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

Moderator: RICHARD A. WINKENWERDER. Panelists: LOYD HOPPER, EDWARD T. FORTE, CAROL A. MARLER

Aspects of Funding and Administration with:

Individual policy pension trusts
Group products
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?
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2. Administration and Services

    a. Plan design
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    d. Valuations - assumptions and methods, gain and loss, Schedule B
    e. Who provides which services?

MR. RICHARD A. WINKENWERDER: Employers and practitioners currently take a variety of approaches to Pension Plans with 10 to 50 Lives. Carol Marler is going to address the subject from the viewpoint of individual policy plans, either wholly insured or split-funded. Loyd Hopper is going to speak about group annuity products; Ed Forte will discuss the self-administered, non-insured trusteed plans.

MRS. CAROL A. MARLER: Beneficial Pension Services provides administrative assistance to small pension plans. BPS is a subsidiary of BSLIC. Our approach is based on the so-called "Split Funding" method, which combines a life insurance policy with a side fund.

Our clients are generally Professional Corporations or small, closely held companies. The Pension Plan is rarely supplemented by group insurance. The principal is generally looking for a plan design that provides both death and retirement benefits. About three fourths of our clients have money-purchase-plans - either defined contribution, profit sharing, or both. When the plan is installed, 40% of the contribution is applied to purchase whole life insurance. The balance is commonly invested in savings accounts, CDs, or mutual funds. Incidentally, we also provide a group Deposit Administration contract, which is used as the side fund on around 10% of our cases.

For cases of more than 5 lives, we have a special product, known as Pension Whole Life, with a reduced policy fee and lower premiums compared to our

Ordinary Life product. This is a guaranteed issue product. The Ordinary Life product is available for under 5 lives with full underwriting. Both products have the same cash value schedules.

These two life insurance products are also used for funding defined benefit plans. Our plans call for insurance face amounts that vary from case to case. The average is probably around fifty times the projected monthly retirement income. Actuarial assumptions for valuation are: 6% interest, no salary scale, no mortality, and no turnover.

We use either the Individual Level Premium method or Entry Age Normal Cost method. The entry Age Normal method is mostly used on take-over cases, or for plan modifications where a fund already exists. Most of our valuations are based on current annuity purchase rates, and based on guaranteed cash values under the policy at age 65. In some cases, we have used the guaranteed annuity purchase rate, which produces a much more rapid funding of the benefit. But, typically, we have been using the current rates, which we feel is more realistic and is better suited to the needs of most of our clients.

The Administration Unit for pensions consists of six people. These people are responsible for marketing support for pension work, for the deposit administration contracts, which include a number of municipal deferred compensation cases, and also for all of the services that are performed for our pension clients. The Actuarial Department does review and sign the actuarial certification, but the actual work of preparing it is done by the Administration Unit under the supervision of a person who is not an actuary.

The actuarial staff of the life insurance company does provide the computer programs that are used in the valuations. These are programs written in the APL language, and they run on the IBM 5100 and 5110 computers, which are in the Actuarial Department. The programs are still in, I think you'd call it, "a continuing state of development", which means that they only work in certain cases, and generally the actuary has to go in and fix them whenever something goes wrong. The output from the computer programs is in a tabular form and is generally photocopied onto BPS paper and presented to the client, rather than being re-organized or retyped in any way. We do have the capability of programming individual employee statements to meet the needs of the client, and this would be done on the basis of the client saying, "I want something that looks something like this." The Administration Unit would work it up in further detail, and then Actuarial Department would provide the programming needed to get this output format.

The life insurance company is the sponsor of the Prototype plans. In virtually all cases, the retirement benefit is purchased from the life insurance company, combining the Cash Value and side fund. Deferred annuities have occasionally been made available for vested benefits to terminated employees, however we use flexible annuity products for funding deferred benefits and require that the contract continue to be held by the trust.

Use of the ordinary life insurance products does produce complications, due to their lack of flexibility. Our plans must deal with minimum benefit increases to trigger purchase of additional life insurance, and the procedures to use when salaries decline. Our flexible payment annuity products

have not been used for pension funding to any great extent, which I feel is unfortunate, because their provisions allow contribution changes with no administrative burden. This product currently credits a 6.7% interest rate, and it has no load, except for a deduction of premium tax, which is done in our company at the front end. In California, the premium tax is ½%, which means that, after paying that ½% for the premium tax, there is no load of any kind against the fund. I have given some thought to the use of adjustable life insurance products, and it seems to me that a slightly modified version of adjustable life would be very suitable for the pension market. One of the products that Beneficial has actually introduced which could be used in pension situations, combines a decreasing life insurance, a flexible purchase annuity, and premium payments to the life insurance that decrease to one-third of the initial amount at the end of one year. It is what most of the states commonly call "deposit term." The fact that it is whole life doesn't keep the states from calling it "deposit term." Because of the flexible payment annuity rider you have, in effect, a retirement income type of product that has the ability to pay current interest rates on the interest accumulation portion, and still have guaranteed non-participating and reasonably low premium rates for the insurance portion. Adjustable life insurance products would seem to be ideal for this market.

