RECORD OF SOCIETY OF ACTUARIES
1977 VOL. 3 NO. 4

ERISA—CURRENT DEVELOPMENTS

Moderator: MARC M. TWINNEY. Panelists: DAVID R. KASS, JOSEPH P. MACAULAY, SUSAN J. VELLEMAN

1. Relationship between actuaries and accountants

   a. Financial Accounting Standards Board (FASB)
   b. Financial statements

2. Problems caused by ERISA and pending legislation

   a. Costs
   b. Mandatory retirement at age 70
   c. Plan mergers

3. Beneficial aspects of ERISA

MR. MARC M. TWINNEY:

Welcome to the concurrent session on ERISA developments.

Since the program was printed, we have added and shifted emphasis on a few topics. The relationship of ERISA to mandatory retirement age has been added. The Pension Benefit Guaranty Corporation (PBGC) topics of most current interest, the head tax increase and the new proposal on Contingent Employee's Liability Insurance (CELI), will also be discussed.

I would like to introduce our panel. Joseph Macaulay is an actuary with a major insurance company. He will start us off with a review of the roles of actuary and accountant. David Kass is a self-employed consultant. David will help answer questions on increased costs from ERISA, including individual policy plans as well as larger groups. Susan Velleman is a pension consultant with a national firm. Susan will specialize in the questions on the beneficial aspects of ERISA, a very short topic for actuaries, and on the PBGC issues.

MR. JOSEPH P. MACAULAY: The FASB exposure draft was issued on April 14 and comments were requested by August 15. About two weeks ago, FASB announced that they have postponed the effective date by at least a year, which means that the earliest anything would have to be reported is as of December 15, 1978. The reason they gave for the postponement was the need to consider the comments they received. In addition to comments from actuaries, which I will discuss further, the Board received a letter from Congressman Erlenborn requesting a delay until DOL and IRS issue regulations. The topic -- even though there has been a postponement -- is still very important to actuaries, because there will eventually be another set of standards. Hopefully, they will first be issued as an exposure draft, with time for comment. New standards will bear heavily on the work of actuaries, especially pension actuaries. Therefore, I think that we all should become somewhat familiar with the issues.

The item questioned by most actuaries in the FASB was the statement of accumulated benefits and the current value of benefits. The FASB draft stated that these should be based on a determination using the accrual provisions of the plan as of the date of the statement and a set of stipulated rates. They specified at that time the rates provided by the PBGC. They also wanted a statement of changes in accumulated benefits from one year to the next.

During the months between April and August, many organizations and individuals filed remarks. Many of the comments stated that the draft provisions would require a lot of extra work which the clients will not want to pay for, is difficult, and is not very well defined.

Another common remark was that the material requested is misleading and has a tendency to imply more or less benefit security than is actually there.

The American Academy of Actuaries put together a task force and made a rather lengthy response to the draft. The basic premise of the Academy's comments was that the law defined specific responsibilities for both actuaries and accountants. They also said that there is a problem of a conflict with the Guide to Professional Conduct with regard to actuarial reports, because the Guide indicates that you have to provide enough information along with the numbers to avoid misunderstanding. They also pointed out some technical problems and inaccuracies. I am going to try to run through fairly quickly many of the points of the Academy's statement.

1. The financial statement should be a statement of assets and immediate liabilities without including any liabilities of an actuarial form.

2. The financial statement should be simple enough to be understood by the average participant.

3. The determination of actuarial liabilities is the sole responsibility of the enrolled actuary.

4. Since the objective is to improve communication about benefit security, the basic concept is good. However, this form of the statement could well cause more confusion.

5. Because the FASB draft specifies special assumptions, it could cause conflicts with other statements of the actuary.

6. It would cost an extreme amount of money to provide these items. There have been a number of estimates starting at 20% of the annual valuation cost and going up.

7. Section 103(b)(3) has no reference to actuarial liabilities even though Section 103(b)(3) is quite specific with regard to the contents of the financial statement.

8. The legislative history would lead one to believe that the statement should not include actual liabilities, because that section was specifically removed by the Conference Committee.

9. The law states that the enrolled actuary should use the same assumptions, based on his or her best estimate, for all actuarial calculations.

10. The instructions for Item 13 on Form 5500 itself state that liabilities do not include values of future pension benefits.

