RECORD OF SOCIETY OF ACTUARIES
1984 VOL. 10 NO. 4A

UNITED STATES EMPLOYEE BENEFITS— CURRENT DEVELOPMENTS

Moderator: F. JAY LINGO. Panelists: GREGORY A. DELAMARTER, VIRGINIA S. OLDS. Recorder: DENNIS J. GRAF

- Fringe Benefits Taxation
- Recent Legislation Impact
- Financial Accounting Standards Board
- What Should Actuaries be Doing?

MR. F. JAY LINGO: There are two individuals who are going to help me this morning to discuss the employee benefits issues, especially those issues that have been raised in the last year or so. Greg Delamarter is going to be discussing the pension aspects of recent Financial Accounting Standards Board (FASB) proposals and the pension aspects of the Deficit Reduction Act. He is also going to make some comments about the recent EEOC position on accruals under pension plans after normal retirement and on the IRS Guidelines for reasonable actuarial assumptions.

Ginny Olds is going to talk about some of the provisions of the Retirement Equity Act and, in particular, some of those areas that are more important - those that are going to cause plan sponsors more problems than others.

I am going to wrap up the presentations here this morning discussing first the legislative outlook for employee benefits in Congress and, if there is time remaining, some of the health and welfare issues of FASB and the Deficit Reduction Act.

MR. GREGORY A. DELAMARTER: I will begin by discussing the Deficit Reduction Act of 1984 (DEFRA). It is obviously impossible to discuss in detail the whole scope of even the retirement aspects of the Deficit Reduction Act. I am going to concentrate on some sections which I feel are probably most important.

First of all, the Deficit Reduction Act has made some changes to Section 415 of the Internal Revenue Code. Under Section 415 the $30,000 and the $90,000 limits were extended for an additional two years; that is, indexing will now begin in 1988. For key employees, the $200,000 compensation limit is tied to the same indexing procedure as the $30,000 and the $90,000 limits. Consequently, that $200,000 limit will also then be changing starting in 1988 rather than in 1986. There is one other place where there is an impact. If you are dealing with any excess benefit plans where you project the Section 415 limits, more of the benefit will have to be funded currently in this excess benefit plan than was the case previously.

Let's move to top heavy plans. The first thing that happened here was the redefinition of a key employee. Key employees, as the prior law stated, had to be participants in a plan. Now the definition has been changed so that key employees are employees, not necessarily plan participants.

For officers, the old law said that if you were an officer that you might be a key employee. The new law says that if you are making less than 1-1/2 times the annual addition limit ($30,000) you will not be a key employee. In addition, the top 10 stock owning employees, or those who are considered as owning the stock, were considered as key employees. That has also been changed so that not as many people will be included as key employees. Only if compensation is in excess of the Section 415 limit (the $30,000) would a person be a key employee. If there are more than 10 people the tie goes to the highest paid employee. If you have more than 10 people who own stock and have the same amount of compensation, then you could conceivably have more than 10 people who were key employees in that situation. This change is effective for 1984 plan years. To the extent that language has to be in your plan, the plan is going to have to be amended. I suspect that for many of us, the fact that we have been waiting for the final regs to come out on top heavy is going to make this job a bit easier.

There is a rule now that says that if an employee is gone for more than five years with no compensation, then his employee account or accrued benefit will not be included in the test even if that account still exists. Under the prior law, if distribution of his account took place more than five years ago, then you could exclude him. But now, if he or she was an employee more than five years ago but has not been for the last five years, then you can exclude that person's accrued benefit in determining if you have 60% or more of the accrued benefits belonging to key employees. This is only effective starting with 1985 plan years. You are going to need the old language for 1984, new language for 1985. There are some other things as well with regard to terminating plans. Where a plan was terminated within the last five years, if you would have needed to include the present value of benefits or the account balances were the plan still in existence, you will still need to include those. The distributions will also need to be included.

As regards 401(k) plans, prior law excluded 401(k) contributions for determining the minimum benefits payable to non-key employees. Now you will need to include those 401(k) contributions. The law has also made it clear that government plans are not included in the top heavy provisions. There was some question about this before. The law now specifically excludes government plans from the Section 416 requirements for top heavy plans.

The law requires the IRS to issue final regulations on Section 416, or if they don't issue final regulations by the end of 1984, then they have to provide some general plan language. The general language can be relied upon and it can be put into the plan until such time that the final regulations come out. If the IRS does not issue this general language, then the language can be incorporated by reference. There is one item, however, that we need to be aware of. If you incorporate by reference and don't include a specific provision, say for vesting, then each employee gets the best vesting that could apply to him. You may want to look carefully at that before you suggest language adoption for your clients.