Another problem area is that of vested benefits for terminated participants. Although the Prototypes provide a method for distributing the insurance policy on termination, we find that most participants would rather have the cash. Our sales force has asked for a high early cash value product for pension use.

The effect of turnover, growth, or reduction can be significant. The life insurance policies carry heavy loading for the commissions. Larger client companies will rarely continue the split-funded route, installing group insurance and going to fully trusteed pension plans.

Another new product which Beneficial has recently introduced also might be adapted to pension situations. It combines decreasing insurance, modified premium payments, and a flexible annuity rider. The effective result is a "Retirement Income" type product, but with the ability to apply current interest rates to the asset accumulation.

In conclusion, I think that the individual policy pension plan approach is not yet dead, that there are a lot of circumstances where it meets the needs of the employer, especially in small group cases. Our clients average five lives; and providing a life insurance or a group insurance product and a pension plan would be an administrative burden. By combining the two products, we feel we have met the needs of the employees and of the principal.

MR. WINKENWERDER: Our second speaker will be Loyd Hopper, talking about the small plans from the group annuity viewpoint.

MR. LOYD HOPPER: The funding vehicle I am going to talk about is what we call a "direct rated deposit administration group annuity contract." The reason we call it "direct rated" is that full interest credits and also full charges for expenses are disclosed to the contractowner. The contract provides for an unallocated deposit fund for each contract. Deposit fund principal is guaranteed by the insurance company. The fund is credited with interest at rates determined on an investment year basis. The rates are intended to credit all investment income net of investment expense to the

contracts. In other words there is no hidden load in the form of a reduced interest rate. The deposit fund is charged a direct expense charge. This charge is intended to cover the insurance company's overhead, the expenses of administration services provided for the plan, and to make a contribution to the insurance company's surplus. When participants retire, annuities are purchased from the fund at competitive current annuity rates. Payment of future benefits to retired lives is then the responsibility of the insurance company. There are alternate versions of the contract which provide for payment of annuity benefits from the deposit fund. However, these versions are seldom used for plans with fewer than 50 participants. Due to the nature of the insurance company's investments which back up this contract, it is not practical to allow an unrestricted payout of the book value of the deposit fund. If a contractowner wishes to move his funds to some other investment medium, he has a choice between payout of book value in installments over approximately five years or payout of market value in a lump sum. The market value is determined by the insurance company to compensate for actual investment costs associated with the timing of the transaction. It has been our experience that there have been very few contract terminations.

The contract also allows investments in a second account, a separate account invested primarily in common stocks. Funds placed in this account share directly in both the investment income and the capital gains and losses experienced by the account's investments. We find that there is little interest in the separate account among ten- to fifty-life plans.

The expense to a plan using this contract is the annual expense charge made by the insurance company. The basic charge for cases of the size we are discussing - say one with a $30,000 annual contribution and a $90,000 fund balance - might amount to 5% of the annual contribution. About 40% of the charge would be salesman's commissions.

There is an additional charge for plans where we provide administrative services. The charge is determined by formula. We don't attempt to charge individually for each service provided or to bill for the time actually spent on each case. The formula is an annual constant plus a charge per employee. The charges vary depending on the plan characteristics. The lowest charges apply to cases whose characteristics fit our valuation systems without special handling. Higher charges apply to cases where we have to develop special computer program modules or divide the plan into separate groups for processing or make calculations by hand. In addition there is a higher charge for contributory plans and there is an initial charge for taking over administration of an existing plan.

Plans using this group annuity contract can experience turnover without generating any additional costs or charges by the insurer. Since the deposit fund is unallocated there is no special cost or loading incurred when one employee leaves the plan and another replaces him.

Plan growth is easily accommodated under this type of contract, since the contract is suitable for and is used by much larger plans. A reduction in plan size may become a problem since the contract is not suitable for very small plans. Near the bottom of the ten- to fifty-life range the expense charge will be a fairly high percentage of plan cost and it may be that the plan could be operated with lower expenses in some other way. We have had some problems with the contract in the sales area. Some sales prospects resist the rather large disclosed expense charge. Some of our competitors

market something called a conventional deposit administration contract which includes guaranteed early interest rates which are higher than our guarantees and very low revealed expense charges. It is difficult to sell our contract when we propose to charge say $2,500 a year for our services when one of our competitors may be offering to do the same thing for $400 a year less 2% of any contributions in excess of $20,000. Explaining the difference between the two contracts is difficult unless the sales representative has exceptionally good rapport with the prospective client. Consequently we are under some pressure from our sales force to offer the conventional hidden charge type of contract, and we are told that some brokers refuse to present the full disclosure contract. So far, we have resisted this pressure and continue to offer only the full disclosure contract.