11. The Department of Labor has determined that the provision of accrued benefit data in the form required by Section 4044 of ERISA is too onerous and has waived the requirement from Form 5500, and it has been recommended to continue the waiver.

The Academy proposed a possible alternative solution. This was a revised Form 5500B for those plans that have to file and a short form containing the items from the revision for plans which did not have to file. This revision included some actuarial liability data desired by the FASB. However, they were to be calculated by the actuary using his or her best estimate assumptions. These could, hopefully, be provided as a by-product of the annual valuations and not involve additional work for the actuary or additional bills to the plan sponsor.

This was basically the Academy position, and it summarized many comments that I have seen. One major comment from others was that Section 103(a)(3)(B) provides that accountants may rely on the correctness of any actuarial matter certified to by the enrolled actuary if the accountant states the reliance. A number of actuaries contend that the law means the accountant should rely.

Another comment said that the draft had expanded the definition of vesting. For auto plans, there are a lot of problems about the contingencies involved, because some early retirement supplements depend on the participant basically not being in the working force. Therefore, the definition of accrued benefits for active participants is a problem.

Those basically are the considerations involved concerning the FASB exposure draft, which has caused much consternation among actuaries since this spring. The FASB will evenually issue new standards and everyone should be informed about the potential problems involved.

The remainder of the topic of relations between actuaries and accountants concerns a problem that many actuaries have run into this year. This is the corporate financial statement. The accountants want to see the backup to our valuation work, and many of them are not relying on the correctness of our work. They are even trying to audit the calculations.

Basically, our problem with accountants -- if one wants to call it a problem -- is the FASB exposure draft which will come back to haunt us. We will, hopefully, be able to work out reasonable working relationships with accountants because we have to work together.

MR. DAVID R. KASS: In the next 12 minutes, I would like to discuss three topics:

1. The problems ERISA has created in the area of plan costs;

2. The implications of the pending Federal legislation which would raise the mandatory retirement age from 65 to 70 in the private sector; and

3. How the proposed IRS Regulations, issued last July, concerning plan mergers and consolidations work.

Added costs flow from ERISA in three categories:

--- Those which result from required changes in plan provisions;

--- Those which flow, directly or indirectly, from the minimum funding requirements; and

--- Those which derive from expanded administrative requirements.

In the first category -- added costs arising from plan changes mandated by ERISA -- we have four items to consider:

Vesting;
Pre-retirement spouse's benefit;
Minimum participation rules; and
Break-in-service rules.

I do not intend to bore you with figures showing the added costs of upgrading vesting or the cost of providing the pre-retirement spouse's benefit. A current twist, however, is that we are now seeing trial balloons aimed at liberalizing standards in both these areas; one balloon says, "Require 100% vesting after 5 years and scrap the three-choice standard we now have." The other balloon says, "Do not wait until early retirement standards are met in order to require the pre-retirement spouse's benefit; require this benefit as soon as vesting starts." I am not at all sure that our balloon-blower-uppers will be happy until they have achieved both.

Naturally, any further legislation here would cause further cost pressures on plan sponsors -- including those who accepted the original upgrades in good faith and continued their plans.

I would like to make one comment on actuarial cost estimates made for plans where the pre-retirement spouse's benefit is elective. The straightforward (and pragmatic) approach is to set up liabilities solely for the participants who have elected the coverage. However, there are clear-cut possibilities for anti-selection. This strongly suggests that there will be a further cost accruing with respect to the participants who have not yet made an election. If so, I suspect that the "additional" cost to the plan sponsor who picks up the tab is more than many of our calculations have shown.

The minimum participation rules will affect only the incidence of costs, not the "true" costs of funding a plan unless liberalized participation requirements create additional benefits or expenses. This is, of course, the dilemma facing plans funded through individual (or group permanent) policies. The pre-ERISA approach was to be as tight as possible in eligibility requirements, in order to avoid issuing policies to employees with high turnover prospects. Since individual policies have high surrender charges at early durations, this avoided saddling the plan with undue expense -- and perhaps the agent with excess first year commissions.

