RECORD OF SOCIETY OF ACTUARIES
1989 VOL. 15 NO. 3A

PENSION SECTION -- LATE BREAKING DEVELOPMENTS

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Recorder: BRUCE ANTHONY CADENHEAD

- o This session will deal with recent regulations, rulings and current topics from the IRS, DOL and PBGC. The panel will consist of government members and leading consultants.
  - -- Short business meeting
  - -- Review of 1989 activities
  - -- Plans for 1990

MR. PAUL A. RIZZUTO: As we attend this last Society meeting of the 1980s, we find the pension planning process to be more complicated and challenging than at any time in the decade. The absence of complete and judicious regulations under the Tax Reform Act of 1986 and under the Omnibus Budget Reconciliation Act (OBRA) 1987 leaves significant uncertainty in plan design and funding; this, in turn, frustrates coordination with the related areas of investment policy and accounting policy.

Ten years ago things were relatively quiet. For many plan sponsors, the plan's basic benefit formula is in transition. Our analyses and recommendations proceed with all deliberate speed.

In addition to traversing the current regulatory quagmire, we have a keen eye on recent developments in Congress. Numerous and diverse pension changes have been introduced, some with far-reaching implications.

We are fortunate to have with us an outstanding panel to address the current regulatory and legislative landscape.

Our first speaker will be Bill Nick. Bill is a Fellow of the SOA and is a principal in the New York Office of Coopers & Lybrand. Bill testified at the hearings on the proposed 401(l) regulations, and will offer one consulting actuary's views on permitted disparity.

Our second speaker will be Rebecca Wilson, staff attorney in the Office of the Chief Counsel, Employee Benefits and Exempt Organizations Division of the IRS. Rebecca will give us a brief update on guidance we might expect under OBRA 1987, and she will review in greater detail the seamless web of nondiscrimination rules under Code Sections 401(a)(4), 401(a)(26), 410(b), and 414(r). Rebecca is the docket attorney for 401(a)(4) and 410(b) regulations.

Our third speaker will be Harry Conaway, principal in the Washington D.C. office of Mercer Meidinger Hansen. Harry will recount budget reconciliation developments in the past few weeks, and will survey the pension proposals that might become law this year or next.

Before turning the program over to Bill, I should mention one other item of interest which was not on the scene ten years ago: continuing professional education credits for enrolled actuaries.

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MR. WILLIAM NICK: Our topic is Late Breaking Developments. Paul asked to me to talk about permitted disparity. I wouldn't call it late breaking -- the regulations have been out for almost a year -- I'd call it broken.

Rather than get into a technical discussion on permitted disparity, I'm going to made some practical observation based on my experiences. We tend to get caught up in rules and regulations responding to client requests and demands. But we, and our legislators and regulators, should all try to be more practical.

I would also like to make some suggestions, again based on my experiences, regarding some things which should be included in the final regulations either under 401(a) or 401(l). Hopefully I can influence Rebecca a little bit.

For a lot of companies, the integration requirements have a much more pronounced effect than ERISA, DEFRA, TEFRA or Retirement Equity Act (REA). While those laws caused plan sponsors to make a lot of changes in their plans, they were peripheral changes -- they were administrative changes, notice requirements, death benefits, etc. They didn't get to the heart of a retirement program which is the benefits themselves. We have clients who have kept the same benefit formula in place for 25 or 30 years without having to make substantial changes because of those acts. The integration requirements are actually making clients change their benefit plans.

Clients, particularly larger clients, don't want to change their benefit plans. They generally have plans which they are happy with and which have been in place for a long time. Performing the required analyses, getting the necessary approval and communicating changes to employees is a long and complicated process.

Employees don't like change either. Companies are going through a lot of changes in other benefit programs, particularly in the health area. Companies are doing a lot to reduce liabilities and to contain costs in this area, frequently either by increasing the employee's contribution or reducing benefits. Throughout these changes the pension program has been relatively stable. Employees are going to get even more upset when the employer starts tinkering with their retirement benefits. This concerns employees and employers and should concern us as practitioners.

Many of these employers truly believe that their plans are nondiscriminatory; and I would agree in a lot of cases. We addressed a group of senior executives at one of our client companies, giving them an overview of the steps they were going to have to take in order to comply. When we mentioned that the pension plan would probably have to change because it was discriminatory, the chairman of the board was extremely upset. He said, "What do you mean it's discriminatory? Our plan covers basically all of our employees with a 50% offset for social security. How can that be discriminatory?" It was difficult for us to explain the basis for the required changes.

