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ADEQUATE FINANCING OF RETIREMENT PLANS

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- What constitutes the proper level of financing of retirement plans? This session will consider:
  - Objectives of proper financing
  - Different measures of funding status
  - Risk related to inadequate financing
  - Recent U.S. developments:

    Tax Reform Bill, Pension Benefit Guaranty Corporation, Financial Accounting Standards Board 87, Governmental Accounting Standards Board-10

MR. MARTIN PEPPER: The Society had panel discussion on a similar topic in the mid to late 1970s. The general outlook at that time was largely influenced by the market losses in 1973 and the new funding requirements of ERISA. At that time, media doomsayers bemoaned the huge underfunded positions of pension plans. I also recall at that meeting a rather lively but acrimonious debate between one actuary serving mostly U.S. plans and another serving mostly Canadian plans. The differences in opinions as to what constitutes reasonable measures of funding, funding assumptions, and funding levels were dramatic.

Since then we have had radical increases in inflation and interest rates by histc[illegible] North American standards, followed by relatively low inflation rates, boor [illegible] and money markets and a proliferation of all kinds of unusual and [illegible] ment and financial instruments. Lastly, if last week is any indi [illegible] e fears of another swing in the economic pendulum.

All of these changes have served to increase the number and diversity of the public audience interested in what constitutes adequate financing. We are in a fish bowl with everyone peering in and stirring the waters. Twenty years after the Accounting Principle Board codified U.S. pension accounting standards, its successor (the Financial Accounting Standards Board) concluded that it was time to make some much needed improvements despite the fact that industry, the actuarial profession, and even the accounting profession at large believe that the standards that were in existence but two years ago were not in need of any changes. But the importance of pensions, the magnitude of the assets and obligations, the number of plans, and the changes in the legal status of pension benefits as well as the dramatic changes in the economy were all cited as reasons for the new focus of attention. Very similar standards have been issued by the Canadian Institute of Chartered Accounts as well.

The actuary has been "drawn," if not yet "quartered," by the various forces keenly interested in the question of adequacy. The radical changes in the economy have had diverse effects. We have had many plans with significant overfunded positions, many of which have taken short-term advantage of the surplus funds by either terminating or restructuring their programs. This has of course raised questions as to whether or not they are really mortgaging the future and has also raised very serious public policy questions which led to the issuance of tri-agency guidelines in the U.S. governing surplus reversions. At the same time, the economic viability of a number of companies has deteriorated and in some cases their plans have become the public charge. The PBGC has thus been burdened by increasing obligations. It is not surprising that the PBGC now has its own agenda for what constitutes adequate financing.

Because of the significant number of surplus reversions and because of other factors, there probably is a wider dispersion of plans across the spectrum of funding status today than a few years ago and if this isn't the case, it may well be the case if the market continues dropping.

At this time there are four proposals in the U.S. relating to termination or funding of pension plans and the fifth is near ready. There is little doubt that a number of major provisions found in these proposals will find their way into legislation shortly. It is particularly noteworthy that one of these proposals places very specific limitations on the interest rate that a plan actuary can use

for valuation purposes. There has never been a time when so much attention from so many directions have been aimed at adequacy. The Committee on Pension Principles is in the middle of a project dealing with this issue. We are examining a number of different definitions of funded status appropriate for different purposes and the interrelationship between them and possible changes in funding rules.

However, events may be outpacing clear and rational thought. Actuaries may no longer be in the middle of this issue where they belong and they should be anxious to get up and be heard. Tom Bleakney from M&R has written a book on Retirement Plans for public employees, and will discuss some of the theoretical considerations and objectives for financing in general and some of the considerations which may be specific for public plans. Ronald Gebhardtsbauer has experience from federal or provincial agencies in the U.S. and Canada and will share some rather important information with us as well as statutory developments.

