RECORD OF SOCIETY OF ACTUARIES
1985 VOL. 11 NO. 4A

THE ACTUARY'S RESPONSIBILITY TO THE PENSION PLAN PARTICIPANT

Moderator: HARRY S. PURNELL III
Panelists: ALLEN BEARD*
JOHN A. MACDOUGALL
LESLIE S. SHAPIRO**
Recorder: PETER A. GOODSELL

- o Ethical and professional issues
- o The actuary's role in:
  - --Plan curtailment or termination
  - --Determining lump-sum values at retirement
  - --Investment strategy

MR. JOHN A. MACDOUGALL: Does the actuary have a responsibility to the pension plan participant? This and the related items set forth in the agenda may well represent a Pandora's box for the actuarial profession.

Consider these situations:

1. The baseball player is able to play the professional game with skill and, at the same time, indulge in questionable habits such as cocaine use while playing the game.

2. The medical doctor in the private voluntary hospital transfers an indigent patient to a public facility under questionable circumstances.

3. The certified public accountant gives an unqualified opinion as to the financial position of a client who then proceeds to go bankrupt to the detriment of the stockholders and others who may have invested in the scheme.

* ɜard, not a member of the Society, is Manager, Actuarial
es Division, at the Pension Benefit Guaranty Corporation.

** apiro, not a member of the Society, is Executive Director,
›oard for the Enrollment of Actuaries.

4. The actuary recommends a weakening of the funding of the pension plan in a situation in which stronger funding would have been justified. The plan subsequently terminates, and the participants do not receive the benefits which they felt they had earned.

What is the common thread in these situations? It is the public perception of the role which each of these persons plays. In each case, the individual probably feels that there is some justification for the role played. In each case, there is public indignation over the results.

Let us look for a moment to the Guides to Professional Conduct issued by the Board of Governors of the Society of Actuaries on October 9, 1983. In paragraph 1.a. there is the statement:

> You must act with honesty and in a manner that fulfills the actuarial profession's responsibility to the public and maintains the dignity and good reputation of the profession.

Further on, in item 4.b. of the Guides there is the statement:

> You must recognize that there are honest differences of opinion, on many matters. In some circumstances the best interest of your employer or client, or of the public, may be served by providing an alternative opinion to that expressed by another actuary, together with an explanation of the factors which in your judgment lend support to your opinion.

There are no definitions or clarifications of "the public" in the Guides or supporting opinions and interpretations from the Society, American Academy of Actuaries, or Conference of Actuaries in Public Practice. Is this lack of definition or clarification an indication of the definite possibility that there is no way of further defining or clarifying the concept of "the public"?

Certainly there are multiple publics involved in the relationship with the actuary as a professional. There are the clients, the regulators, those impacted by the actuary's results (e.g., pension plan participants), purchasers of the various forms of insurance, and so on. In addition to these publics, there is the "broad public."

As we look at the several issues on the agenda, one might well ask, "What is the actuary's role?":

1. Is the actuary a source of facts and opinion only?

2. Is the actuary in no way involved in the issues of a situation?

3. Does the actuary have a fiduciary capacity?

4. What are the implications of the fees charged by the actuary?

There is a broad but somewhat nebulous public. Who represents that public:

1. when pension assets revert to the plan sponsor?

2. when a pension fund fails to meet its obligations?

3. when an employee receives a lower lump-sum settlement in lieu of a monthly pension because of a change in valuation assumptions?

4. for whatever pension concern might be the issue at the moment?

Of course, the United States Congress and the state legislatures represent that public.

Are you aware that the Committee on Ways and Means markup of the President's Tax Reform Proposals proposes an amendment to the Internal Revenue Code and the Employee Retirement Income Security Act (ERISA) that would "require that certain actuarial assumptions that have a material effect on the measurement of liabilities (e.g., interest rate and marital status) be reasonable standing alone"? One of the reasons given by the Committee staff for this change, involves a public perception of what actuaries do.

What are the actuary's responsibilities to the pension plan participant? If the answer is "none," then our problems may be just beginning.

