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## FUNDING VEHICLES AND ADMINISTRATION FOR PENSION PLANS WITH 10 TO 50 LIVES

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Discussion of the following aspects of funding and administration with respect to individual policy pension trusts, group products, and non-insurance company consultants.

1. Funding vehicles or contracts
  - a. Type of contract or media
  - b. Expenses
  - c. Effects of turnover, growth or reduction
  - d. Problems; solutions; profitability?
  - e. Changes and developments
  
2. Administration and services
  - a. Plan design
  - b. Forms, documents and reports
  - c. Record-keeping and statements
  - d. Valuations - assumptions and methods, gain and loss, Schedule B
  - e. Who provides which services?

MR. MALCOLM T. MACPHEE, JR.: The topic of small pension plans is not addressed to any great extent in textbooks, and the small plan does present some unique problems. The funding of small plan benefits may involve vehicles not commonly used for larger plans, including life insurance policies. However, in many areas, the status of the small plan has now been elevated to the complicated level of large plans by ERISA, and the concern of those involved with these plans has been heightened. Where local agents and administrators once handled the plans, there is now much the same demand for the services of actuaries, attorneys and accountants as there is for larger plans. The approaches used for small plans range from the group annuity products offered by the insurance companies to the individually designed plans, usually handled by a consulting actuary and utilizing a great variety of vehicles. These are the areas we will cover this morning.

MR. CHARLES E. FARR: It seemed to me, when preparing for this session, that one could categorize in various ways the types of contracts used in funding vehicles for small insured pension plans. Contracts could be categorized according to their use with defined benefit plans or defined contribution plans. Contracts could be described as participating, non-participating, or direct-rated. Or the characteristics of allocated or unallocated by participant could be used.

For purposes of today's session, I will classify insured funding vehicles into four product types, using the several characteristics just mentioned. The four product types are dividend products, direct-rated products, modified direct-rated products, and non-participating products.

By dividend products I mean the traditional participating type of product, with guarantees, and a dividend formula to distribute performance results more favorable than guarantees. Such products easily fall into the categories of unallocated or allocated.

We tend to think of deposit administration group annuity contracts as an unallocated product type, even though allocation does occur, normally, at retirement. Deposit administration group annuities are most widely used in connection with defined benefit plans, and could be said to be the standard product type used with such plans covering 10 to 50 participants.

Allocated products have been around longer than the unallocated type, and involve accounts for individual participants both before and after retirement. This type naturally falls into those products used with defined benefit plans, such as group deferred annuities or group permanent types, and those used with defined contribution plans, such as accumulation type products.

The group deferred annuity can use either level premiums or step-rate premiums. And the level premium type may or may not involve life contingencies before retirement. Group permanent products generally involve individual level premiums, and mature at retirement age for part or all of \$10 of monthly annuity per \$1,000 of insurance. These allocated products are not as widely used today for new defined benefit plans as they were twenty years ago. Accumulation products used with allocated, defined contribution plans can have either a front-end or a back-end load, and dividends take the form of excess interest credited to each participant's accumulation account.

In this classification, direct-rated products are those in which full investment performance is credited to, and expenses incurred are charged against the contract funds. Direct-rated products may be either of the unallocated or the allocated type. The unallocated type is really unallocated primarily before retirement, but sometimes after retirement, also. The IPG, or immediate participation guarantee, contract is one of these. It is issued primarily in connection with defined benefit plans. The unallocated after-retirement aspect occurs when the contract is used primarily for the investment of pension plan funds without the intention of using it as a vehicle for distributing benefits to the participants.

The allocated, direct rated products are generally allocated both before and after retirement, and are issued primarily in connection with defined contribution plans. More about these later.

For purposes of this classification, direct-rated products have been split into the type just described, and a type which I'll call modified direct-rated products. These latter products are used in situations involving allocation to individuals both before and after retirement. Their use is with defined contribution plans. They are called modified because there is a front-end loading, generally a percentage of deposits. The net accumulation then is direct-rated with respect to investment performance, and is either paid in a single sum at termination of employment, or is applied at favorable rates to provide an annuity.

