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INDIVIDUAL POLICY PENSION TRUST

*Moderator: LYND T. BLATCHFORD. Panelists: AMY J. ABRAHAMS, JAMES J. BAGSHAW, JAMES A. KING**

1. Plan design problems as they relate to plan administration.

2. Technical aspects of handling the Funding Standard Account.

3. Reporting and disclosure.

4. Current practices in plan terminations.

MR. LYND BLATCHFORD: Our major topics this morning are plan design problems as they relate to plan administration, technical aspects of handling the funding standard account, reporting and disclosure, and finally current practices in plan termination. The emphasis of this session will be on the practical considerations and the design and administration of plans, rather than on purely actuarial concerns.

MRS. AMY ABRAHAMS: As everyone in this room undoubtedly knows, the passage of ERISA has mandated the complete review and amendment of virtually every defined benefit plan in existence at the time. The most obvious changes were those involving eligibility requirements, vesting provisions, accrued benefit rules, minimum funding provisions, and joint-and-survivor options. And although there may have been confusion at the start, I believe most small IPPT plans took a straightforward approach and adopted the prototype provisions suggested by the insurance company servicing the policyholder. This relatively simple amendment procedure may have eased the pain of ERISA compliance, but in many cases it created an administrative and financial burden that the employer was unwilling to bear. Unfortunately, many plan sponsors either terminated or curtailed benefits before other cost-saving alternatives were thoroughly investigated.

The first area that comes to mind is the alleged financial burden imposed by ERISA's liberal eligibility requirements. I use the word "alleged", because with proper plan design and administration, the additional cost of compliance with ERISA eligibility rules can be essentially minimized or eliminated altogether. Most plan sponsors were advised by their servicing agents or consultants to amend vesting schedules to preclude the payment of vested benefits to short-service employees. No one, of course, can argue with this attempt to cut costs, but in reality the decrease in costs will be long-term in nature as actuarial gains emerge. I make that statement as a result of the fact that no turnover assumption is used in the funding of the majority of small IPPT plans.

For those plan sponsors who are interested in an immediate reduction of plan costs, New England Life has put forth the suggestion that the issue of insurance be delayed until a minimum period of service is completed. For those plans choosing this option, this minimum period of service is now equivalent to the eligibility requirement in effect prior to ERISA. The overall effect is to keep the cost of death benefits down to the

*Mr. King, not a member of the Society, is a consulting actuary.

pre-ERISA level. For socially conscious employers who wish to be non-discriminatory in their coverage of death benefits for all plan participants, the use of Yearly Renewable Term is an appropriate alternative. If and when the participant completes the pre-ERISA service requirement, conversion to a permanent insurance product takes place. For an IPPT plan with a substantial number of short-service employees, the overall effect is to cut death benefit costs drastically. Reverting back for a moment to the first alternative, i.e. the delay of insurance, it's extremely important that death benefit provisions be worded properly. Prior to ERISA, many of our plans provided for a standard death benefit equal to some multiple of the projected pension benefit, with no other stipulation. If this provision is not amended, the actuary will be forced to add additional liabilities to the actuarial valuation of the plan in order to cover death benefits during the waiting period prior to the issue of insurance. In my opinion, this alternative of self-insuring death benefits is totally unacceptable for the majority of IPPT plans. Instead, we would require that the trust be amended to provide a death benefit equal to the present value of the accrued benefit when no policies are in force for the participant. If a substantial number of employees fall into this uninsured category, our only change to the funding of the plan would be the elimination of a mortality discount.

Another design area to consider is the inclusion of more than one entry date into the plan. At New England Life, if only one annual entry date is used, we require that service eligibility be limited to a maximum of 6 months. This is imposed by the ERISA requirement that plan participation must occur no later than 6 months following the date of completion of one year of service. If the plan is amended to allow for two entry dates six months apart, then the eligibility requirement can be raised to one year of service. This can significantly decrease the administrative workload if a large percentage of employees terminate prior to completion of one year of service. The use of two entry dates does, however, create its own set of problems. Unless the agent and employer are willing to purchase insurance contracts and receive billing notices twice each year, the problem of death benefit coverage comes up again. One alternative would be to cover mid-year entrants with temporary term until permanent insurance is issued at the next servicing anniversary date. But this option involves extra time on the part of the agent to service the policyholder at mid-year. For those who balk at the idea of any additional administrative work whatsoever, we suggest that there not be any insurance coverage between the mid-year entry date and the succeeding annual anniversary date. Again, the wording of the death benefit provision is important here. The one I mentioned previously, where the value of the accrued benefit is paid, would be appropriate in this situation also. Once the decision is made to issue insurance on one date only, the dual plan entry provision requires nothing more than some belated record keeping of the participant's actual entry date. We also encourage such plans to use completed months, rather than years, in the determination of accrued benefits.