ERISA has created a problem for such plans, by mandating coverage after 1 year of service and age 25. I suggest that a solution lies in developing a program of preliminary term insurance -- perhaps for as long as 3 years -- which would automatically "convert" to whole life at the end of the term period. Valuable insurance coverage would be provided, but high surrender charges could be substantially curbed. I should think the underwriting problems are minimal, and would hope to see constructive things done here. Another alternative -- which smacks of "throwing out the baby with the bathwater" -- is to defer insurance benefits until 3 or 4 years of employment, and to fund the new participant solely through the side fund until insurance eligibility is met. This also avoids the early surrender charge problem, but is a less desirable plan design since it defers insurance coverage.

Before ERISA, the problems involved with setting liabilities for "suspended" participants were mostly limited to area-wide Taft-Hartley plans. ERISA's break-in-service rules now require the actuary of every plan to decide what liability -- if any -- should be included in the valuation for participants who have terminated employment, but have not yet gone beyond the "rule of parity" term. If they are to be included, what assumptions should be made concerning the probability of their return to active status? The magnitude of the problem -- as for some of our clients who are hospitals in small communities -- can be considerable. To the pragmatist, the question is, "Can acceptable figures be calculated concerning a plan's liability for accrued benefits without including these 'suspended' people?"

Many problems flow from the minimum funding requirements. Clients seem to have had very little problem adapting to a "normal cost plus 40-year amortization" basis. Those who had funded liabilities generously before ERISA might feel a bit put out that this progress is largely ignored when the ERISA transition is made -- but we have heard no complaints here.

The "best estimate" standard ERISA imposes on the actuary's assumptions has proven to be more traumatic for some plan sponsors and their actuarial consultants. If prior valuation assumptions were unrealistic, cost dislocations arise when they are changed. Costs of the "final average" salaried plan -- previously valued on very low interest and salary assumptions -- may increase 50% to 100% on adopting realistic assumptions. Costs of the collectively bargained plan -- which had used overly conservative interest and turnover rates -- may have been overstated 10% to 35%, especially if investment losses in the stock market have been avoided.

On a more mundane level, we have had some awkward situations where plan years and corporate fiscal years did not correspond. The client who routinely obtains maximum tax extensions and pays the full year's contribution at the time the tax is filed could be making the contribution after the minimum funding deadline. Even if the maximum contribution is made, it does not meet minimum funding requirements if not made timely.

Another irritating problem flows from Revenue Ruling 77-151, which states that any excess contribution made prior to the first plan year subject to minimum funding requirements (MFR) may not be used to meet the MFR. That means that the plan sponsor with a tax carry-forward may have to wait a number of years to take a tax deduction for his pre-ERISA contribution (since he is forced to make the MFR contribution each subsequent year) -- the only portion of the tax carry-forward that may be taken in any ERISA year is the difference between the MFR which must be contributed, and the tax-deductible maximum.

Added costs flowing from added administrative requirements are difficult to quantify. So long as expenses are not paid from the pension fund, the actuary is not obligated to estimate them (unless, of course, he is providing the extra administration, and has to figure out a bill for it, but that is an entirely different matter).

Should ERISA's record-keeping requirements force a Taft-Hartley plan administrator to increase expense levels, the plan actuary must recognize this in his expense provision; similar administrative cost increases -- in a single-employer plan -- may be borne by the plan sponsor and not the plan itself.

Mandatory retirement age legislation is a recent development. First of all, what is it? It takes the form of an amendment to the Age Discrimination in Employment Act (ADEA). The House Bill (HR 5383) was passed on September 23, and would take effect 6 months after enactment of the bill. It raises the upper age limit of private sector workers covered by ADEA from 65 to 70, and clarifies a section of ADEA to make it clear that pension plans and seniority systems may not be used to force retirement before age 70. On September 30, the Senate Human Resource Committee approved a counterpart bill which reflected a business-backed amendment exempting corporate executives who receive immediate retirement compensation in excess of $20,000 annually. Provision also is included for the Secretary of Labor to permit mandatory retirement below age 70 if bona fide occupational requirements warrant.

In the course of the Senate proceedings, the Department of Labor was asked to comment on any possible conflict between ADEA and ERISA. A letter from Donald Elisburg, Asst. Secretary of Labor, to Senator Williams, found no conflict and commented as follows on 5 specific matters:

1. Would ERISA's benefit accrual rules be affected by the ADEA amendment? The answer is a guarded "no", pointing out that two of the three accrual rules do not require benefit accruals past the Plan's normal retirement age.

2. Would an employer have to pay the actuarial equivalent of normal retirement benefits to an employee who works beyond his normal retirement age? No.