So far as profitability for the insurance company goes, on a statutory basis our group annuity line has experienced losses in each of the past several years. A substantial component of the statutory loss is retired life annuity reserves greater than the gross premiums we have charged. When this component is adjusted out, the result is still a net loss in each of the past several years, but the loss is relatively small. During these years, the business in force has grown rapidly and if a proper value were put on future profits from the cases we have sold, we would find that the group annuity line has been profitable.

We have recently increased the expense charges that we make against the deposit funds. This was necessary to offset the increases in our own expenses due to (1) the additional services plans must now have to comply with the law and (2) the effects of inflation. We expect modest losses to continue during the present, high-growth period. In effect, we are investing in new business and in developing the capacity to handle it. The expected long run result is a positive contribution to the insurance company surplus.

We anticipate no substantial changes in the important provisions of the group annuity contract I have described. It is an efficient and convenient funding medium for small to medium sized pension plans. I am assuming of course that the government does not erect the few additional regulatory hurdles needed to either wipe out pension plans entirely or wipe out insurance companies entirely. The contract is very suitable for plans in the ten to fifty life range. Investment results have been favorable - seven to nine percent interest over the past several years. I expect little change in the general contract specifications.

Administration and services for plans using the group annuity contract may be provided either by the plan's own outside consultants or by the insurance company. For plans in the ten to fifty life range, services are almost always provided by the insurance company. In the remainder of my comments about plan administration services, one theme which will recur frequently is mass production. This is the key to providing services at a price that plans in this size range can afford. Try to do things in a way that can be used over and over again, rather than developing special procedures for each plan.

In our group annuity operation, new plans are designed in a cooperative effort between our field people - salaried group pension representatives - and a home office proposal specialist. A computer system is used to illustrate benefits and calculate actuarial costs for plans which are proposed.

It is quite common to prepare illustrations on a number of alternate plans for any one prospect.

We try to encourage plan designs which we can administer efficiently by using different expense charge factors for different types of plans. As I mentioned earlier, we charge less for a plan which fits our systems than for one which does not.

We are now developing a master plan that will carry with it an even lower expense charge formula. We hope that people will see that this plan does the really important things they want to do, and that the low charge makes it appropriate to perhaps give up some relatively unimportant special provision which might be available in an individually-designed plan. If the master plan does sell well, we will be able to administer a large number of plans efficiently and cheaply.

Revisions of existing plans to comply with ERISA were generally proposed in conjunction with the actuarial valuation done as of the date compliance was required. In most cases, we proposed the minimum changes required to bring the plan into compliance. Generally waiting periods were shortened and vesting schedules were strengthened. Actuarial costs were quoted accordingly. Our present valuation system (which is now in need of serious modification, by the way) was up and running early in 1975 so throughout the process of revising plans to comply with ERISA, we also tried to eliminate any plan provisions that did not fit the system. We were reasonably successful at this, so our plans are much more uniform now than they were before ERISA. This allows us to be more efficient and less expensive in providing administration and valuation services to the plans.

Our approach to forms, documents, reports and other administrative services for pension plans has been to provide a complete service. This may be the only way that employers of the size we are talking about can have a pension plan. An employer this size does not have access, at least not reliable access, to the information that is needed to run a plan. It is unlikely that he will have an employee benefit specialist on his payroll. He probably has an attorney whom he hires only on occasion; he does not retain one to keep him informed of new requirements. His accountant or bookkeeper is often uninformed in the specialized area of pension plans. So for employers of this size it seems likely that we are going to have to keep them informed if they are going to be able to do everything they have to do and meet all the deadlines they have to meet.

Also, we can operate more efficiently if we do everything. Here again, mass production is the key. It is much easier for us to draft a plan document using our pre-recorded text and a summary plan description using our pre-recorded text, than it would be for us to try to adapt our summary plan description text to a plan document drafted by someone else. Consequently, we draft the plan for review by the employer's attorney. We have been very successful in this approach, especially in the Portland area where much of our business is concentrated. Most of the larger law firms will have an attorney specializing in pensions and the attorney on our staff has developed excellent rapport with these specialists. Consequently a Portland employer who uses one of the larger law firms will almost certainly be referred to an attorney we are accustomed to working with.

