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LATE-BREAKING DEVELOPMENTS

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The panelists will focus on recent legislative and regulatory developments in the U.S. and Canada.

MR. RICHARD G. SCHREITMUELLER: We'll cover pension material from both the U.S. and Canada. I'm director of regulatory and legislative services at Alexander & Alexander Consulting Group. That means that I help the company keep track of late-breaking developments.

As you may know, the late-breaking-development session always is a kind of wild-card session. For example, when this meeting was being planned in January 1995, everything that was then known or expected to be important was put on the program at other sessions. But we get to talk about anything that's considered brand-new in the past five months. Most new developments are from the government side because our business is so heavily regulated. We have news from government agencies, from the courts, and from Congress. We also have a couple new items from the actuarial profession.

Our first speaker is John Christie from The Alexander Consulting Group in Vancouver, British Columbia. John began his actuarial career in Scotland, where he became a Fellow of the Faculty of Actuaries. He came to Canada in 1969 and has been in consulting ever since. John is a consultant on pensions and group benefits and, as you might guess from his origins, he's also a consultant on the asset side. John is an Associate of the Society and a Fellow of the CIA.

Our other panelist is Mark Wintner. Mark is a partner in the New York City law firm of Stoock & Stoock & Lavan, where he heads up its ERISA and employee benefit group. Mark is very active in legal consulting to corporations on a broad range of employee benefit issues, especially regarding bankruptcy and reorganization. He's been very interested in the 1994 PBGC legislation. Mark did his undergraduate work at Queens College. He then attended the University of Chicago Law School, and he also got a degree in taxation from the NYU School of Law. Mark often speaks before professional groups, and this is his third time as a SOA program participant.

MR. JOHN M. CHRISTIE: Although most of you are from the U.S., at some stage you may need to consult for a U.S. corporation with a Canadian subsidiary. Be aware, things are different in Canada. I want to talk first about pension surplus and contribution holidays, and then about the CIA discipline process.

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PENSION SURPLUS AND CONTRIBUTION HOLIDAYS
There has been a fairly active debate in Canada over who owns surplus since about the mid-1980s. There were discussions on a lower level before then, but the classic case was the Dominion Stores case, which brought the matter to the front page of the newspapers. Briefly, Dominion Stores was a well-known grocery chain, mainly in eastern Canada, and was owned by Conrad Black, who has since gone on to newspaper fame in both the U.K. and Australia. Dominion Stores was not in good shape, so Black decided to close it down, wind up the pension plan, and pocket the pension surplus. After the employees cried "foul," he shot back at them, saying that they had been stealing goods off the shelves for years and that was why the company was in such bad shape. The rest is history; after about three years in the courts, they agreed to split the surplus about 50/50 between the company and employees.

Ontario Hydro is another well-known case in which a court ruled that, because of the specific language in the Ontario Hydro plan, contribution holidays were not permissible. The plan said that the employer had to pay the current service cost each year. There was no mention of paying less if the plan had a surplus.

The Hospitals of Ontario Pension Plan had slightly different language, and there the courts ruled that contribution holidays were permissible.

The last and still almost current leading case involves the Bank of British Columbia, which largely wound up in 1986 with a surplus in the plan. The bank claimed it, and so did the employees. The courts in British Columbia went through some processes and awarded most of the surplus to the bank. But various appeals were launched, and it still is in process. I'll talk a little more about it as it is still one of the leading cases, potentially not quite decided.

The two main themes in the Canadian courts have been what exactly did the plan document say, and what exactly did the trust agreement say? The courts looked at two possible themes of law. One is trust law, basically saying that if money is put in a trust, then it has to stay in for the beneficiaries, unless it was very specifically and explicitly provided in advance for it to be returned to the settler of the trust. The second theme is contract law; that this fund was only set up for a purpose, namely the provision of pensions. If the pensions have been provided, then the company is home free. If there was money left over, the settler could do what he or she liked with it.

Because lawyers and actuaries were spending so much time arguing about surplus, the CIA developed a 1991 paper as a contribution to the public policy debate. I think this concept may be rather foreign to the SOA, but certainly the CIA feels a responsibility to its public to contribute where it thinks it can contribute to debates with a significant actuarial component. The paper did not come down on one side or the other, but merely pointed out the arguments for allowing a plan sponsor to take some credit for the surplus or a contribution holiday and some potential consequences of changing the law one way or the other.

Currently, the CIA has a task force under way that is concentrating more on the issue of contribution holidays. The two most recent cases, the *Singer case* and the *Bank of British Columbia case*, both get into the area of contribution holidays, and this is now more of an

issue than surplus was. The task force intends to largely endorse the findings of the 1991 paper and then proceed to say a few more interesting things about contribution holidays.

The three leading cases now in Canada are:

1. *Air Products*, which is a case that was in the Supreme Court of Canada. It was decided on the basis of trust law, although there are some interesting descents there.
2. *Singer*, which is a Quebec case. Quebec law is slightly different from the rest of Canada in that it is based on the civil court rather than on the English Common Law system. But it, again, was decided on trust law principles.
3. The *Bank of British Columbia case*, which started off being decided on contract law and has now switched over to trust law.

In the *Air Products case*, the surplus was largely awarded to the members on the basis-of-trust principle. There was no clear language in the text, although the beginning of the text said the surplus could revert to the settler. However, the Supreme Court went on to talk about contribution holidays and it thought that contribution holidays were indeed lawful, provided there is some reference in the text to an actuarial process. As we all know, a common actuarial process will be to reduce the contribution rate required from the corporation sponsoring the plan if there is a surplus, to use up that surplus either in one gulp or over a period of years. The Supreme Court held that was quite an appropriate use of surplus.