Up to this point I have restricted my discussion to plan procedures and amendments which tend to reduce the impact of ERISA. But I would be wrong not to mention other areas of plan design which have an impact on costs and administrative procedures.

Again, in the area of insurance and death benefits, a multitude of arrangements is available to cover almost any need or desire on the part of the

plan sponsor. If the general need is to cut costs without altering the major benefit provisions of the plan, one suggestion we make is to restrict the issue of insurance up to a limiting age, not necessarily coincident with the end of the salary averaging period. For a plan where significant salary increases are not unusual at the later ages, this administrative rule can certainly provide some relief. At the other end of the spectrum are those employers who want to maximize death benefits for uninsurable, rated, and older participants. For such plans, we suggest that the trust be worded to provide for death benefits equal to the proceeds of insurance policies, if any, plus the present value of the accrued benefit minus the cash value of insurance contracts. If a significant number of participants fall into this category, elimination of any mortality discount would probably be appropriate for funding purposes.

At this point I'd like to discuss a plan design feature which has been generally overlooked by plan administrators. The subject I'm referring to is in the area of deferred retirement benefits. Most plans clearly state how the normal retirement benefit should be adjusted, if at all; but the handling of insurance policies is generally ignored. The result is that steps taken at normal retirement are in many cases inconsistent with other plan provisions. As an example, most of our plans provide for the payment of the present value of the deferred retirement benefit if death should occur after the normal retirement date but prior to the actual commencement of benefit payments. We have found that in many cases the insurance policies are being kept in force beyond normal retirement. This constitutes purposeful overfunding of benefits and is a violation of incidental death benefit rules if the full face amount is paid to the beneficiary in the event of the participant's death. Instead, the trust should be strictly worded to provide for either the surrender of all insurance contracts or the application of nonforfeiture provisions to place the contract in an accumulation status when available.

MR. JAMES BAGSHAW: The first thing I will do is give you a simple description of what the forms are and where they apply. There are two kinds of forms: a base form for each kind of plan, and a series of schedules. There are three different base forms.

1. Form 5500 covers plans with 100 or more participants.

2. Form 5500-C covers plans with fewer than 100 participants and with no owner employees.

3. The last form is Form 5500-K. It covers the self-proprietorships and partnerships with fewer than 100 employees.

Regardless of which form you start with, you have three basic schedules that must be attached to that form. They are relatively simple. The first one is Schedule A, which covers insurance information. The second one, Schedule B, covers the plan actuarial information and the certification of the Minimum Funding Standard Account. If any participants terminated during the year with vested benefits, there is Schedule SSA, which notifies the government of the rights of those participants, when they will accrue, etc.

Form 5500-C applies to corporate plans with fewer than 100 participants. The information that is required is relatively simple. For example, it

asks who is the plan sponsor and who is the plan administrator. They are often one and the same.

The form asks for the name of the plan, when was it adopted, what is its reference number, what kind of plan is it, how it is funded, where are the assets held, how many participants by category (how many active, how many vested, deferred, semi-retired), how many employees? Was the plan terminated during the year? Was there a decrease in participation of greater than 20%? Were there any party-in-interest transactions? Is the plan defined bènefit or defined contribution? Finally, there is an asset exhibit on the back of the form.

Schedule A is completed by the insurance company. There are two parts to Schedule A.

The first is a summary of the insurance coverage, answering the questions of how many insureds, and how much paid in commissions and fees. Some insurance companies are using commissions at the agent level, some are including commission overrides, rent allowances, depreciation, etc.

The second part of Schedule A asks three questions. The first question is simply the basis of the premium rates. The second question concerns the total of the premiums paid. The last one is a problem. It asks for "acquisition expenses and retention expenses, not specifically included above", both amount and nature.