The final category, classified as non-participating products, consists of immediate and deferred annuities. These products are used where a retirement plan is terminating and fully guaranteed benefits are desired for the participants by the plan sponsor. A contract can initially involve both deferred and immediate annuities. The non-participating approach is used for a variety of good reasons. The pricing of such contracts is very competitive, and is importantly a function of current investment markets. Another use of non-participating products is in the purchase of immediate or deferred annuities for participants terminating from an uninsured pension or profit sharing plan with a vested benefit.

Turning now to the expenses of these small retirement plans, one of the characteristics of the smaller plan is that expenses are relatively larger as a percentage of premium or deposit than for larger plans. Some costs are fixed, differing little between small and large plans. The approach used to collect money to cover these expenses takes various forms. A front-end load or back-end load, a traditional approach, is still used. Another common approach is to make periodic direct charges against plan assets, either at the level of actual expenses or according to a pre-established formula. At least part of the provision for expense frequently comes through a deduction from the interest earned before arriving at the interest actually credited. With increasing frequency, plan sponsors are choosing to pay their defined contribution plan expenses directly, in order that participants' accounts not be depleted by expense charges.

The pricing structure of dividend products normally establishes a provision for expense. This can take the form of any or all of loading on premiums, interest deductions, administration charges and so on. Expense charges are then made in the dividend calculation in accordance with dividend formula expense scales, normally set to recover actual expenses incurred in connection with participating contracts.

Of course, the level of expenses assessed to a particular contract inevitably depends upon the services provided to that contract. An IPG contract entered into solely for the purposes of investment would naturally be assessed much lower expenses than an allocated contract issued to a profit sharing plan under which reports of the individual accounts are desired by the plan sponsor each month. Charges under the investment-only IPG would be close to a minimum level of basic expenses for general administration and overhead.

A final comment has to do with the equitable allocation of expenses to a company's various pension products. Generally speaking the greatest financial stability is attained when each product type carries its own fair share of the expense load.

Employee turnover has a greater impact on the administrative functions performed under a group contract maintaining individual participant records than under one that does not. Contrast a non-contributory DA with a front-end load, accumulation type product used with profit sharing plans. Ultimately the latter will have higher administrative costs. Greater equity between contracts of the same accumulation type product can be achieved, with a penalty of greater complexity, if administrative expense charges are based on frequency of occurrence.

The effects of growth in a product line can be illustrated by considering modified direct-rated products. Let us consider a product which is allocated, is of the accumulation type, has a level front-end load, and under which the agent is paid high-low commissions. It is likely that the level front-end load includes high-low commissions that are levelized according to chosen assumptions as to contract persistency. During the early years of a product line, or during later periods of exceptional growth, the excess of commissions paid over levelized commissions included in the loading produces deficits. Alternatively, a product line that is shrinking can produce gains rather than deficits for the same reason. One needs to stay on top of these situations, comparing financial progress with financial projections.

I will list a handful of problems which can cause an armload of trouble. The first one has to do with expenses. Small plans cost relatively more to administer and operate than do large plans. An insurer selling mostly smaller plans will have higher general expenses as a percentage of premium than other insurers. Some steps can be taken to reduce the expense levels. These include standardizing, streamlining, computerizing, using prototype and master plans, and engaging in effective training programs for employees.

Of course ERISA, with its regulations concerning procedures, disclosure and reporting has greatly augmented the administrative functions connected with retirement plans. A comprehensive, well-planned approach to satisfying the requirements is a necessity.

Enrolled Actuaries are subject to personal liability, and of course their employer would probably be involved in any action against the Enrolled Actuary. It is incumbent on any organization in which Enrolled Actuaries function to take the steps they consider necessary to insure that the performance of the Enrolled Actuaries is beyond question as to its professional quality and comprehensiveness.

Another problem that has been at least exacerbated by ERISA has to do with the flow of funds out of retirement plans. ERISA has to some extent made defined contribution plans attractive. Defined contribution plans tend to provide cash surrender values more frequently than do defined benefit plans. Intelligent choices, to the extent made by plan participants in their own interest, can result in an overall outflow of funds to the detriment of better investment performance.

A final example of a problem has to do with the impact on surplus of rapid growth of a company's pension operation. If surplus goals are related to a specified asset growth rate, and the rate of growth exceeds that, surplus will decline relative to expectations. The antidote to too rapid growth is to not grow so fast, but accomplishing this without destroying your field force, or your viability in the industry, poses problems.