The *Singer case* in Quebec said that the surplus had to belong to the members, even though an amendment was made a year or two before the windup of the plan, which permitted surplus to come back to the employer. It held that the amendment was invalid because it was contrary to previous plan provisions and also there was no disclosure to the members that this amendment had been made. It also said that past contribution holidays were illegal because they had not been authorized implicitly or explicitly until the 1985 amendment. This ruling of the Quebec courts on contribution holidays, from March or April 1995, was generally thought to be contrary to the *Air Products* decision, which was rendered by the Supreme Court of Canada in the middle of 1994. So immediately there was a potential conflict between the courts.

With *Singer*, the company is seeking leave appeal to the Supreme Court. We do not know whether it will be granted leave. The Quebec minister who is responsible for the regulation of pension funds has also referred this matter to the Regent de Rant, who is the Quebec regulator, to come up with a solution to continuing, conflicting court decisions, which are obviously not good for the health of the private pension industry.

The Bank of British Columbia, in its earlier rulings, which were appealed and judged in the British Columbia court of appeal, held that the surplus did belong to the sponsor. The court followed the contract law theme, but there was room for further appeal. In the *Air Products* decision, the Supreme Court of Canada was rather scathing about the British Columbia court of appeal judgment and basically said to the British Columbia court of appeal, "Look, we think you're wrong."

At the time of the Supreme Court decision on *Air Products*, the British Columbia court of appeal was in the middle of another appeal in connection with the *Bank of British*

Columbia case. So it took three or four months to study the *Air Products* decision and then decided to reverse itself and basically follow *Air Products*, agreeing with the trust law interpretation. But it went a great deal further. It awarded the surplus to members. It made a very, very strict interpretation of the plan text and the Federal Pension Benefit Standards Act, which is the governing legislation for the Bank of British Columbia.

The court said that no contribution holidays were permitted in this case because there was no reference in the plan text to the magical word *actuary* or *actuarial*. There were references in the text to the employer contributing based on professional advice, but there was not enough mention of the word *actuary*. Therefore, the court ruled that the normal actuarial process of reducing contributions by the surplus was not appropriate in this case. The court also said that payment of expenses from the pension fund, which everyone thought was reasonably appropriate, was not acceptable in this case. It ruled that most of these expenses were for the benefit of the bank rather than for the benefit of the plan members. Again, the lawyers for the bank are seeking leave this judgment to the Supreme Court of Canada. So all I can say at this point is, more will develop.

CIA DISCIPLINE PROCESS

I'd now like to turn to the discipline process in the CIA, which is, I think, very different from what you may be used to in the U.S. It is a new area for us, too. We are having problems with it, and we're continuing to review it to see whether it is achieving the goals that we had hoped it would.

The discipline committee is made up of 15 senior practitioners in the CIA: 12 members plus three ex officio members: the president, the past president, and the president-elect. The discipline process went through major revisions in 1988–90 because previously, although we had a discipline committee, nobody knew what it was doing. Nobody could see that it existed, and many people thought it was just a sham.

We thought we had to concentrate on several main themes in our discipline process. We had to fulfill our responsibility to our various publics to retain our ability to be a self-governing profession. Also, the process had to be visible, both inside the profession and to those of our publics who want to see that the profession is actively monitoring its members' activities.

Since the major revisions, there have been ongoing minor revisions, but now we've had about five or six years of the new process. We are starting to try to stand back a little and say, "Hey, hold on here. What is going on? We're consuming enormous resources. Are we achieving the goals we should be?"

In terms of the numbers of cases that we've been looking at, in the 1992–93 year, activities of 17 actuaries were investigated in one way or another by the discipline committee (Table 1). In 1993–94, there were 28. In the six months preceding February 1995, there were 30, and in the six months preceding June 1995, there were 24. Not all of these are different cases, because disciplinary cases take a very long time to move through proper due process. So many of these cases involve the same people, but the cases may be taking two or three years to resolve.

TABLE 1
SUMMARY OF CIA DISCIPLINE COMMITTEE ACTIVITIES

Practice Area	1992-93	1993-94	Six Months Preceding February 1995	Six Months Preceding June 1995
Actuarial Evidence	2	2	4	2
Life	3	2	5	4
Pension	10	18	15	15
Property/Casualty	1	1	3	3
Miscellaneous	1	5	3	0
Total	17	28	30	24

There have been three disciplinary public tribunals: October 1993, November 1993, and August 1994. Anyone can attend. We expect another one will be held in July 1995, and we're in the process of scheduling two or three more for the fall. One appeal tribunal was held one day in March 1994, and it was then decided that it would need to take longer so it reconvened in May 1994. And three cases have been dealt with in what we call the fast-track process. Those are cases in which there has been an infringement of our rules of professional conduct, but the matter is not deemed serious enough to go through the whole disciplinary tribunal process. Instead, the member admits guilt and accepts a recommendation of a sanction of the discipline committee without any formal public hearing.

What happens in the process? The discipline committee may receive information from a member or from someone outside, such as a regulator, or may receive a complaint from somebody who is just very concerned. An informer is not entitled to any further information about what we do with the progress of the case until it comes into the public domain. But someone who lays a complaint is entitled to know how we are proceeding with investigating the complaint. The discipline committee may lay a complaint, and that has happened quite frequently. Information was received, it was not a complaint, but the discipline committee decided it needed proper investigation.