Given that companies don't want to change, what are they doing? Right now they're doing nothing. They may have analyzed some alternative formulas, but until the 401(a)(4) regulations are issued there's still a possibility that they may not have to change their plans to comply with the nondiscrimination requirements. This is unfortunate because a lot of plans are operating now under various levels of frozen benefits and this could continue for several years if, as rumored, the relief provided by the model amendments is extended.

While the model amendment relief was much needed, it becomes more difficult to continue in this manner because it's difficult to communicate to employees why their benefits are frozen. All they have is a letter telling them that their benefits are frozen because of some rules that aren't out yet but that when they are out, the employer will go back and fix them so don't worry about it. Employees don't like it, which makes it a difficult environment in which to operate.

It would make sense to have some safe harbors either in the 401(l) regulations or, if the service feels that it doesn't have the statutory authority, in the 401(a)(4) regulations. If you have to test for compliance every year or every quarter, then if you pass one year but fail the next what happens to your plan formula? How does your plan operate and what do you communicate to employees? Unless you pass by a wide margin, this approach is not a very practical way to operate, especially for a large company.

One reasonable safe harbor would be to allow plans to have an offset based on the primary insurance amount. We all appreciate that one of the intentions of the 401(l) regulations was to correct certain abuses and I think we would all admit that abuses exist. But if the following requirements are met, then these abuses would be corrected:

- The offset must not be more than 50% of the primary insurance amount. Conceptually 50% makes a lot of sense because the employee pays for half and the employer pays for half.

- Proportionally reduce the offset for periods of service less than 35 years. This reduction eliminates the potential abuse where a person works five years for a company which then uses 83.33% for the offset.

- Require that a participant's benefit after application of the offset cannot be less than 50% of the benefit before the application of the offset. This is already in the regulations indirectly.

The obvious advantages to this approach are:

- It retains the Primary Insurance Amount (PIA) offset approach which is conceptually still the most reasonable way to provide pension plan benefits.

- It would eliminate the potentially abusive situations.

- It would provide a minimum level of benefits.

- It would allow those companies whose pension plans are not discriminatory, in particular large companies whose plans provide benefits for broad classes of employees, to continue to provide meaningful benefits without the need to communicate a change and cause concern among its employees.

- It would be a simple, practical and effective approach for dealing with integration which would be appreciated by companies, employees and practitioners.

We've done some analyses for companies that have these nondiscriminatory PIA offset plans. We have found that when you try to fit a plan under the new rules to the current plan -- *fit* meaning costs remain the same and benefits are replicated as closely as possible -- you can get 90% of the people within 10% of their prior plan benefits. In that case why do we have to change the rules and cause all this concern? Particularly since employees aren't going to understand these new formulas. They might not like the fact that their benefits are being reduced by Social Security, but they understand the concept of 50% because they pay for 50% and the employer pays for 50%. And they understand what a Social Security benefit is. They're not going to understand what covered compensation is or where 26.25% comes from.

It would also be helpful to include in either the 401(l) or 401(a)(4) regulations, an approach which would allow the offset to be the lesser of either an offset based on the primary insurance amount or an offset based on the 401(l) regulations. This approach is specifically prohibited in the preamble to the regulations based on the requirement that benefits must be uniform. I would question whether the statute should really be interpreted in this manner. Under the 401(l) regulations the offset and excess approaches are mathematically equivalent. The statute goes to great pains describing an offset plan and an excess plan. Why would the legislators establish two separate definitions unless they intended for an offset plan to be able to use the one offset and compare it with an alternative offset? And as long as an offset is less than the offset in the 401(l) regulations, it should be permitted.

We should work closer with people at the Service to achieve a reasonable end. Their objectives are not necessarily inconsistent with ours, but they may not appreciate the difficulties plans are facing and the fact that many plans are not discriminatory and that there aren't a lot of these abuses going on. In addition we have top heavy rules, 415 limits and the $200,000 limit on compensation to prevent abuses. Anything further would be like chasing ghosts. I can't envision how I could design a discriminatory plan since the loopholes have already been closed.

The 401(a)(4) regulations are obviously important because clients with offset plans who have not complied with 401(l) are waiting for them. Currently we have no idea how these rules will work.