Your program has a question mark after the word profitability. Some insurers are not in the small retirement plan field because of the impression that it is not profitable, or that to enter it would raise the expense level of their larger plans. I submit that there is no logical alternative to making this business profitable if you are in it at all. If small retirement plans is the only game you are in, you have to make it profitable in order to survive. If a company deals in both small and large retirement plans, the small plan operation must be profitable in order not to produce losses which will ultimately make the large plan operation non-competitive.

This business must be continuously monitored. Studies of expenses, comparing expense money collected with expenses incurred by product, studies of lapse rates, studies of mortality, studies of real surplus and its sources, all these and others need to be done on a scheduled, repetitive basis, and deliberate action taken when indicated by the analysis of the results from those studies.

Among the developments of the last three or four years is the increase in the number of terminations of small plans. Many of these end up in insurance companies on a non-par, single premium basis, and there has been a considerable increase in that activity of a few insurers. Associated with this has been an observed trend away from defined benefit plans and toward defined contribution plans. New plans are more likely to be defined contribution plans than before.

Direct-rated products, such as IPG, were normally reserved for the larger plans in years past. There has been a trend toward the use of direct-rated products down to smaller and smaller size cases. For example, some insurers will issue IPG down to as low as \$15,000 of annual deposit. The demand is there. Perhaps one reason for the higher underwriting limit in years past was the feeling that expense levels revealed in the annual report were more acceptable to the plan sponsor on larger cases. In recent years and today plan sponsors are increasingly interested in knowing the charges made against their plan. By and large, they will accept reasonable expense charges. The IPG fund statement, showing expenses charged directly to the fund, tells them what they need to know.

Another development that may be spreading to smaller plans is the increasing interest, on the part of plan sponsors, in good investment return. Good investment return has always been desired to lower costs or to improve benefits. Now, however, plan fiduciaries may feel that they are being derelict in discharging their duties if they do not seek out an arrangement which will return to the plan the best investment return available to them.

In the small retirement plan field there is an increasing use of prototype and master plans. Some insurers make their use mandatory for the smallest plans, and push their use (but don't require it) for intermediate size plans. What determines a small plan for which the use of a prototype is required is either the number of lives in the plan or the amount of the deposit. A reasonable variety of plan provisions is available under today's prototypes. Of course, for the larger plans the insurer tailors the plan to the specifications that are desired by the employer, to the greatest extent possible.

Documents needed for small plans are similar to those needed for larger plans. The list includes the plan document, the trust agreement, the group contract, the employee booklet and the employee certificate. The trust agreement and plan document are normally carefully reviewed by the plan sponsor's lawyers, but the insurer often plays a part in the basic development of the two. ERISA filing requirements include EBS-1, PBGC-1, the 5300 Series, Summary Plan Description, the 5500 Series, Summary Annual Report, and others.

I think a positive, constructive attitude toward the reports and disclosure statements required by ERISA is necessary. An insurer can adopt the point of view that the responsibility is solely that of the plan administrator, and the insurer's responsibility is to supply the things required from it. On the other hand, the approach of adopting a more comprehensive and perhaps somewhat paternalistic stance can be taken, under which the insurer voluntarily takes on the task of advising the plan sponsor of current requirements, and of changes as they occur.

Recordkeeping requirements can vary from none to heavy. The heavy end involves defined contribution, allocated products, and the light end would normally involve unallocated, defined benefit products. However, there can be recordkeeping requirements connected with the defined benefit unallocated products which are contributory, and there can be no recordkeeping requirements connected with defined contribution plans, such as profit sharing plans, where the plan sponsor keeps all the records.

DA and IPG fund statements are normally provided annually, sometimes including a coverage record for each employee showing, in addition to basic data, the accumulated participant's contributions. In addition to the fund statement, a company may provide to its DA customers complete dividend information each year, although this practice is not universal.

Practice with regard to defined contribution products ranges from a statement of each participant's accounts monthly to a statement of only the total fund once a year. This latter would be provided in connection with a plan under which the insurer keeps no records for individuals. I have used the word accounts in the plural because of the potential use of a separate account for equity investments for participants under some of these products.