MR. THOMAS P. BLEAKNEY: One of the advantages that I have in spending essentially all of my working career in the public sector, is that I can approach a subject like this with practically no predisposed point of view, at least that which might be disposed because of legislative enactment, because in the public sector any legislative control is within the state or city which results in significant variances to the rules. As I am sure most of you know, at least in the United States, very little federal regulation of state and local systems takes place. It happens to be a topic though that in some ways in the public sector is even more important because whether we like it or not, in the private sector many of our decisions are being taken over by the federal government. In the public sector though, there is still room to move and that provides a certain uneasiness at times in deciding just exactly how to go about setting up, shall we say, standards for funding adequacy which is the basic topic.

One thing that will be very good for you is that part of what I am going to talk about is what somebody else has provided and that somebody else is C. Trowbridge. For those of you who were at the spring meeting in Colorado Springs, you will have heard his comments. I presume most of you were not and I am not about to read them all. But I would like to pick out a few key points and suggest that when the *Record* comes out for that Colorado Springs

Meeting, you might want to read the whole talk that he prepared. As is usual with Trowbridge's work, it is an outstanding analysis. His key points lead into the subject rather effectively.

There are really two key reasons for advanced funding. He points out that the combination of pay-as-you-go and rising costs leads almost inevitably to poor employer accounting, while a combination of pay-as-you-go and the mortality of employers, or the termination of plans, throws a dark cloud on employee benefit expectations. There is the fact that the employer may not be around forever and also that the pay-as-you-go method leads to poor accounting practice if that's all that the employer is looking at. I recognize that you have to look at this not from the accounting side, but in the environment of federal legislation and rule making.

As to employee benefit security, the objectives of any good plan of pension financing are the enhancement of employee benefit security and the promotion of sound employer accounting. He considers the creation of a conservatism index to any given funding pattern, which would increase the sense of benefit security by becoming more conservative, with more conservative assumptions, and more conservative funding patterns. When is more conservatism more desirable? Who can say? And then he brings forth this rather interesting analysis ". . . can we agree that from the point of view of employee benefit security more funding is a good thing?" Certainly it would seem so on the surface, but even here we run into questions. Supposing the choice is between a conservatively funded, but initially expensive plan of a modest benefit level and a less well-funded but more generous plan that from the employer's viewpoint bears a similar current price tag. Would you as an employee opt for the former over the latter? I am sure most of us have run across that little problem and have attempted to deal with it. But he does point out that's one of the questions or the problems with the notion of employee benefit security.

Addressing the matter of accounting, he wonders if North American actuaries have really looked into the European repartition arrangements, which are essentially large multiemployer plans in the private sector with very little advanced funding. Under certain not too implausible economic conditions, it could be demonstrated that advanced funding causes a plan to cost more. How indeed can we make even a start in judging the degree of funding of another

multiemployer plan? He then concludes that ". . . if you believe there is no objective standard by which pension funding can be judged you have passed beyond the first level of ignorance."

Let me expand a little on these thoughts. I mentioned earlier that I have a much narrower focus in dealing in the public employee sector, and again I will emphasize this is in the United States, state and local plans. However, I do hope that limitation won't stand in the way because it is valuable to give a little broader perspective on some issues where it isn't necessary to be limited to the structure implied by federal regulations. By that broader perspective, hopefully we will, as actuaries, be able to exert some influence on how regulations and accounting further develop in this area.

I have one primary thesis that I would like to emphasize. It grew out of the work of the Pension Principle Committee of the Society on pension adequacy. I found that I differed quite significantly from most of the other members and I think those differences came from my bias in this respect. There is a tendency in private plans to focus upon what I'll call balance sheet liabilities. In the public sector, at least, I think that there is more emphasis on what I'll call the operating statement, the actuarial cost as opposed to the unfunded liability. I feel that there are some significant shortcomings with emphasis on the balance sheet. And yet I can see that it is increasingly a focus of attention. Certainly the accountants tend to emphasize the balance sheet. They emphasize it in a manner which is often very foreign to actuaries.

For example, the FASB 35 balance sheet item which they say is not really a balance sheet item, still looks and tastes and smells like a balance sheet item. From my perspective, that concept is not a reasonable one to look at. The question of surplus reversion which Marty referred to certainly emphasizes the balance sheet as do the commitments that private plans have in case of plan closeout. That is, to my mind, a balance sheet approach. One of the problems that I have with the balance sheet concept is that to get from balance sheet to balance sheet you must reference the income statement. To the extent that the balance sheet does not focus on a projected benefit obligation with salary projections, but instead with the accrued benefit obligation with no salary projection, we are forced into unit credit cost without salary projection for

incremental cost recognition without necessarily calling it that. But we all know that is not an acceptable cost method for a salary related plan.