3. Must pensions start at age 65 if an employee works beyond that age? No, unless the Plan says that; if so, the Plan could be amended suitably without violating either law.

4. Would the increase in the upper age limit of ADEA increase the funding costs for private plans? So long as the Plan freezes pension levels at normal retirement age, no; if further benefit accruals are permitted, probably not, since Plan assets earn interest and retirees would have shorter life expectancies.

5. Granting that ERISA does not require benefit accruals past normal retirement age, would an employer's failure to provide such benefits constitute age discrimination under ADEA? No.

My own view is that the biggest problem the ADEA will create in the pension world is not actuarial in nature, but legal; many plans contain language requiring employer consent for continued employment beyond the Plan's normal retirement age of 65. The alternatives would seem to be:

--- To amend the Plan yet again, to alter the language; or
--- To let the Plan stand without amendment, and take suitable corporate action to effectively give the necessary consent for continued employment uniformly until age 70, subject to the normal (non-age-related) reasons for terminating employment.

Finally, I would like to comment on the recently-issued regulations concerning plan merger and consolidation. These attempt to implement ERISA's Delphic requirements concerning mergers, which state that, in the event of a merger, "each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger (if the plan had then terminated)". The good folks who drafted this lovely language -- like the folks who named Walla-Walla -- liked it so much, they used it twice! This language appears as both Section 401(a)(12) AND 414(1). In my own heart, just as in yours, I have known all along that it is impossible to implement, since two plans will never be equally well funded. Accordingly, when two plans merge, one will be better funded than the other. How much better will depend on how you define "well-funded" -- but exact equality of funding under any standard is just not going to happen.

The Code also specifies that continuing participants in the merged Plan must be at least as well off "If the Plan then terminated", i.e., if it terminated immediately after merger -- it does not seem to say anything about termination a day later.

In any event, the IRS has struggled with this, and three years later has come up with a valiant effort in a losing cause. The regulations are framed in terms of matching up the assets of each plan with its Section 4044 liabilities by priority categories, to see how far down the list they go for each plan. They then call for establishment of a special schedule of individuals and their benefits -- this special schedule will be used to allocate the assets of the merged plan only if it should terminate within 5 years of the merger.

As an alternative to drawing up this list, the regulations permit the plan's actuary to designate the type of information necessary to create such a list. It appears that an enrolled actuary must certify as to the type of data to be maintained, and the Plan Administrator must maintain it for the 5-year "cooling off" period. If this is done, the special schedule need not be drawn up. This seems to be a pragmatic solution, since the extensive actuarial work is not required unless the plan terminates within 5 years.

MRS. SUSAN J. VELLEMAN: The topic "Beneficial aspects of ERISA" is broadened quite a bit by adding the parenthetical phrase "with corresponding problems". As I outlined my comments this morning, I found it very difficult to deal with the benefits without commenting on the problems.

The impact of ERISA, in my opinion, should be first approached in terms of its intended beneficiaries -- plan participants.

Plan participants are receiving more information than was ever readily available to them. Not only do employers distribute the required information, but in many cases, have gone beyond statutory requirements by distributing, for example, individual employee benefit statements, which show

accrued and projected benefits and vesting status. In some cases, the value of this communication goes even beyond the general goal of enabling participants and beneficiaries to better understand their rights. For example, the benefits manager of one of my large, multidivisional clients gets back letters from retirees in response to each communication thanking the Company for remembering to write, sending regards to old friends at the plant, and passing along news about an oldest daughter's new twins.

Actually, the most significant impact to date has been the availability of information, since in most cases Summary Plan Descriptions have not yet been distributed and Summary Annual Reports don't really provide much intelligible information. The distribution of material such as the Summary Annual Report and the Notice to Interested Parties has in fact caused concern and confusion among recipients. The same benefits manager that I mentioned earlier aso gets letters and phone calls after each communication from retirees who are concerned that their benefits are being stopped or reduced.