Some insurance companies are "the actuary" for many pension plans. This places a heavy load on their Enrolled Actuaries. This makes standardization of actuarial valuation methods and actuarial valuation assumptions very desirable. The actuarial valuation method, uncommonly called the LVFS method, is widely used because of its several desirable characteristics. LVFS stands for Level Value Fixed Supplement, and is the same as the old frozen initial liability method.

The heavy load on Enrolled Actuaries places a premium on developing competent actuarial assistants, and training programs are springing up in home offices to prepare capable employees for future EA exams. The required actuarial certification on Schedule B focuses the special attention of the Enrolled Actuary on the handling of problem cases. There are many different kinds of problems, of course, but two of the more frequent ones are plans where there have been inadequate contributions, and plans where there are unacceptable assets held outside the insurer.

The length of the list of services that can be provided in connection with a pension plan is a function of the creativity of the person preparing the list. Plan services range all the way from "preparation of contracts and announcement pieces" to "a willingness to fit the customers needs on a sound basis to assure thorough satisfaction with the plan and its operation".

Recordkeeping services are just one type of service that can be provided on this long list. IPG's with cafeteria-style service arrangements are an example of the way in which administrative services can be provided. They can range all the way from no services other than investment of and accounting for funds, to an arrangement where individual records are maintained, actuarial services are provided, and benefit payments are made to annuitants.

It is common for the insurer to maintain individual records and accounts on defined contribution plans and to pay lifetime annuities for those who choose them at retirement.

A fairly recent development is the establishment of small service organizations that are providing plan services, including completion of the report forms required by ERISA, at a very reasonable cost. The existence of such firms leads to the request to insurers to develop an investment-only product for small plans, with all administrative services being performed in the outside service organization.

MR. WALTER S. RUGLAND: I think Chuck's comments are very helpful in understanding the perspective of the insurance company operating in the small pension case market. In many instances, his comments are applicable to split funded as well as group only situations. I thought it would be appropriate for me to concentrate on what I think are the causes of the problems underlying the recognition of the opportunities in the pension market within the life insurance company. I look on this as a marketing discussion, as opposed to a product or an administration discussion. I think we will see how they tie together before my few minutes are up.

In essence, a company has to have a pension product strategy that is keyed to operating in the pension environment. There are some presumptions regarding that strategy, and I believe that it must take direction from earlier agreed upon strategies with regard to corporate purpose, marketing and profits. For discussion purposes, let us presume that the marketing strategy reads something like this: "Our marketing effort promotes increased productivity per producer through pensions which are sold aggressively and competently in our current markets". You may want to describe your marketing strategy differently than that, such as in a new market which we have now identified. Let us presume the profit strategy reads something like this: "We will maintain profitability in pension products and services which is consistent with other company products, in terms of investment, risk taking, and administrative expense". I believe that this type of strategy preempts the possibility of negative profits arising in any segment of the emerging pension product portfolio. It has been my observation that many companies wrestling with what to do with pensions have not clearly defined their markets, and these markets need definition. If this has not already been done, one of the ways to get a handle on it quickly is to ask agents and other types of producers what their markets are, and use that group as a source of raw data in terms of developing identification of the current pension market. This group should be a confirming organization, not one that tells you what is happening out there. In my Company experience, I have learned not to ask an agent if he could use something, because he always could; but somehow you have to raise the question, "If you have the opportunity to do such and such, would it be of value to you, and what priority would you put on such an opportunity?"