With the funding limitations in the United States and in Canada this kind of thinking does not present a hazard, but in the public sector where some of these things tend to spill over we don't have the protection of federal legislation to keep us properly "up to snuff." In any event, I think it is a very poor form to think of in terms of where we're going to go if the plan terminates. I don't know how many private plans will terminate. I hope it's very few. But I do know that in the public sector, for all practical purposes, no public systems will terminate. They may undergo restructuring, but they won't terminate. Employee rights under public plans, at least in the United States, tend almost always to be protected. Current benefit formulae are almost always protected so long as the employee stays on the job. That kind of process requires a more aggressive look at the funding requirements. For a continuing plan, I don't believe the balance sheet focus is adequate.

I happen to be strongly in favor of the concept of an entry age actuarial cost method simply because it provides one rather important element in public sector financing which is relative smooth financing of most plan sizes. That gives assurance of stability of cost to program sponsors who generally do not have much freedom to increase and lower revenues. Recognizing that almost all of the systems that I deal with are salary related, I look to level percentage of pay contributions rather than level dollar. I suspect most of you know that in the public sector, it's very common to not only go beyond the normal cost as a level of percentage of pay but also to convert the unfunded liability to a level of percentage of pay. This is a reasonable basis for paying for costs in an environment where there is a continuity of potential contributions.

From this perspective, the ideal basis for adequate financing of a system, recognizing the operating statement and not the balance sheet, is the theoretical entry age actuarial cost method normal cost plus a level percentage of pay amortization of the unfunded liability. This particular funding procedure will have a tendency to have minimal likelihood for increasing contribution rates but instead will have a level or reducing contribution basis. The underlying thesis is that we should not expect future taxpayers to pay more as a percentage of pay than what we're asking of current taxpayers. This should be the

underlying fundamental principle in arriving at a cost method for adequate financing for public systems supported by a level tax base or income base.

Recently I have come across what I will define as an overfunded public sector plan, not in the sense of what the federal government calls overfunded, but instead where the unfunded liability is now completely paid off. When you get to that status, it's appropriate to think of switching over to an aggregate cost method. If, however, you have actuarial gain which has caused you to pop over the top and get into a negative unfunded liability on an entry age actuarial cost method, the basic premise has been destroyed, hopefully not very substantially. In this case, the contribution that is currently being made is actually lower than the normal cost. Again falling back to the basic theory, the normal cost will be the ultimate cost rate; but in the meantime we have an increasing cost basis. This is not a very common problem.

My focus on overall adequacy of funding is a bit different than you are going to be hearing from Mr. Gebhardtsbauer, but I hope that you keep it in mind.

MR. PEPPER: Tom has provided us with some perspective from the public plan sector. But some audiences are more interested than others in assuring that plans are not just perfectly funded but rather not underfunded. The provincial authorities in Canada as well as the PBGC in the U.S. quite naturally hoist this banner. Mr. Ron Gebhardtsbauer is the Chief Actuary for the PBGC. Pension funding reforms which are now in the proposal state in Washington are giving Ron a run for the money. Ron previously worked as an enrolled actuary for the Civil Service Retirement System and before that for The Wyatt Company, and is therefore aware of both public and private pension issues. Some suggest that this might constitute double vision.

MR. RONALD GEBHARDTSBAUER: As Marty said, I'm going to be speaking on the topic of adequate funding from my perspective as the Chief Actuary of the PBGC. I will address three areas. (1) I would like to relate my own past experience to this subject. (2) I would like to give three examples of some very badly underfunded plans that have come to the PBGC recently. (3) I would like to discuss solutions and how we need your help. But first I digress a bit.

My experience covers insurance, pension consulting for the Civil Service Retirement System and finally my work at the PBGC. Each of these areas has given me a different perspective on what adequate funding means, what soundness means. My insurance experience might suggest that we ought to fund our pension plans immediately. And I'll bet there was a lot of resistance to something like that back in the last century when the poorly funded mutual benefit societies decided that they had to switch over and become well funded insurance companies. But I don't think I'm advertising that for pension plans.

