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SMALL PLAN ISSUES

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Panelists: WILLIAM T. WILSON
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Recorder: GERALD D. FACCIANI

- What issues are facing small plans today?
- Do small plans still exist?
- Do defined-benefit plans still serve the objectives of small plan sponsors?
- Target-benefit plans versus age-related, profit-sharing plans

MR. GERALD D. FACCIANI: Bill Wilson is a Vice President and Defined-Benefit Practice Group Leader and consulting actuary for W.F. Corroon in Cleveland, Ohio. Bill has 10 years of experience in the employee benefits field. He's a Fellow of the Society of Actuaries, an Enrolled Actuary, and a member of the American Academy of Actuaries.

Bob Lebenson has been active in the employee benefit field for over 30 years. Bob was a member of the initial group of Enrolled Actuaries to be so designated by the federal government in 1976. His firm, Lebenson Actuarial Services, Inc., has its principal office in Las Vegas, Nevada, providing actuarial and consulting services to a wide clientele. Bob is a nationally recognized authority on a number of aspects of pension planning and has lectured on these topics on behalf of such institutions as Georgetown University Law School, Purdue University, Iona College, Manhattanville College, and American International College. His extensive writing on pension subjects has appeared in a diverse variety of publications. In addition to frequent appearances at the American Society of Pension Actuaries conferences, he has spoken at national meetings sponsored by the American Academy of Actuaries, of which he is a member, the Society of Actuaries and the Conference of Consulting Actuaries.

In 1985, Bob was president of ASPA, which, as you know, is a national professional society of over 3,000 members whose primary purpose is the education of actuaries and consultants in the pension field. Prior to his term as president of ASPA, Bob was vice president of ASPA and has been a member of its board of directors for the past nine years. He's been chairperson of its Government Affairs and Legislative Policy Committee, in which roles he has frequently testified before Congress and other federal agencies with regard to legislative and regulatory issues. He serves as chairperson of the Significant Issues Committee for the Las Vegas Chapter of the Western Pension Benefits Conference and as a member of the Chapter's Steering Committee.

Bob has just completed a three-year term as representative of the Actuarial Counseling Field on the Department of Labor, ERISA Advisory Council. For 1991, Bob was appointed by Assistant Secretary Ball as chairman of a Labor Department work group on small business retirement plans under the auspices of the Advisory Council. The report of that work group is an excellent summary of all the issues facing the small business private pension, profit-sharing, retirement plan sector. We really could not have asked for a better outline. So in order to facilitate what we consider to be the best kind of discussion and presentation for this session, we've decided to let Bob present some of the more salutary parts of this report, and then, since this is an open forum, we would like to handle a variety of questions after Bob has finished with his report.

MR. ROBERT D. LEBENSON: The work group that was convened in 1991 by the Department of Labor to address the issue of small business retirement plans was a very interesting group. Toward the back of the report is a listing of the individuals who were members of it, and you will see that it was hardly what you might call a stacked deck. As a matter of fact, only two of the ten people on the work group really had any direct experience with smaller businesses. Some were representatives of large employers. We had a representative of the AFL-CIO, Arthur Andersen & Company, so the report that we came out with is hardly something that was written by a "small business group."

It was written by a fairly representative sampling of people who have experience with benefit programs and experience in Washington, but not necessarily experience on the small plan side. A great deal of the input to the report, of course, came from organizations with an interest in small business -- everywhere from ASPA to the Small Business Council of America, the United States Chamber of Commerce and the New York State Bar Association, prominent among small business organizations, but the Pension Rights Center and the Employee Benefit Research Institute (EBRI) and other organizations that were perhaps more neutral were also a part of the witnesses that appeared before the work group which occupied most of 1991.

What I'd like to do is to just briefly discuss the 10 or 11 conclusions that we came to as a work group, and I will say that every one of the conclusions that's embodied in this report was unanimously agreed to by each of the members of the work group, and the report the work group prepared was unanimously endorsed by the full Labor Department ERISA Advisory Council. Naturally, one of the concerns that we went into -- at least the small plan practitioners -- was that of the complexity of the pension rules, the changing nature of the pension rules, and the effect these might have on small business. In fact, we came to the conclusion that, despite the complexity of the rules and the fact that complexity certainly does have an effect on retirement income coverage in the small business sector, the basic reason that small business retirement plan coverage is so much lower than it is in medium- and large-sized businesses is due to a series of economic factors.