Perhaps the most complicated portion of DEFRA is in the area of plan distribution rules. The pre-TEFRA distribution rules said that monies had to begin to be paid out by the time that the employee reached age 70½ or retired (whichever was later) unless he was an <u>owner-employee</u>, and the monies had to be paid out over the lifetime or expected lifetime of the employee or the employee and his spouse. Under TEFRA, this was changed so that again it was 70½ or retirement unless it was a <u>key employee</u>, with the same pay out period requirements, that is the life expectancy or the lifetime. If it were a death benefit we were dealing with, then benefits had to be paid out within five years if they had not already commenced, unless the annuity was payable for a period certain or a joint survivor annuity with the spouse. DEFRA came along and effectively repealed that particular section of TEFRA back to the effective date of TEFRA. Theoretically, we are now back under the old owner-employee restrictions for age 70½ or retirement, saying that the owner-employee is going to have to start drawing his benefits out at age 70½ whether or not he is retired. Of course, they did add a caveat that basically said that you would not disqualify the plan if you had done something like that for pre-1984 designated distributions. DEFRA added its own provisions effective for 1985 and later plan years, except that for government plans these provisions don't take effect until 1987 plan years.

Basically the DEFRA distribution requirements are as follows. First of all, benefits do not have to commence until the April 1 following the later of attainment of age 70½ or retirement unless you are a 5% owner. If you are a 5% owner, benefits must commence by the April 1 following age 70½ regardless of retirement status. There is an exception for PAYSOP and TRASOP amounts which, as you may know, have an 84 month requirement. They must be in the plan for 84 months and even for 5% owners that money doesn't have to be paid starting at 70½ if it hasn't been in the plan for 84 months. The payout period has been changed. Benefits are to be paid out over the lifetime or the expected lifetime of the employee or of the employee and a designated beneficiary, not necessarily the spouse.

For death benefits we had the old five year provision under TEFRA. If the benefits have already commenced, DEFRA says that the payout must continue in at least as rapid a fashion as it was when it originally started. If the benefit has not yet commenced, then the funds have to be paid out over a five year period with a couple of exceptions. Those exceptions deal with designated beneficiaries and with surviving spouses. The surviving spouse can wait until the employee would have been 70½ and can begin to draw the benefits as late as that.

There is another new thing called a life expectancy recalculation. You can annually recalculate the life expectancy over which you have to pay out a benefit, but only for the employee and the spouse, not for the designated beneficiary. Another feature says that the benefit can go to a child until he reaches majority or such other age as defined in regulations and then can go to the spouse. As far as the law is concerned, that is a benefit that was going to the spouse the whole time. That allows you to have a situation where a designated beneficiary is the child and yet still provide for the spouse after the child has reached a later age. These rules also apply to IRA's, both the individual retirement accounts and the individual retirement annuities as well as to retirement plans. They don't affect collective bargaining agreements until 1988 plan years or the expiration of the contract if it is sooner.

There are some other distribution rules with regard to employee plans where 85% of the contributions are made by the employees in a representative period. Under those circumstances, the interest earnings are deemed to be withdrawn first, not the contributions. It will be fun keeping records for those of you involved in that. The Federal Government, incidentally, can aggregate plans in that particular type of situation for determining whether they have 85% employee contributions.

Other changes have been made with respect to partial distributions. You can now have a rollover of a partial distribution under certain circumstances. Under prior law you had to take the entire balance out and then you could roll some portion of it over. Now you will be allowed, under certain circumstances, to take part of your money out and roll that over. This affects retirement plans, annuity plans, and 403(b) annuities, but you can only roll them into individual retirement type of plans. You cannot roll them to another plan or 403(b) or 403(a) kind of situation. You can do this if you withdraw at least 50% of the balance to the credit of the employee account in that particular plan. You do not have to aggregate plans. It is merely a matter of taking at least 50% out of that particular plan. It cannot be part of a periodic distribution. You have to elect a rollover in accordance with regulations. There are some problems. If you make this rollover you lose the 10 year forward averaging on any future distributions from all aggregated plans of that type. So the remaining 49% or whatever is left in the account of that plan, plus any plans of the same type, will lose the 10 year averaging in the capital gains treatment. Also, in that particular distribution, you lose your unrealized appreciation special treatment although you can get it for future distributions. In the event of employee death, the spouse has the same options available. Incidentally, the penalties which used to apply under the law, the 10% penalty tax for early withdrawal for key employees, now applies instead to 5% owners, whether or not key employees.

Another item that has been changed is that the estate tax exclusion which was available under IRA's and qualified plans is gone, although for community property agreements the law does allow you to make sure that half will not be taxed at the time of the spouse's death.

There have been some changes in the 401(k) plan area. The 1/3-2/3 test is now required whereas before it was an option. Prior law said that you would be considered to have passed it if, indeed, you used the 1/3-2/3 rule, it was a "safe harbor." The new law says that if you are going to have a cash or deferred plan you must use the 1/3-2/3.

One other change is that medical benefits under pension plans are going to have to be counted in some situations against the Section 415 limits.