We prepare initial filings for the IRS and Department of Labor, we fill out

the appropriate forms with all the information we have and we indicate missing information to be completed by the employer or his accountant or attorney. Missing information typically is information we would not need to have in our role in the pension plan, such as the total number of employees the employer has. Often the employer will only report to us employees eligible for the plan.

We prepare and print the employee booklet or summary plan description. We try to make booklets good looking. We personalize them for each employer using his own logo. Our sales people feel that an attractive booklet is important because, for the employees, it is one of the few pieces of evidence that a plan even exists.

We prepare annual filings, the 5500 forms. Here again, we complete the information we have, indicate the blanks that still need completion, and send the form to the employer for completion and filing. We also prepare the summary annual report which so far we have done with a one-page letter and a copy of appropriate schedules from the annual filing. If the requirement for a summary annual report is not discontinued we will do some development work and make it more of a promotion piece.

We do employee record keeping and annual benefit statements. The statements are difficult to produce because of the need to be extremely accurate, but they, along with the booklet, are the employee's only evidence that there is a pension plan. As you know, pension plans are extremely expensive and it does not seem to make sense to go to that expense and then fail to keep the employees informed of what you are doing. Our present computer systems for producing benefit statements are in need of improvement and we are starting that project this year. The benefit statements are very well received by the employers and the employees and it is our intention to continue to provide complete record keeping and benefit statement service.

In the area of actuarial valuations, we also try to mass produce. The assumptions we use are stock. We almost always use 6% interest, 4% salary scale, and 1971 Group Annuity Mortality Table. The only variable is the termination table which is chosen on the basis of almost no information other than the employee census and perhaps the nature of the employer's business. We do monitor gains and losses in an approximate way and a steady pattern of either gains or losses from terminations will lead to a change in the termination assumptions. The termination assumptions we use are generally conservative and this is often appropriate for small plans where costs may be heavily concentrated on a few individuals with ownership interests. The monitoring of gains and losses is quite a bit of work but it does give us a consistency check which helps to detect errors.

We use just about all actuarial cost methods. The individual entry age normal is the automatic option. We don't use unit credit very often. We use individual level premium in situations where the plan (and probably the business) may terminate when one or two important participants retire.

We complete the Schedule B for the plan and our enrolled actuary, who happens to be me, signs them.

Under the present rules, I think our procedure is a reasonably efficient way to meet the requirements for plans of this size. I feel that the do-everything approach is the best one. Our own people are probably the most

efficient people in the world at completing government filings for our particular plans. The people filling out forms know that in our plan the benefit provisions are in Section 4.1, the vesting provisions are in Section 5.1, etc.

The approach I have outlined is especially suitable for the small employer who does not want to spend a lot of time on his pension plan. It is not suitable for an employer who wants more involvement by himself or his advisors. For example, an employer who is interested in investments and may want to choose his own investments should not sign up for our group annuity contract. If he wants elaborate actuarial analyses to help him make choices about the plan, he probably wants the services of a consulting actuary and not the mass-produced, grind-'em-out approach that we use. But, if he wants to have a plan which was designed by qualified people to fit his needs, which operates at low expense, and which takes a minimum of his own time - the group annuity route is appropriate.

MR. WINKENWERDER: Thank you, Loyd, Our third and final speaker, Ed Forte.

MR. EDWARD T. FORTE: I am going to speak about self-insured trusteed plans where there are fewer than 50 lives, and primarily here, I am concentrating on the very small situation, in fact, less than ten lives.

In selecting this type of funding vehicle, the first question you ask is what type of company has a plan covering fewer than fifty lives. Our experience is that these fall into three categories: one, a professional corporation; second, a small, closely held corporation; and third, a medium-sized corporation where most of the employees are covered by a negotiated plan and so are excluded from coverage under this plan.

What are the objectives of the companies in establishing a plan? Tax shelter of income is the primary motivation in the professional corporation, and it is very important for the others. Plans are also adopted to discourage unionization. Third, there is the goal of providing retirement income. The objectives of the corporation will greatly influence its decision in the selecting of the type of funding vehicle. Where tax shelters are a primary concern, the flexibility associated with the self-insured, trusteed plan is most attractive.

What types of contracts and investment media are available? Basically, there are two types of contracts: an individual or a corporate trustee. An advantage associated with individual trustees is lower costs. Most banks or trust companies will charge between one-half and three-quarters percent of the assets that they hold as a trustee's fee. In addition, they quite often set high minimums so that for very small plans in the early years the percentage is much higher. A second advantage is the flexibility of investments. The individual trustee is limited only by the rules under ERISA, including the prudent man rule. A third advantage is the speed of valuation. Certainly an individual trustee can determine the value of the plan assets quickly at any time.