For example, more than 50% of small businesses that start in this country do not make it for five years. Now, assume you're a small business owner and you're in a position where you're trying to survive that five-year period and obviously a bit longer than that five-year period. Probably the last thing on your mind, when you're struggling to make payroll and do all of those other kinds of things that are really necessary to keep a business afloat, is the establishment of a retirement plan. The fact is that in the area of businesses with under 100 employees, which are independently owned as opposed to a few businesses that have less than 100 employees but are owned by larger companies and participate in their benefit programs, only 35% of employees are covered by retirement programs compared to 81% in the over-100 category. So you can see that there's a dramatic drop in coverage. Less than half the employees in the smaller businesses are covered percentagewise compared to the larger businesses.

Then, if you drop down to below 25, the figure gets cut in half again. Only 17% of employees in businesses with less than 26 employees have retirement plan coverage.

The basic reason, to repeat, is economic factors, and one of the central economic factors is simply the staggering cost of health care. I know that Chairman Rostenkowski spoke about that at the General Session. That is a major issue facing small business. It's certainly one facing my small business, which employs 22 people, and has had a 91% health insurance rate increase over the last 2.25 years. The fact of the matter is, particularly in the small business population, which tends to be individuals who are younger and less skilled than perhaps the average population working in larger businesses, health benefits are far more important than retirement benefits.

The surveys that EBRI has done have indicated that the most important fringe benefit is health care. The second most important fringe benefit is more health care, and only 32% of the individuals in small business who responded to an EBRI Gallop study indicated that the absence or presence of a retirement plan would have an effect upon their decision to take a job at a particular small firm. So retirement plan coverage is down the line in employee perception and the cost of health care is something that, since it is so important, has become by far the primary benefit in small business, putting retirement plans in a distant second place.

One of the things that we found quite interesting was, considering what I just said, the only way to get small business retirement plan coverage is to mandate it. President Carter's Commission, of course, came up with the idea of a Minimum Universal Pension System (MUPS). EBRI did a study about MUPS in the small business community, and EBRI found that, among employers with less than 25 employees, just barely 50% of those employees would be covered even if coverage were mandated under the terms that MUPS suggested, which were basically the ERISA eligibility requirements of a year of service/1,000 hours. Only about 69% of employees in the 25-99 quadrant of employees would be covered. This reflects the fact that the small business work force contains an inordinately disproportionate share of part-time employees who would not benefit even from a MUPS-type proposal.

Now, this sort of set the framework for the remainder of the deliberations on our work group. We recognized that a lot of the problems that I just spoke about were really beyond the scope of any group that had an advisory capacity with respect to pensions. There's nothing that the ERISA Advisory Council can do about the rate of business failure among small firms. It isn't in its charter to have too much to do with the cost of health care. So what we then did was to focus our remaining recommendations and our remaining study on those businesses that we called economically stable, those businesses that were in a position to afford a retirement plan but, for one reason or another, did not have one. Among those businesses, we did find that government regulation was a very significant, if not the predominant reason, that the firms that did not sponsor retirement plans were in that position.

A number of our recommendations from that point forward focused on that economically stable segment of small business. Primary among those recommendations was that a high degree of importance be attached to any form of recommendation that relates to improving the rate of preservation of retirement benefits over the years.

The Labor Department Advisory Council had a lot of study groups over the years on the subject of portability. Portability sort of divides into two categories: one of them being accrual portability, the actual ability to take your accrued benefit with you to a new employer and have it enhanced by subsequent pay increase; the other, which is a lot easier to deal with in many respects and has been labeled preservation, is simply addressing the fact that, among employees of all-sized employers, of the distributions that are taken from retirement plans at termination of employment where such distributions are available, either from defined contribution plans or from defined-benefit plans that have lump-sum options, more than 85% of that money is consumed immediately.

The structure of the law today does not in any way enhance the preservation level of retirement benefits, and consequently, even among employees who do have retirement plan coverage, the likelihood that they will reach what one might think of as a retirement age with actual retirement savings from any but their last employer is very low, if 85% of that money is spent. Interestingly enough, the biggest single category of spending of retirement plan distributions is to repay credit card loans. We found that absolutely amazing.