Next, I would like to discuss the Financial Accounting Standards Board (FASB) proposals. In 1982 the Financial Accounting Standards Board released its Preliminary Views dealing with the net pension liability and intangible asset items which they were suggesting should be included on corporate financial statements. After this was done in November 1982, they released a second Discussion Memorandum, released some field test results, and then held some public hearings in January of 1984. There were a number of presentations made, including a few by actuaries, and most of them were against the balance sheet treatment for a number of reasons. A few examples: some people felt that the proposed liability wasn't really a liability. They felt that the net pension liability could be quite volatile especially because of the impact of asset market value fluctuations. Others suggested that intangible assets are not conventional assets, the reporting is too complex for financial reporting purposes, the length of the required explanation outweighs the relative value of the information presented. Some objected to the limitation to one cost method, or that the amortization period was too short. There were a number of participants who suggested other possible alternatives. Since that time the Board met and reconsidered a number of things. They decided to separate the nonpension post-employment benefits from the pension project, but these will run concurrently, thus allowing proper weight to be given to each study.

In an April 1984 meeting the Board agreed that fewer cost methods, rather than unlimited choice of cost methods, was desirable and that the Measurement Valuation Allowance, the intangible asset amortization for expensing purposes, should be related to the characteristics of the group. There should not be some arbitrary period like 30 years or anything like that. More recently the Board has tentatively concluded that a single cost method really is most appropriate. They have not defined the method and have backed off a little from the Preliminary Views where the projected unit credit cost method was the one that was stated. They have discussed projected unit credit and also a new one called cost compensation. The cost compensation method is apparently some sort of entry age normal method.

They also, apparently at this point, have decided that the net pension liability, as it was defined under the Preliminary Views, should not be a balance sheet item. However, some other kind of item may be a balance sheet item. Perhaps the unfunded vested benefit as determined for FASB 35 purposes or something like that might be included instead with the possible recognition of excess plan assets in some fashion. They have also done some things with the amortization period. Depending on which cost method is used for expensing they may change the amortization method to comply with whichever approach they eventually decide on.

The exposure draft is expected out before the end of this year. There will be a comment period during which actuaries and others can respond so you may want to get a look at that exposure draft and make sure you can live with it. The statement itself is expected to be issued by the end of 1985.

The Government Accounting Standards Board (GASB) is a new organization which started in the last three or four months sponsored by the same organization that brought you the Financial Accounting Standards Board. There is some interesting history behind this, which adds some perspective to where this organization comes from. Governmental questions had often been handled by the National Council of Governmental Accounting (NCGA) which was basically put together by the Government Finance Officers Association. Whenever they had an issue that they thought was specific to government plans, NCGA would deal with it. At the same time, FASB was also concerned about government plans and was occasionally issuing statements that had to do with them.

When FASB 35 was adopted, it was made applicable to government plans. The NCGA had a problem with this. They had some disagreements with FASB 35. For example, they did not like market value because they believed book was more appropriate in many situations. They also believed that there should be salary projection whereas FASB 35 did not require salary projection. So the NCGA issued Statement No. 6 and told government plans that they had to abide by that. Here there were two conflicting statements and somebody had to give and nobody wanted to give. Eventually it was agreed that a new independent body should monitor government issues and hence GASB was born. Both FASB and the NCGA backed off from their initial positions. They have now set up an agenda for the future. They are allowing FASB 35, NCGA 6, or an older NCGA 1 to be used for pension matters. GASB has set some priorities including a Project Five, on pension disclosure and reporting, which reviews the idea of pension benefits obligations on the employer's balance sheet. The exposure draft is due out in the first quarter of 1985. The statement is due out the third quarter of 1985.

I want to briefly mention that the EEOC is apparently going to issue regulations soon which are going to require the accrual of benefits and contributions past age 65. They are going to reverse the position that they have taken for the last several years. Regulations aren't in proposed form yet but are about to be circulated to the Labor and Treasury Departments. They will apparently not affect "30 and out" type provisions, but only those provisions which were directly impacted by age 65 requirements. They would most likely apply prospectively.

I have one more thing that I want to discuss. It's called an Actuarial Assumptions Worksheet. It is Document 6904 from the Internal Revenue Service and it's new. It asks questions such as "Were the employer contributions made within the prescribed time?" "Has Form 5330 been filed (if you have an accumulated funding deficiency)?" Now we get some interesting questions, in reviewing the entries in the funding standard account. For example, "Do the amortization bases and amounts appear to be correct?" (Now remember that this is for an auditor. They are not for you the actuary to fill out.) "Does the net of the Section 404 umamortized amounts (balance of the 10 year bases) minus any undeducted contributions, equal the unfunded liability?" "Is the deduction not greater than the full funding limitation?" (Could you do that before you became an actuary?)

"For all funding methods except Aggregate (Modified Aggregate, Individual Aggregate, etc.), complete the following questions to determine whether the balance equation is satisfied as of the valuation date." For example, "If the method is a unit credit method and the plan benefits are based on final average pay, does the benefit considered accruing in any year satisfy the regulations?" All kinds of interesting things here. Then there is a six-column reasonable actuarial assumptions worksheet which says for each of six different periods - beginning of period being analyzed, end of period being analyzed, valuation date within period, and then goes through and analyzes the experience gains and losses of various kinds. For example, for spread gain methods, accrual rates - line (a), line (b) - PVFC or other factor. (I assume that is present value of future compensation but I question whether I would have known that if I hadn't spent some time studying the subject.)

