: How do we collect proper charges for all this auditing and overseeing and checking that we are going to do on the small plans. I hope the plan sponsors and participants that are getting the benefit of all this appreciate that the large fees are coming as a result of the requirements that are set down here.

On the interest element in the minimum funding standard account, the more tricky problem is to tell people who insist on making the absolute minimum payment, exactly what dollar amount they are to make during the year, even though we do not know at what times those payments might come in. We quote the minimum payable at the beginning of the year, as if it was payable at the end of the year and tell the client that whatever payments he makes should accumulate with interest to a figure no less than the amount shown as due at the end of the year. If he does not understand that, then he should make the payment as exhibited at the end of the year.

MR. CROSS: I recently saw a letter in which the writer was complaining about the increased "actuarial costs" under his plan and he felt we should do something about it. There had been relatively little change in the plan to comply with ERISA, but the actuarial fees tripled, i.e. where the actuarial fees previously were of the order of 3 or 4 percent of his contribution, they had risen to about 12 percent of the contribution. I replied along these lines, "The actuarial fee for the first ERISA year reflects a very substantial amount of 'transition work.' There is a great deal more to actuarial services than just doing the valuation. Actuaries have had to study the law, to figure out what changes had to be made to comply with it, to set up any new administrative procedures, to restudy the whole cost basis of the valuation standard, and so on. Hopefully, once these 'set-up' tasks are completed and an efficient system established, it may be possible to see that actuarial fee reduced somewhat." I hope that was a reasonable response.

MR. WILLIAM T. TOZER: We have enrolled actuaries who are doing certifications on programs that have been sold by insurance salesmen. You also mentioned that an enrolled actuary, working for an insurance company, can also do the certification of his own pension plan. Is there any need for complete independence as far as certification under the enrolled actuary situation? For example, if he is an employee of the insurance company and certifying that company's own plan, I do not think you really have independence there, because he is under the control of the employer. I think there may be a question of whether there is independence if the agent or the insurance company is selling a program to a client and then their actuary is also doing the certification of that plan to the plan participants and to the Federal Government. Is that a problem or not?

MR. ARNOLD: On reviewing the various insurance policies which are available to protect myself (e.g. errors and omissions, actuarial professional policies, etc.) I found that principal carriers in this field may very well choose not to cover you if you are certifying to a plan of which you are a participant or an officer or a major shareholder. Thus, if I was to certify to the plan of my consulting firm, the insurance that we have now would not protect me if I did something wrong or was sued by a participant. Would the actuary in insurance companies be in a similar position with this kind of coverage?

MR. CROSS: The responsibility of the actuary, as far as the Joint Board or the IRS is concerned, turns on the extent to which he makes reasonably objective judgments based upon information that he has gathered. Now, insofar as he has done things which clearly are self-serving and to the detriment of others, that might be grounds for action against him. In other words, the criticism would be more on general misconduct grounds, rather than through either the IRS or the Joint Board.

MR. BOOTHROYD: On the subject of general independence, I would not take it as given that it is going to be very difficult for an actuary to perform professionally or independently, merely because he works for an insurance company. Similar pressures apply to a consulting firm just as well; for example, if 20 percent of the firm's revenue comes from one particular client, or if the firm does a lot of its business with a local trust company, there can be as much of a tie-in there as the fact that you are certifying to your company's own group contract. Each enrolled actuary has certain legal liabilities now, and he also has a code of professional ethics. Wherever he is working, he must decide whether he feels he can operate comfortably. Both insurance companies, and incorporated consulting firms have the same obligation to create conditions where their actuaries can operate effectively.

MR. ARNOLD: The more pressing question within an insurance company is, if a participant of a pension plan contacts the enrolled actuary directly and says, "What are the alternative funding vehicles that could be used?", or, "Is the funding vehicle which is being used currently an appropriate funding vehicle for the size of plan or for the particular plan we have?", then the enrolled actuary may be really caught for an answer. I doubt that he can simply say, "That is not within what I certified and why don't you go ask somebody else, e.g., an independent consulting actuary." What do you do if a question is asked where the answer could jeopardize your job with the insurance company?