I'm concerned because this is a very complex area with the potential for very complex regulations -- we've seen very complex regulations in areas one would not expect to be very complex. Hopefully these regulations will be drafted in a practical manner.

We do know that the calculations will be similar to the average benefit test under 410(b). I am curious as to whether, when we perform the 401(a)(4) test, benefit levels for highly compensated employees will be allowed a 30% margin over benefit levels for non-highly-compensated employees. If so, the typical offset plan -- 50% of pay less 50% of Social Security -- should be able to pass.

MS. REBECCA WILSON: I'm one of about 60 attorneys in the Employee Benefits and Exempt Organizations division of the Office of Chief Counsel at the IRS. We write regulations on employee benefits matters, both pension and welfare. We also write revenue rulings and private letter rulings. When we work on proposed regulations we work with the Treasury attorneys from Tax Legislative Counsel as well as both attorneys and actuaries from Employee Plans Technical. So we do have some actuarial input when we work on these regulations.

I'm the docket attorney on the section 410(b) and 401(a)(4) regulations. This means that I attend and participate in all the meetings of the drafting group. In addition I take all the phone calls and will be seeing these proposed regulations through to final form.

I've only been with the service for about a year. Before that I worked for about 5 years in a law firm in Portland, Oregon, doing mostly benefits work. So the attacks on the Service sort of roll off me because until very recently I was out there making those same attacks.

I should begin with a disclaimer; what I say is not necessarily the view of the IRS. My remarks are my own.

The primary focus at the IRS for the next few months will be to provide guidance enabling plans to get through this transition period and to get them amended and into compliance with the Tax Reform Act of 1986, the Technical and Miscellaneous Revenue Act (TAMRA) and OBRA. What we think is needed most and first are regulations under 401(a)(4) and the 414(r) separate line of business rules.

First, let me tell you about one other thing on which we are working on a very fast track. We will be issuing a notice or a revenue procedure very soon that will extend the 410(b) amendment period probably to the end of the 1990 plan year, although the exact period of the extension isn't set yet.

The 410(b) notice will first address transition rules. When we issue proposed regulations, we include rules designed to provide a fair and reasonable transition to accommodate the needs of the affected plans. These rules are based on our judgment at the time of drafting and sometimes with hindsight we see that they need some adjustment. We are now looking at some of the transition rules that we have issued in the past to see what adjustments might be needed.

Consider, for example, the 401(a)(26) proposed regulations on minimum participation. The general rule, remember, is that whenever you have a different right or feature under a plan, it creates a separate benefit structure, each of which must separately pass the 401(a)(26) requirement of 50 employees or 40% of all employees. The transition rule provides that a plan can ignore all separate benefit structures for the 1989 plan year except those created by the base retirement, early retirement and joint and survivor benefits. The 410(b) notice will probably extend this transition rule through the 1990 plan year, providing us with a way to give more guidance under 401(a)(26) with enough time for plans to comply with these regulations. We hope to issue additional guidance on 410(a)(26) in early 1990.

Because we need to get the notice out quickly, the 410(b) notice will not cover all of the transition rules. Those which are left out will be included in the proposed regulations under 401(a)(4) or 414(r). We are considering a transition extension for model amendment 3 under Notice 88-131. This is a troubling area because while it has been relied on by many employers, it is the least protective of participants' rights.

I would like to talk about 401(l) integration briefly. We recognize that there are some unresolved issues and some rumors about what we are going to do. All I can say is that we are considering

these issues and hope to have them resolved in the 401(a)(4) proposed regulations. It is too early to tell what, if anything, will be changed.

The 401(l) permitted disparity can be viewed as a safe harbor exception to the general rule of 401(a)(4) that would otherwise require equality of benefits. We are considering whether there should be other approaches such as perhaps what Bill Nick suggested. It's too early to tell right now. Your suggestions and comments can be very helpful, especially in those practical areas where you see problems that perhaps we don't.

One of the rumors I've heard lately is that we're going to kill flat benefit plans that use the fractional rate of accrual. There are still some unresolved issues in this area. I know this is a frustrating thing to hear, but it may be worth your while to wait for the 401(a)(4) regulations.

I spoke to somebody regarding the average benefits test who said that from what they could figure out about the test it looked like their clients' plans were going to pass. Then they finally got a return call from somebody at the IRS who told them something which produced an unfavorable result when they ran the test again. There's currently nothing that anybody at the service can tell you that will affect the outcome of the average benefit test because nobody knows exactly how it's going to work out.