Awareness of rights has come about as much from general publicity about ERISA as from the required communication under the law. However, general publicity also tended to confuse, and more sadly, mislead. Many of you may remember a television documentary called "The Broken Promise". This program illustrated many of the abuses ERISA was designed to alleviate. However, along with ERISA have been created a whole new group of broken promises. For example, have any of the articles publicizing the pre-retirement surviving spouse's benefit indicated that the benefit is derived by determing an accrued benefit, reducing it to reflect early commencement and the joint and survivor form of payment and then providing 50% of that amount as a monthly pension? The widow who had read about her lifetime benefit didn't expect it, in most cases, to be only $37.98 per month. A similar situation exists for the 35 year old terminating worker who finds that he is vested in $12.50 per month beginning 30 years from now.

But let's get back to the beneficial aspects. Additional benefits are being paid under plans today that would not have existed pre-ERISA, due to the eligibility, vesting, and pre-retirement death benefit provisions of the law. In some cases, employers may have substituted these mandated changes for other planned improvements, but in many cases they are real benefit gains to employees. In fact, in the interests of simplicity and equity, some employers have gone beyond the minimal requirements of the law. For example, few of my clients make use of all of the legally allowed service exclusions under the law; and many provide the pre-retirement death benefits on an employer-paid basis. These liberalizations simplify both disclosure and administration. Some employers, in the interest of equity, provide pre-retirement surviving spouse benefits to all vested employees or alternate pre-retirement death benefits to non-married employees.

The formalization and federal jurisdiction in fiduciary areas such as prudence and diversification have shown some tangible results, most notably in the Teamsters Central States Pension Fund situation. Violations of these standards affect a small minority of plan participants and so the impact of the law in this area is not widespread. Where applicable, it is an important protection for plan participants. However, the fear of litigation has caused some administrators to overreact, causing justifiable concern over the effect of ERISA on capital formation and investment in the medium-size or small corporation.

Title IV of ERISA is of real value to those participants of poorly funded plans sponsored by marginal companies. The most dramatic success of ERISA in this area is the coverage of the Millinery Workers pension plan. Barring future legislative clarification, the real impact of this section of the Act may be determined by court proceedings.

These are currently three cases of interest in this area.

In Connolly v. PBGC, now pending in the Ninth Circuit Court of Appeals, the issue is whether the Operating Engineers' Pension Trust, which specifies a defined benefit but also bases contributions on a cents-per-hour agreement, is considered to be a defined contribution plan and therefore exempt from Title IV of ERISA. If the Court of Appeals upholds the U.S. District Court's ruling against the PBGC, many, if not most, negotiated plans may be exempt.

In Chicago, the U.S. District Court is hearing the case of Nachman Corp. v. PBGC. In this case, Nachman claims that its plan specified that benefits vested on plan termination were limited to those that could be provided from fund assets. The Plan terminated on December 31, 1975, before the Nachman Corp. plan became subject to the vesting requirements of ERISA. Therefore, Nachman Corp. contends that there are no nonforfeitable benefits under ERISA and no PBGC coverage.

The third case, before the U.S. District Court in Boston, is that of Avon Sole Co. and others v. Ouimet Corp. Avon Sole Co., which is now bankrupt, was a wholly-owned subsidiary of Ouimet Corp. and is therefore part of a controlled group of corporations. The issue is whether Ouimet is responsible for Avon's contingent employer liability with respect to its pension plan.

A more basic question than those raised by these cases is whether the value of the security offered plan participants under Title IV outweighs the benefit losses due to the termination of a large number of plans.

My topic gets more challenging as I progress. Next is beneficial aspects of ERISA for plan sponsors.

Primarily I think that ERISA, assisted by spiraling inflation, affects plan sponsors with respect to benefit costs similar to the way in which parents affect their children with respect to homework. It's a question of forcing someone to pay attention to something they've been trying to ignore, although they know that eventually they'll be sorry. We see our clients expending the effort to learn more about benefit costs -- with much of that effort shifted from the personnel director's office to that of the financial officer. This concern is necessary before plan sponsors learn to use money expended for benefits more efficiently and effectively. As a result, there has been substantial evaluation and redesign of "patchwork" benefit programs.

This, by the way, must also be listed as a beneficial aspect for actuaries and consultants. It allows us to deal more creatively with a more knowledgable and interested public.

One other area in which ERISA has had an impact for plan sponsors has to do with the role of employers when dealing with employees and their spouses. First, the beneficial aspect -- employees' spouses generally have

more information about benefits, preventing a recurrence of this pre-ERISA situation: The personnel manager explained all of the options, including a full range of joint & survivor benefits, available to the retiring employee. The retiree chose the life annuity. At the retirement party a month later, the personnel manager chatted with the retiree's spouse over a cocktail, but had to excuse himself quickly when he was asked why his company's retirement plan did not allow employees to take reduced benefits to provide for their families.