MR. ALLEN BEARD: The purpose of the Pension Benefit Guaranty Corporation (PBGC) is three-fold as we see it and as stated by Congress:

1. To encourage continuation of private pension plans.

2. To provide timely and uninterrupted payment of pension benefits to the participants.

3. To maintain premiums at the lowest level consistent with carrying out its obligations.

The PBGC is trying to get a little more premium, but that would just allow us to do the other two charges. We have two actuarial divisions in PBGC. One is the Actuarial Policy Division which until recently was headed by Vincent Amoroso. The other is the Actuarial Services Division of which I'm manager. We have two subdivisions in the services division: the technical and policy branch headed by Al Redding and the actuarial operations branch headed by Dave Gustavson.

There are areas of responsibility to participants that we feel very deeply. One of those is in the area of excess assets. When a plan terminates and there are assets in excess of those required for the first six categories of priority and where there have been employee contributions to fund the plan, we feel that part of the excess assets should revert to those employees. Section 4044(d)(2) of ERISA states that in the allocation of assets, "if any assets of the plan attributable to employee contributions remain after all liabilities of the plan to participants and their beneficiaries have been satisfied, such assets shall be equitably distributed to the employees who made such contributions (or their beneficiaries) in accordance with their rate of contributions." Furthermore, we cite Regulation 2618.31. This is an issue of primary importance in an actuary's responsibility to participants. Section 2.c. of the Society of Actuaries Guides to Professional Conduct states that you "must recognize that you have an ethical responsibility to those persons or organizations whose actions may be directly influenced by your actuarial work."

MR. LESLIE S. SHAPIRO: My role is to discuss the enrolled actuary's public--that is, the enrolled actuary's clients--from my perspective, and perhaps of greater importance, my experience as to whether or not the enrolled actuary recognizes a professional responsibility to his or her public. With respect to the enrolled actuary, identification of the person to whom responsibility is owed is challenging. The enrolled actuary's client, in the normally accepted context, would be the person who is paying the actuary's fee. In this regard, an enrolled actuary is not unlike other professionals such as lawyers and accountants. An enrolled actuary owes the client confidence, loyalty, and confidentiality.

If the person paying the fee were always the client, frequently that would be the pension plan administrator. However, this is not always the case. The law places a special emphasis on the responsibility of the enrolled actuary by providing, in essence, that he or she is to perform actuarial services under ERISA on behalf of the plan participant. Since this is a congressionally mandated responsibility, it cannot be ignored and must always be embraced within an enrolled actuary's duties. Consequently, the enrolled actuary has a dual loyalty as he performs professional services relative to federal tax and related laws.

Under the circumstance of being charged with the duty of performing services under federal tax and related laws, it is generally recognized by other professions that perform services in relation to the tax laws that, in addition to owing the client (be it the plan sponsor and/or the participant) competence, loyalty, and confidentiality, the practitioner has a responsibility to the tax system as well. This latter responsibility is of pervasive importance. However, it is an imprecise concept which has been described as blending together notions of obligations to society, one's profession, and the law. In the normal practitioner/client relationship, both duties are recognized and carried out. However, there are situations when this is difficult. In those situations, the practitioner is required to decide which obligation prevails and, in so doing, may correctly conclude that the obligation to the tax system is paramount. In this connection, the efforts of the Treasury Department are to accomplish its mission of administering the tax code efficiently and effectively. In so doing, we rely on tax practitioners to assist us by being fair and honest in their dealings with the Internal Revenue Service (IRS) and by fostering the confidence of their clients in the integrity of the tax system and in complying with it. Therefore, I would not be so presumptuous as to refer to the government as a client. I am serious about an actuary's responsibility to our tax system.

There's yet another element that must be considered in the context of clients and client responsibility as it relates to the work of the enrolled actuary. I refer to what has come to be called in the profession third party certification work. By this I mean, an enrolled actuary is not retained by the plan administrator, rather that actuary is engaged, for example, by a pension plan administration firm. This layer complicates the actuary's responsibilities and, as we have seen in my office, often adversely affects his or her discharge of professional services. So, as can be seen, an enrolled actuary has many masters including the actuary's boss (e.g., senior partner in a consulting firm or the enrolled actuary's supervisor).