One obvious thing that I might tell you on this is that the cure for flunking the average benefit test would be to add benefits for non-highly-compensated employees in order to boost their average benefits percentage. You should, however, think twice before adding benefits for non-highly-compensated employees because these additional benefits will be protected by 411(d)(6).

Revenue Ruling 81-202 will be the basis for comparability and for the average benefits test, which may be comforting to actuaries who are familiar with how 81-202 works. The legislative history of the Tax Reform Act of 1986 indicates that Congress intended for us to start with revenue ruling 81-202 with certain modifications expected.

For the 1989 plan year, you must use a reasonable and good faith approach until regulations come out. One way to do that is to use 81-202, update it as best you can, and apply it to your plan. If at this point your plan doesn't comply with 81-202, you probably will not satisfy 401(a)(4).

Keep in mind that 81-202 focuses on plan participants, which is fine for the 401(a)(4) analysis. But the average benefits test is administered on an employer-wide basis, taking account of benefits provided to all employees. An employee who does not benefit under any plan will have an average benefits percentage of 0.

The 401(a)(4) regulations will probably use the same restructuring approach found in the 401(a)(26) proposed regulations and 401(a)(4) optional form of benefit regulations. The restructuring would apply to both the comparability and average benefits test. This approach responds somewhat to Bill's concern that the 30% disparity should be available under both 401(a)(4) and 410(b). 401(a)(4) does not actually contain any provision for a 30% disparity, but by restructuring you may actually be able to take advantage of such a disparity. This is a change from our earlier position, but we feel that if the employer's plan scheme covers all employees then he exceeds the requirements of 410(b). In this case it would be unfair to penalize him, even if some employees receive greater benefits than others. The restructuring concept would allow plans to provide greater benefits to certain employees if they have a broad enough base of non-highly-compensated employees receiving the extra benefit under the restructured plans.

We hope to issue 414(r) separate line of business proposed regulations by the end of this year. We're trying to develop objective rules and some safe harbors. The hardest thing about developing regulations under 414(r) is determining exactly what constitutes a separate line of business. We are trying to establish objective standards that would make the test simpler if not easier to pass.

One possible objective standard is the Standard Industrial Codes (SIC). One question here is how many digits to use. You can use two, three, or as many as four digits. Another possible source is the Financial Accounting Standards Board (FASB) rules. If an entity is a separate line of business under those rules then maybe the Service should recognize it as such. A third possibility is what we're calling the investment banker analysis. If the employer sold off what he claims is a separate line of business, would both the employer and the buyer be left with a whole business?

The separate line of business provision also requires a nondiscriminatory classification test. We are considering using the test contained in the 410(b) proposed regulations. This two-part test consists of the reasonable classification requirement and the safe/unsafe harbor test with all the numbers and charts. Until the Service starts a ruling procedure under 414(r), you're left with the reasonable and good faith standard.

One other thing under separate line of business is the safe harbor in the statute which requires a filing. We're still trying to consider what approach to use under the filing requirement. We want to achieve compliance without imposing a great administrative burden. You can help us in this area. If you come up with an approach for determining what constitutes a separate line of business, let us know. We read and consider the written comments we receive before the regulations come out. They can be very helpful and you can actually be drafting a part of the regulation.

Paul asked me some questions on OBRA 1987 which I will try to answer.

- The current liability interest rate. We did issue notice 89-31 in May which gave some guidance. Additional guidance will be forthcoming within the next month or two.

- Possible exceptions to the 150% of current liability full funding limit. Apparently there is something in the OBRA 1989 proposed legislation which Harry may be able to tell us about. Unless that passes, the Service won't make an exception to the 150% rule.

- 401(a)(2) liabilities. The definition will be contained in a proposed regulation which will hopefully be issued in the early spring.

- 412(l). We don't have anything coming out on this anytime soon. We do recognize that it is very important to you that we issue some guidance in this area. However, our emphasis right now has to be on the basic guidance that employers need to amend their plans, meaning 401(a)(4) and 414(r) regulations. These OBRA 1987 issues are a lower priority item right now; we will try to get guidance out in early spring.