I suspect the mathematics of all of this are probably right, but my concern is whether someone who has not gone through the rigorous training to become an actuary is going to understand this material. I suspect that what is going to happen is that people are going to come to the actuary and ask him to fill this out. I might want to begin reviewing some of my documentation procedures so that if this does become something real serious in the years ahead, at least I know where I can get the numbers if I need to help somebody fill this out.

MS. VIRGINIA S. OLDS: Unlike Greg, I have only one topic to discuss, the Retirement Equity Act of 1984, (REA). It was designed primarily to accomplish two goals - to assure that women will be more able to earn retirement credits during their child raising years, when their careers may be interrupted, and also to assure that surviving spouses will have a better chance of sharing in their spouse's retirement benefits. Since it amends ERISA, REA does not really have an impact on government plans nor on non-ERISA church-related plans. Today I will go over the basic ideas that are in the Act, addressing some questions and introducing others, and go over some of the impact it has on us and our clients.

The eligibility age for participation was decreased from age 25 to age 21, or from age 30 to 26 for certain tax exempt educational institutions. The effective date for this and for all the other provisions, unless I specifically say otherwise, will be for plan years beginning after 1984. For collectively bargained plans the effective date is the plan year beginning after the earlier of December 31, 1986, or the expiration of the last collective bargaining agreement in effect on August 23, 1984.

The participation eligibility rules apply only to accruals after the effective date, so you do not have to go back to pick up accruals for people who did not come into the plan until 1985. Because of this the ultimate cost of the plan increases, since up to four additional years of service would be used in calculating benefits. For plans not using the rule of 45 for vesting, the eligibility age has been dropped from age 22 to age 18. This provision is retroactive for those participants who have an hour of service after the effective date. These two provisions seem to create no special problems. Their cost impact on a plan is very slight, if any at all. If you are administering a plan that requires a change in vesting age, slight modifications to some data or to the computer programs might be necessary.

The next three provisions I am going discuss, breaks-in-service, joint and survivor benefits, and domestic relation order payments, will cause cost increases and primarily administrative changes and costs.

The Rule of Parity for break-in-service has been changed so that any participant who has a break-in-service with less than five years of service must have that service restored if he returns within a five year period. (The plan can require one year of post-break service before restoring the pre-break service.) This provision will require administrators to leave terminated participants on the records for a minimum of five years. In addition, suspense accounts for defined contribution plans will have to be maintained for five years. Regulations dealing with taxation of lump sum distributions for partially vested participants will need to be changed. Also, lump sum distributions can now be repaid to the plan up to five years from the date of distribution as opposed to one year under prior law. The actual increase in costs for benefits to the plan should be minimal, if any, since the majority of participants in most plans do not return to work after breaks-in-service. This provision is not retroactive. If a participant loses his service before the effective date, it cannot be picked up at a later date. If the parity date has not been reached as of the effective date, however, the new provision will become effective.

If a participant is on maternity, paternity, or adoption leave, they will receive credit up to 501 hours for the service they would have earned during that time. These hours do not count toward vesting or benefit accrual, only toward preventing a break-in-service. These hours are credited in either the year the absence begins or, if needed, in the following year.

A joint and survivor benefit provision applies to all defined benefit plans and most defined contribution plans (unless they allow only lump sum distributions, are not transferee plans, and provide for automatic payment of vested benefits to the spouse on death of the participant). Unless waived, all vested active and inactive participants must be provided a minimum of a 50% qualified joint and survivor annuity. On commencement of benefits to a participant, a qualified joint and survivor benefit of between 50 and 100% must be provided unless waived. On death of either an active or inactive vested participant, a qualified pre-retirement survivor annuity must be provided. The latter is payable on the date of death or, if later, on the earliest date he would have been eligible to retire. These benefits must be provided unless waived by both the participant and the spouse, if they are provided by the plan at cost to the participant.

For a qualified joint and survivor annuity, the waiver must be provided within 90 days before the date the benefit payments commence. The participant and spouse may also revoke a waiver during this time. Within a reasonable period of time before the annuity starting date, the plan must provide to the participant the terms and conditions of the joint and survivor annuity, the right of election to waive or revoke a waiver, and the spouse's rights. For a qualified pre-retirement survivor annuity the participant must be allowed to waive or revoke the waiver from the earlier of the first day of the plan year he reaches age 35 and the date he terminates with vested benefits, until his date of death. The plan must provide a written explanation to the participant during the period covering the plan years in which he reaches age 32 and age 34. So you must notify participants of their retirement rights much earlier than was true in the past. In order to be effective, the waiver must be signed by the spouse, and either witnessed by a notary or the plan administrator. It would seem reasonable that a notary be used, as most administrators would not want the added responsibility of proving that the person signing the form was actually the participant's spouse. The waiver is also effective if there is no spouse or if the spouse cannot be located, or for other reasons that the Secretary of Treasury decides upon regulation. As before, the cost of providing this benefit may be passed on to the participant through a reduction in benefits. Studies are also being done on using term costs for the pre-retirement benefits.