When we receive a complaint, we first look at the materiality of it to determine whether there seems to be some prima facie evidence that an offense may have been committed. If the discipline committee believes that there is sufficient prima facie evidence, it will appoint an investigation team—usually one member of the committee plus two other experienced actuaries in the area of practice. The committee will send a copy of the complaint to the actuary against whom the complaint has been made, informing him or her that it has been accepted as a complaint and that an investigation team has been established.

The investigation team then reviews the evidence it already has. The team will contact the actuary against whom the complaint has been made to hear his or her side of the story, and they may contact other actuaries who may have some knowledge of the complaint. They may even contact nonactuaries, provided they agree to keep this contact in total confidence. Then they report back to the discipline committee with their findings.

The discipline committee reviews the report from the investigation team and essentially has two choices. It may lay a charge against the member for a breach of the rules of professional conduct, or it may dismiss the complaint. I haven't done an analysis, but quite a

number of complaints have been dismissed at this stage. Also, some have gone forward where charges have been laid. The committee then informs the actuary and the complainer of its conclusion, and makes sure that all complaints and investigations that take place are totally confidential up to the point when a charge is laid.

If a complaint is dismissed, the whole thing is never supposed to see the light of day. But there has been one case so far, and another case is being considered, where a complaint has been dismissed, and then the actuary against whom the complaint was made requested that the Institute publish the fact that a complaint had been investigated and dismissed. In the one case that we dealt with, we agreed to publish that as a brief notice in our bulletin to members. Basically, I think these are cases in which a number of people knew a complaint had been made and the actuary wished to have his or her name cleared by publicizing the fact that the complaint was dismissed.

If the matter proceeds to a charge, then the president, the past president, and the president-elect appoint a disciplinary tribunal, consisting of two senior practitioners and chaired by a retired judge. The tribunal arranges to hold public hearings of the matter, and the investigation team turns into the prosecutor of the charges. Legal counsel are, of course, involved on both sides, and the tribunal will hear witnesses and take evidence, not quite as formally as in a court of law but following the normal rules of procedure.

The disciplinary tribunal then will decide whether the member is guilty of the various charges that may be laid and will also decide on penalties, which can be a reprimand, a suspension, an expulsion, or a fine. The tribunal can also award the cost against the member who has been found guilty of a charge and can require some further education, such as writing a certain part of the Society's exams. That's not necessarily the end of the process, because there is provision for appeal. If there is an appeal by either side, the CIA will appoint three members as the appeal tribunal. Again, there will be public hearings, with both sides represented by legal counsel.

As far as publicity is concerned, the whole process is confidential up to the point the charge is made. At that point it is no longer confidential, but it is not something we publicize in any way. It becomes nonconfidential to the extent that anyone may phone the executive director of the Institute in Ottawa and ask, "Are there any charges against John Doe?" or "Are there any charges that are outstanding?" The executive director will answer yes or no, as the case may be, and give information about the charge, say which member it is against, and tell when the tribunal will take place.

Hearings of the two tribunals are public. If a member is found guilty of some charge, we publicize the decision to members through a discipline bulletin, which outlines the charges and outlines the decisions of the tribunals. And in the case of an expulsion or a suspension, there is also a provision for the Institute to publish a notice in a newspaper where the member principally practices. Also, there is some provision for the CIA to inform other actuarial bodies of which the member may also be a member, although there are some technical problems with that provision right now, and I'm not quite sure how it's actually being applied.

As I've alluded to, there are certainly a number of challenges for the CIA in the discipline process. We do have a fairly rigorous approach to conflicts of interest in that any member

of the discipline committee who has a conflict or even a perceived conflict will eliminate himself or herself from any discussion of the case. When we are discussing cases at meetings of the discipline committee, sometimes the doors are just like revolving doors. But we feel this is absolutely necessary to preserve the integrity of the process.

Timeliness is a big problem. The discipline cases are taking an enormous length of time to get through, and the members against whom complaints are laid are put through an enormous amount of stress because they have this huge cloud hanging over themselves and their careers. A year is almost a fast track in terms of doing the investigation. Some have dragged on for two, three, or even four years in the investigation stage. My personal view is that this is just unacceptable. We must find a way of moving more promptly. One problem is that we're dealing with volunteer labor. It's hard to beat on members of the investigation team when we know they're volunteering their time, but we do need to deal with it more appropriately.

I think we also have a problem dealing with less serious offenses. A real sledgehammer is available in the form of disciplinary tribunals and appeal tribunals for serious cases, but there are many relatively minor cases. The question there is how to appropriately deal with that. Do we throw them out entirely even though there may be some minor infraction of our rules? Or do we use the fast track process? The fast track was introduced to deal with the relatively minor cases, but even that may be too severe. Right now we have only the fast track or the full sledgehammer. A number of us think we should have more of a spectrum of ways of dealing with cases so that we can grade them more appropriately, depending on how the discipline committee feels about their seriousness. The costs are unbelievable when lawyers are involved; my apologies to Mark.

MR. MARK S. WINTNER: Not U. S. lawyers; Canadian lawyers.

MR. CHRISTIE: Maybe there's an opportunity for you up here. The cost just skyrockets. The CIA budget for the last couple years for external legal fees, largely for the discipline process, was on the order of $500,000–600,000. That may not sound like much, and it's only Canadian dollars. But it's about 20–25% of the total budget of the CIA. Is this a worthwhile expenditure of our financial resources?

Also, there's a heavy cost in terms of our people resources. We are relying on volunteers, and only so many people will devote time to the profession. The CIA has just under 2,000 Fellows, not all of them practicing in Canada. A number are retired, so we're probably looking at 1,300–1,400 active fellows. Those who become involved in the discipline process, acting as members of the discipline committee or the investigations teams, must spend a huge quantity of time on disciplinary matters. Is that an appropriate use of our very scarce resources?