My experience with the Civil Service Retirement System showed me a totally different view of pension plans than I had ever known because it's outside the ERISA environment. The Civil Service Retirement System is deemed a qualified pension plan. And thus, we really didn't need to follow ERISA, even though I argued for voluntary compliance. I felt that for all the rules we make for you we should obey ourselves, but Congress didn't listen to that. The civil service didn't have to comply with ERISA's minimum funding standards. Our trust fund was inside the government's unified budget. Thus, a treasury contribution to our retirement fund was also a receipt, so it didn't affect the unified budget at all. It doesn't affect the annual deficit either. For these reasons, soundness or funding adequacy is a very ambiguous goal at the Civil Service Retirement System if you never go bankrupt. Also, what purpose is it to be covering termination benefits by a sound fund? As it turns out however, I thought possibly it might be a budget of the civil service. Why is that? Because new federal employees now are going into a thrift plan. At the same time we're paying the old retirees their benefits. At the same time, you the taxpayer are actually funding two retirement plans. You're paying for our current employees' thrift plan contribution, which is an outlay, and at the same time you are also paying for the retiree benefits from the old plan. Thus it might have been good if we had funded this earlier. Funding also encourages better decisions by Congress when they are thinking of improving benefits. Also, the fund has good psychological value to participants who want to get a benefit someday from that plan.

The Civil Service Retirement System also had shutdown benefits or early retirement windows which were sort of automatic. They result from major agency reorganizations, reduction in force, involuntary leave, loss of a political job, or loss of an election. These events happened in political cycles rather than on an

annual basis. They weren't easy to predict, but we did fund for them in advance. We had an assumption that approximately 1% of the people between ages 40 and 60 who met the age and service eligibility conditions would go out, receiving a better benefit because there is no age reduction or just a little age reduction for benefit.

Recently, I changed hats and I am now the Chief Actuary at the PBGC, and I am happily digging into the details of ERISA again. A lot has happened since I was at The Wyatt Company. As you might expect, the plans that we trustee at the PBGC are not healthy. I was hoping to speak as a prophet to the actuarial community. But instead, I may be like the psychiatrist who sees a lot of sick patients and assumes the whole world is sick. If I do that, it's not my intention, because I know that most plans, 85% to 90%, are well funded. Thus I am only speaking of the few plans that are not. The part of my new job at the PBGC that has really awakened my passion is my concern over the soundness of these pension plans. Wearing my new hat, I find myself much more aware of the consulting actuary's responsibility for adequate funding. You should all be concerned too, even if you don't have any poorly funded plans, because your well-funded plans are paying the premiums which may escalate to pay off the benefits of the weak plans. For instance, your premiums help Wheeling Pittsburgh Steel have an unfair advantage over its competitors, because you're paying for their unfunded benefits.

Let's look at some of the plans that have come the the PBGC. Most of the plans that we get now are even funded worse than Studebaker was, which is one of the primary reasons for the passage of ERISA. When we first started out, plans that came in our door were about 60% funded; now they are around 40% funded. Some plans are getting better funded but the ones that we see are getting worse.

I would like to talk about a few of these plan terminations. They are matter of public record now, so none of this is confidential information. They are Allis Chalmers, Wheeling Pittsburgh Steel, and LTV Steel. The pension plan of Allis Chalmers, which is a farm equipment company, was 3% funded when we took the pension plan over, despite the fact they followed all of ERISA's minimum funding rules. They never used a waiver and they never used unreasonably optimistic actuarial assumptions. How could this happen 11 years after ERISA? The

answer is pretty simple. Imagine a very underfunded pension plan of mainly retirees existing on January 1, 1974. The minimum funding rules allowed them to fund their liabilities over 40 years. A typical group of retirees, of course, is not even going to live half that long. A plan of just retirees could have actually been out of money in 10 years. The plan also granted retiree increases which could be funded over 30 years. Under ERISA, a company can actually grant retiree increases that will drain the fund. It was cheaper for Allis Chalmers to pay for those retiree increases through the pension plan than to actually pay for them out of pocket. That's not advanced funding; that's not even pay-as-you-go funding. In fact, it sounds more like a loan from the plan, which of course Allis Chalmers never paid back because it's now a terminated plan. But this is allowed under ERISA.