An advantage of the corporate trustee is employee confidence. Employees feel safer when there is a bank holding the funds. In addition, there is the aspect of the qualified fiduciary watchdog. The banks will monitor transactions and will not allow certain transactions to occur. Corporate trustees have the availability of the co-mingled investment funds; this

opens investment opportunities that are not otherwise available for very small plans. And, last, the corporate trustee will often provide the accounting services for the plan.

In the area of investment return, risk and guarantees, since virtually any type of investment is possible, the range of return and of risk is quite wide. If riskless return is wanted, the trustee could use an insurance company investment contract, or bank term deposits. If large potential gains are desired, 100% equity is possible, as well as many other types of investment. I think one of the strongest arguments in favor of a self-insured trust is the total flexibility, both with regard to investment selection and in the ability to change that selection at any time.

What about expenses associated with self-insured trusts? In general, the investment expense and the fund administration under a self-insured trust should be approximately the same as those under other funding media. We will see these expenses come out to be the same, unless some of the cost of administration is being absorbed in order to develop business. For example, under the self-insured arrangement, we might find that some administrative work might be provided at a low fee, in order to obtain the investment management of the assets. Similarly, an insurance company may provide some of these services in order to get additional insurance in force. But, basically, the expenses are derived from the same aspects, and I list six. They fall in the following categories: we have actuarial expenses, governmental reporting, recordkeeping of employee data, fund recordkeeping, investment fees, and trustee's fees. I contend that, basically, no matter what the funding media would be, these expenses are basically the same.

What are the effects of turnover, growth, or reduction? Size is not a material factor in the selection of the self-insured route. This type of funding vehicle is used from the largest plans to plans involving one life. High turnover will tend to increase the cost of operating the plan, since, quite often, in a smaller plan, they tend to have more rapid vesting and, as a result, termination benefits must be calculated. This funding vehicle is well suited to any size group; therefore, should the group grow or shrink in size, no change in funding vehicle will be necessary. We have several self-insured plans in our office covering one life. The effects of experience in a self-insured plan: Since none of the benefits are covered by insurance, all experienced gains and losses are immediately reflected in the cost of the plan. In most cases, annuities are purchased at retirement so that retired life experience is eliminated. These annuities are usually shopped on the market to find the best price. In very small plans which are centered around one or two lives, the impact of experience can have a significant effect on cost. This fact should be thoroughly explained to the client at the initial phase of the consulting.

Unless a prototype or pattern plan is used, the only limitation on plan design are the IRS and DOL rules and regulations, and the creativity of the individual designing the plan. One of the major factors influencing design would be cost: Is the cost of the plan to be held down, or is the client really seeking to obtain maximum deductible contributions? Second, the salary, age and service characteristics of the participants. It is possible that a defined contribution plan will serve a client's objectives best. In such a case, objective consulting becomes a matter of professional ethics. Third, in designing a retirement plan, you need to consider the corporation's other benefits. For example, are high

death benefits needed in the retirement plan or can they be provided elsewhere? Last, you need to consider whether the corporation will go out of existence upon the death or retirement of one individual. I think this characteristic is probably more important in the choice of the funding method than in the choice of the funding media.

In regard to administrative services, there are two approaches. One is what I label the "limited variation approach." Here, we would have a completely prestructured administrative system, incorporating restricted variability in major plan provisions, such as death benefits, form of retirement benefits, or retirement ages. We would have restrictions in the actuarial method and assumptions used. We would have prestructured forms and reports. We have limited or unique choice of a trustee and investment possibilities. Second would be the "tailored approach." Here, each case would be dealt with individually. In order to reduce the size of administrative fees, practitioners may tend to adopt the first approach, or one very close to it. The amount of tailoring will depend upon the client's wishes and willingness to pay for individual services.

In regard to the valuation methods, there are many alternatives available. However, in addressing the very small plans and analyzing their unique needs, we have determined the following four requirements of any method to be used:

1. Costs usually are required to be determined prior to the end of the fiscal year. This is especially true for cash basis taxpayers which comprise a large portion of these clients.

2. Costs should bear a direct relationship to the level of compensation during the year.

3. Gains and losses should be amortized by the time the principals are scheduled to retire.

4. Advance notice of extreme changes in the contribution is imperative.

In order to accomplish these, we have tended to use a variation of the individual level premium funding method, which uses the market value of assets at the beginning of the plan year, but uses either the actual or the approximate compensation for the plan year. This method seems to meet all the requirements above, although we have not yet determined what bearing the recent proposed regulations on deductions will have on the method.

MR. WINKENWERDER: Thank you, Ed. That completes the prepared remarks portion. I want to encourage questions or comments from the audience.