These new requirements may create administrative problems and additional benefit costs for the plan. If a plan is currently paying for the pre-retirement survivor's benefit, the change in eligibility for the benefit will have a very small impact on cost, probably not more then one or two percent. This is primarily due to the fact that the benefits will be very small when a participant dies before being eligible for early retirement. If the plan decides to change from employee paid to employer paid pre-retirement benefits in order to avoid the administrative costs of obtaining and retaining waivers, the added cost would be greater, perhaps in the five to six percent range. It depends on the demographics of the plan. Most plans now provide that participants pay for the qualified joint and survivor benefit at retirement through the use of actuarial reductions. Will the cost to the plan sponsor due to additional administrative problems of obtaining waivers, determining current marital status, and trying to find spouses, etc., be worth the savings in benefit costs?

One way to lessen the impact of the pre-retirement spouse benefit may be to cash out benefits if the present value is less than $3,500. This applies to vested terminated participants. If the lump sum is paid, cost of maintaining participant's records, along with the PBGC premiums for them, will be eliminated. Cash outs of $3,500 or more, however, require the consent of both participant and spouse.

Effective January 1, 1985 (this is a different effective date), plans must be amended to allow payments pursuant to a qualified domestic relations order. This allows payments to an alternate payee for provision of child support, alimony, or marital property rights. A plan must not be required to provide any form of benefit or option not otherwise provided by the plan. In addition the plan cannot be required to provide actuarially increased benefits. Payments can begin to the alternate payee prior to the date that the participant actually retires, but they cannot begin prior to the earliest retirement date under the plan. If the order involves receiving payments before the date that the participant receives payment, any early retirement subsidy does not have to be paid to the alternate payee.

Statements required to be given terminating participants with vested benefits must include notice of any benefits which are forfeitable due to death before a certain date. This would primarily apply to people who have waivers in effect or to people who are unmarried at the time. There is some question whether this statement also has to be given to active participants who request information. In addition, a written explanation of how a roll-over to an eligible retirement plan would defer tax and how the distribution would be taxed if there is no roll-over must be provided.

The last provision I'll discuss extends the rule - that a plan amendment may not reduce accrued benefits - to any early retirement benefit, retirement type subsidy, or optional form of benefit with respect to pre-amendment service. This does not apply to benefits payable only during a "window period." Changes can be made to future benefit accruals. This provision is effective for amendments adopted after July 30, 1984.

The major impact on costs caused by REA does not appear to be from plan design changes but more from greatly increased administrative costs. Earlier participation may initially increase costs but will have little, if any, impact on long term cost due to high termination rates at the younger ages. The same is true of the decrease in vesting age, however there will be increased administrative charges because more people will be added to data roles and PBGC premiums, if it is a defined benefit plan, will also have to be paid for these people.

Break-in-service, survivor benefit, and domestic relation provisions all seem to generate great administrative problems. Records must now be kept for five years, including suspense accounts for breaks-in-service. With suspense accounts you get into allocating forfeitures, or holding them for five years, and if you hold them for five years, what happens to those people who terminate during that five year period? That seems to create many administrative problems.

Spousal information must be maintained, including waivers and any alternate payees that are entitled to future benefits. Plan sponsors will have to keep track of who is married, who is not married, who has waivers on file and the process to go about finding people. The initial problem of obtaining waivers for every active and terminated vested participant may seem overwhelming to some plans. Additional forms and procedures must be designed. Questions will arise as to how to find a spouse and how much needs to be done before this spouse is said to be unlocateable under the law. The question of each state's definition of common law marriage may also come into play in determining who is married and who is not married.

In addition to records for participants, you have to set up additional records for alternate payees. Keeping track of participants who leave with a vested benefit is not a major concern at present. Form SSA is filed and at age 65 you make an effort to find the person. Since these people are now eligible for a pre-retirement spouse's annuity, unless waived, what is the plan's responsibility to these people in regard to maintaining closer contact to make sure the benefits are paid?

We have just completed amending or restating every plan due to TEFRA and other amendments. Because these new rules are effective almost immediately in 1985, we are going to have to go back and make major amendments to every plan again.

MR. LINGO: From the comments that Greg and Ginny have made you can see that the employee benefits area has undergone a great many changes in the last year. It is becoming increasingly difficult for plan sponsors to grasp what is going on. Many of them are upset with this situation and I am afraid that the near future doesn't look any better in terms of reduced legislation in the employee benefits area.