The negative aspect of this situation for plan sponsors follows directly. We have plan sponsors who get complaints from employees every time that they mail out a benefits communication. The employees don't want anything going home so their spouses can see it.

Some fiduciaries have benefited from ERISA since they can now, without sanction, follow the pack. A key indication of this is the emergence of the "index" fund, the composition of which parallels components of market indices. There is a corresponding problem, of course, for those fiduciaries who were willing to accept extra risk in working toward extra return.

For insurance companies, from the point of view of the actuary outside the insurance company, ERISA seems to have created and/or stimulated the market place in areas such as IRA products, fiduciary liability insurance, and guaranteed return investment contracts.

I would like to go on now to make a few comments about the second part of the proposed July 1, 1977 regulations on mergers and consolidations of plans. David Kass spoke about one side of the issue -- that is, mergers of plans. My comments deal with the other side -- that is, spinoffs.

Provision for the spinoff separation of a defined benefit plan into more than one plan without an allocation under Section 4044 of ERISA is allowed under the following circumstances:

First, if each participant is covered under only one plan and if all accrued benefits in each plan are fully covered by the assets of the plan.

Second, if, under the de minimus rule, the assets spun off are less than 3% of the total assets and they fully cover the present value of accrued benefits of the spunoff plan.

Third, and this is the issue I want to focus on, up to July 1, 1978, there can be a spinoff if there "has been separate accounting of assets" under the plan. The regulations do not include any further requirements such as the method of keeping separate assets or the length of time such separate accounting must have been kept.

The specific situation that I would like to consider is a plan of a multidivisional company, covering several groups of employees in different divisions or locations. Assuming that there has been separate accounting, I would like to comment on, and to raise some questions in connection with, the use of the temporary opportunity to effect a plan spinoff.

First, creating separate plans may require more administration and separate reporting and disclosure. Presumably separate cost computations are already being prepared to accomplish the separate accounting. Second, if

assets cover vested liabilities for some groups but not for others, maintaining one plan will produce a lower unfunded vested liability to be reflected in corporate financial statements. Third, if one plan is maintained, contingent employer liability seems to be clearly limited to 30% of corporate net worth. If several plans are created, all to subsequently terminate, the overall limitation on liability is unclear and, under some interpretations, may exceed 30% of net worth.

The question that I find most interesting is the effect of a potential plant shutdown.

If the plan has been separated, any deficiency in the plan for employees of the terminating division with respect to vested liabilities will give rise to a contingent employer liability which will have an immediate impact on the employer's balance sheet, even if an arrangement for deferred funding is accomplished.

What if the plan has not been separated? Let's assume that the IRS has determined this plant shutdown to result in a partial termination and that the de minimus rule does not apply. The first response of the PBGC to a partial termination is that it is only a reportable event, which may or may not trigger further PBGC action.

My first question, which seems to evoke varied opinions, is whether a 4044 allocation is to be performed for the entire plan?

If so, does the deficiency of assets for our terminating group trigger termination insurance and subsequent contingent employer liability? If not, will the deficiency come from assets in excess of those proportionally associated with the terminating group?

Alternatively, will all assets of the total plan be available to the terminating group? If so, will all accrued benefits be covered? Finally, if your answer to this last question is yes, are the resulting losses to be amortized over 15 years as an actuarial loss or may they be amortized over 30 years as an increase in accrued liability due to plan amendment?

Perhaps in order to answer these questions, separate cases have to be defined based on the relationships between assets and vested or accrued liabilities.

After considering this type of problem, I suggest one more beneficial aspect of ERISA for pension actuaries. It makes early, or even disability retirement something to look forward to.

QUESTION FROM THE FLOOR: What has been done about qualified joint and survivor annuities for disabled members under age 55?

MR. TWINNEY: I would like to comment on the approach taken by the Ford Motor Company in the UAW Plan.

