RECORD OF SOCIETY OF ACTUARIES
1995 VOL. 21 NO. 3A

# CHANGES IN FUNDING METHOD

Instructors: JANICE P. BRICKER
NEIL A. PARMENTER

*This is a minimum funding seminar teaching session which will discuss problems related to establishing and amortizing change-in-method amortization bases.*

MR. NEIL A. PARMENTER: I would like to introduce Janice Bricker from CIGNA Retirement Services. A good portion of the outline and appreciation should go to Janice for putting this session together. My name is Neil Parmenter, and I'm from the Principal Financial Group's Pension Actuarial Defined-Benefit Services.

We would like to start by getting a feel for what people's expectations were when they decided to come to this session. How many are here for, basically, continuing professional education and want us to start at the beginning of the outline and kind of walk through all the requirements? Quite a few, so I think maybe we better do that if we want to meet those expectations. And then that will automatically, I think, meet the expectations for those who have done quite a few changes in funding methods.

So we'll start with a little background. We'll start with, what is a cost method. According to the IRS, the cost method includes not only the underlying type, like entry-age normal or unit credit, or projected unit credit or aggregate (there's six of them within the IRS), but it also includes any calculation methodology that you use in connection with your cost method. You might cost some benefits on a single-term cost basis, as they call it—there may be other benefits that you throw into the present value. You might actually try to take the present value of those benefits based on contingencies of when they'll happen and what the value is today. So all the methodologies are part of that generic cost method, like aggregate and unit credit and so on.

Computer software, for example, is part of the cost method. In my company, we recently changed from an in-house system to Lynchval and we had to get a class ruling from the IRS to allow that. At the same time, we buried many things in our class ruling, but basically we changed the computer system. That is part of your cost method.

My opinion is the government errs on the side of calling everything a change in cost method. However, I think that there is some latitude. If you take over a plan from somebody and it's an entry-age normal, and you continue to use entry-age normal, and you can reproduce their numbers within a fair tolerance (and I certainly would think 5% is a fair tolerance) then I probably would not consider that a change in cost method. I would not go to the government, that's about as close as I can get. Although, to be safe, when we had Revenue Procedure 85-29, which is the automatic approval of changing a cost method, we treated every one of them as a change in cost method, just so we didn't have to ask; we just figured it to be a change in cost method. Now that we don't have Revenue Procedure 85-29, we kind of do it. If we're pretty close, we don't call it a change in cost method. Is that what you do, Janice?

MS. JANICE P. BRICKER: Yes. I would say, basically, when you're taking something over from another actuary, there are many changes that you're going to see in your

valuation method, but do you really reproduce the prior numbers? I haven't done that. I think you try, but it is costly to redo a valuation.

MR. PARMENTER: Yes. I think the consensus of the group is you try to reproduce, as close as you can, what the prior actuaries developed, which generally means you have to have data from the prior actuary. It's one thing when you take over a case, every actuarial report from the previous year is supposed to have enough information so the next actuary can pick it up and do it, right? But sometimes the data in everybody's valuation report isn't complete enough to really to do that and it gets to be a very difficult job. That's why many times we just will call it a change in cost method. What's the cost, $275, or something like that to apply for an individual change in cost method? And we're going to talk more about what has to be included in that application for a change in cost method with the IRS. After you've done it a few times, it really isn't all that bad.

We've talked about the liability side of the change in cost method. What is sometimes forgotten is that the asset valuation method is also part of the cost method. And I think that everybody would agree with that. That's just as important to benefits. Let's talk about some of the situations in which a change in cost method might be appropriate. I don't think that I need to elaborate on the list below:

- Benefit Freeze
- Plan Termination
- Negative Normal Cost
- Negative Unfunded
- Merger/Acquisition
- Employer Demographics
- Employer Business Considerations
- Consistency with *SFAS*
- New EA/Actuarial Services Provider
- Change in Plan Year
- Change in Plan Investment Vehicles