One of the areas in which we may face some change is the Medicare area. It is perceived that we are running into financing problems with the Medicare program. There are alternatives available to help solve this situation. One possibility is to make Medicare a secondary payor to other programs, such as was done as a result of TEFRA, which made Medicare secondary to other programs for active employees over age 65. This could possibly be extended to retirees as well. It has been recommended that the minimum age requirement or eligibility requirement for Medicare could be extended to age 67 or 68 as it has been for retirement benefits under OASDI. Bob Myers is in the audience and hopefully in the question and answer session Bob will be willing to discuss his perspective of what might happen in that area.

Congress, through some of the committees and forums that are being sponsored by these committees, has been holding some hearings on the 10th anniversary of ERISA, discussing ERISA's effectiveness and what needs to be done in the future. One of the common threads that have been coming out of these discussions is that ERISA has been effective from the standpoint of protecting participant rights, providing minimum funding, providing minimum benefit accruals and vesting, at least in the retirement area. One of the weak points of ERISA has been the paperwork involved, both on the welfare and on the retirement side, and also that the regulation of the ERISA has been accomplished through three different government agencies, Department of Labor, Treasury and the PBGC. This has caused some confusion in understanding who regulates what areas. There has been quite a bit of discussion of the need to incorporate the regulation of ERISA and other laws into one agency rather than by having multiple agencies conducting the regulation of these laws.

Some people feel that ERISA and even the Retirement Equity Act have not gone far enough in protecting benefit rights, minimum benefits, vesting and so forth for plan participants. I have been in the work force since college for 13 years. I have worked for three employers, two of them major companies and so far I am not one percent vested in a pension benefit. My situation is probably not unusual. We find many people switching jobs, especially in the early part of their careers. Should there be some better provision for today's increased work force mobility?

ERISA, of course, dealt with welfare plans as well as retirement and pension plans. The Deficit Reduction Act of 1984 (DEFRA) has directed the Treasury Department to undergo a study of the minimum funding, vesting and accrual rules with regard to welfare plans.

Another area where we are very likely to see some legislative activity is pension plan terminations. We are almost certainly going to see an increase in PBGC premiums. There are bills that would increase the PBGC premium rate to $7 or $8 per participant. There has been some pressure to base the PBGC premiums on the funded position of the various pension plans. This makes some sense. Why is it proper for a pension plan that has all the termination liabilities funded to have to continue to pay PBGC premiums, especially when they start jumping from $2.60 per participant to $7 or $8. For many plans this is going to be a significant expense. There has also been some support for the PBGC to start insuring benefits on a different basis. Instead of insuring benefits in a plan termination situation, they could insure against insolvency of the employer. This possible scenario comes about in part because of what has happened in the multi-employer plan area where 1980 legislation was passed which changed the PBGC basis for insurance to one in which they were insuring against insolvency rather than termination. One of the features of this program is that if the PBGC takes the multi-employer route, the payments that are made by the PBGC will not necessarily be forgiven. If the employer later on has the ability to repay these PBGC payments, then the employer will have to repay them.

One interesting piece of legislation has been developed, although I don't think it has been introduced yet. Developed by Representative Edward Roybal of California, the provisions of his legislation would do several things. It would prohibit reversions to the employer in the event of plan termination, except in the event of financial distress of the employer. Also, the employer could not set up a comparable plan, meaning a defined benefit plan, within five years. There would be some sort of excise tax, perhaps 10% on any amounts that revert to the employer, and there would be a reduction in the limit on employer securities that could be part of the pension fund. This would be reduced from its current 10% level to 5% of plan assets. One of the most important points that has come about in Rep. Roybal's legislation is that he views plan termination of defined benefit plans as invalidating the minimum funding requirements of ERISA.

For example, you can have a defined benefit pension plan that has been in existence for a number of years barely meeting the minimum funding requirements of ERISA. Let's suppose the plan is terminated and the employer recovers a large amount of assets in excess of the termination liabilities. Then he sets up a successor plan, virtually identical to the plan he had before. The only funding that has been done is with respect to the termination liabilities, and that basically amounts to a situation where the ERISA minimum funding requirements for practical purposes had been circumvented. To the extent that this point can be driven home, there is likely to be more legislation, and different policies taken by the PBGC and the IRS in the plan termination area.

One of the hottest issues today is the possible taxation of employee benefits or fringe benefit programs. In 1985 we are going to see heavy consideration given to taxation of fringe benefit programs including both health and retirement programs. This may come about in part because of research into finding alternative ways of funding the federal deficit. There are several issues which revolve around this taxation of fringe benefits. One of them is that the U.S. Treasury Department has said that the U.S. Government is foregoing tax income of approximately $64 billion, as estimated for 1985, because of fringe benefits not being included in the tax base. Retirement and fringe benefit plan design is greatly affected by the tax status of these programs. All you really have to do is take a look at 401(k) plans and IRA's and their popularity, to see that tax legislation definitely affects retirement planning. To the extent that legislation comes about which taxes fringe benefit programs, you are likely to see changes in the benefit levels provided by employers. What actually happens will depend on who is taxed, whether it is the employer or employee. There will very likely be a change in the structure of our benefit programs if the tax policies are changed drastically. If this happens, there is the potential that if benefit cutbacks occur, governments, either state, local, or federal, could be exposed to pressure to provide increased welfare benefits.