While this practice may be fine for a well-funded plan, it's clearly not reasonable to allow an underfunded plan such a free lunch. Such actions drain the pension plans of their assets and make it far too easy for a company to grant retiree increases when they shouldn't and when they can't pay for it. A recent survey by The Wyatt Company shows that half of the plans surveyed amortize retiree increases over 30 years. I was also surprised to note that almost half of the companies in that survey contribute at the ERISA minimum level. If this is true, then the minimum funding standards are doing us a disservice, because they are not enough for underfunded plans.

This leads us to the question, How can we change the minimum funding rules in order to fix the situation without hurting well-funded plans? Thirty years certainly seems too long a period to amortize retiree increases. Canadian plans amortize this much faster. The law is not static. If actuaries are not professionals concerned about the soundness of pension plans in general, and are not only technicians calculating the minimum funding standard account, then their voices need to be heard on Capitol Hill.

The Reagan administration proposals and those developed by the Department of Labor, IRS Treasury, and also the PBGC together call for faster funding of underfunded plans. Well-funded plans would not be affected because the administration decided not to fix something that wasn't broken. Also, it would not be desirable to have a plan that is almost fully funded to be affected much. That is why they have not been affected much. However, the proposed funding

standards substantially increase the required contribution of the most poorly funded plans. A reasonable set of transition rules would balance the avoidance of premature plan terminations with maintenance of long-term effectiveness of the proposed standards. However, the transition rules would also reflect the principle that plans should be responsible for their promises.

We examined the effect of these proposals on the future funding position of poorly and well funded plans. We used Academy Group I for a model population. Academy Group I derives from an American Academy of Actuaries study of the effect on funding of the FASB proposals. Academy Group I was very heavy in retirees and not much of an active workforce. In fact, it had a declining workforce. We considered three different plans. One has 25% of their liabilities covered with assets. Another starts at 50%. Another starts at 75%. Our analysis shows that the current funding standards will allow those funded ratios to go down. The administration has developed a funding method where it goes up and eventually gets to around 100%. We found that the contributions are quite large in their early years. That's why there is a need for transition rules.

We also used Academy Group A which is a typical plan with a normal number of retirees and actives. And we again started off at three different places. We assumed that 25%, 50% or 75% of its liabilities were covered by assets. We looked at the old rules which we felt for a plan like this were adequate, even though the plan is not fully funded or is at least funded for termination liabilities. Under the administration proposal that even though these plans are not 100% funded for termination liabilities, the new administration proposal will not change the contribution. For the 50% funded plan and the 75% plan the old 412 rules and administration rules get to the same level because the old rules have the plans continually going up towards 100% and even further. For the 25% funded plan, the administration's proposal does force a little faster funding. But basically, we only wanted to hit underfunded plans with very mature liabilities. The administration's proposal on quicker funding would be also extremely helpful where the benefits are equal to a dollar times service or career average plans. These are the plans that are amended frequently to keep up with inflation and each time they amend their plans, the unfunded liabilities skyrocket. These are the very plans that we see most frequently coming through our doors at the

PBGC. The administration's proposals would mandate faster funding of these amendments.

We spoke about Allis Chalmers. Another comparably bad situation existed at LTV. It was the largest corporate reorganization in history, and the PBGC is the largest creditor of that largest reorganization. When LTV Steel didn't even have enough money to pay its October 1986 monthly benefits, we had to take it over. One reason this happened was because 90% of LTV retirees recently took lump sum withdrawals, and these were calculated at very favorable interest rates compared with market rates at the time. The plan was underfunded by $230 million when it was terminated. The administration's cash flow proposal would handle this by mandating the contributions at least equal the outgo, including lump sums and expenses. This proposal is particularly important when the plan's assets could be depleted during the current year. Current minimum funding rules really don't speak to that at all. A plan can actually be out of money and the minimum laws would just allow that to happen. The administration's cash flow or anti-insolvency rule would keep this alarming situation from happening.