I don't know the answers to these questions. Those are some issues we're grappling with right now.

MR. WINTNER: I want to talk about the Department of Labor's (DOL's) "safest available annuity provider" rules announced in Interpretive Bulletin 95-1. It's often said that generals are always fighting the last war and, in some respects, that's what 95-1 is. It is the DOL's reaction, in large part, to what happened in the 1980s with regard to

corporate takeovers and terminations of overfunded plans, in many cases resulting in annuities from Executive Life or other thinly capitalized or risky insurance companies. In 1995, the DOL came out with its Interpretive Bulletin. In general terms, it states that choosing an annuity is a fiduciary function when the annuity provides in full the benefit payment to a participant. Typically, this occurs at termination of a pension plan, but it could also occur when an ongoing plan simply annuitizes a benefit obligation. The starting premise is that this is a fiduciary function and that the decision as to which insurance company is chosen is a fiduciary decision.

To the extent that the DOL felt a need to say that, there's probably close to a consensus at this point, and many cases would support that. And if there was ever a doubt about it, it's not a bad thing to go on record to state that. However, it went further. The DOL went on to say that, in general, it would be incumbent upon the fiduciary to purchase an annuity from the safest available annuity provider regardless of cost. That would mean that, theoretically, if there were five providers and one was "the safest," then that is the proper one to be chosen by a fiduciary according to 95-1, regardless of the cost to the plan or to the employer.

Now disregard of the cost to the employer is probably what the DOL had in mind. Although some employers might grumble about it, there wouldn't be a whole lot of debate on that. However, it did push the envelope a bit when it comes to "without regard to cost to the plan." Again, my own view is that it was thinking of abusive situations in which a pension plan is terminated to produce a reversion; given the excise taxes and income taxes on reversions, that hardly ever happens anymore. Or they were otherwise thinking of a situation where it was to the employer's advantage that the decision was being made. But 95-1 says that it applies in other situations. Indeed, it goes on to say that, more or less, the only time that other factors can be considered is when it might benefit the participants; for example, if a plan would top up benefits over and above the formula to the extent that there's an excess. There, theoretically, fiduciaries could take into account the cost as well as the degree of riskiness between two or more different providers.

Interpretive Bulletin 95-1 goes on to say that unless the fiduciaries themselves are expert in rating and evaluating insurance company finances, they would have to rely on an independent expert. People for the last five or ten years have often turned to independent experts to vouch for whether an insurance company is in good financial shape, has good administrative procedures, and so forth.

Any fiduciary reading this bulletin is almost certainly going to say, "somebody had better go out and hire an independent expert because I don't get paid to take this kind of risk in the face of this kind of Interpretive Bulletin." So, to the extent that it's not already standard operating procedure to get an expert opinion, I think this DOL announcement will make it strictly standard.

I would argue that the bulletin ignores certain instances in which it might well be legitimate to look at things other than "the safest annuity provider." For one thing, the bulletin does say that in the context of a defined-benefit plan, it is never acceptable to drop down from the safest to a risky annuity provider if the plan doesn't have enough assets to pay all benefits. Again, I think that in most cases that's probably true, and the DOL probably has in mind that between the company obligation to fund the plan and the PBGC

standing behind it, in most cases there's no reason to put the employees at risk. However, that's not always the case.

Dick did mention that I have been involved in many bankruptcies, and this experience sensitizes one to the fact that sometimes a company may be standing behind an obligation but there's nothing standing behind that company. You may very well have situations in which, given limited resources, a terminating plan might be able to provide for either all benefits or a higher level of benefits by dropping down to the second or third safest provider; but going to the safest provider may simply leave the nonguaranteed benefits totally at risk, and the employer may not have the financial ability to stand behind it either.

Be that as it may, and I think you can question the policy, if a fiduciary comes to me and asks, "What should I do?" I'm going to say that unless he or she has a very good indemnification clause, he is better off just going with the flow. The DOL has just made it very difficult to make a fiduciary decision that takes into account anything other than the safest rule.

Beyond that, I think the safest annuity provider interpretation of the DOL may have some other collateral effects. First, it will tend to encourage the use of lump sums instead of annuities. I think everybody accepts the fact that, at least in the states, if you offer a person a choice between a lump-sum option and an annuity option, at least if he or she is not already in pay status, nine out of ten times the person will to take the lump sum. And to the extent that lump sums are now more attractive to plans and sponsors, things are headed that way anyway. But again, given the problem of going out and annuitizing in the light of this, I think it will be more and more of a push to either add annuity options as a choice at termination or perhaps even to enhance the way in which they are calculated. It may be cheaper than having to go out and pay a premium to an insurance company to fit within this safe harbor.

The second thing it may do, in situations in which even terminating is too expensive, is that many terminations may simply not happen. It may very well shift a few borderline cases in which employers are debating whether or not to terminate a plan. If it's that difficult and that expensive and that risky for a fiduciary to go through the termination process, why do it? Why not just continue the planned payout benefits as long as you feel comfortable that it won't cause funding to go up in the future, which you can control although not totally? It may just tilt you toward continuing a plan in a frozen state as an alternative to termination.

The bulletin does indicate it would not be applicable in situations where you are purchasing an annuity out of an individual account, and the decision to buy the safest annuity will reduce the amount available to the participant. In that situation, there is certainly the benefit of getting a higher annuity from one carrier instead of another as proper fiduciary function.