The Company's decision to follow the temporary guidelines and obtain early IRS approval led to acquiescing to the UAW's proposal to provide the disability survivorship option before age 55 on an elective basis. The

regulations were quite clear -- the option before age 55 was required in both the temporary and proposed regulations. The Company was not convinced that this interpretation would remain once final regulations were out. The legislative history was, in fact, convincing the other way -- that is, Congress did not intend to require the plan to provide the spouse's survivorship regardless of age solely because benefit payments had begun to the participant. Nevertheless, it was decided to proceed to offer the option to the union, even if it would not be possible to retract it after final regulations were out.

The option proposed to the UAW makes full use of the provisions in the regulations limiting the protection required to accidental deaths during the first two years of retirement and deferring the start of payments to the survivor until the employee would have been age 55. This makes for some strange looking actuarial equivalent factors, indeed, because upon attaining age 55, the option expires. At age 55, a disabled retiree is eligible under the plan for the subsidized survivor option at considerably less cost to himself (except, of course, for retirees who become disabled at ages 53 or 54). Illustrative reduction factors are as follows:

Disability Survivor Option Before Age 55
(Percent Benefits Reduced By)

Age of Employee When Benefits Commence	Age Difference Between Disabled Employee and Spouse if Spouse is: 10 Years Younger	5 Years Younger	Same Age	5 Years Older	10 Years Older
30	8.6%	8.1%	7.5%	6.7%	5.9%
35	10.4	9.9	9.2	8.3	7.2
40	12.5	11.8	11.0	10.0	8.8
45	14.3	13.5	12.7	11.6	10.3
50	13.9	13.2	12.4	11.4	10.2
51	13.1	12.5	11.7	10.8	9.7
52	10.4	9.9	9.3	8.6	7.7
53	3.4	3.2	3.0	2.8	2.5
54	3.4	3.3	3.1	2.8	2.5

MR. RUSSELL J. MUELLER: The following excerpts from an October 14, 1977 letter from Congressmen Dent and Erlenborn to the Financial Accounting Standards Board clarify their intent that decisions relating to the disclosure to plan participants of pension benefit "liabilities" are best left to the Secretary of Labor. This development highlights the contemporary principle which I shall call the "Rule of Disclosure". The rule says, "If two or more interest groups call for the public disclosure of X, then the disclosure of X will be required." I might add that if such disclosure is not accomplished through non-governmental efforts, then the government will require it. Presently, there is a challenge to the actuarial profession and others to develop appropriate forms of disclosure for public employee pension plan costs and liabilities.

"Thank you for your letter of September 30, 1977 indicating that the FASB will delay the issuance of standards on "Accounting and Reporting by Defined Benefit Pension Plans" in order to consider any regulations under Section 103(d)(6) which might be issued by the Department of Labor. We are

pleased to know that the Board shares our view that disclosure to pension plan participants should not create unnecessary conflicts, duplication, and confusion.

"In your letter you ask for our views on what you describe to be an unresolved ERISA issue raised by some of the respondents to the FASB Exposure Draft. You have stated that it is the Board's belief that it was not the intent of Congress to limit, in any way, the efforts of the FASB to establish generally accepted accounting principles for pension plans pursuant to the requirements of Section 103(a)(3)(A) of ERISA. We wish to respond to your request for clarification and to present our understanding of the facts in regard to this matter.

"From the time we first took up pension reform legislation in the 93rd Congress, we considered the disclosure of pension plan assets and the actuarially computed present value of nonforfeitable and accrued benefits to be of major importance to plan participants in assessing their benefit security (see section 104(e) of H.R. 2 as introduced on January 3, 1973). Throughout the hearing process and the legislative consideration of H.R. 2, we listened to the opinions from many quarters of the pension community as to what the form and content such benefit disclosure should take.

"In the final analysis we were persuaded, as were the other Conference Committee Members on H.R. 2, that the Secretary of Labor should be given discretion to determine the scope, form, and content of any disclosure required of a pension plan relating to the present value of a plan's liabilities for nonforfeitable or accrued benefits (see ERISA Section 103(d)(6)). In earlier versions of H.R. 2 we did consider a requirement that such information be made part of the "annual report" subject to an audit by a qualified public accountant using generally accepted accounting principles (see Section 103(b) of H.R. 2 as passed by the House on February 28, 1974). In rejecting the earlier approach we specifically delegated to the Secretary of Labor the difficult task of weighing the costs and benefits of requiring the disclosure of such information. You can easily understand the basis of our action since many of the considerations which led us to delegate this decision are well articulated in the responses your Board has received in regard to the Exposure Draft (for example, refer to the comments made by the Pension Benefit Guaranty Corporation).