We recommended strongly that prior Advisory Council reports on preservation be considered by the Secretary of Labor in legislative recommendations. We were also concerned about measures to enhance benefit security, particularly given the fact that within the small business retirement community defined-contribution plans are so prevalent. One of the issues we had been asked by the Secretary to address was whether some form of expansion of simplified employee pensions (SEPs) would make a major contribution toward retirement plan coverage and participation in the small business area. I don't think the Secretary was particularly happy to find out, considering that the Power Proposal, which is the administration's cornerstone proposal regarding retirement plan simplification and includes a significant expansion of SEPs, that we came to the conclusion that an SEP was not a vehicle that had a significant chance of improving employee coverage regardless of how it was modified and regardless of what changes were made to make it theoretically more attractive to small employers.

I think it's interesting to note that SEPs have been around since the Revenue Act of 1978. During that period, which is now 14 years only 1% of small employers have adopted an SEP. In our opinion, the Power Proposal initiatives to theoretically enhance SEPs would not result in any significant level of improvement beyond that. However, we did feel that there were a number of legislative initiatives that could be taken that would, in fact, enhance retirement plan coverage and participation in the economically stable segment of small business.

A number of these were contained in legislative proposals that were made by one member of Congress or another in 1991. Others of them are recommendations that the work group made relatively unilaterally, and frankly, they have not found their way into any legislative form to date. Page 63 of the report has a discussion of the areas wherein we recommended modification to the existing law, and we figured we'd come on strong with the most controversial one of them coming first, which is the repeal of the top heavy rules. Virtually all the witnesses that we heard during the period of time that we took public testimony were unanimous in supporting the top-heavy repeal concept.

We also felt that the definition of highly compensated employees should be simplified. Now, this is something that has been contained in a number of legislative proposals, so we're encouraged that it may be enacted if pension simplification becomes a part of tax legislation during 1992 or 1993. Small business, in particular, is sensitive to the family aggregation rules that are a part of the highly compensated definition -- there was unanimous agreement that those rules should be repealed. Separate line of business rules should be modified to remove the 50-employee minimum. There's nothing different between a separate line of business that employs less than 50 employees and more than 50 employees. The minimum participation rules should be repealed.

In regard to Section 401(a)(4) regulations, a number of suggestions were made for modification, but principal among them was the removal of the restrictions on the usage of past service credits beyond the safe harbor period. Recognizing that small businesses tend to be so fragile in their early years, it's virtually impossible to start a retirement plan within that five-year period simply because the businessman is fighting for his life. To deny the opportunity to receive past service credit once the business does become economically viable seemed to us to be discrimination directly against small employers. Modification of the 401(k) plan tests to permit look-back testing is certainly something that has been included in most of the legislative proposals, and we do expect to see some activity on modification or elimination of the quarterly contribution requirement with respect to small plans and well-funded plans.

The recommendations that our work group made -- and I have to emphasize the fact that the work group was not stacked in favor of small business interests -- were recommendations that would be considered relatively a good wish list by individuals who are directly involved in small business retirement plans. The rest of the report is self-explanatory. I'll be more than happy to take any questions on the report.

MR. ROBERT I. MCCAW: I'm a small plan actuary and one area that I find particularly obnoxious is the 417(e) requirements as to interest rates on lump-sum pay-outs in coordination with the interest rates that are required for current liability calculations and this kind of thing. Often you find yourself in a position where it's absolutely impossible to fund your liabilities with deductible contributions. Was this brought up in the report at all?

MR. LEBENSON: Bob, it was not brought up in the report. I have to admit that, in the process of conducting this work group and because we had such a diverse group of individuals who were not necessarily familiar with the more technical aspects, the conduct of the work group, to an extent, was an educational process -- the witnesses educating the members and then me and one other individual who was involved with small plans coming along and trying to educate them still further. Frankly, we didn't get down to that level of detail. I know that it has been specifically addressed by ASPA in its legislative recommendations for the last year or year-and-a-half, but it didn't find its way into our report.

MR. ETHAN E. KRA: I know you've defined the small employer as being 100 and down. There are smallish employers, or however you'd like to call them, let's say 100-500 employees. In our practice, we've noticed a trend over the past number of years of many of them moving away from defined-benefit plans because of the onerous administrative burdens being imposed upon them by the IRS and the PBGC and other bodies. If you go back a dozen years, these employers needed one actuarial evaluation every three years. Today you need four valuations every year: one for FASB, two for IRS and one for the PBGC. To what extent was this highlighted that the high administrative burdens being put on plan sponsors in relation to the amount of benefits being delivered may have reached the point that, for many employers, the plan is no longer an economically viable means of delivering benefits and compensation to employees?