Two related court cases are worth mentioning here. Early this year, almost immediately after the "safest annuity provider" rule was announced by the DOL as we just discussed, a decision came down in a case called *Kays vs. Pacific Lumber*. Pacific Lumber was a leveraged buyout in the mid-to-late 1980s, with Maxxam doing the acquiring. They were fairly well known for some aggressive takeovers in the mid-1980s. One thing they did was

terminate the Pacific Lumber plan and buy Executive Life annuities. In effect, it was exactly the kind of situation the DOL was trying to prevent after the fact.

In any event, that was a case, where in an earlier round, there was a question as to whether participants who had received Executive Life or other terminal funding annuity contracts were still participants within the meaning stated by ERISA, and therefore, had standing to sue in an ERISA case. Theoretically, by having received their insurance contract, whether or not it was paid in full, that was a full discharge of their liability and thereafter they were no longer participants and no longer had standing to sue. That issue, which was debated to some degree in other cases, was reversed legislatively by the Pension Annuitants Protection Act (PAPA), which expanded Section 502 of ERISA to explicitly state that in that situation, former participants who received such benefits do remain participants for jurisdictional purposes. In any event, the circuit court did reinstate the case based upon the legislative change.

The more interesting part of that decision was a discussion of the degree to which officers of Maxxam and other officers individually could be viewed as fiduciaries, notwithstanding the fact that when they made fiduciary decisions, such as buying Executive Life annuity contracts, theoretically they were acting as corporate officers. A separate line of cases is developing regarding a corporate officer exercising fiduciary or judgmental decision-making capabilities, as part of his or her official duties as president, vice president, treasurer, and so forth, and whether that makes him or her an individual fiduciary over and above the company being a fiduciary. In any event, the discussion in this case is quite disturbing in terms of implying that to the degree the officer had individual discretion, he or she is a fiduciary just under the plain language of the statute and the regulation.

Another announcement was settlement of a case brought by the DOL against Smith Corporation, another Executive Life termination reversion-type fact pattern. The company agreed to pay $4 million of additional funds, over and above what was used to purchase the terminal funding annuity contract, to be made available to participants who have lost benefits as a result of Executive Life. The DOL indicated that whether or not the $4 million turned out to be too much or too little in terms of who was going to come forward to claim it, participants could still come in and sue the company. Settlement with the DOL is not settlement with the participants.

Turning from that DOL foray into the next one, in late April 1995 the DOL announced a new compliance program for delinquent Form 5500 filers and the like. I think everybody knows or remembers what was sometimes referred to as an amnesty program. I don't know that it quite met the definition. Back in 1992, the DOL announced that although 5500s have been required since enactment of ERISA 20 years ago, there have been some significant late-filing penalties under Title I since 1988. The DOL was getting serious about going after nonfilers but was giving everybody an amnesty that lasted through most of 1992. And that did produce a very good response by all accounts. Many employers went through their files and uncovered plans they had forgotten about; usually welfare plans or top-hat plans, where it's debatable whether they are ERISA plans to begin with, such as employee assistance programs and similar types of noncore arrangements. In any event, there were many filings with the DOL, but many people still didn't make it.

So this new program, called the Delinquent Filer Voluntary Compliance program, was announced as a permanent program, as they put it, of indefinite duration. While it can be changed or terminated at any time, there's no sunset provision in this program. This program would allow people to file delinquent returns. The terms of the program lay out how to you do it in terms of filling out part of the 5500, filing some with the IRS and some with the DOL. The checks go to the DOL. You can look at the program or the details. I do not want to get bogged down in that right now.

What is important to note is that if you bring yourself within this program, you have to include a late filing payment to the DOL. Basically, if a return is late for a full year, if you're dealing with a 5500, there is a $5,000 penalty. If you're dealing with a 5500-C, it's a $2,500 penalty per year. By per year, I mean if you missed it for five years, then you have to file it for five years' worth of penalty. There are also partial payments if you are late for less than a full year and those are slightly less.

The penalties are far less than the amounts that could be imposed by the DOL under Section 502. It announced several years ago that if the DOL, in effect, catches you and you are a nonfiler, it can impose penalties of up to $300 per day or $30,000 per year. These penalties are far smaller. If you wish to avail yourself of this program, however, when you include the check, that's it. You can't include the check and then ask the DOL to abate it based on reasonable cause. So if you fall under this program, it accepts the check, you accept that you've gotten your release and you are no longer exposed for further late-filing penalties, but you've written off the check. If instead you want to appeal regarding whether you had reasonable cause, you cannot avail yourself of this program. Also, as is usually the case in these voluntary compliance programs, you cannot use this program if the IRS sent you a notice that you did not file for previous years. So this is a voluntary compliance program, not an involuntary or "oops" compliance program.

The DOL has emphasized that it is using it as a stick, which is not unexpected. It is saying, "Hey, everybody, you know we have the ability to go through your files, so bring yourselves current on filing requirements under ERISA, and the penalty will not be too hard or too harsh." With the availability of this compliance program, it is also saying it will renew and reinvigorate its efforts to enforce filing requirements. It will look more often for people who have plans that are not filed. And if it finds you before you turn yourself in, then I don't doubt that, in the future, it will be harsher on people who don't file. To the extent that people have this available, it will harden the DOL's attitude toward people when the DOL initiated the process and say, "You've had this plan for a while and you haven't filed it. Why not?"

For those of you who do consulting, now is a time to get your clients to go through a checklist of plans that they have. Often they must be made aware of what a plan is. Top-hat plans, plans for senior executives—whether they be three or four separate contracts—continue to be troublesome. At least in the view of the DOL, even a single contract for an executive can be a top-hat plan, and the program includes a special rule for top-hat plans. You can file a top-hat plan with the one-time registration statement. By including a one-time $2,500 check, regardless of how many top-hat plans you have and how many years' delinquent you are, you will bring yourself current with regard to DOL filings, and you won't have to worry about it in the future. The DOL also made it clear

that you could file a top-hat plan only once, even though arguably you have different arrangements with different executives. It will cover all them.