Let me tell you about the hearings we have coming up. The 401(a)(26) minimum participation proposed regulations hearings are set for October 30 and 31. That should take two days. We've had a number of comments and quite a few people are coming to speak at that hearing. The 410(b) coverage proposed regulations hearing is set for November 20 and the deadline for submitting outlines for comments is November 6. I'll be on the panel at this hearing. This hearing should take only one day since we didn't have as many comments on this topic. In December we have a public hearing on the 414(q) and (s) proposed regulations on highly-compensated employees and the definition of compensation.

We hope to have the 401(a)(4) and 414(r) proposed regulations by the end of the year and the 401(l) and 401(a)(2) proposed regulations by the early spring.

Paul asked me a question about the written comments on proposed regulations: "Does anyone read them?" Yes we read them. One of the docket attorney's responsibilities on a regulations project is to go over the written comments, studying them for possible changes to be made in the final regulations. So do write to us. We would like to hear from you and we do consider your comments. If you like, you can call us first to check out your interpretation of what we've been doing. It is sometimes hard to get hold of us. I'm about a week behind on returning phone calls now and that's good. But if you can't get hold of us, just write.

MR. HARRY CONAWAY: Now we turn to the legislative situation with respect to employee benefits. I would first like to review the recent procedural high points and then discuss some of the substantive provisions which are currently in the Senate budget bill or the House budget bill -- first provisions which have appeared in budget bills but have been dropped and may reappear before the budget reconciliation process is completed -- then provisions which haven't been at any bill but which have been talked about and which may turn up in a final budget reconciliation bill or perhaps a second tax bill this year.

PENSION SECTION -- LATE BREAKING DEVELOPMENTS

Recently, the House Budget Committee combined the deficit reduction proposals of the Ways and Means, Education and Labor, and other committees into a single House budget bill. This bill was taken to the floor and, after several modifications, it passed 333 to 91.

The big modifications on the floor are:

- o Complete repeal of section 89 and the reinstatement of various prior law rules.
- o Complete repeal of the Medicare catastrophic program.
- o The elimination of Visclosky joint trusteeship provision, which I'll go into more a little bit later.
- o Required filing fees for required filings. Otherwise known as a duck.
- o A $200 per participant plan termination fee.
- o Approval of the child care package.

Most of these modifications were done on the House floor before the final adoption of the House budget bill proposals.

The House modifications were folded into a Senate budget bill which was then taken to the floor. This budget bill was made a clean bill, eliminating most revenue losers. The stripped-down bill passed 87 to 7. The Senate also passed a separate bill, S1726, which cuts back the Medicare catastrophic program. So we currently have a stripped-down Senate budget bill with a very broad and far-reaching House budget bill.

House conferees began meeting last week and are continuing to meet this week to determine what strategy they will take in negotiations with the Senate. It appears that the House will decide to adopt a stripped-down budget bill similar to the Senate budget bill. The two sides will then go to conference and hopefully will reach an agreement within one or two days.

Once the budget bills are passed, the Senate and the House may do a second tax bill before the end of this year. The extent to which the budget bills are stripped down will be an important factor. For example, if the catastrophic program changes and the repeal of section 89 are not included in the budget bill, then there will be much more pressure for another tax bill.

I will now turn to some of the specific items in the bills as they currently stand, beginning with the Senate budget bill. The few provisions dealing with employee benefits would:

- o Repeal the section 133 50% interest exclusion for securities acquisition loans for employee stock ownership plans (ESOPs) where the ESOP owns less than 30% of the employer's stock.

- o Overrule an IRS general counsel's memorandum (GCM) and private letter ruling which permits deductible employer contributions to 401(h) retiree health accounts where the associated pension plan exceeds the 150% of current liability full-funding limit. Under the GCM, the subordination rule under 401(h) can be determined based on 25% of normal cost rather than 25% of the aggregate contributions made to the plan.

- o Increase PBGC premiums from $16-18 per participant. This increase became necessary after the Senate Labor Committee removed the filing fees and termination fees leaving a premium increase as the best way or perhaps the only way the Senate Labor Committee could find to meet its deficit reduction target.

As I mentioned before there's also a separate bill in the Senate cutting back the Medicare catastrophic program.

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Ways and Means provisions included in the current House budget bill are as follows:

- o Repeal of section 89 -- both the nondiscrimination and the qualification rules.

- o Restoration of the old 105(h) nondiscrimination rules for self-funded health plans; restoration of the old section 125 cafeteria plan nondiscrimination rules; reliance on the old section 79 nondiscrimination rules and the $200,000 compensation cap on Voluntary Employees' Beneficiary Association (VEBAs) under section 505.