The second schedule, Schedule B, is the actuarial certification. The first three questions are: do you have any waivers, have you had any and if so, do you have any extension of those waivers.

Question 4 is the actuarial certification. The questions are relatively simple. The first question asks when did you do the last valuation? Most people know that. The second question is more of a problem, especially for an insurance company actuary who does not have control of the asset flow, and does not actually receive the contributions. This question asks what part of this year's contribution really belongs to last year. Most of us in the insurance business have not, through the years, been able to accurately determine this. It is impossible to complete Schedule B without full and proper information as to the assets: the assets at the beginning of the year, the cash flow during the year, the dates and amounts of deposits and disbursements. The third question is the Funding Standard Account which I shall return to in a minute. The fourth question is a statement of liabilities, assets and unfunded liabilities. The assets are the adjusted assets for the minimum funding standard account. These would include contributions that are going to be paid at a later date within the permissible periods. The fifth part asks specifically for the value of benefits if calculated. The next question involves assets: how much do you have, how much are you going to put in the next 75 days, how much is there today. It asks about covered employees: how many, how many actives, how many inactives, etc. It also deals with gains and losses. It contains a statement of actuarial assumptions and methods. This has to be attached. The last item on the back of Schedule B is the Funding Standard Account.

If you start a plan today, you do not have any beginning deficiency. You have no plan amendments and no prior waived contributions. The only entry

is normal cost and past service liability amortization, if any, and interest on the normal cost for one year. This is compared to the actual deposits with interest at the valuation rate to the end of the year. Any gain or loss during the year will be amortized. If a plan amendment increases the past service liabilities, that increase in past service liability must be amortized. Each item in itself is very simple. Your only concerns are the periods over which you may amortize. Actuarial gains or losses don't occur under many of the methods being used, gains and losses being assigned to the future and spread over the so-called remaining working lifetime of each of the active employee participants.

In the area of disclosure, EBS-1 is the one form with the smallest legal liability. It is "yes and no" form, and does not require interpretation of terms used by the form designer. The designer was the government, not the individual consultant who is trying to fill out the form. In the area of the ordinary life pension trust, the EBS-1 is the communication vehicle to the participant.

MR. JAMES KING: All good things must come to an end and I have the most fascinating part of small pension plans - their termination. I say fascinating because it gives you an opportunity to see what other people do, what other insurers do, and to examine their services prior to the time that the files are delivered to you. It is an extraordinary journey. You find such things as photocopied 5717 violations. And you also find many forms which were filled out very inadequately and accepted by the government. Before I criticize the government, let me give a round of applause to the IRS because I think the Form 5310 is fantastic, and I'm using the Hollywood meaning of "fantastic", improvement over the old predecessor Form 4576. I wonder how anyone could have honestly filled out those old forms when they had to precisely allocate the contributions and accumulate them over the plan years when, as many insurers are finding out, there really weren't any plan years in the old days. The plan year was the fiscal year, it was the anniversary year, it was the time that the person paid premiums, et cetera.

In looking at some of the problems associated with individual pension plans that are terminating, you have to be quite honest and face the impact of life insurance premiums in the calculation of assets that would be available to fund the deferred benefits. This is the biggest problem.

If there be any need, you almost require a salary scale, which is nothing more than an inflation instrument, a machine to build up greater assets to have them available at the time of termination. You also need to be extremely careful in plan design to ensure that when one defines the accrued benefit, one is careful to take into consideration an average that has taken place historically. The typical drafting of prototypes and other "boiler-plate" type pension plan trust instruments typically define "compensation" as "current compensation". More astute instruments define it as current compensation or the historic average (usually over five or three years) if greater. This is utilized "for funding". Of course, if this is not being utilized for funding, then you are violating the terms of the plan. Thus, in many instances, you have to admonish the author of the pension plan trust which you have to modify because we're not going to fund based on the current compensation, we are going to fund based on a projected compensation.

The third item which creeps into most pension plans that I see is the "4-40" Rule. Because the IRS will presumably approve plans using the 4-40 Rule without any great examination as to turnover, schedules, et cetera, the rule is used, particularly by attorneys. But the 4-40 Rule isn't always understood by an attorney at law. He doesn't really understand this does not mean credited service, which excludes service before 22, et cetera. It means service measured from day of employment. It is quite possible to install a plan for a company that is ten or fifteen years old and has a large portion of the accrued benefits already vested because, of course, people have been employed longer than four years, sometimes as long as eight or nine years. The 4-40 Rule has 100% vesting at the end of eleven years. Valuation of a pension plan as a terminated plan should be an integral part of an actuary's report. In addition to Schedule B (which I personally will not sign, I sign an attachment) an actuary may wish to include the priority classes and the value of the vested benefits by priority class in an attachment. This assures that the interested participant can obtain this essential information concerning the condition of the plan.