You have probably heard that the PBGC, in order to protect the pension insurance system from abuse, recently restored three of the LTV pension plans back to LTV. We haven't made a decision yet on the fourth plan, which was out of money. The Steel company had created follow-on plans providing substantially similar benefits to plan participants, basically using the PBGC as a funding mechanism for an ongoing pension arrangement. Furthermore, LTV is also experiencing a significant improvement in its financial situation. Restoration of the LTV plans, while decreasing the PBGC's deficit and discouraging future abuse, is not a cure-all for the PBGC. Our deficit is still $2 billion. Thus legislative reform is still very much a necessity in such areas as minimum funding, variable rate premium, and treatment of our claims in bankruptcy.

Another large termination occurred in 1985. When Wheeling Pittsburgh Steel Corporation terminated its very large underfunded pension plans, retirement experience displayed in the actuarial valuation reports showed that the average retirement age in the past 5 to 10 years was much lower than the assumption that was continuing to be used. Let's also look at the spread between their interest rate and their salary scale. The Wyatt Company survey of assumptions

shows that the average spread in 1984 between interest rates and salary scales was about 1.5%, a very typical set of assumptions for actuaries, at least in The Wyatt Company study. In only 4% of the plans in The Wyatt Company survey was a spread greater than 3%. In less than 1% of the plans did the actuary have a spread greater than 4%. Wheeling Pittsburgh was much beyond that. The economic assumptions that we used varied quite a lot.

If actuaries don't say what set of assumptions is not reasonable, then we can't complain when the government or an accounting body decides that they need to draw the line for their purposes. The administration's proposal does not do that. It mandates faster amortization of experience losses. However, as Marty has eluded to, just last week or the week before, the House Ways and Means Committee appears to be mandating explicit assumptions for actuaries, and setting a range for discount assumption equal to the average of a historical rate on government bonds, 7 years to 30 years in duration. The averaging period would be over the past 15 years, and you would peg your interest rate to a level in a plus or minus 20% band around the average. Suppose the average over the last 15 years of this long-term rate was like 8%. Your interest assumption would have to be below 9.6% and above 6.4%. It's important for practitioners to know about this so that they can respond. We need to come up with solutions to this that will satisfy all sides instead of just objecting to the Ways and Means Committee.

MR. MICHAEL COHEN: Let me try to give you a little background on solvency valuations. The first question is what is wrong with the old rules which required funding of current service cost on a going-concern basis (including salary projections in final salary plans) and amortization of unfunded liabilities due to benefit increases on basis strengthening over 15 years, and experience losses over five years, and what we have had in the Pension Benefits Standards Act, 1985, and the Ontario rules, and Quebec, and so on. And I guess the answer is not too much. There are a number of problems that we had identified although they're not anything necessarily that would make you overturn them and start again.

One particular problem, I think, was always the artificiality in distinguishing between experience losses and certain changes in assumptions, and with a little bit of foresight, one could be turned into the other. You could get a 15-year

amortization period for what would essentially be a likely experience loss. The other problem we identified was the distinction between a genuine plan increase such as going from 1.5% to 2% or putting in a joint and survivor benefit (something which I guess would be impossible now in Ontario), and then the regular updates to career average, or even the ad hoc increases to all sorts of plans which are really not that genuine. They're increases but, nonetheless, they occur on a regular basis and perhaps do not deserve the full 15-year amortization period. Certainly in some flat benefit plans, the situation is that really the current service cost is being funded on average almost seven years in arrears.

Another item is a problem that Quebec had in court a number of years ago. Pension plan regulation is primarily at the provincial level, although plans for employees in certain industries, such as banking, international and inter-provincial transportation and telecommunications, are supervised at the federal level. All provinces except British Columbia and Prince Edward Island have pension legislation in force, as well as the federal government. Quebec felt that a stronger and more precise solvency standard was required. Since the jurisdictions try to come up with the same funding rules if possible, they put together a reasonably good stab at setting up this solvency valuation. The solvency valuation is superimposed on the funding valuation; it's not at all in place of the funding valuation. Many of you are probably familiar with the test valuations that Quebec, ourselves and Ontario put in place a number of years ago and I think the solvency valuations borrow a lot from the concepts that were set up in that test valuation. The difference from the test valuation is that it was voluntary and optional, whereas the solvency valuation is mandatory. If a plan, in fact, is found to be solvent on the solvency basis, then there is much more flexibility on the funding basis. You can amortize any going-concern deficiency, whether it's derived from a plan amendment or from an experience deficiency, over 15 years.