MR. LEBENSON: You make a series of very excellent points. One of the recommendations that we made, and this will sound like it isn't what you're talking about, but I think it will come back around to it, was that each legislative proposal and executive department regulation that the federal government enacts in the retirement plan area should be required, by law, to submit to a rigorous cost-benefit analysis to address just the kind of concerns that you're talking about. You're certainly hitting on some very valid areas. There are a number of other very valid areas where you see regulations put together to make sure that the possible employers who could abuse something or other can't get away with it and that anyone with a reasonable eye toward a cost benefit analysis would say, "That's pure nonsense. You can't micromanage retirement plans or the economy to the extent that you're attempting to do it."

We did, by definition, only address employers with under 100 employees, so I have to admit that we didn't consider difficulties in our work group that you're expressing for employers in the next group up. But I can tell you that I agree with you that those problems are causing defined-benefit terminations in my own practice in Nevada and, as Jerry knows, if a defined-benefit plan terminates in Nevada, that cuts the defined-benefit population in Nevada by 10%. We don't have a whole bunch of them out here to start with, because Nevada's economy really only came to life in the early and mid-1970s, and by that time ERISA was on the books and the trend toward defined-contribution plans was on.

Since ERISA was enacted, and this is at all segments of business, 80% of the new retirement plans that have been formed have been defined-contribution plans. That rate is going up, and it's for the types of reasons that you just mentioned.

MR. KRA: We've seen in our practice that, if you go back into the late 1970s, post-ERISA, you still would see employers in units of 20, 30, 50, 100, 200, 500 employees thinking nothing about setting up a new defined benefit program. Over the years, as the regulations and the requirements for compliance have grown more and more complex, that threshold number of minimum number of employees has grown and grown to the point now that very rarely do we see a group of under-500 lives coming in to set up a new defined-benefit plan, and that generally they'll go for a defined-contribution plan, or sometimes even nothing.

MR. LEBENSON: I'm in full agreement with you, and I'll just carry it to the next size level or maybe beyond that. As you folks drive around Las Vegas, you'll see a number of remarkably large hotels. You're in one. This is only the fourth largest hotel in town, by the way, and soon to be sixth, but this hotel employs 5,000 people. To my knowledge, only one hotel of what you might call the major strip hotels sponsors a defined-benefit plan. Every other hotel in town, whether they have 1,000, 2,000 or 5,000 employees, are relying on a defined-contribution plan at this point.

Jerry suggested that I touch on a couple of the other recommendations that we made. Throughout the testimony that we heard, particularly from small business advocates, there was a concern about the fact that in the small business area in particular, which after all, has less facility and access to nonqualified plans to supplement qualified plans, plus has to bear, as the gentleman indicated, a much higher proportional cost of compliance with the law and everything else like that, that the reductions in the various maximum limitations was one of the factors that contributed toward the lack of coverage in the small business area.

A retirement plan simply isn't worth it if the limitations are as low as they are. I think you should recognize that when I say as low as they are, that the current limitations are considerably less than 50% of what they would have been had the TEFRA freeze not taken place, along with the subsequent reductions that have also occurred. The original ERISA limitations on benefits would be significantly higher than what we have now. Whenever you talk in Washington and you talk about increasing a limitation, you have to talk about the fact that it theoretically will cost the government some money in the form of a tax expenditure.

One of the suggestions that was made by another member of the work group was that there has to be some kind of a balancing point if we're concerned about retirement preservation and if it is clear, which it seems to be from the numbers I quoted earlier, that 85% of the preretirement distribution money is consumed immediately, and that the 10% penalty tax is not one that has any material effect on preservation of retirement benefits.

It occurred to us that some kind of a balance could be struck between a simultaneous increase in that rate of taxation combined with some kind of an increase in the various limitations of Section 415, and so on, such that you could produce a revenue neutral pattern that would have, on the one hand, the increase in retirement benefit allowances that would make retirement plans more attractive to small businesses and, on the other hand, the preservation objective might also be satisfied in that the higher rate of tax would be a deterrent to some segment of the population that leaves employment with retirement plan distributions and does not roll it into another retirement vehicle.

I was very surprised at how cordially this suggestion was received by the folks at the Labor Department. I'm saying the Assistant Secretary and his various deputies. We had a long, semiprivate discussion. You're not allowed to have really private discussions because of some act that they passed back during Nixon's administration or something. In any event, the idea was one that was favorably received. I can't say that it has appeared in any legislation at this point, but I'm really not surprised that it hasn't because it does take the Labor Department, and any other department in Washington for that matter, some time for a new idea to percolate up to the point where it actually becomes a part of an initiative by an executive department and then translates into any sort of legislative action.