Another point is the sufficiency of assets. Up to now, I had no problem in dealing with this, because most of the plans that we're talking about come from the pre-ERISA period. Where there was consideration for termination, there's been some sort of examination by reviewing the file to see whether or not it made sense from a sufficiency point of view. Also, we're enjoying a very favorable period of time. We're blessed with low single premium purchase rates for annuities. However, if you monitor them from month to month, they are going up. The price jumps by something like five dollars per dollar. However, because interest rates are still up, you can find products that will allow you to have a noninsufficiency problem. I do wonder whether it is not also a continuing responsibility of the servicing actuary to make sure that his estimates are realistic and have margins above current deferred single premium annuity purchase rates or conversion rates of the insurer who is issuing the contract.

With small plans, market value should be used. It is disturbing to see old reports where in many instances cost was used and there was no market value indicated. Now,of course, we look at the difference between market and cost. Sometimes you'll find differences as much as 30%.

An enrolled actuary who is employed by an insurance company could be confronted by the "borrow dilemma". What does he do when he is faced with a sufficiency of assets problem and must go across the street and look at the products of the competitor. I really don't know how an enrolled actuary will function, in relation to the responsibilities that he has, if he's attached to a life insurance company. It is very difficult to see how one can make certain recommendations, if one is restricted to the products of the insurer by whom he is employed.

Now having solved the problems from the pre-ERISA period, let's go to the post-ERISA period. Problems really shouldn't arise with too great frequency in the individual pension trust area, provided you closely monitor the plan. If one is giving schedules of vested benefits, present value of vested benefits, and using market value, one really knows, and so do the plan administrator and the plan participants, where the plan stands from a liquidation point of view.

If ERISA did nothing else, it did alert the lay person to the fact that in order to have benefits, one must have money. No one really expects a lay person who is a participant of a plan to be able to understand anything other than that there is a sum of money there that covers the present value of what they are said to be vested in. Nothing else makes too much sense. ERISA did away with defined benefit plans which became defined contribution plans with no responsibility when they terminated. The participant was vested in the cash value and in an allocated account, whatever that was. The allocated account was related to the current value of the assets. There was no further responsibility even though the present value of the deferred accrued vested benefit may have exceeded the account value. With complete reporting continuing over the next five years, plan terminations, particularly in the small plan area, will cause no great hardship. It will force a plan administrator or plan sponsor to initially look, and understand, what he's getting himself into. Once that happens, the days of participants being very disappointed will slowly come to an end.

MR. BLATCHFORD: Recently, I saw a very small plan with the normal option at retirement as a qualified joint and survivor annuity. I would like to ask the panelists from a viewpoint of plan design, from a viewpoint of actuarial valuation, for potential termination problems, for potential reporting problems, can you or do you as an actuary take a position on plans where the normal option would be a qualified joint and survivor. What are the advantages, what are the dangers? What would you disclose in your actuarial reports?

MR. BAGSHAW: One of the real problems in plan design, particularly for the PC and the small employer, is that there's a need to spend dollars. And if you look towards that need to spend dollars and you look at the restrictions that are involved in the defined contribution plan, the dollars are high enough to force you to consider the defined benefit area. Then you look at the benefit formulas that are allowable and you wonder how you're going to spend what is required to be spent on a particular proposal. The 1.4 rule may still not leave enough room. Under ERISA, you are not penalized in terms of the maximum benefit if the normal form of the annuity is a qualified joint and survivor. It can be a qualified joint and survivor at the 50% level, or it can be a qualified joint and survivor at the 100% level. An actuary can find himself using the qualified joint and survivor level at 100% to the survivor. That gives you all kinds of actuarial valuation problems. How do you reserve for a liability that may be 20 or 30 years off for your principal and maybe 45 years off for the younger people in the firm who aren't even married yet? We looked at that problem and decided we had to take a rigid view of what the average age differential would be between the participant and the participant's spouse. We use a five year age differential assuming that the female party will always be five years younger than the male. The current average is roughly three years, but you always have to guard against the person who comes up in their late 50's, early 60's, after 40 years of marriage gets a divorce and marries someone who's 25 years younger than he is. That would just about destroy the funding of some of the plans we have. If we must guarantee a qualified joint and survivor, the only way you've got to get a load in there is to keep that second age low. You can use the actual age relationship at the early retirement age.