If the plan has a solvency deficiency (and I will try and explain rapidly how that deficiency might be calculated), then there are more restrictive funding requirements. In fact, the solvency deficiency itself has to be amortized over five years. So in some ways, we are replacing this dichotomy of plan amendments and basis strengthening versus experience losses, with a going-concern amortization over 15 years from whatever source versus a solvency valuation.

The solvency valuation itself is fairly easy to describe and perhaps more difficult to do. The concepts behind the solvency valuation are very similar to the test valuation. The liabilities are to be done on a termination basis, so obviously the first thing one would look at would be interest rates. There is no specified interest rate as there is in a test valuation in our jurisdiction as it was before, but we expect actuaries to look at current interest rates, reinvestment risks and so on and use either a streamed assumption or level assumption, but one that can take into account the current investment experience or investment outlook. Salary scales can usually be dropped. Inflation assumptions (and that's something that's glossed over in a test valuation), generally speaking, depend on what the provisions are in the plan. If the plan has inflation protection (either after retirement or for deferred vesteds), then depending on what the provisions are on plan termination, then you can either drop the inflation assumption or you may have to use a recent inflation assumption. Some plans that have indexation may not even talk about plan termination, and we have some of those; so that would very much be a judgmental matter for the actuary to decide whether he or she feels that on plan termination, indexation may apply. For retirement age, generally speaking, one would be looking at the earliest age at which an employee could retire. Now in some flat benefit plans, assumed retirement ages are higher than the first age at which an employee can retire because many employees will not retire since it is not in their economic interest. The assumption is that on a plan termination they would indeed start drawing a benefit because there would be no better alternative. Withdrawal rates cannot be used. I guess we haven't left very many other assumptions to be determined, but any reasonable assumptions would normally be accepted.

The method would be accrued benefit pro-rated on service, although the regulations don't specifically state that. Presumably, other methods would be more conservative, but I would think that the accrued benefit method would be the one chosen.

The assets are in some ways trickier to deal with than the liabilities. Naturally, the assets would include the marketable securities or the invested assets of the plan at some market related value; some smoothing technique over five years would be permitted. If there are no marketable securities, a reasonable approximation of what their market value would be is used.

The special payments are lots of fun. Essentially, the principle is that all plans should be fully solvent within five years of a particular solvency valuation, so that means in principle only the next five years' special payments can be taken into account even though the payments may go on later. If you are amortizing an unfunded liability on a going-concern basis, only the next five years' payments can be taken into account. Some exceptions to that are the special payments paid in respect of unfunded liabilities that arose before January 1, 1987. So that's a sort of transitional provision to try to avoid plans actually starting off with a solvency deficiency. Another transitional provision is to allow full credit for all payments in respect of new plans or service that is recognized for the first time, and this is to deal with the situation where a new plan is put into effect and recognizes past service. Without that special provision, all of those past service benefits would have to be amortized over five years, and we felt to encourage the establishment of new plans, that should not be the case. In a way, it's an attempt to distinguish between the so-called genuine plan improvements and the more periodic updates although it's a very coarse filter. It won't identify those particular types exactly but it's an attempt at identifying those two different types. The other tricky thing is "what five years?"; and essentially we do not intend to use a rolling five-years' credit. What we are trying to do is that where a solvency valuation takes place and where a solvency deficiency is identified, then the next five years' payments will be credited -- taken into account. Then, further valuations will just take into account the balance of those five years.