MS. PATRICIA M. ADAMS: This question is directed at Loyd. What do you do about taking over a plan when there have been no prior actuarial services? Do you provide back services for a fee, or do you refuse them?

MR. HOPPER: This has not been a great problem because we had a clean start in 1976. We have solved this problem on a case-by-case basis. It is going to become a worse problem, certainly, in the future, if a plan has not had any actuarial service since minimum funding requirements began. I do not have a good solution for it.

MS. ADAMS: I have one other related question and that is, when you take over a plan, and you try to get it to fit your valuation system, have you ever applied to the IRS for a change of cost method, or have any feel for how long that takes?

MR. HOPPER: The IRS seems to be very willing to issue a letter allowing you to make changes in the case of taking over a plan that either appears not to have had any prior actuarial work done on it, or if done, the method can't be determined.

MR. MARTIN STEMPEL: I would just like to have Ed explore a little more about how he handles the flexibility in plan design for the small cases, whether you tend to use standard plan designs, perhaps with a flat fee, or how you actually charge for the particular plan tailoring. This question relates to all three types of plans which Ed discussed.

MR. FORTE: At this point in time, we are still trying to tailor the plans to the individual situations. As a result, we are finding that our fees are sometimes large. In a professional corporation, because the contributions there are often, even for one or two individuals, over $100,000, as a percentage of the contribution, it does not look that bad. We hope to make some attempts to standardize certain provisions within the plan that have a direct bearing on the actuarial nature of the plan. If so then maybe we can effect some efficiencies in the actuarial aspects of it.

MR. WINKENWERDER: I might just second Ed's comments. I cannot speak for all of M & R, but I can speak for the Seattle office, at any rate. Virtually all the professional corporation plans that our Seattle office has are coming through law firms, where those plans have been essentially designed with the possible exception of the benefit formula itself. So, we do not have too much concern about that. But, with the other two types of organizations that Ed included in his comments, we have been continuing to use the tailored approach, and our services are most valuable in those areas. If the fee, which we can talk about in advance, seems too high, we can direct that party to some place where he can get a package plan approach.

MR. DARYLE G. JOHNSON: In describing the direct-rated, deposit administration contract, I believe Loyd said that, in the event of discontinuance, the funds could be transferred over a five-year period at book value. That is a relatively short transfer period, and I want to know what kind of interest is credited during the five-year payout period.

MR. HOPPER: We use the same interest rates which we use on other contracts, and you are right, it is a relatively short period.

MR. WINKENWERDER: I have a question for both Carol and Loyd. All of us, of course, whether independent consultants or insurance company actuaries, have been converting everything over to ERISA for three plus years. Loyd said his company has been operating at a loss in the group pension area. I want to know whether Standard changed its fee, or expense schedules in any fashion to try to recoup some of those additional costs. Now we have a new Social Security law which undoubtedly will require a review of all those plans that are integrated. We now have the Amendment to the Employment Act, changing the mandatory retirement age to nothing less than 70, which is going to require a review of all plans, and probably there will be

amendments to every plan. What are you going to do in terms of trying to recoup some of the additional costs?

MR. HOPPER: We did increase our expense charges. Under our old approach, we had an "initial expense" on a new case, and that was spread over the first six contract years, and then there was a continuing annual expense. In building our new contract charges, I took the idea that a plan is going to require substantial revision approximately every six years, and so we just continued the initial expense.

MRS. MARLER: At the time that I arrived at Beneficial Standard, the Pension Unit was in the process of taking all of our prototype plans and, as they came up for revaluation, submitting individual revisions to those plans to bring them into compliance with ERISA. Now we have a collection of plans that are, in effect, individually designed plans. They are so considered by the IRS, even though they follow the same pattern as our eventually approved prototype that we modified. This cost money. Right now we are using prototypes, and they have been put together in such a way that, hopefully, this will not come about again. We have in our compensation agreement a provision that allows us to charge more when the plan is first installed, or whenever it is revised. The rate is simply a flat amount plus a per-participant charge that grades down as the number of participants increases. We did not charge all of our clients the full cost of what we did for them -- in fact, in most cases, we just charged it to overhead, saying we are learning how to conduct pension business properly.

MR. JOHN D. KIRKMAN: My question is directed also to Carol and Loyd. Both of you mentioned that you were in the process of developing, or had developed and are maintaining, in-house computer systems to provide such services as proposals, valuations, Schedules B and maybe annual benefit statements. I had wondered whether or not you have made a commitment to doing these things in-house and, if so, whether or not you have rejected out-of-house facilities to provide those same services, and what the reasons might have been.