MR. KING: This is an example of what I call maximizing benefits. Typically, in this situation you are using the 1.4 rule. Up to now in design-

ing what has been a defined benefit pension plan, usually nonintegrated, together with a money purchase pension plan, I have toyed with the idea of a target benefit plan, and one of those is under consideration at this particular point in time. Incidentally, approval, if it means anything, has taken place on five situations, with the combination of a defined benefit and a defined contribution plan. The funding in all instances was based on the actual situation. Three of these situations were professional corporations involving large sums of earnings, over $300,000 gross income, and possibly over $200,000 individual income to the practitioner. There are, of course, residual problems, such as how to treat the surplus resulting from the death of the spouse. The plan is overfunded, and if there is a subsequent remarriage, and the spouse happens to be very young and there is a great age differential, the situation changes again.

Let us examine the situation that typically occurs: a defined benefit maximized type plan where the principal is 47 or older. How does one deal with early retirement and a subsequent death. I have suggested certain things. One is that the beneficiary of any life insurance contracts be made the trust so you don't have the problem of trying to get back benefits that have been paid directly to a beneficiary. You can see the problem where you have a huge joint and survivor benefit being funded. In most instances, however, all of the plans being funded for full joint and survivor plans are noninsured.

MR. DALE GRIFFIN: Some defined benefit plans, in the past, have used what they call a "waiver of participation", where older potential participants have signed an informal statement saying they were not in the plan. We haven't honored those statements in funding, since we don't feel we can say that we aren't funding for those people. Is there any validity to an arrangement such as this? Also, has there been any progress made in the area of life insurance plan design specifically for the pension market?

MR. KING: I would suggest you examine some of your trust documents because many of the trust documents categorically state that you cannot waive out of the plan to effect an IRA. The restated trust itself may say you cannot waive. Second, much depends on who waives. If he happens to be a shareholder employee, that is entirely different from the little old lady in tennis shoes. The burden has to be on the plan administrator that the person who waived received something for that waiver. I would suggest that waiver problems be corrected, and have everyone put into the plan.

MRS. ABRAHAMS: Waiver could only be appropriate in a situation where there are mandatory contributions required by the participant, in which case they should have the option to waive participation in the plan.

MR. BAGSHAW: I've only seen one morally legitimate waiver of participation by an employee in the whole time that ERISA has been in effect. It involved a relatively small employer with 20 to 25 employees. The conditions of the plan were such that one specific employee would receive a negligible benefit. The employer did, in that specific instance, get a waiver of participation from the employee for $20 of monthly pension for an employment contract that was going to give that particular employee $200 a month. I objected to the waiver of participation because I felt it could cause problems. We've had some statements from representatives of the Internal Revenue Service that in the instances where there were waivers of participation on the part of an employee, who was covered by a noncontributory

plan, that did not relieve the sponsor from the funding of those benefits. The waiver did not relieve the actuary from the responsibility of including the waived participants in the valuation.

MR. HAROLD INGRAHAM: At New England Life we do three things in selling a pension plan to try and control costs of terminations. Mrs. Abrahams mentioned the first two. Either sell the plan with no insurance for x years or sell insurance on a yearly renewable term basis for x years. One could recognize that agents have to eat regularly and bet on favorable persistency, by selling ordinary life at the beginning with the stipulation that we will impose what we call modified surrender rules. If the individual terminates from the plan within three years from date of hire, and I emphasize the word hire, not participation, then it will be rewritten as though we have originally written YRT. What this means is we will give back to the employer the difference between the net premiums on the ordinary life and the net premiums on the YRT with an appropriate commission charge back. This certainly gives the clients a fair shake if there is a high degree of employee termination in the early years. It insulates the product pricing so the actuary can keep the dividends at a level which will be supportable and not have to otherwise reflect lapse rate. It even helped the agent because we have an agent's bonus which is based on persistency and by washing the transaction by writing it as YRT we protected his bonus. We can use a step rate eligibility test, such as age 25 and three years of service, 30 years and two years of service, age 40 and one year of service. Our lapse rates before ERISA, on pension trust business, were 8% per year at all durations. It was a scale comparable to what we had experienced on minimum deposit or nonpension business. As a result of ERISA, in a study of the business exposed in 1976, all durations and ages combined, we discovered that it had jumped to 12 or 13 percent. The reasons for this jump were ERISA-related. Some of them had to do with the standards of funding imposed on the clients, others with revulsion at the red tape, the reporting and disclosure. Now the rate has fallen back this year to a 10% level.