MR. SAMUEL S. STANLEY: A number of comments were made regarding how actuaries should make their views known to Congress. And I am just wondering, is it realistic to expect that Congress will listen to the actuarial profession and/or the employee benefits community? When has this really happened? Consider the Retirement Equity Act and the employee benefit provisions of the Tax Reform Act. And I also note that the profession has recommended postretirement medical funding for quite some time with minimal success. And second, does the panel believe that all of these government rules and regulations have really helped funding adequacy of defined benefit plans on an overall basis?

MR. PEPPER: Perhaps I might just address a couple of those points. I believe that collectively, as a group, actuaries are busy, perhaps very busy helping

their constituencies, whatever they may be. Through professional organizations that they support, they provide input to the legislative process. However, in every instance where that has taken place, it has been after the barn door is open and the horse is out. And although we represent a small professional group by any comparative standards to others, we nevertheless have that much greater responsibility, to react and provide some meaningful input in advance and that's where we have failed. I know the American Academy and the Society and some of its committees have only in the last few years really taken this more seriously. With the most recent round of legislative proposals we are again behind the eight ball. I think it is reasonable that actuaries can be somewhat influential. I think it is particularly noteworthy that the accounting profession, with a membership many times as great as actuaries, also did not have as much influence as they would have liked in connection with SFAS 87 coming out. There is a solution and it is a question of greater involvement.

MR. GEBHARDTSBAUER: I know ASPA is much more attuned to what's going on in Capitol Hill. I think if it is something they can do, and they are much smaller than we are, there is a lot more that we can be doing. We can also talk to our clients. Some of our very large clients probably have some people that can be talking to people on the Hill. There are also committees like the ERISA Industry Committee (ERIC). I think it does take an awful lot of energy to lobby the Hill. In fact it has taken an awful lot of energy for the PBGC to get where it is right now on the minimum funding rules. A year ago I would have not been sure if something was going to happen or not. But it looks like something will happen. I think it's going to happen by the end of November. It's either going to be law or vetoed; I am not sure. But I think we need to work on this quickly.

MR. BLEAKNEY: I don't think there will be a strong lobby effort among actuaries. But I do think that it's important to recognize that as individuals, we do have an opportunity. And I don't think we should lobby just because of some frustrations that we are not going to be heard. I suspect that just about everybody has had occasion to find that his or her opinion is respected and I think that's an important thing to recognize. The frustration that comes with not always having everything come through properly should dominate. Part of the problem is that we do have a variety of rules and regulations and we should at least be working on trying to straighten some of them out. I think in terms

of benefit security, which is probably what led to ERISA. I suspect we do have better security now than we had 13 years ago.

MR. DAVID P. ROSENBERG: I have a question for Mr. Gebhardtsbauer and a comment. Observers of the Senate hearings on the Bork nomination have become familiar with a notion of original intent. I think that it is fair to say that the original intent of the framers of ERISA was that the PBGC would guarantee the security of employee benefits and not take companies off the hook if they promise their employees benefits, and then don't for one reason or another want to pay for them. I commend the PBGC for putting the ball back into LTV's court. Does this represent a real change in the way that the insurance program is going to be conducted? I am reminded of a story that some years ago when the Chrysler Corporation approached the U.S. Government for financial help, pension liabilities emerged as an important issue in the discussions. There was the implication that if the Chrysler Corporation had not received the federal loans these pension liabilities would be thrust on the PBGC with the horrific financial impact they would have had. Is it true that this was an important inducement in arranging the loan? Is this not likely to occur in the future as a result of what appears to be a changed PBGC posture?

MR. GEBHARDTSBAUER: With respect to your Chrysler scenario, I have only been at the PBGC a year so I don't know the answer to that. Perhaps there is someone here who might know the answer to that question.

MR. HOWARD YOUNG: I used to be with the United Auto Workers and was involved in the Chrysler discussion. Essentially you are correct, but some of the details are incorrect. The government didn't make any loan to Chrysler. It advanced a loan guaranty. And the point that was made was that the loan guaranty was a contention obligation and that through the PBGC system the government already had a contention obligation to Chrysler. So it was pointed out that at least to that extent there was not a new obligation that was being created.

MR. PEPPER: One thing is clear. In any event, overriding public policy concerns will impose their own definitions of adequacy and I just hope that actuaries don't become bystanders in the process.