Let me advance to an initial proposition which can be validated in your own company by your own activity. Let us assume in this example that the company is a career agency company, and operates in several markets. The first market might be salaried employees. I would describe this market as requiring one call or two calls by a producer. During this one or two call situation, the agent sells a single policy for a simple need within the family income spectrum of needs analysis. The producer working in this market is probably a financed agent, an agent in his early maturing career agency years, or a property and casualty agent who looks on life insurance as a sideline. His pensions are an important consideration for a company working this market. I think that if a company identifies this as its major market, it perhaps should not be in the pension business. There is a second type of sale that is made in this market. I characterize that as a simple or computer-assisted solution to family income needs after the death of the wage earner. This sale probably entails two or three calls by an agent or other producer and is done during a slightly later stage of the producer's career development. Are his pensions a consideration in this market? I do not think so, if the market is salaried employees. Once in awhile you may sneak a business service owner, such as a gas station owner or a farmer, into this type of market, and in that case, it may be that pensions do have a role to play. Let us address the small business owner situation as a separate market. The mature agent, primarily, works in this market, and he talks about liquidity. His analysis of need is probably based on equity and his pensions are a factor in this situation. Also, with a small business owner, the discussion may regard sheltered asset accumulations. This, again, is done by mature producers, and his pensions are a factor. The small business owner is also subject to producer activity regarding complex estate and business planning analysis, buy and sell, and key-man insurance. What type of producer is involved in this business? Again, I believe it is the mature agent, and his pensions are a consideration if the company is in this market. The small business owner may also want to discuss simple retirement income needs for employees. At what stage of the producer's career will this need emerge? Probably at the later stage of his financed years or during his mature years, or perhaps from property and casualty agents who are working in commercial line coverages. His pensions are certainly a consideration for this type of retirement income funding.

In our example company, they probably had some statements that need verification. First, is it unrealistic to assume that the company's agency group will not work in a market that exceeds 50 employees? Second, is it reasonable to assume that a company's pension sales are solid and that most groups being sold pension plans will increase in size two or three times over the initial 10 years or 15 years? This is an underwriting consideration that needs study. Thirdly, is it reasonable to assume that the company's career agent, or other producer, has control of sales situations in which he proposes a pension solution. And, if there is any competition involved at all, is it at the agent level and self-perceived, rather than actually a real comparative situation? Each company will answer that question slightly differently.

There is another thread that comes out of this analysis; that is that there are probably four approaches to selling pensions in this 10 to 50 life situation. One is the appeal of tax deferral on current income. The second is the life insurance need on the part of people who control the expenditures. Thirdly, there is a need to accumulate assets with the business owners outside



of the business but prior to taxes. And fourthly, there is a monthly income need during retirement years for the owner and for the employees. I have talked with various companies that put a different order on this, so don't write 1, 2, 3, 4. Your company may have them in reverse order, or any other permutation. The further analysis of the pension market should really include a look at the responsibilities of the individual who is making the decision to install a pension plan. At the one extreme, he is buying for himself, in order to solve his own problems with his own money, which is still in the corporation. At the other extreme, he is buying with other people's money, and is really subject to fiduciary responsibilities to the participants and stewardship responsibilities to the stockholders. This spectrum is a broad one, and there are many potential mixes.

With regard to the funding vehicles or contracts, and what type of contract or media is most appropriate, I believe it is dangerous to generalize here. In certain situations with certain markets, any type of contract might be appropriate. I would encourage you not to discount the possible validity and continued vitality of the retirement income contract to particular markets in particular situations.

It is my position that administrative expenses, which are caused by products being a part of a pension plan, should not be covered by the premiums attached to the policies. These expenses are subject to environmental influences too great to have a company assume the risks in its premium setting. Life insurance policy premiums should be used to cover only the traditional contractual obligations of the insurance company.

Our experience shows, and a number of studies validate, that turnover in pension cases is not at all similar to that in non-pension situations. The market identification process within the company will help identify to what extent the turnover will be different. It really depends on the individual making the buying decision and the reasons for purchasing the insurance. In some companies, the profit testing is segregated between life insurance covering business owners and the insurance which is supplied to the other employees.

There are some pitfalls with regard to profitability. One is offering guaranteed issue on decision makers. I believe that there are a lot of companies today that are insuring uninsurable decision makers for significant amounts of insurance. The second problem is taking products which are apparently profitable in non-pension situations, and using them in pension situations, where the assumptions really have not been tested out. A third problem is the inability of many companies to really understand what it costs them to be in the pension business with regard to their marketing expenses, and matching up these marketing expenses to the expected lapse rates which the pension products might incur.

There are some other potential changes and developments that need to be considered. One of these involves the prohibited transaction exemptions, which can have significant impact on the future of the split funded plan. For example, in the past, most companies have not allowed the transfer of existing life insurance into a pension plan, but now there has been a prohibited transaction exemption that says such a transfer is possible. This creates a real

problem with companies that have two rate books, because a sale can be made before the plan has started on the regular rate book, and then the product can be moved into the pension plan at a later date. Additionally, there has been an Internal Revenue Service opinion that lets the retirement income contract purchase whatever it can at current rates rather than purchase just the defined benefit amounts as provided under the plan. I think that this is one aspect of the current developments that will make retirement income plans somewhat more attractive.