Many times, in a benefit freeze, where your future normal cost is going to be zero because your not accruing any benefits, you might want to go to a cost method such as unit credit (using dollars times years) or a formula like that, where you don't have a normal cost. Many laymen are confused when you talk about a cost method like entry-age normal, in which you're talking about cost accrual. You take the total present value, you kind of slice it up over the future funding period in terms of cost accrual and then you freeze the benefit formula. That doesn't necessarily mean that all the cost accruals have been paid; they probably haven't, and so you continue cost accruals because you're still paying some of those benefits that accrued in the past. The layman wonders, "Well I froze my benefits; so why isn't my normal cost zero?" So many times you want to change your cost method if you get a zero normal cost.

Plan termination is the obvious one. I think most people go through the accrued-benefit cost method on plan termination.

MS. BRICKER: How many people have changed cost methods in the past couple of years? The majority. Can we get some ideas about the rationale for it? Was it a takeover case? Were there any special issues?

MR. PARMENTER: If you didn't hear the comment, the change in cost method was because of your computer program. Did that arise from present values only? That is a change in methodology, I guess.

There have been quite a few things issued that apply to change in cost methods. The fundamental requirement is approval from the Secretary of Treasury, and that's in the IRS Section 412(c)(5), which is a duplicate of ERISA Section 302(c)(5). It also indicates a few of the requirements that you have to meet to get a change in the cost method.

Revenue Procedure 78-37 talks about your procedure for requesting that approval. Any change after the first year the plan was subject to minimum funding in the Internal Revenue Code (IRC), Section 412, is a change in cost method, and you have to get approval, and you have to change to an approved method. Revenue Procedure 78-37 goes on and is fairly long. We attached a copy of it. We have to write a request to the Commissioner. The actuary sent a letter to the employer giving information the employer can use to request a change in cost method. The actuary doesn't request the change; the employer does. The plan administrator actually does. In this case, we're assuming the plan administrator is the employer, but the actuary has to furnish the data. The employer then turns around and writes a letter to the IRS and says we'd like to change, and, if you need any additional information, call the actuary. This is the plan administrator talking.

MS. BRICKER: Until calendar year 1993, you could make the change automatically. Now, for 1994–95, you have to request approval. The approval has to be requested prior to plan year-end, so yes, I don't know how you could do the Schedule B before the end of the plan year.

FROM THE FLOOR: The way to avoid the administrative hassle is by working with the plan administrator. You always do; you get the power of attorney and do most of that stuff yourself. It works pretty smoothly.

MR. PARMENTER: That is true. An easy way to do it, is to get a power of attorney. I might say that in Revenue Procedure 85-29, there's a lot of speculation in the profession or in the retirement income industry about whether there will be an extension to 85-29 subsequently issued. Some speculate that there might be, particularly for situations like plan termination, because it's pretty obvious that everybody wants to go to an accrued benefit; it's the logical method and you use it in your Pension Benefit Guaranty Corporation (PBGC) filing and so on. So I think there's a chance that we'll get an extension to 85-29, but I don't think it will be as all encompassing as it has been in the past. The IRS has been mildly critical of all the situations that it has encountered where there have been changes in cost methods. I've heard Jim Holland of the IRS say that the IRS has been somewhat surprised and perhaps even disappointed that actuaries don't try harder to reproduce the prior actuary's method and then just stay on it. But many times, they don't feel there's really a bona fide reason for changing the cost method, and there are requirements that we're all supposed to be able to pick up each other's valuations and do the valuation and reproduce those costs. I think the IRS's mind-set is if it issues an extension to 85-29, it will be more restrictive than it has been in the past, which is unfortunate.

FROM THE FLOOR: There have been many cases where we've taken over plans that have come pretty close to the prior actuary's numbers, but we've often had real concerns

about what they did. I'm not necessarily saying they were wrong. It's just that there were things that we didn't particularly like, so we weren't going to stick with that methodology. We went ahead and made a change. And we have in several cases just because there were things that we weren't real comfortable with and we didn't want to sign Schedule Bs that had those numbers in them.