- The section 129 dependent care 55% average benefit test would be retained.

- Permit a one-time tax-free transfer of excess defined benefit plan assets from the defined benefit plan to a 401(h) retiree health account in 1990 and 1991. The amount which could be transferred would be limited. Excess assets would be defined as assets in excess of 140% of current liability. Accrued benefits would have to be vested and annuitized before the transfer would be permitted.

- A transition rule under 414(r), separate line of business. In light of the repeal of section 89, this really affects only the pension area. An employer would be allowed to take a reasonable position with respect to whether it maintains separate lines of business and it can rely on that reasonable position for any plan year that begins before either the IRS issues guidance or the IRS opens its determination letter program with respect to 1986 tax reform changes. A reasonable position does not mean what the employer would like the rules to be, but rather a reasonable interpretation of the existing statutes. Although there is no legislative history to this effect, earlier in the section 89 discussions there was a reasonable position provision and a comment was made in the legislative history that it is not reasonable for employers to consistently take positions that were adverse to the government and favor the employer.

- A two-year extension of the section 127 exclusion for employer-provided educational assistance.

- It does not extend the section 120 group legal exclusion.

- A two-year extension of the 25% deduction for self-employed individual health premiums.

- Like the Senate, repeal section 133 for ESOPs that don't own at least 30% of the employer stock.

- Repeal the section 404(k) deduction for dividends paid with respect to stock held by an ESOP, again where the ESOP doesn't own at least 30% of the employer stock.

- Phase out the child care exclusion where adjusted gross income exceeds $70,000.

- Full repeal of the Medicare catastrophic provisions -- it's only a cutback on the Senate side. Due to the interaction of the effective dates of the repeal of the premiums and the surtax and the cutback in the benefits, it appears that the maintenance of efforts provision will have to be complied with for 1989. This is an important issue for employers confronted with big maintenance of effort issues.

I will now turn to the House Education and Labor Committee provisions which are included in the House budget bill. Although the Education and Labor Committee sent a variety of provisions to the House budget committee, they did not have much success getting the full House to adopt those provisions. The only major Education and Labor provision remaining in the House budget bill is the ban on employer reversions from terminating defined benefit plans.

Let me move now to the various provisions which have previously been included in bills but have been struck. The Education and Labor Committee provisions are as follows:

- The Visclosky proposal requiring all single employer qualified plans to have joint trustees with equal employee/employer representation. In many cases the Labor Department would have to oversee the election of the employee representatives. This proposal was not very popular and was soundly defeated in one of the few times there's been an explicit employee benefits vote on the House floor.

- Required filing fees for 5500s and the $200 per participant termination fee. The filing fee, which would be on required reports only, was an attempt by the Education and Labor Committee to raise revenue. The provision was characterized, as a procedural matter on the House floor, as a tax, and it was eliminated because the Ways and Means Committee had not passed on it. The $200 per participant termination fee was similarly ruled out of order. Since the proceeds would have gone to the PBGC, the termination fee was really an exit premium from the defined benefit plans system. People in the Education and Labor

Committee argued that the fee was akin to the withdrawal liability rule if you consider the PBGC a multiple employer reinsurance plan in which all single employer plans participate. All departing employers would share in the deficit of the PBGC, regardless of how well funded the plan.

- o Employee right to sue provisions. These provisions give employees the right to sue with respect to purported employer violations of the tax qualification rules. In most cases the tax qualification rules are also contained in title I of ERISA, so where these rules are concerned the provision doesn't add anything new. The significance of this proposal is that it would have allowed employees to sue to enforce the 410(b) minimum coverage rules, the 401(a)(4) nondiscrimination rules, the 401(l) permitted disparity rules, the 401(a)(26) minimum participation rules and the 416 top-heavy rules, all of which are not included in title I of ERISA.

Also still around:

- o Proposals to make civil penalties under ERISA mandatory. The Labor committees, in particular, are concerned that the Secretary of Labor is not viewed with enough fear in terms of enforcing title I of ERISA and so various penalties would become mandatory rather than discretionary. These provisions would impose a mandatory $200 fee for late filing of a report -- a 5500 for example -- which, after 90 days of tardiness, would be increased by a $1000 per day additional penalty. They would also impose a mandatory penalty of 20% of the assets involved for violations of title I of ERISA such as the exclusive purpose rule.