Historically at New England Life, we never had to worry about policy loans. Even in the credit crunches of 1966, 1969, 1970, 1973 and 1974, our pension loan rates were running three and four percent. On nonpension business loan rates were 10 times as high. However, a study we did just recently was very alarming because it showed on our pension trust business written with a 5 percent policy loan interest rate a 23% or 24% loan rate. All this has happened in the last two years. The 6% business is much lower but it hasn't aged as much. I have discovered that, at least in a number of cases, some of our leaders have been actually telling clients to arbitrage the policy loans, i.e. take policy loans at 5% and put the money in the XYZ auxiliary fund to optimize their yield and therefore minimize the funding outlay.

There is a one year reprieve granted by the Labor Department, just a couple of weeks ago, for plans of under 100 lives such that the industry will be able to avoid for one more year the disclosure of sales compensation. You must think about pension trust compensation itself and the traditional commission scale of 50% first year and then some renewals which may or may not be heaped. Can that kind of commission scale really be condoned in the future, if pension trust business itself is to be deemed a suitable product. We talked recently with some of our leading pension writers and they've come to the conclusion that a much more suitable scale would

be 20% or 25% commission in first year, with renewals of four 15's and five 6's. The key difference would be that all of the commissions would be transferable to whoever is servicing the case at that time, rather than locking it up on a vesting basis, so that when the agent died, the money would go with him and there would be no monies for the new servicing agent.

MR. BLATCHFORD: I have noted in a number of companies that this problem of arbitrage or potential arbitrage exists. I've seen companies where you do have five and six percent loan rates and can also obtain eight percent guarantees on the side funds. The plan administrator might not be operating on behalf of the participants if he did not go in and take policy loans. It is a potentially severe problem.

MR. DONALD RISING: First of all on the 5500-C, on page two, question 13, regarding assets. Where, if at all, do you feel that individual policy cash values should be reported on this item? On Schedule A, should policy dividends that are used to reduce premiums be netted out of premium figures? On Schedule B, how are you handling credit balances in figuring the cost of the subsequent years? Especially when you get considerable excess balances?

MR. BAGSHAW: We don't have any formal method for getting cash values onto Form 5500. I've seen some interesting approaches by some of the insurance companies. One company uses a complete balance sheet in which the policy cash values are included in the beginning and they are included in the end. There is a specific line of income, an additional line which they place, which is the increase in the cash value from the premium. If you are going to have full disclosure, you must disclose the gross premium and the dividend separately. The way you put it on the form is really a matter of individual choice, but it has to be there.

MR. KING: Specifically on item 13(f), other assets, insurance cash values would appear in columns B and D. They should not appear as party-in-interest loans in columns A and C. Down below, under item 14(m), changes in net assets and other changes, one could show the increase in insurance cash values. For example, take a December 31 case with the premiums paid through December 31. The cash value that has been created as a result of that would be shown. Naturally, if there were a termination, the monies received would have been shown in the previous items under 13, so you would not have to concern yourself. The increase in total policy values is the increase in cash value. It is easier to understand that way and also you are always adding to the cash value, as just another item, when you finish with the receipt of the statement of the auxiliary fund.

MRS. MARLIES S. MORRISSEY: When you have loans under defined benefit plans, as an insurance company are you willing to make out a Schedule B for them and sign for it?

MRS. ABRAHAMS: Yes, we do. In order to prepare the valuation we reduce the reported assets by the actual amount of the policy loan outstanding, plus interest due as of the valuation date. As long as the information has been certified as to the total assets and the total policy loans outstanding, we will sign the Schedule B.