The Internal Revenue Code requires an actuarial report of a plan to be prepared and signed by an enrolled actuary. Regulations under this section require that the report contain, among other things:

1. A statement by the enrolled actuary signing the report that to the best of the actuary's knowledge, the report is complete and accurate.

2. A statement by the enrolled actuary signing the report that in the actuary's opinion the actuarial assumptions used are, in the aggregate, reasonably related to the experience under the plan and to reasonable expectations and represent the actuary's best estimate of anticipated experience under the plan.

The foregoing is essentially the same certification found at the bottom of the Schedule B form that the enrolled actuary is required to sign. The regulations of the Joint Board require, in part, that the enrolled actuary shall exercise due care, skill, prudence, and diligence to ensure that the actuarial assumptions are reasonable in the aggregate and the actuarial cost method and the actuarial method of valuation of assets are appropriate; that the calculations are accurately carried out; and that the report, any recommendations to the plan administrator, and any supplemental advice or explanation relevant to the report reflect the results of the calculations. Further, an enrolled actuary shall include in any report a certification stating actuarial costs or liabilities; a statement or reference describing or clearly identifying the data; any material inadequacies therein and the implications thereof; and the actuarial methods and assumptions employed.

These are the responsibilities of an enrolled actuary. We have found that these requirements often have not been met. Consequently, the enrolled actuary in those situations has not fulfilled his or her responsibilities to the client and/or the public. In some instances, the reason for this is caused in part by the actuary's relationship with the client and its impact on the discharge of his or her professional responsibilities. So, regardless of which master you are serving, and even with the mix of them, the enrolled actuary has an affirmative duty to comply with the requirements of the law.

MR. DONALD J. SEGAL: Are there any conflicts between the enrolled actuary's obligation to the plan participants and his obligation to the plan? I'm differentiating that from the plan sponsor. Mr. MacDougall referred to cash-out values of a plan. Is the actuary acting in the best interest of the plan participants if the actuarial equivalent value is changed such that the participant will get less money in a single sum for a given annuity, even though that might be in the interest of the plan?

MR. MACDOUGALL: Most of us would say that in a defined benefit plan, the lump-sum settlement is a minor aspect of the entire program of benefits. It's typically an option that is sometimes present. But, nevertheless, there is reaction if one had been around a particular negotiated plan when assumptions had been changed despite the recommendations of the plan actuary. In effect, if the lump-sum distribution is lowered, there is often a sizeable reaction on the part of the participant. I would suggest that it is an interest of the participant which the actuary has every right to ignore, but that actuary should set the groundwork for an appropriate position well in advance.

MR. COLIN B. ENGLAND: What about a terminating plan? You have the situation often where a plan has not been amended for actuarial equivalents yet. But it has been using, say, 5 percent as the interest rate to calculate lump sums. Now, it is going to terminate and is amended to comply with Revenue Ruling 79-90. The plan is amended with the PBGC rate fully knowing that the plan is going to terminate shortly after the amendment, and that lump sums will be paid to everyone based on the PBGC graded rates which produce substantially lower lump sums. Is there any responsibility to the plan participants? Are you saying that there is no liability for the actuary to inform the plan participants?

MR. MACDOUGALL: If I were terminating a plan, I would not be focusing on lump-sum settlements. We're talking again about a defined benefit plan, so I would consider that a minor issue. The plan is designed to provide monthly benefits, and it's to the participant's interest to provide a monthly benefit. The lump sum is merely the present value of the promise to the participant.

MR. ENGLAND: In a number of terminations I've been involved in, a lump sum is the preferred option that most plan participants take. If given the option of a lump sum or an annuity, I'd say probably three-quarters or more will take the lump sum. Now, here the lump sum might be much less valuable than the annuity. Do we have a need to inform the participants that this is the case?

MR. HARRY S. PURNELL III: Why would the lump-sum value be less than the annuity?