There is a special concern that affects split funded contracts. How do you keep track of all of the data, especially if your company does not have the side fund under its own management? This, perhaps, is encouragement enough for companies to try to figure out ways to manage this money. For every premium dollar that comes in on a split funded plan, there is another dollar and a half that is invested in a side fund, and most companies are ignoring the opportunity to manage that money. The problems created by not managing the money can be immense, and there are a lot of reasons to try to design products that will attract that money.

MR. CHARLES F. MONROE: I have been asked to discuss administration and services for smaller pension plans, from the viewpoint of an independent consulting actuary.

Obviously, the first consideration in plan design is the determination of whether a particular company should have a defined contribution plan or a defined benefit plan. This choice, of course, will depend on many factors such as variability of company profits from year to year, ages and past service of potential participants, and career average aspects of defined contribution plans. Although the actuary can provide valuable input and advice concerning this selection, I believe the actuary's role has ended if the choice is a defined contribution plan. Once this choice has been made, I see no reason for the employer to incur actuarial expense on what is essentially a record keeping type of plan. Consequently, my remarks are directed to defined benefit plans for smaller employers.

The design of the plan is fundamentally affected by the purpose of the plan; whether the plan shall be designed to provide retirement income (more typical of larger groups) or whether the plan shall be designed to provide tax deferral of income (more typical of smaller groups). If the purpose of the plan is to provide retirement income, death benefits appear less applicable and problems with individual insurance policies may be avoided. For larger groups, the vesting schedule is more likely to be extended (such as the 10 year or 5/15 vesting schedule) since discrimination is not as large a problem as with smaller groups.

For plans emphasizing tax deferral, death benefits are applicable in order to return the money "invested". If insurance policies are used in the plan, the plan should be designed to take advantage of the provisions of Revenue Ruling 74-307 in order to provide a return of reserve in addition to the proceeds of life insurance policies. For administrative ease the reserve should be defined as the reserve on the last policy anniversary; in this way, the actuary may identify the reserve on his valuation and this death benefit can remain unchanged until the next anniversary date.

The vesting schedule under smaller plans usually is the 4/40 schedule or a variant of that schedule because the possibility of discrimination is more likely in a smaller plan. For administrative ease and for better participant understanding, we have always recommended a 4/40 vesting schedule going up 10% each year rather than 5% in the first two years. Under this schedule, the employee's place can be easily determined by multiplying his years of service (so long as he has 4 years of service) by 10%.

For plans without individual insurance products, participation requirements become a matter of choice and any reasonable requirements will be acceptable. For administrative ease and expense saving, however, eligibility standards should be fairly strict under plans providing individual insurance policies. Because of the high turnover of lower age and service employees, the maximum ERISA standards (age 25 with one year of service) appear to be advisable. Again, for ease of administration, the single entry date seems best since all premiums will be due and all cash value increments will occur on the plan anniversary date. This will require entrance of some employees with only 6 months service, of course, but that will be balanced by 18 month requirements for employees at the other extreme.

One aspect of plan design for smaller plans has never ceased to puzzle me; the designer usually pays a great deal of attention to integration of the benefit formula in order to weigh the benefit and contributions toward the higher compensated employees and then gives no consideration to the form of the benefit. Since most highly compensated individuals in smaller plans are male and, despite court opinions to the contrary, females live longer than men, a plan which wishes to weigh the results toward the highly compensated individuals should use a joint and survivor benefit form in order to accomplish this goal. Not only does the principal bring in a female life to the benefit form, the female life is usually younger; in addition, about 85% males at age 65 are married while only 60% females at age 65 are married. The introduction of a joint life benefit form represents somewhat of a gamble since the principal's wife may predecease him, but it appears to be a reasonable gamble when designing a plan to weigh benefits for the higher compensated.

For larger groups, approaching 50 lives, the methods and approaches of the valuation closely duplicate valuations of large groups. The entry age normal (EANC) valuation method, turnover rates, etc. appear applicable.