I'm really optimistic that we may see something of that nature. By the way, I should make the statement, and I would love Mr. Facciani to disagree with me because we have an awful lot of fun arguing about things like this, that I really believe that we're at the point where the pendulum is just about to start swinging in the other direction with respect to retirement plan legislation, and particularly retirement plan legislation that has to do with small plans. I'm not saying that we're ever going to get back to Nirvana of the late 1970s where there was really a boom in small business retirement plans, and retirement plans of all sizes, but I do think that there's a fairly widespread recognition in Washington that things have gone too far. The fact is that the tax bill that was recently enacted by Congress and vetoed by the President -- but, of course, his veto had nothing to do with retirement plan issues -- did contain a number of the recommendations that we made in our work group and that have been made by other representatives of small business. The fact of the delay and apparent significant rewrite of the 401(a)(4) regulations and related Treasury issuances is another sign to me that the folks in Washington are being forced to listen. I certainly have to say that, when you have the entire Senate Finance Committee on a bipartisan basis writing a letter to the Secretary of the Treasury demanding that these regulations be deferred for at least a year and that study be given to modifying them, you have a pretty powerful bunch of people who are starting to sound like they're on your side.

MR. FACCIANI: If it's an argument you want, you'll get it. First of all, the small defined-benefit plan is dead in my opinion. Our business has been through a cycle in Ohio and the western states where 95% of what we did was small defined-benefit plans and virtually all of those have been terminated. I think, if anything, the pendulum has finally swung to slit the throat of the small business plan rather than swinging upward away from the body. I think if we see anything in the reactionary measures of those Senators, Congressional Representatives and regulators who are decrying the demise of the small business plan -- and there aren't that many of them, Bob, you know that -- there aren't that many of them who really understand the issue, that it is just a popular thing to talk about because small business is pretty powerful, and it is griping about a lot of things now, mostly health care.

I think the more likely scenario is that, if small business retirement delivery becomes a critical national priority, we're more bound to see mandated systems rather than voluntary systems for all the reasons that your group reported. So, while I won't go so far as to say that I think you're deluding yourself, because I don't think you're a deluding sort of guy, I do think that you're being awfully optimistic about what might happen with regard to private, voluntary coverage. A more likely scenario is to give employers the opportunity, whether they be big employers or small employers, either to implement defined-contribution plans without the 1,000 hour/one-year requirement that was in the President's Commission on Pension Policy Report issued in 1981 or to mandate a wider net under Social Security, which would be a little bit harder to sell. Then, again, the opt-out would be the defined-contribution approach.

There are just too many things going the other way. As we all know, there's been a small plan audit program that has turned small business off. Now there's the closing agreement procedure (CAP) program and this administrative policy regarding sanctions (APRS), which are going to nail small plans and large plans. Nobody is implementing small defined-benefit plans. Everybody is recommending against them. The trend, as you said, is 80% defined contribution since ERISA and moving upward. How on earth can you think that it's going to go any other way?

MR. LEBENSON: This session is billed as an open forum, so you've heard what Jerry and I each had to say. I'd sure like to hear what other members of our audience have to say. I will say that I do agree with one point that Jerry made and only one, and that is that there are a very limited number of members of Congress who really understand these issues. Anybody who'd like to comment on either of the positions that Jerry and I took, or maybe take a third one? Don't be shy!

MR. FACCIANI: If you're all going to be shy, then I'm going to ask a question. Have any of you felt the impact of the IRS CAP Program, or the APRS on small plans? I'd really be curious to hear from those of you who have had any experience with this. No one has had experience? Bob, have you? Bill?

MR. WILLIAM T. WILSON: We've had a few plans in our office where we've had the IRS basically say these are the infractions that we've determined that you've made and here's what you need to pay, and we'll call everything even. It's all been directed just towards the very smallest plans that we've had. None of our substantial plans have even been approached by the IRS on this, so just from my limited experience, it seems like there is a direction toward just the small plans.

MR. KRA: The case I know of is anecdotal. It's not one handled by our firm, but I have, third-hand, a situation of a small plan, for a professional corporation, where a physician had retained an actuary to do his actuarial work and the physician knew nothing of actuarial science methods, laws or regulations and entrusted his plan to a professional or an individual he believed to be a professional. The actuary not only used what might be viewed by the IRS as aggressive assumptions, but also the actuary valued, assuming age 62 retirement, the 415 limit at age 62 would be payable and the benefit payable at age 63 following an age 62 retirement would be the 415 benefit payable at age 63, increasing to $90,000 at age 65. The IRS was so incensed with that methodology that it has refused to allow the physician into its closing program, saying that this was egregious and wants to throw the book at the small group. The physician is ripping his hair out saying, "I don't know what all this stuff means, but they said it was so terrible that they won't let me even settle." Any comments?