MRS. MARLER: We had gone through a couple of situations where Beneficial attempted to use a consulting or package program and, in both cases, the expenses that we were being charged seemed to be out of line for the services we were receiving. The chief actuary at Beneficial is a great proponent of the IBM 5100. He appeared in some full-page ads in the Wall Street Journal and his basic approach was, "We can do it here more cheaply and more efficiently;" therefore, we are committed to doing it this way. I think that we are really providing a system that will do the kinds of things that our plan needs without providing all the bells and whistles that have nothing to do with the options that our clients need.

MR. HOPPER: In our case, we have a fairly satisfactory valuation and proposal system now. It has evolved over the years, starting when we got a 1401 in 1964. It works pretty well. There are some package systems available that could replace it, perhaps give us some additional capabilities, but the valuation and proposal portion is not a big problem. The problem is the benefit accounting and benefit statements, and I am not aware of any packaged general systems for doing that. I am interested in knowing if any of those exist because we are, right now, figuring out how to solve that problem.

MR. HARRY GROSS: With the small plans where cost is such an important consideration, what are the general procedures with your respective organizations, as to whether annual valuations are performed, or perhaps just triannual valuations are performed? If annual valuations are not performed what procedures are used to estimate the cost in the intervening years, and in filling out the Schedule B?

MR. WINKENWERDER: I am an advocate of annual valuations, and it is certainly not related to the additional work and the fees that are generated. If you do valuations on a less frequent basis than annual, you are probably going to end up with just about twice the fee as for doing the individual valuations because of the increased recordkeeping. For small companies, our experience has been they are difficult to deal with; they are not learned about pensions; the data is difficult to gather and it is hard to get proper answers. The longer you wait to gather that information, the more headaches you have.

MRS. MARLER: Beneficial is committed to doing annual valuations as well, and our retention agreement says that we will provide on an annual basis the valuation and other reports for primarily the same kind of reasons that Wink mentioned.

MR. FORTE: We are providing benefit statements and benefit accounting. At present, that is tied in with the valuation system, and you must do that every year -- you cannot wait three years and pick up all the salaries and calculate accrued benefits. So, we provide an annual valuation, too.

MR. WINKENWERDER: We do very little work with plans that have individual policies or individual annuities. But we did have an opportunity to work with some companies in redesigning prototypes as a result of ERISA, and it made me aware of some problems that insurance carriers have on individual policies that perhaps many consultants are not aware of because they do not deal in that type of plan. In the old pre-ERISA days, when you had individual policies, those policies were typically being issued annually on an anniversary date, and now, with the eligibility requirements of ERISA, it seems as though that sort of approach is no longer possible unless you went into some full immediate vesting. You almost had to direct attention to at least semi-annual entries into the plan and, if that be the case, would you issue policies semi-annually?

MRS. MARLER: In our prototype, we use the nearest anniversary approach which allowed us to get around that problem. A person who retired, for example, three months after the anniversary would be considered to be a participant from that prior anniversary, because it is the nearest anniversary. The insurance provisions of the prototype are pretty complex, but they do call for purchase of insurance policies only on anniversaries, so that some participant might wait nine months before getting the insurance coverage, and we did not run into any questions from the IRS at that point.

MR. WINKENWERDER: We handle a number of professional corporation plans. These are all level individual funding to retirement to make sure that all that is withdrawn from wages goes directly into that particular person's pot for payment at death, retirement or termination. One of the attorneys with whom we work in designing these plans was concerned about that, and so we attempted to get by IRS Seattle an accrued benefit definition that would incorporate two things. It would be one of the ERISA accrued

benefit formulas, modified to provide that, in the event the person's accumulated contributions exceeded the accrued benefit, the accumulated contributions would be the accrued benefit. IRS would not accept it, so it is definitely possible now, under the professional corporation plans that we are handling, that one of two things can happen: (1) a person could terminate prior to retirement, and not get back in the form of a benefit as much as he had had withdrawn from his wages; or (2) that he might get back more than he had put in, which means he is getting monies from the fund that were put in by his partners.

MR. FORTE: The only solution we can come up with is that agreements outside of the pension plan can be made between the individual and the firm, so that upon this type of termination, he would be made whole. In some cases, he might have to reimburse the corporation for the additional amounts that went in. This produces one other problem which has recently come to light. You see a situation where an individual left and received an amount of money that was substantially less than was contributed "out of his salary," resulting in a large gain to the corporation. The side agreement would call for a payment to the individual of that amount of money. We are faced with the problem of trying to work out a method that would allow the corporation to reduce its contribution in that year in the amount that is being paid to the participant who is terminating; in other words, taking a direct reduction in the contribution for essentially the forfeited amount.