- o A Senate Finance Committee proposal to extend the section 120 group legal services exemption. This proposal is not currently included in either the House or the Senate bill. The Senate Finance Committee also proposed an extension of the 72(t) waiver of the early distribution tax for ESOPs through 1991.

- o Capital gains and IRAs. New proposals are being made regularly for IRAs which would put the tax benefit up front, in the middle, or at the end. It's still very unclear as to how that will turn out.

- o An alternative to the 150% full funding limitation. This proposal would have increased the full-funding limitation for certain employers with younger work forces and without a top-heavy plan. The Senate Finance Committee report, however, indicates that because they are working on a budget bill, they feel that this provision should be revenue neutral. To the extent necessary to maintain revue neutrality, the IRS would be directed to reduce the 150% full-funding limit for other employers. This provision was dropped from the stripped-down Senate bill, but I believe it was introduced into the House bill by Mrs. Kennelly of Connecticut.

- o A provision permitting 501(c)(3) tax exempt organizations to maintain 401(k) plans.

- o A provision in the Senate Finance bill which would have permitted increases in December 31, 1988 accrued benefits based on post-1988 pay increases under the 401(l) permitted disparity rules. In this case an employer would be allowed, both currently and in the future, to maintain only a nonintegrated plan with respect to affected employees. Based on my understanding, the proposals that the IRS and Treasury have been discussing are not as restrictive. One, I believe, would permit the post-1988 pay increases to relate to pre-1989 years of service without violating 401(l) as long as the 2-1 ratio portion of the rule was maintained. So, for example, an excess-only plan would be unable to take advantage of this rule because benefits would increase only for those with pay in excess of the integration level.

- o A rule directing the service to modify the geographic locale limitation under section 501(c)(9) for multiple employer VEBAs.

- o Changes in the employee leasing rules.

- o Changes in the 132 fringe benefit rules.

- Pension portability. The annual effort to make pension portability changes was included in the Senate bill but was stripped out. Portability sounds great and we're all in favor of it, but upon examination, any particular proposal would seem to create a large administrative burden without any significant gains. The administration strongly opposes both the reversion proposal in the Senate Labor Committee and the portability proposal.

Let me now mention a couple of proposals which are being discussed and may well appear in one of the final bills or in a subsequent tax bill.

There are a variety of bills introduced to override the Supreme Court decision in *Ohio vs. Betts* which overruled Equal Employment Opportunity Commission (EEOC) regulations with respect to age discrimination in employee benefit plans. The Betts decision was very favorable to many employers. These bills would retroactively reinstate the EEOC regulations.

The effect of the EEOC regulations on early retirement window programs and early retirement subsidies has created some difficulties. There have been hearings on this issue during which employers have voiced their complaints. It may prove more difficult than anticipated to overrule the Betts decision.

If, as expected, Betts is overruled retroactively, employers will not be able adopt programs in the interim which would violate the EEOC rules.

Senator Kasten of Wisconsin has reintroduced a bill in the House to make sure that section 89 will be repealed in the ultimate budget bill. My understanding of the bill (I haven't read it yet) is that it would not only repeal section 89, but it would also repeal section 105(h), effectively eliminating all nondiscrimination rules for employer-provided health plans. Because of the attention being paid to section 89, section 105(h) has also come under considerable scrutiny by those opposed to section 89. The 105(h) rules and the IRS regulations are currently very unclear and there is a lot of concern among employers about how those would be applied and the burden they would impose.

Senators Kassebaum and Dole have introduced what they call the "Excessive Churning and Speculation Act." This act would impose a 10% excise tax on gains received by pension plans from the sale of assets held for less than 30 days and a 5% excise tax on gains attributable to sales of assets held less than 90 days. Although this has not yet been approved by any committee, Senator Dole is a significant participant in the legislative process. The fact that he has signed on as co-sponsor should cause people to take this proposal somewhat seriously.

When Secretary Brady came on board during my last six months at the Treasury Department last year, he expressed a great deal of concern about the short-term perspective of corporate management. At that time we were working on a proposal which was very similar to the Kassebaum-Dole proposal. So it may not be a matter of a couple of isolated Senators interested in taxing the inside buildup of qualified plans but rather a broader option on a lot of agendas.