The next program is not from the DOL but from the IRS. This is the tax-sheltered annuity voluntary correction (TVC) program and is somewhat analogous to the voluntary compliance resolution (VCR) program and closing agreement program (CAP) that the IRS has operated during the last few years. The TVC program is specifically for 403(b) tax-sheltered annuities, whether they be single arrangements or plans covering many employees. The TVC is generally successful, although there are mixed results.

As a matter of general background, the IRS recognizes that while there are similarities between 403(b) programs and 401(a) qualified plans, there are also significant differences. For example, 403(b) programs often involve annuity contracts or mutual fund custodial accounts in which the employer does little but take the money from the employee and send it on to the promoter of the 403(b) program. The degree of employer control is somewhat different. Title I of ERISA says you don't have an ERISA plan if that's all the employer does, and so many employers eligible for 403(b) programs do not want to become more involved. Indeed, there's a tension between the IRS, which is trying to get employers to be more responsible, and the DOL, which is saying your reward for being responsible is to now have another Title I plan.

The second big difference is that by the very nature of 403(b) programs, the employer is tax-exempt. The 403(b) programs are available to 501(c)(3) charitable organizations and educational institutions only. That means one big thing upfront; the employer can't lose a deduction. A tax-exempt employer doesn't need a deduction and doesn't get a deduction. It is not indifferent to whether its employees are subject to unwanted taxes, but its degree of concern over the consequences of a 403(b) problem are very different from an employer's concern over a 401(a) problem. So any attempt or threat to disqualify the plan or the arrangement falls directly on the employee and only very indirectly on the employer other than in its role of trying to keep employees happy.

The TVC program includes a method for sponsors of 403(b) plans to identify any problem, in terms of whether or not they met all the requirements of 403(b), either in form or in practice, and to voluntarily come in to the IRS to get it corrected. If they do get it corrected, the IRS will not seek to tax the employees or the 403(b) annuity or the 403(b) custodial account. However, to do so, the employer must identify the nature of the 403(b) failure and propose a way of correcting the failure by changing administrative practices so that the failure will not recur.

Not surprisingly, for those of you who know the IRS, the employer also must pay a filing fee. It's on a graduated scale, from $500 to $10,000, depending upon how many employees are in the program. More important, the employer must agree to pay sanctions, if that is found to be appropriate. The sanctions will be based upon the taxes, the IRS could have collected by going back to the open tax years and either taxing the earnings of the 403(b) plan or assessing income taxes against the employees. There are several glitches in that. For one thing, certain 403(b) failings don't depend on whether the whole plan is bad, but on whether a given individual had a good deferral. So without going item by item, you must look at the particular failure to see whether the tax consequences that are at stake involve only an individual or everybody covered by the plan.

Also, only certain defects are eligible. Those mainly go to the distribution rules: minimum distributions at age 70.5, no distributions in service before age 59.5, rollover rules, and the like. Certain ineligible defects simply can't be brought within this program. This would include an employer's not being eligible because it is not a 501(c)3 institution or an educational institution to begin with. I don't know of any company that has a 403(b) and is not eligible. I do know that many people think that if a company is tax-exempt, then it is eligible to have a 403(b), and that is not the case. A pension plan that has a staff, for instance, is a tax-exempt employer, but it cannot have a 403(b). It could have a 457, it can have other things, but not a 403(b). A civic league cannot have a 403(b). A union cannot have a 403(b). I would hope they're aware of it, but perhaps some tax-exempts may have innocently thought they could have a 403(b) when they can't. Such defects cannot be corrected by this program.

Once you've decided that a sanction is theoretically possible, it is calculated to the extent that there might be income on highly compensated employees at a flat 28% rate and for nonhighly compensated employees at a flat 20% rate. The sanction is to be paid by the employer. So the employer would have to sit down and figure out how much the sanction is. However, that is a tentative sanction. In fact, if you submit to this program, the highest sanction that will be imposed is 40% of the total taxes that could have been assessed against the program and/or the employees for open tax years. Between 0% and 40% is a negotiation with the IRS as to all the facts and circumstances, whether it was agreed, whether there were good reasons for it, who got hurt, and who did not get hurt.

As usual, in announcing the program the IRS is very warm and fuzzy and reassuring about how understanding it will be. In the VCR program, for instance, where we heard all the same warm and fuzzy sounds when it was first announced, experience has been mixed. Some very modest sanctions have been imposed as part of that program, and some other sanctions have been much more expensive. The IRS likes to continue to tell everybody to come in and only trumpets how reasonable it has been. Don't get me wrong; it has not been unreasonable, but it has not been uniform. Therefore you must be careful.

IRS officials have made many speeches at conferences such as this and elsewhere in the two months since it announced the TVC program. It seems a little disappointed that more people haven't come in, which I think in two months is unrealistic. But it has heard some grumbling and has been getting feedback that employers still think this is too expensive and they'd rather just wait around for an audit. The IRS has been disappointed by that reaction and, somewhat like the DOL, has taken the attack. The IRS is saying that now that this program is out there, if you wait to get audited, then it's too late to bring yourself within the voluntary program. It will be far less understanding of somebody it catches through the audit process in terms of what the sanctions will be, simply because of the availability of this program. I don't doubt that is the case.