For smaller groups, however, we invariably use a variation of the individual level premium (VILP) method, especially when individual insurance products have been used in the plan. This is an aggregate method applied to the individual; in other words, the value of his benefits minus assets is the numerator, and the value of his future salaries or service is the denominator for each individual. The advantages of this method are that it is easily understood, it automatically spreads gains and losses, it provides an assignment of cost to each participant, and it protects against a funding period out-running a highly paid participant's expected retirement date. The disadvantage of the VILP is, of course, its lack of flexibility in providing a range of contributions.

When we prepare valuations for smaller plans, we actually do two valuations: one on the entry age normal and the second on the VILP. The EANC valuation serves two purposes: it tests for the full funding limitation under section

415 and it is used to allocate the assets for the VILP valuation. The EANC valuation is done using participation ages as the entry ages for asset allocation; if a full funding problem arises, we will do a second EANC valuation using employment ages as the entry ages.

We use straight market value as our asset valuation for smaller plans. Under the VILP, sizable market increases will be spread over the participant's future working lifetime and contribution jumps will therefore be deflated. When EANC is used, the 15 year amortization of gains seems adequate to handle market value increases.

In smaller plans, our "standard" valuation assumptions are 5 1/2% interest to retirement, 4 1/2% interest after retirement, and 3 1/2% salary scale. The interest rate to retirement and the salary scale are fairly common and require no elaboration. The interest rate after retirement was set at 4 1/2% since, with great actuarial wisdom, it was found to lie in between settlement option rates under individual policies and market rates and, thus, represented a compromise. The setting of post-retirement values has bothered me for quite some time since this is the one area an actuary can determine plan results through his own independent action. As a plan provides lump sum options or actuarial equivalent options to be purchased with the lump sum, then the resulting benefit of a retiring employee will depend not only on the benefit formula, but on the rate the actuary has selected. Consequently, this must be discussed thoroughly with the client prior to the valuation.

We do not use turnover rates for the very small plans (perhaps 20 lives and below) but we do use mortality rates for any size plan if the reserve is not paid at death. This is done because of pre-ERISA regulation 1.404(a)-3b which mandated the use of mortality rates. Occasionally, we will lower the salary scale for highly compensated individuals since they are much more in control of their own wages.

When individual insurance policies are in the plan, we assume no further purchase of insurance. In subsequent years, when insurance is purchased, the liabilities and costs are thus transferred from the side fund to the insurance policies.

Schedule B presents no special problems since it is a well designed form. One small problem seems to occur with some frequency, however; contributions have been made and deducted on the company's form 1120 which are in excess of our computed contribution. This has been handled by reducing the next year contribution by the funding excess; if IRS, upon audit, finds this excess to be material, it will then carry forward only to the next year.

When form 5500-C was first required in 1975, we offered services to complete the annual returns for our clients. This turned out to be a mistake and we no longer will do annual returns (with the exception of Schedule B, of course) for clients. In order to complete the form, we had to request information from the company's accountant in a practically identical form as shown on form 5500-C. This caused needless expense to the client since the accountant could just as well prepare the form himself with the information on hand. In addition, we found ourselves emersed in bookkeeping problems requiring several follow-ups that an actuarial office is not set up to do; instead of doing actuarial work, we were doing accounting work, and the actuarial work suffered because of it.

Similarly, we believe the administrator is the best record keeper since he has the basic data on hand and can integrate it with his payroll data for ease of administration. The actuary will be needed for initial advice with respect to the form of data, such as hours credited in a plan year. Once the records are set up, the actuary is unnecessary.

The plan document may be prepared by either the company's attorney or by the actuary. Whichever professional drafts the document, the other should review it. Summary plan descriptions may be similarly done with review by the actuary or attorney.

Employee statements seem to be a natural for the actuary. He has all of the data and is familiar with the benefit provisions when performing the valuation. Consequently, we make it a routine to provide either individual employee statements at each valuation date or a summary statement that the employer may transfer to his own individual statements. Projections of benefits at retirement must have the appropriate disclaimers in order to avoid future problems if an employee does not earn a full year of service during each year of future employment. In addition, careful disclaimer statements must be presented for the entire employee statement, since some data may have been reported incorrectly.