The trade associations in Washington have been attacking this idea very aggressively and I'm sure they'll continue to do so. The concern is that even if such excise taxes are adopted under the policy objective of encouraging a longer-term investment perspective, it will become the old nose of the camel under the tent with respect to taxing the inside buildup of qualified plans; 5% and 10% will become 15%, 90 days will become one year and then all of a sudden you've got a tax on the inside buildup. This is one of those issues that should be fought as a matter of principle from the very beginning.

I will wrap up by discussing next year a little bit. The budget deficit reduction target for fiscal 1990 was between $10 and $15 billion. The tax committees were directed to raise $5.3 billion in new revenue, and you may have been following the gyrations that the committee and the Congress have been going through over the last nine months. The Gramm-Rudman target for fiscal 1991 is between $50-60 billion, so this year may well be nothing compared to next year.

I'm sure there's been discussions by some of the prominent leaders in Congress about changing the Gramm-Rudman rules. What this means is that the targets would be reduced to below the current $50-60 billion. There's a sense that budget deficits are bad, but they're not bad enough, in light of the fact that the economy is still doing alright, to justify the political pain that members of Congress will feel in trying to fully meet the deficit reduction targets.

Regardless of what Congress chooses as its deficit reduction target, it's important to note that the number one area of foregone federal revenues by reason of a tax preference in the entire Code is the exclusion for employer-provided pensions, which amounts to $50 billion per year. Number four in the entire code is the exclusion for employer-provided health benefits, amounting to about $30 billion a year. If Congress is really trying to get $50-60 billion in deficit reduction next year, some of that will have to be achieved through revenue pickups. It's natural that Congress will look to pensions and health to help achieve these goals.

The Congressional Budget Office has proposed reducing the 415 limits significantly, and a further reduction in the 401(k) annual contribution limit to $4,000 or $5,000. Mr. Rostenkowski has made it clear that the section 89 repeal is not the end of the health debate. He and others are talking about a limit, a reintroduction of the tax cap idea and capping the exclusion. In addition I think new nondiscrimination rules may be proposed in the future.

I will close on that happy/unhappy note.

MR. THEODORE J. KOWALCHUK: I worked on large Fortune 500 clients when I was with George Buck, and other firms like that, but I have my own company now, and many of my clients have one or two people in their plans. I have about 1,000 clients. I appreciate Rebecca's coming here and I hope we didn't put too much heat on you. I really appreciate your sincere interest in getting our comments and I feel that actuaries should have a larger say in legislation and regulations and would encourage the actuarial profession to give the good people in Washington more input. I don't think that the regulations and laws should just be written by attorneys and economists and accountants. With due respect to a lot of the fine actuaries here, I have learned that the small-plan business is very different than the large-plan business and I would encourage many of my smaller-plan counterparts to play an increasing role in trying to achieve greater simplicity for smaller plans. We may be throwing out the baby with the bath water. Take 401(a)(26) for example -- the code itself, added by Congress, is half a page. The regulations are something like about 118-125 pages on separate benefit structures. The IRS seems to be overreaching by making rather than interpreting laws. The very intelligent people we have in Washington are making things too darn complicated. We need greater practicality.

Congress seems to be trying to come up with a new quick fix every year. They need to understand that with pension plans you have the concept of accrual of benefits. How can you administer a plan if five years from now you'll have to amend the plan again? Why should the IRS be put in a Catch-22 situation requiring model amendments A, B, C, D or 1 through 4? We've got problems. I think there are too many people in Washington who stay up nights thinking up abuses which really aren't there.

How can you have the IRS administer something like 401(a)(26)? My recommendation with respect to the proposed regulations for 401(a)(26) is to throw them in a basket and start fresh! Come up with something sensible and practical that's about 15 or 20 pages! I'm pleading with the profession and the good people in Washington. Let's not kill the private pension industry! Congress is being short sighted! Actuaries have done mortality studies showing that people are living longer and longer. Is Congress going to provide for all these people by means of Social Security? We need a good sound continued growth in the private pension industry! Let's all work together!

MR. CLAY R. CPREK: Rebecca, you made one comment with regard to the OBRA guidance to the effect that we will just have to bear with it. I would like to make one request that I hope you can pass along. I think we're all fairly certain that sometime around Christmas we're going to get an issuance of relief from OBRA for 1989. I think it was obvious to all of us that nothing was coming in 1989, so why can't we get that notice in January instead of the end of the year so that we can operate with at least some knowledge. I know you can't address that, but I'd appreciate it if you could pass it along.