Even then, however, let me come back to the fact that the IRS has only limited ability to hit the employer directly. One thing it can do, and even if you go through this voluntary compliance program it doesn't give you any protection, is assess employment taxes and other payroll taxes that should have been withheld but were not because money theoretically went into a 403(b). The employer still must make good on that even if it is in the TVC program and will be assessed with it if it is picked up on audit. That's one pressure

point. Theoretically, I suppose it could also go after the employer for underreporting income and the like.

What's more important is the IRS has been reviewing many practices of tax-exempt employers, particularly in the hospital and health care field, but elsewhere as well, by questioning whether they are truly tax-exempt. Presumably it's not the Red Cross, but many tax-exempt hospitals look much like taxable hospitals in terms of how they operate and how they compensate people, although there are still very significant differences. IRS officials are also beginning to make noises that if they pick you up on audit for a blatant 403(b) violation in which the 403(b) has been used to shelter income for employees without any regard to the rules, maybe they will begin to take that into account as well in terms of whether they call into question the tax-exemption of the sponsor; in effect, whether the sponsor is letting its exemption be used for the benefit of individuals.

Now I'm going to quickly go through some court cases that we listed. The first case worthy of some mention is *Albertson's*. It has been in the news, or at least what we call the news, for some time now, partly because it went through several rounds. The courts kept changing their mind. But it goes to the issue of whether the interest or earnings component on nonqualified deferred compensation can be currently deducted by an accrual-basis taxpayer, that is, the employer, as it accrues over time or whether instead it's only deductible in the year in which payment is made to the employee.

The IRS and most employers always thought you had to wait until distribution was made to deduct any portion of that deferred compensation element. The first *Albertson's* decision, however, said that while that was true of the amount deferred from the year in which the employee earned it, to the extent it was increased during the deferral period by interest, that interest could be deductible. In its second opinion in which it reversed itself, the ninth circuit, as well as the district court, eventually agreed with the IRS and said, "No, it isn't deductible until paid out." Albertson's, somewhat to my surprise, has asked the Supreme Court to review it. I don't know if it will, but that's the current status. The IRS continues to be adamantly opposed.

Bear in mind, there's a little quirk to this. Other employers are hoping that Albertson's continues to lose. If Albertson's were to win and establish that an accrual-basis taxpayer could deduct those amounts on a current basis, then other employers might be barred from deducting the amount in the future when they pay it out and barred from going back by the statute of limitations, then deducting it in prior years, because their understanding was to the contrary. If it ever lost *Albertson's*, I don't know whether the IRS would give the company relief. Presumably it would. But there's a quirkiness to this, and other than Albertson's, very few employers are taking that position.

Second is *Curtiss-Wright*. As you probably know, the *Curtiss-Wright* Supreme Court decision came down in March 1995. It has been widely summarized that the lower-court opinion said that you couldn't amend a retiree health and welfare program if you didn't have a very proper amendment procedure in your plan. And that is correct. But on a slightly narrower basis, what was at issue in the *Curtiss-Wright* decision was whether language that said the corporation or the company can amend was adequate or whether you have to identify who in the company had the amendment power. The third circuit thought that just saying the company can amend was inadequate to give participants notice

of who had that power. The Supreme Court basically reversed, although it reversed it for further findings, but did say you didn't have to name an individual. If the company had a clear procedure internally as to who had the responsibility for amending, it was adequate language if the ERISA plan simply said that the company can amend.

Curtiss-Wright is behind us but the implementation remains important. If you and your clients haven't already done so, you must look at all your plans and make sure that there is amendment language in them. It's one thing to say that all you have to name is the company. The reality is that many plans, particularly welfare plans, don't have plan documents still, or if they have plan documents, they may not have thought about having the amendment procedure in the plan document. This is a wake-up call to everybody. It's just a due diligence function and if people get caught in the future, they're going to feel very foolish and perhaps be liable.

Two related cases go a step further in terms of what happens if the plan doesn't have a specific rule for termination. One is the *Lilly* case from the tenth circuit last year [1994]. It held that, although a plan didn't have a rule for amendment, the employer, by implication, could always terminate the plan. The court was not going to find that the employer did not have the implied authority to terminate a plan, whether or not there is an amendment procedure in the plan.

In a more recent decision that came down a month or two ago, the third circuit ruled to the contrary and said that where ERISA said your plan needs an amendment procedure, amendment includes termination. Also, in the absence of a specific procedure in the plan for amending and terminating, an employer could not terminate the plan. So if you don't have something that says the plan can be amended or terminated by the company at any time, you may have a problem.

A further issue is if the plan doesn't have that now, can you amend the plan to add an amendment procedure, or would that amendment be unauthorized because the plan currently has no amendment procedure? I guess you could say the same thing about termination. The third circuit, which is where *Curtiss-Wright* and the earlier *Curtiss-Wright* decision came from, said, "Yes, you need a procedure in the plan, but if you don't have one, you could always add one and it'll be effective after it's been added," which is a common sense result. I would not be surprised, though, if somebody challenged in another circuit whether a plan that doesn't have any amendment procedure in the first place can be amended to have one after the fact.

The issue is not terribly important, but the PBGC asked me to include Piggly Wiggly because it wants to point out to people that it, too, has an audit process. And while it hasn't been very active in the past, it does sometimes get around to auditing plans after they've terminated to see that they indeed did everything they said they were going to do in terms of calculating benefits and making distributions. The facts are a little murky because there was an honest disagreement between Piggly Wiggly and the PBGC over what rates were to be used in evaluation. In any event, the bigger issue for other people is that once the PBGC has signed off, it doesn't mean your process is over. You have to make sure the distributions are completed and conform to what you represented to the agency.