MR. ENGLAND: If you're calculating a lump sum on the PBGC assumptions, that might not be the same. If the participant took the lump sum and went to an insurance company to buy an annuity, very likely with the lump sum he received, he would not have been able to buy an annuity of the same amount he would have received from the plan.

MR. PURNELL: But if the plan benefit and the purchase rate were reasonably close to that PBGC rate, then the participant is given a fair choice, would you not agree?

MR. ENGLAND: In this case it is. What of the case of the company that used a 15 percent rate for calculating lump sums, which was challenged by the PBGC? It had to get to the PBGC to be disapproved. Should the actuary have done anything earlier?

MR. MACDOUGALL: It's in the perception of that public as to what is being done there. If the purpose of the 15 to 16 percent interest rate is perceived to be a device that increases the reversion, there may be a problem. For example, if I had a plan which provided that all of the assets go to the employees, as is the case in many negotiated plans, then using a 20 percent interest rate wouldn't matter. If you convince everybody that they should take a 15 percent lump-sum settlement, which is obviously outside the market, then one might question that. But if it is within the market, in terms of providing a benefit to the participant equal to the benefit he has accrued under the plan, then the promise is kept. But I agree, it gets into a gray area.

MR. VICTOR MODUGNO: One thing I have noticed recently on these lump sums is that many employers are choosing to purchase annuities down to very low amounts to avoid paying lump-sum money on the PBGC basis because they find it's actually cheaper. It does matter what interest rate you use even if you are allocating all the assets to employees because it affects the relative amounts that the younger deferreds get over the older immediates. Now, it seems to me that, with the PBGC insuring the benefits of the average plan participant, it's either the stockholders or the taxpayers who are going to lose if the plan is underfunded and there is a termination. It's not the plan participants that get hurt in these circumstances anymore.

MR. BEARD: They do get hurt if the plan is insufficient. Participants certainly get more if the plan is fully funded than they would if there's an insufficiency.

MR. PURNELL: If the plan had been amended in the five years before the termination, there would be uninsured benefits. It's an interesting perspective, though, that the PBGC is left holding the bag rather than the plan participant. Perhaps to a significant extent that's a true observation. That should make us think about who the PBGC actually represents. The PBGC doesn't print money--all it really does is pass through the premiums it collects from the sponsors of other defined benefit plans. So, in a very real sense, the PBGC is the public at large or, more accurately, corporate America. It is not the government that's paying for any underfunding but rather other plan sponsors.

MR. LEROY B. PARKS, JR.: There has been a recent lawsuit involving the PBGC and Buck Consultants, which seems to relate to the actuary not properly discharging his responsibility, at least to the PBGC and the IRS and arguably to the plan participants. Would the representatives from PBGC and the Joint Board care to discuss with us the issues involved in that lawsuit, and where they think that suit may go?

MR. BEARD: The issue involved is whether the actuary used proper assumptions in arriving at the minimum contribution. It appeared to be fairly obvious that the plan sponsor was going downhill rather rapidly and, in fact, had closed some of its plants. At issue is whether or not the actuary should have been able to see this and make recommendations to the client to fund for benefits which become effective when a plant shutdown occurs. Those are the issues as we see them.

MR. SHAPIRO: My office is very interested in this litigation and will be following it closely. As I understand the complaint, it is against both the consulting firm and an individual within the firm. The Joint Board deals with individuals, not with firms. In other words, our regulations do not provide that we can take disciplinary action against a firm. So it would only be the members within the firm who were found to have violated the regulations who would be subject to any form of disciplinary action from the Joint Board. I do not possess in-depth knowledge of the basis for the litigation. Irrespective of the outcome of the litigation, my office still has the authority to review the underlying facts that precipitated PBGC interest in the matter. For example, if the case is settled without any admission of wrongdoing by the parties involved, which is often an element in a settlement of a civil action, our office will be able to explore and evaluate the underlying facts to make a determination as to whether or not there was a violation of the regulations governing the discharge of professional services by enrolled actuaries.