MR. WILSON: That's the first I've heard of a time when they did not want to settle with a private employer.

MR. KRA: They're only willing to settle on the basis of "throw the book at them, everything under the sun," not the standard closing.

MR. LEBENSON: They're looking to go for full disqualification.

MR. KRA: They're going for blood.

MR. LEBENSON: I think that I've been relatively lucky. We've had our share of actuarial audits relating to assumptions, but the audits that we've had in our office have not uncovered issues that would be related to the CAP as of this moment. I'm really not too experienced in its operations. Again, if anyone else would like to come forward, we'd love to hear what you have to say.

MR. KRA: It would be interesting to read copies of some of the transcripts, if they're available yet, of the court proceedings before Judge Clapp in Washington in January 1992. The feedback I have, anecdotally again, is that the private sector did a very credible job in its presentation of its cases, and that it would be well worth getting transcripts of the actuarial testimony for both sides.

MR. LEBENSON: From what I know of it, Ethan, I again agree with you. I think that of equal importance to the fact that the private sector did a very credible job is the fact that the IRS seemed to select a bunch of expert witnesses who didn't agree with the IRS positions. If you look at the testimony, it clearly is between the two points of view, but it is closer to supporting the private sector side than the IRS's demands. Let me also point out, and this is not intended to cut anybody off on this discussion because we certainly want to hear as much from the audience as possible, but there is going to be a small plan audit session at this meeting. I know it's being conducted by three of the individuals who were directly involved in the testimony and the hearing process before Judge Clapp, so a lot of the information that Ethan was just suggesting may be available in Session 62.

MR. FACCIANI: I would like to hear from the audience to see if anyone is implementing small defined-benefit plans, to see if there's any way to reverse the trend of small defined-benefit plan terminations. We want your opinions on this. We've got to know what's going on out there in the marketplace. We have our opinions, but we'd like to hear what you have to say.

MR. BRADFORD A. CREVELING: We've seen the start of a couple of new defined-benefit plans, but they're all one person to put their kids through school, 55 years old, high five-figure, low six-figure income, maybe a spouse who's retired, so they want to salt away as much as they possibly can and well in excess of the 25%. I think nationwide there may be 100 or 200 of these plans for us, but we are seeing some, but not in the small employer where it might be PBGC covered. That's a problem.

MR. LEBENSON: Brad, just out of curiosity, what geographic area are you?

MR. CREVELING: Portland, Oregon.

MR. MCCAW: We're putting in a few, too, some of the type that Brad described. Another niche that we found is university professors and similar types of people often have a consulting income on the side and, considering the security of their position as a professor, you find that they've got the ability to set up a defined-benefit plan.

MR. LEBENSON: Southern California?

MR. MCCAW: Seattle.

MR. LEBENSON: Well, things are starting to pick up in the Pacific Northwest it seems.

MR. RICHARD JOSS: I hate to make this comment, but we might as well get it on the table. I think the defined-benefit plans are fairly dead, period, of all sizes. The reason I say that has to do a lot more with technology than with government regulation. If you can put yourself mentally back 20 years, and you're running a big company and you have your choice of trying to keep track of individual records in a precomputer era versus having a defined-benefit plan that may have vesting at age 55 and 20 years of service, no funding requirement and you only do a benefit calculation when someone quits and is vested, there is only one choice: defined benefit.

We're now living in a very different time in which large employers are going to try to use defined contribution to the extent possible and to the extent they can afford it and only use defined benefits as a boutique or a special-situation-type solution. As an actuary, and I'm looking towards health insurance as a place to get smart in a hurry. That's the end of my comment.

MR. WILSON: I would like to ask a question. We've seen increasing complexity in the government regulation for quite a number of years, and I, for one, was very surprised when Section 89 was repealed. I just want to know the attitude or the opinion of some of you if you think we're getting close to having some simplification on a major scale or repeal in the retirement plan area of regulations.