Esco is a recent case involving a Chapter 7 trustee and whether he had the obligation to terminate a pension plan or whether he could just walk away from it. Again, the facts are a little quirky. To me, the more significant part of the decision is (and it's something that people don't always focus on), under Title 4, a plan administrator and not an employer can terminate a pension plan. Often the company and the plan administrator are one and the same, so it doesn't make a difference. But in a situation such as Esco, in which the plan administrator was an administrative committee and the employer, in effect, was taken into the Chapter 7 process by a trustee, there was a distinction between the two. Ultimately, the board said that the Chapter 7 trustee had neither the obligation nor the authority to terminate the pension plan. You had to look back to the plan administrator just the way ERISA said.

Finally, *Citrus Valley* was the last of the IRS actuarial assumption cases to hit the circuit courts. The court held against the IRS. My own personal opinion is that the issues there were probably the most favorable to the IRS of any of the cases to have hit the Circuit Court of Appeals. I think what was done there was much grayer than what was done in either *Rocktel* or *Vincent & Elkins*. In any event, the IRS lost again. The IRS decided in early June not to seek review by the Supreme Court and simultaneously announced that it would move forward with closing many small-plan cases now. So if you have cases out there, you ought to be hearing from the IRS soon. If not, you ought to call the IRS to find out if your case is about to be closed; and if not, why not? That will vary in different parts of the country. At least in the second circuit, my experience is that after the earlier decision in the *Rocktel* case, it basically closed all the cases that I'm aware of, and I think most people have had the same experience. But the experience may not have been nationwide, and at this point it should be.

MR. SCHREITMUELLER: I want to just make a couple of very minor follow-up comments on what Mark said regarding the safest-annuity rule. I agree 100% that this rule is likely to increase the use of lump sums. At the 1995 EA meeting, an actuary from Metropolitan Life made a long presentation about how it will also increase the use of participating annuities that invest in separate accounts, and his logic made quite a bit of sense. But part of his presentation was that you must give at least $10 million to Metropolitan Life to do that. So it's not exactly a small-plan alternative, but it seems likely to be used more because a separate account can get you out of the insurance company solvency type of risk.

As you probably know, there are some new pensioner mortality tables. They've been on a fast track the past few months. Last month the SOA Board voted to approve those in final form. I don't believe most members have actually seen the final tables, which include some minor adjustments. For example, there is an end to the tables. The tables don't go on forever. Everyone dies at age 120 now, according to those rates, and that changes the numbers somewhat. It ripples up the line. We're talking about the Group Annuity Reserving (GAR-94) table and the Uninsured Pensioner (UP- 94) table, plus a report that tells how to use those.

The covered compensation tables came out in March 1995, when the IRS finally issued the 1994–95 covered compensation tables. These are for use by integrated plans under Section 401(l) of the tax code. Part of the deal is that the IRS made it clear that it won't publish any more tables rounded to $600 multiples, as it did in the past. Those tables

stopped being issued several years back, and they are allowed for compliance only through 1993. From 1994 on, you can round it to either $12 or $3,000. Also, if you look closely at the high end of that $3,000 table, you see the IRS now is rounding the numbers in a slightly different way. Anyone who wants to use the $600 table can still do so. I know we have a few clients that do that, but it is not a safe-harbor table under 401(l), so you're supposed to pass the 401(a)(4) nondiscrimination test. It may be that you have to run that test for other reasons anyway.

The last subject I want to touch on is a survey done by my firm, Alexander & Alexander Consulting Group. The survey results cover Financial Accounting Standard (*FAS*) 87 and *FAS 106* assumptions of Fortune 100 companies. The tables include 71 companies. The other 29 either haven't made their annual report available, don't have a defined-benefit plan, don't have retiree medical, or they are mutual insurance companies and we can't figure out where to find their numbers. Effective this year, the Fortune 100 list no longer includes *only* industrial firms, but most of them are still industrial. Still, a good many service and financial companies are now on the list. You'll see Metropolitan Life and Prudential and a number of retail firms, such as Albertson's grocery chain.

FROM THE FLOOR: The DOL's Interpretive Bulletin 95-1 talks about the safest insurance company for buying annuities. I suppose the guidance there is obtained from ratings from various agencies, but six or seven or eight different rating agencies do not always agree. Do you have any guidance on how to pick the best company?

MR. SCHREITMUELLER: Good question. The bulletin actually says you must not rely solely on financial ratings. The rating agencies are doing their ratings for different purposes. They overlap but are not the same as an ability to provide a long-run annuity. The DOL says you need an expert to advise your plan on whether this insurance company's balance sheet looks good, whether it has a good history of administering benefits, and so forth. You may be looking at a 30-year payout whereas the rating agencies may be looking at a 5-year or a 10-year scope. It's not just a matter of which rating agency to believe. Your expert must investigate annuity providers independently.

MR. WINTNER: The language of the interpretive bulletin says very explicitly that you must look at certain financial characteristics of the insurance companies, and all this seems geared to the DOL litigation. It knows full well that Executive Life was getting good ratings. So it wanted to put out a bulletin to support what it was doing in the courts. It has some unsettling effects for people who are trying to operate in the real world afterward. A subsidiary of our company is registered with the SEC and does some consulting in this area. It makes an elaborate analysis, and I think some other firms do that, too. They go way beyond the ratings. The usual type of situation then is you do your best, you act in good faith. But if the insurance company goes under, you're still responsible.

MR. SCHREITMUELLER: That's right. In fact, for defined-contribution plans, the bulletin says, "Oh yes, you can take into account other things. But you must never, never buy an unsafe annuity." With hindsight, everybody will know what an unsafe annuity is—just wait long enough.