There are some individuals who believe that fringe benefits should be taxed. Some employers utilize fringe benefit programs heavily, while others do not. For employers that provide most of the total compensation through direct pay as opposed to fringe benefit programs, their employees are being taxed more heavily. Those employers who utilize fringe benefit programs heavily are avoiding some of this tax on their employees. To the extent that there are increases in the amount of total compensation provided through fringe benefit programs in the future, necessary increases in the tax rates against the existing tax base could increase this inequity for those employers and employee groups that do not increase their participation in fringe benefit programs.

Another possible factor, that could lead to some pressure to tax fringe benefits are President Reagan's statements that he will not increase taxes in this country, except as a last resort in order to reduce the deficit in this country. If we interpret taxes to mean tax rates instead of tax base, it's possible that fringe benefits could be a part of an increased tax base. What are some of the alternatives for taxation of fringe benefits? What would the tax structure look like? There is a decision of whether the employer is to bear the tax versus the employee. The employer could be taxed by not allowing deductions for contributions to fringe benefit plans in excess of a certain amount. On the other hand, contributions to fringe benefit programs in excess of a certain amount could be taxed to the employee as income. Certainly some combination of the two could be involved.

It is possible that all fringes, including retirement benefits, could be taxed, not just health insurance. There has been much discussion on the taxation and caps placed on expenditures for health care, but several people have commented that there is no reason why taxation cannot extend to benefits other than health insurance. One of the methods that has been suggested is that of using a capped approach to taxation of fringe benefits. One approach is simply to use a flat percent of compensation as defining a maximum nontaxable expenditure on fringe benefits. Perhaps this could be 10%, 15% or even 20% of compensation. Anything above that would be taxed. It is also possible for the percentage, rather than being a flat percentage for all employees, to be a graded percentage. Perhaps it would be a higher percentage for lower paid individuals so that they be taxed relatively less than higher wage earner. There are arguments for and against the capped approach. One argument for the capped approach is that some people believe that nontaxable expenditures, if capped, would provide for some control in the health care area by making people more aware of the health care costs and increases in those costs. There are also some arguments against the capped approach. There are some internal and geographic inequities involved. Different geographic areas in the country have different levels of medical cost. You have to be careful how you define the tax exempt maximum to avoid these inequities.

If the taxation of fringe benefits extends to retirement plans, it is possible that funding of retirement plans, depending on the structure of the taxation, could be decreased and, therefore, capital infusion into the economy could be reduced. This is a factor that needs to be considered as well.

Enough about tax policy. The flip side of this issue is retirement policy. Many people in the country today believe that we don't have retirement and welfare policies that are integrated with tax policies. I agree with this, and I believe that, as long as we don't have a national policy in these areas, these programs are continually going to be open to tax manipulation and other changes that are affected by changes in our tax structure. Development of these policies and adherence to them could go a long way in stabilizing these rapid changes that we have been seeing in the retirement area over the last few years.

Many people are bothered by the growth in defined contribution plans relative to defined benefit plans since the enactment of ERISA. On one hand, many of these defined contribution plans, 401(k) plans for instance, largely involve employee contributions so that you are stressing the three-leg stool philosophy on retirement income. Dallas Salisbury of the Employee Benefit Research Institute has indicated that there are several reasons, in addition to using defined contribution plans as supplemental plans to existing defined benefit plans, for the rapid increase in the number of defined contribution plans. He mentions ERISA as one. Because of ERISA there has been more complexity involving defined benefit plans as opposed to defined contribution plans, and this has led to greater use of the defined contribution plans. He mentions that tax policy is another issue that has driven many employers to use defined contribution plans. The growth in 401(k) plans is an example of the situation where there have been tax incentives for setting up a certain type of defined contribution plan.

Recessions and international competitive forces are another factor mentioned by Mr. Salisbury. Defined contribution plans are better vehicles if the employer is looking for a way to control the contribution level. By their very nature, it's not possible to control the level of funding for defined benefit programs as well as for defined contribution programs. The last point that he mentions is the apparent shift from an economy in which we are involved in heavy industry to a more service oriented economy. To the extent that the service corporations and companies in this country have historically used defined contribution plans as opposed to defined benefit plans, the shift to service type industries may certainly be a reason for a shift to defined contribution plans.

Congress certainly is the focus for developing retirement policies and health and welfare policies, as well as tax policies. It is going to be interesting to see what happens in the next year or so with regard to the review that is currently under way with respect to the retirement program for federal employees hired after 1983. The Social Security Amendments Act of 1983 required that these employees be brought under the Social Security system. This has triggered a review by several bodies within Washington, the Office of

Personnel Management, and the legislative Congressional committees that have jurisdiction over the federal employees retirement system. These people are currently taking a very active look and coming up with alternatives for federal civil service employees. Many of the proposals that I have read about at this point are drastically different than the current program and it's going to be an interesting situation to watch and see what develops. It is one of the largest, if not the largest, retirement plan in the country, so it is an important one to watch. To the extent that people lean on that program as a basis for national policy, it will be widely looked at.