MR. KRA: Back prerepeal of Section 89, when Section 89 was alive and kicking -- I won't say alive and well because I don't think it ever was well for our country -- I attended a session where Kent Mason, one of the principal authors of Section 89, was a presenter. Afterwards, my comment to him was that effectively what Section 89 did was create a lot of nonsensible, nincompoopal paperwork, paper pushing and decreased efficiency of the American economy, decreased productivity, and effectively helped America turn itself over to the foreign competition. Section 89 did not add anything to the economic welfare of this country, other than shifting a smidgeon for a tremendous amount of overhead.

Much of our pension regulations, I think, may have finally reached that point because Congressmen are finally focusing in on them. When did you ever have Senate committees and senators introduce bills into Congress to defer an effective date of a regulation? They didn't intend it to be this complex when they passed what sounded like simple, pure words almost six years ago. They never envisioned it would take six years just to figure out what to write, let alone how to interpret it on the other side of the table.

I hope the repeal of Section 89 followed by the deferral of the 401(a)(4) regulation package just is the start of a whole trend where the government is recognizing that, to the extent it imposes burdens on business, effectively it is making the American economy uncompetitive and turning America over to foreign competition.

MR. WILSON: That's a very good point. In fact, it would be interesting to watch the effect of the economy and the complex regulations in conjunction. Thinking back, we had very productive and growing economic times during most of these pieces of legislation, and now we have quite a different scenario.

MR. LEBENSON: I think it's safe to say that, if the members of Congress, thinking back to what Jerry said and my agreement with him that very few of them understand what they're doing, went back and read what they wrote or what their staff wrote for them in 1986 concerning that which has become the 401(a)(4) regulations and read the legislative history, they would find that the regulations as issued at this point are directly contrary to what was said in the Conference Committee report and the statement of managers for the Tax Reform Act of 1986. That legislative history specifically instructs the Treasury Department to fundamentally follow the approach of Revenue Ruling 81-202; that is, to test discrimination on the basis of projected retirement benefits. Those exact words are contained in that legislative history. Of course, that is not what has happened in 401(a)(4).

Even those folks who have been paying attention or who have come to the conclusion that the regulations are a bit too complicated don't necessarily understand that they're not only complicated, but also they may not be what was meant to be said in the first place. There is a Council on Competitiveness that has been formed within the Executive Branch to study just the kind of questions that Ethan has commented on, and that Bill has commented on with regard to the drag on the American economy that these federal regulations may have.

MR. JEFFREY F. HARTMANN: I remain kind of pessimistic about the future of the small defined-benefit plans. I don't think I've set up any in my company in the last couple of years. As long as the full-funding limitation is still in place, and we don't raise the limits more than just cost of living, I see very few candidates for the defined-benefit plan being the better plan for somebody to look at. We've been terminating a fair number of plans lately, but I think most of those terminations recently have just been the economic situations of the company involved. Maybe we're past the phase of where the regulations are causing the terminations. We have set up some plans and our focus is on some of the newer ideas in the defined-contribution area with the age-weighted, profit-sharing plan. I was wondering what anybody's experience has been in setting up these plans? Are you finding a lot of interest in them?

I also saw a new wrinkle surface recently, and I don't know how long it's going to be alive or whether much is going to happen, but some firms have been promoting what they call new comparability where they use some of the nuances of the general test. They actually do what smells discriminatory to me, where they have, let's say, a 20-30 life plan, a law firm where a couple partners are making over $200,000 and they get a $30,000 contribution for the partners, which is about a 13% rate of contribution, and everybody else is getting 3% of contribution and it passes the general test.

MR. LEBENSON: That was the Lou Kravitz presentation at the ALI-ABA.

MR. HARTMAN: Yes, right.

MR. LEBENSON: Speaking for myself, we have found that after utilizing age-weighted profit-sharing plans, when we started talking about them, which was really pretty shortly after the proposed regulations came out, we decided to call them target profit-sharing plans. Our terminology seems to have been overtaken by the industry, which is calling them age-weighted, but we have seen enormous enthusiasm for them, and I will say that it is not limited to small business by any stretch of the imagination. We have two or three firms that have between 500 and 1,000 employees that have had a profit-sharing plan for a number of years or a defined-contribution plan – one of them was profit sharing and one wasn't – that have converted to an age-weighted, not the full-blown general test approach that you're talking about, but just simply weighing on the basis of the present value of an accrual of 1% of pay, which is your basic age-weighted, profit-sharing approach.