MR. WINKENWERDER: Let me raise another issue about professional corporations. These people generally make considerable sums of money, and the contributions to the plan, although there may be only a handful of participants, can be well into six digits. We have a number of these where they make such substantial sums that they have a projected benefit that exceeds the current ERISA maximum in a defined benefit plan. As I understand it, you cannot fund for and take a deduction for the portion of a projected benefit which exceeds the maximum. And, if you do not fund for the whole benefit, it causes rapidly escalating costs as you go on in years. These are generally final pay plans, the pay goes up, the ERISA maximum goes up and you continue to squeeze into a shorter and shorter funding period those additional benefit amounts. Have you faced the same issue, with the same conclusion?

MR. FORTE: That is correct. We have come to the same conclusion that you cannot fund for them. We have shown the same demonstration and, in fact, have demonstrated it recently to some IRS officials. They do not seem too concerned about it, even though you can point out that, later on, they would be losing tax revenues because of the greatly increased required funding. I think they figure that, sooner or later, they will have overall deduction limitations that would eliminate these large deductions in future years, so they do not seem concerned about the problem.

MS. ADAMS: With regard to the ERISA maximum defined benefit, how do you reconcile the IRS saying you cannot fund for it in determining the maximum deductible contribution with the requirement that the assumptions be reasonable in complying with minimum funding standards. Have you ever considered using it in the minimum and not in the maximum?

MR. FORTE: We considered it, but came to the conclusion we could not do it.

MS. ADAMS: Yes, sometimes they crisscross.

MR. STEMPEL: With respect to the funding issues that you just raised, isn't it possible, or even likely, for a professional corporation to have substantially lower normal retirement ages and fund to a higher benefit cost, even if the maximum benefit is still paid, or have the normal form of benefit be a joint survivor type of benefit.

MR. FORTE: In most of the professional corporations where we are trying to maximize it, we are using that approach and apparently, initially, the IRS was resisting retirement ages earlier than 65, unless there was a really valid reason in the profession -- it seems to me that they have backed off of that and are allowing it. The normal form is almost always a joint full survivor. I have some questions in my mind as to how those benefits will eventually be paid and whether, at the time of payment, they will not exceed 415 limitations if you tried to pay a lump sum that is equivalent to a joint 100% survivor benefit, but we are trying it.

MR. WINKENWERDER: Carol, you mentioned in your remarks that you are using current annuity purchase rates for your funding basis, and my immediate reaction is that the current annuity rates tend to change frequently and, if that be the case, what happens to your funding levels?

MS. MARLER: The last time we established a new set of current annuity purchase rates, we said that they would change from time to time, and that was about eighteen months ago.

MR. WINKENWERDER: You apparently do not anticipate it to be a problem?

MRS. MARLER: No, we tend to be fairly conservative in setting our current rates, and so they do not move rapidly. They do recognize changes in the investment climate, and I would say we probably would be making a change, on the average, once a year, but it would not be a rapid fluctuation. It would be a modification.

MR. WINKENWERDER: One thing that I am waiting to be faced with from IRS, and I am sure we will be, is an audit of a professional corporation regarding the appropriateness of the actuarial assumptions being used. The bulk of our PC's are handling their own investment, and the rates of return vacillate wildly from year to year. You might have a minus 18% and the next year a plus 27%, and then you get a plus 15%, and minus 8%. I know we face these kinds of things in much larger plans, too, but it seems not quite to the same degree because of the types of investments these people generally use. As a consequence, I stick with 5%, 5½%, maybe up to 6% on these kinds of cases. I do not know what reaction IRS is going to have.

MR. FORTE: We're using between 5% and 6%, and we have not had an audit yet, but I know what you mean. I have asked, in most situations where a consultant other than an actuary has been involved in the initial contact, that he thoroughly explain to the client the effects of these fluctuations and what they will do to the cost of the plan. If the individual knows the results of the fluctuations, he may tend to be more prudent in his investment and keep the range narrower.

MR. WINKENWERDER: I want to ask Ed one more question. You talked about trustees and you talked about the pros and cons of individual trustees versus corporate trustees. I have been more conservative and I am strongly advising all of my clients, even through an intermediary, to avoid the

individual trusteed approach because of the potential liabilities. Does your firm not share that same feeling about fiduciary liability?

MR. FORTE: We share your concerns, but, usually in a situation of a PC, you are really talking to the principals and the ones that have the most money in the funds, while the other employees have rather minor amounts. I think fiduciary responsibility does not worry me as much when the fiduciaries are dealing with their own funds.

MR. WINKENWERDER: Perhaps there is a difference between the recommendations or comments relative to the individual trusteeship, of a professional corporation versus one of the other two types of groups we have discussed.