There have been many comments about Congress not being informed as much as it should be on employee benefit issues when it is in the process of drafting legislation. In part this is true. In part, many of the problems we have seen haven't been caused by Congress, they have been caused by the regulatory agencies. Congressman Erlenborn is one individual who has a strong interest in retirement issues. His retirement from Congress certainly is not going to help matters any. But there will be other individuals who will take his place in Congress. As these fringe benefit issues come to the forefront they are becoming more important to more Congressmen, who will take a harder look at this area. As actuaries, either through the Society or through the Academy, through your local groups and contacts with your local Congressmen, you can help by trying to touch bases with them. Write letters to these people and express your views.

This concludes my comments. We have gone over a number of issues in the employee benefit area. You can see that there are many things going on. There is much that we weren't able to discuss in great detail, but I am sure that you have some questions. My thanks to Greg and Ginny.

MR. ROBERT J. MYERS: Mr. Lingo raised the question as to whether the term "no increases in taxes" refers solely to tax rates or whether it has the broader meaning of "total tax payments." I believe that what is generally meant is the former basis. For example, the maximum taxable earnings base for OASDI will very likely be increased from the present $37,800 to $39,300 or $39,600 for 1985 (the promulgation is to be issued before the end of October). This should not properly be termed an increase in taxes, but rather a keeping up to date with changes in economic conditions.

Mr. Lingo also mentioned two possibilities as to alleviating the coming Medicare Hospital Insurance financing problem. The first was having Medicare be secondary to retiree health benefits under private plans, just as is done in the case of active workers aged 65-69 and spouses aged 65-69 for active workers under age 70. I am convinced that this will not be done, because it would be so unfair and illogical, just as would be the case if private pensions were offset against OASDI benefits for retirees who had been dually covered concurrently under OASDI and the private plan.

The second possibility was to increase the minimum eligibility age for Medicare in the same manner as has been legislated for OASDI (i.e., beginning with those who attain age 62 in the year 2000). I believe that this should be done, but it will do nothing to alleviate the looming financial crisis for Hospital Insurance in the 1990s. I believe that it would not be desirable to increase the minimum eligibility age for Medicare in advance of the scheduled increases for OASDI (nor would I favor any earlier increase for OASDI).

MR. RALPH J. BRASKETT: Ginny, regarding death benefits under REA, at what point do you have to be concerned with that? Most of my plans have graded vesting, both the pension and the defined contribution plans. The defined contribution plans are not a problem. Virtually all of them have a death benefit of the full amount, 100% vested, with perhaps one or two exceptions. But in the defined benefit plan, what age do you need to start paying death benefits? It used to be the early retirement age, if you had an early retirement provision.

MS. OLDS: But now it's the date that they are initially vested. If someone dies and they are entitled to a vested benefit of any kind (had they terminated on the day before they died, being entitled to a vested benefit), their spouse is entitled to a surviving spouse's benefit. Now you do not have to begin paying the benefit until the date that the person would first have been eligible for early retirement under the plan. So, if the person dies at 35, and early retirement under the plan is 55, you can hold that survivor on your roles for 20 years before you start paying them benefits.

MR. BRASKETT: Do you use the plan's actuarial assumptions to determine cash out amounts? I recently had an argument with two lawyers who claim you can use the PBGC immediate rates down to age 30. Are they right?

MS. OLDS: The act says that the interest rate cannot be higher than the rate used for PBGC or the plan termination rate. Under Revenue Ruling 79-90 you have to have the actuarial assumptions stated in the plan. If you have the plan assumptions stated in the plan, you are reducing accrued benefits or early retirement benefits if you use a PBGC rate instead of your plan assumption rates. That is why I would stick with using your plan assumption rates to pay off the lump sum.

MR. BRASKETT: I understand what you are saying. But someone else has said that since the legislation permits the use of PBGC rates, you can reduce people's accrued benefits by using the legislation.

MS. OLDS: I don't know the answer to that.

MR. BRASKETT: The other question I have is that when it says PBGC interest rate, do they mean the true PBGC rates or do they mean the retirement rate? If the latter is true, most lump sum payouts will be very tiny amounts.

MS. OLDS: That is why I would probably advise my clients to use the plan assumption rates.

MR. DELAMARTER: I have seen some situations where the plan assumption rate has been defined in terms of the PBGC rate as in effect on a certain date and perhaps updated annually. It's my understanding that if your plan provision is written in a general fashion that allows that kind of a change, the benefit will still be considered to be definitely determinable and thus, you can have the best of both. You can have PBGC rates and they are in the plan.

MR. LINGO: In some of our plans, the plans state that lump sum values are based on PBGC rates under similar language. We have determination letters on these plans.

I thank you for your attendance, and again thanks to Ginny and Greg for your help.