It's something that has met with a great deal of enthusiasm, and frankly, I don't think it's anything to do with being a discriminatory plan. It may look like it's discriminatory, but what you are doing is following the exact spirit of the nondiscrimination rules and providing an equivalent accrual rate in terms of benefits across the board. How about other people's experience with either age-weighted, profit-sharing plans or target plans or things of that nature, which are all sort of in the same family? Have you been doing many of them, Bill?

MR. WILSON: We haven't seen much interest for them. It might have a little bit to do with the type of industries and the geographic area where we're practicing. What we have seen has been basically much more interest in converting a current plan into one of these than in starting up an age-weighted, profit-sharing plan from an employer that has nothing currently.

MR. LEBENSON: Another thing that we've seen a bit of interest in, and this is not the kind of a thing that works in every kind of a situation, is a combination of plans where you're looking at a defined benefit plan and it may be an existing defined-benefit plan that wants to stay as close to the way it is as possible or, in those rare instances, it may be a new defined-benefit plan that would, in fact, tend to fail the general test. We found a lot of interest in using what we simplistically call a helper plan, which is simply a profit-sharing plan that, by definition, includes no highly compensated employees, with the idea that we're going to test on a benefit basis the two plans combined.

If you've got a defined-benefit plan that is mildly over the limits, you'd be surprised what a low rate of contribution to the profit-sharing plan will correct that. You find yourself all of the sudden passing the general test going away. Of course, another advantage to it is the fact that you're in a position to determine, after you have done the test, exactly what that rate of contribution needs to be so that you can vary it from year to year to maintain the contribution level at the point that it needs to be in the profit-sharing plan.

MR. KRA: With age-weighted, profit-sharing plans, you can easily replicate a career average defined-benefit plan. Has anyone given thought to ways of dealing with past service credits that you could do in a defined-benefit plan and get them through the age-weighted, profit-sharing? Because very often you'll see in that middle-size market that plans are willing to contribute the dollars to produce the benefits, but they view the age-weighted profit-sharing plan as a way of getting out from under the administrative burdens: PBGC premiums and all the actuarial certifications. You just do a calculation and credit everyone's account. People love to be able to control their investments. But how do you deal with past service credits? Any ideas?

MR. WILSON: No.

MR. LEBENSON: We haven't at this point, but I'd love to hear how anybody else has.

MR. MCCAW: We have seen a couple of these. There's a limit to what you can do. We felt like we have to stay within the spirit of the 401(a)(4) regulations since that's what age-based, profit-sharing plans are coming from in the first place, but you're not necessarily limited to providing the same accrual rate on everybody. You're allowed to count five years of past service, at least from the date of inception of the plan, so you can be creative to some extent in the formula that allocates the contributions as long as you're passing the general test.

MR. LEBENSON: How many folks out there have worked on one or more age-weighted, profit-sharing plans? It looks like about a third of the folks. We'd love to hear any other experiences you've had with them.

MR. FACCIANI: We have now hit every subject area. I think we've concluded that small defined-benefit plans are dead, that there may be a market for age-weighted, profit-sharing plans given the fact that a third of the hands went up; but since nobody spoke up that must mean that not many of them have been put in.

MS. MARILYN DUNSTAN: I had a question regarding your comments on mandated benefits. If you mandate benefits, to the extent that you mandate them, what is the need then to provide an incentive for employers to provide these? Could there not be an argument made that you don't need the employer deduction? You're looking at tremendous amounts of tax savings.

MR. FACCIANI: What I'm saying is that, if there is really a hue and cry for plan coverage, that mandating is really the only way to accomplish that objective. Clearly, there would be a revenue loss associated with mandating of the coverage, but I'm assuming that the revenue loss would be made up some other way, perhaps by means testing in Social Security or means testing through the mandated-type plans, or just a general increase in overall income taxes.

MS. DUNSTAN: I see. What I was referring to was if you're mandating the coverage and doing away with the tax deduction.

MR. FACCIANI: I'm assuming that the tax deduction would remain in effect, but that doesn't mean it would have to.

MS. DUNSTAN: It would seem to be an attractive possibility for the government to do away with that. If you're mandating coverage and a certain level of benefits, for example, there isn't the incentive then. You don't have to provide the incentive to the employer to provide it since he's forced to anyhow.

MR. LEBENSON: I think, though, that you'd find that it would face enormous resistance from business. What you're basically saying is if you take that step, then you could take the next step and say that Social Security payroll taxes shouldn't be deductible to the employer. That is theoretically possible, but I wouldn't really expect it to happen.

MR. FACCIANI: I would think a more likely scenario would be means testing. Means testing can cover a lot of sins.