MR. KING: An attorney wrote to the IRS, received a letter which was published stating that in defined contribution plans, effective January 1,

1976, one could not make loans. That was subsequently reversed by the IRS, but I utilized it in corresponding with a life insurance company, pointing out that they could not make an automatic premium loan. I now have to write to them and say that the technical ruling which I cited has been reversed.

MR. BAGSHAW: Jim King stated a minute ago that one of his principles was that he treated every valuation as an ongoing concern and also certified to a total termination situation in the supplement that he provided to Schedule B. If this approach is taken, the problem of policy loans disappears, because the payment of the policy loan will be shown in that supplement.

MR. KING: Unlike some life insurance company actuaries, I very rarely use the annuity values of a life insurance company which has series by policy. The annuity value that I usually use, both for funding and equivalency purposes in determining vested benefits, is that produced by mortality table assumptions. I can see where there would be difficulty in preparing a vesting schedule for various bands, if you utilize conversion rates, whether you use current or guaranteed rates. I have seen several insurance companies that have series of ranges; they have guaranteed rates, they have rates that they are currently using, and they have rates that change every six months. For example, assume a current rate of about $135 per dollar of monthly income. Assume further that next year's current rate is $136. That means that there has been an increase in the present value of vested benefits that cannot be easily explained, other than a change of assumptions. This is a problem.

MRS. ABRAHAMS: For purposes of valuation, we do not fund towards a particular nonparticipating rate currently being offered. We use assumptions just as you do. We currently use $6.25 monthly income per $1,000 of proceeds, which is slightly more conservative than our current nonparticipating rates. Even if those rates do change slightly, we are still valuing our vested benefits on the funding assumptions, so they do not change from year to year.

MR. ZACHARY GRANOVETTER: With regard to professional corporations, where the participants are in direct control of their own compensation, how would the panel regard a request to waive a salary scale projection?

MRS. ABRAHAMS: At New England Life, for small corporations we have graded our salary scales based on the weighting of the key employees as a percentage of the entire group. Four percent is our current maximum salary scale. We grade down to 1% if everybody in the plan is a key employee with controlled compensation.

MR. KING: Typically in a PC, the name of the game is increase the deduction. In fact, an examination of what the principal has been earning forces you to use a salary scale. The principal does not get an increase of 1½%. He does not get an increase of 2%. He gets increases in the 5's and 10's of thousands. You need a salary scale because you know that if that plan terminates, the corporation has terminated. The actuary must remember that the principal is the key, and that when he leaves that corporation, the corporation folds.

MR. BAGSHAW: We may be stressing the PC too much. We all had ordinary

life pension trust business long before we had PC's and DA's. There are thousands and thousands of little businesses out there that are current accounts on the books. Where there are small corporations the principal has labored hard from age 35 to 55. His salary jumps are very dependent on the income of the business. A man might have been earning $35,000 for year after year, and suddenly jump to $40,000. His accountant could worry about what the Internal Revenue Service might do in terms of unreasonable compensation. That particular individual is unlikely to get an annually increasing basic wage. A salary scale is inapplicable to that type of situation, particularly if the benefit is primarily attributable to the integrated portion. If you use a salary scale, you need to worry about the three people down the line who have a $20 benefit. What are they going to increase to? A $400 benefit graded in terms of the cost. That one person up at the top is going to create utter havoc. You still have the problem of dealing with the maximum benefit of ERISA. You cannot fund for more than the maximum benefit as exists at that point in time.

MRS. ABRAHAMS: The graded set of salary scales is what we use on a proposal basis until we have some experience in order to study the plan, since most of the time we have no historical records on the plan.

MR. KING: When that method is used, how do you calculate the accrued benefit. I require at least five years of compensation in order to properly calculate the accrued benefit.

MR. GRANOVETTER: When you have a one life case where the professional has had a constant salary over the past ten years, and he is fully cognizant of the fact that it will remain constant, then he would not want necessarily to make a larger contribution early and possibly have lower contributions at a later time.

MR. BLATCHFORD: If you know the facts of the situation, you should apply them accordingly. For my own practice, I have found cases of all the types that have just been covered including the one that you just described. I do not feel it appropriate to automatically attach a salary scale. On the other hand, I do not think it appropriate to automatically exclude salary scales. In all of the work that we do, we should try to stay within practical limits and within the plan sponsor's budget while trying to do our best with the facts of the situation.