"In summary, we would like the record to be clear that our intent was to exclude information on pension plan benefit liabilities from the financial statement and schedules required under ERISA Section 103(b) and, therefore, not to require such information to be included within the scope of the audit under ERISA Section 103(a). In the ERISA context, we intended for the Secretary of Labor alone to determine the scope, form, and content of disclosure to participants regarding benefit liabilities.

"We urge the Financial Accounting Standards Board to work closely with the accounting and actuarial professions and with the Department of Labor in developing standards which do not create unnecessary conflicts, duplication and confusion. We would like for you to know that we have some additional concerns in regard to the Exposure Draft as it relates to pension plans for public employees. We request that you contact the staff of the Pension Task Force in order that they may share with you the results of a comprehensive study detailing the unique aspects of public employee retirement systems."

MR. CHARLES J. SHERFEY: Last Thursday (October 20, 1977) I attended a meeting at which the Pension Benefit Guaranty Corporation staff explained the rationale for the premium rate increase requested for the single employer basic program. As you may have read, the PBGC has formally requested approval of a $2.25 per participant per year premium rate to replace the $1.00 per participant per year rate, effective January 1, 1978. Some of the assumptions upon which this rate increase is based are:

1. A $41 million deficit at the end of September, 1976.

2. A projected $60 million deficit at the end of 1977.

3. 10-year amortization of deficits.

4. Non-conservative assumptions (in my opinion) in other areas:

   (a) Claim rates have not been affected by ERISA; future claim rates will decline somewhat as the economy improves;

   (b) No establishment of contingency reserves for fluctuations caused by large claims or adverse investment performance;

   (c) Continuation of the current investment policy (private sector);

   (d) Legal right to assess employer liability will be sustained.

The last two assumptions deserve further comment:

1. The PBGC has calculated that a $3 premium rate would result if it is required to invest 40% of its assets in U.S. Government securities and a $3.85 premium rate would result if it is required to invest 100% of its assets in U.S. Government securities. The PBGC has also determined that permitting private sector investments will avoid a potential doubling of the employer liability for sponsors that terminate a plan with insufficient assets and reduce by 50% the number of terminated plans that will be insufficient. The interest rate assumption's effect upon premium rates and PBGC operations is most apparent.

2. A court decision which questions PBGC's ability to assess employer liability has been appealed by the PBGC. PBGC has assumed that this court decision will be reversed.

The House Labor Committee and the General Accounting Office have reviewed the premium rate increase and expressed no objection. However, the Senate Finance Committee wishes to defer action for 6 months because it feels that the amount of premium rate increase requested is not sufficient.

The PBGC has prepared two reports documenting its premium rate assumptions and calculations. Copies are available to interested parties.

The PBGC is also exploring assessing premiums on a basis that would be risk-related rather than on a dollars and cents per participant per year basis. Changes in the law would probably be required to implement a risk-related basis. One problem with the current law is that the employer's net worth is not a factor that can be considered in determining premium rates.

On a different but related issue, the PBGC is still exploring ways to offer Contingent Employers Liability Insurance coverage. The CELI program was intended to be a solution to a problem created by ERISA. ERISA requires a lump sum payment from employers upon termination of insufficient plans. PBGC has negotiated with some plan sponsors to avoid formal plan termination; in most cases benefit accruals are stopped and the plan sponsor continues to make payment to reduce the deficit. This solution is better than requiring a lump sum payment, from both the employer's and the PBGC's standpoint. If implemented on a broad scale, it could limit the need for CELI to those plans whose sponsors actually go out of business.

PBGC's CELI Advisory Panel has recommended a two-tier CELI program which would formalize some of the practices PBGC has been using to avoid formal plan termination. The first tier of coverage would provide a $5 million maximum payment for employers who filed for Chapter X or XI bankruptcy. The second tier of coverage would provide a $25,000 maximum payment for employers who demonstrated financial hardship -- cumulative business losses for the three-year period prior to plan termination.

The Panel's recommendation appears workable but may become obsolete because of the subsequent developments. The effective date of mandatory coverage under the multi-employer basic program and multi-employer CELI coverage will probably be delayed. The requirement for a single employer CELI program may also be deferred or eliminated.