MR. PARMENTER: I agree.

FROM THE FLOOR: So I think there are really legitimate reasons in a lot of cases for changing the method. If you have a change in cost method for a particular year, when do you have to file the request for approval of the IRS? Suppose I'm contemplating changing the funding method as of January 1, 1995. When do I then have to request this approval from the IRS?

MR. PARMENTER: I thought it should be done by the end of the plan year beginning January 1, 1995, but the gentleman in the back row said you can do it after that?

FROM THE FLOOR: The language says "should be" filed.

MR. PARMENTER: So, apparently, I think if you do it in the plan year, it's safe to say that the method should be acceptable. But, if you do it after the end of the plan year, I suppose you run a little risk of it not being approved, but you can still try.

MS. REBECCA A. SIELMAN: We filed for four of the same changes; we were changing from an end-of-the-year to a beginning-of-the-year valuation, and we received calls from two different IRS reviewers on the same day about a month after we had filed. And, when they realized that we had submitted four essentially identical requests, they consolidated them and had one person handle them. Just a word to the wise though—when the two different reviewers initially contacted us, they asked us for different additional materials. We said to them, "Wait a minute." They did consolidate and get their act together, but they weren't very organized or consistent about what we needed to provide.

MR. PARMENTER: The review was done at the district or the national level?

MS. BRICKER: I know some reorganizations have been done at the IRS offices, so make sure you know which one you're supposed to be targeting.

MR. PARMENTER: I have one in now that I think has been in three months and I really haven't heard from anybody, so maybe districts are different and run on different time clocks. My personal experience has been they aren't all that efficient, but they're more efficient now than they were three or four years ago. Has anybody else had any experience with the timeliness of the IRS? It must not be a major complaint. Some of the things that you have to send in are: valuation reports, Schedule Bs from the last couple of years, descriptions of the methods, reasons for change (this is all in Revenue Procedure 78-37), previous changes requested, change in plan year, and worksheet entries.

There are a couple of kinds of waiver requests that you can make in Revenue Procedure 78-37. You can ask for an individual change in cost method, basically, one plan, or you can ask for a class ruling in which you have to specify more than ten plans. But that class

ruling can be used in more than ten plans. Usually, when your change is approved and comes back from them, you get a copy of the letter and you must attach that to your Schedule B, because on the front page of your Schedule B you're going to check the box that states there has been a change in the funding method during the plan year. So the IRS's automatic signal then is to look at the attachment to see if you received an approval letter.

FROM THE FLOOR: What's covered by a cost ruling? If any takeovers are using a different form of frozen initial liability (FIL) than my method and I see there's going to be multiple ones, can I file for a class ruling on that? She said she filed four separate ones on the same day. Why not file a class ruling there?

MS. SIELMAN: For a class ruling, you have to have at least ten plans.

FROM THE FLOOR: Are they plans of the same firm, of the same actuary? If Wyatt files a class ruling, can everyone in our office use it, or do we have to do them all separately?

FROM THE FLOOR: We did a class ruling on our computer system and they did that at the national level with every office, so you can do it on the national level.

MR. PARMENTER: Yes let's hope, but they probably won't approve it.

FROM THE FLOOR: You list the changes exactly like you do for Revenue Ruling 85-29; that is, you can change the unit-credit cost in the year of the termination of a plan. You can change to one of the approved ones. Change the valuation dates from the beginning to the end of the year, or vice versa; things like that were automatically approved before. It seems to me, if they offer class rulings, that maybe the Society can file some for us. My understanding of the whole reason for failing to extend it is because they're trying to compile data on exactly what kinds of method changes are actually being done out there. They're trying to find out what's going on in terms of standard practice.

MS. BRICKER: I think with class rulings there's an issue with respect to timing. You have a certain period of time, you know, that ten plans have to adopt that new method. There may be an issue and then it's not effective or valid if you don't have at least ten plans. But that may be a problem if you're filing a number of class rulings nationally. That might be an issue. I have an observation—if we have acceptable funding methods and they are listed, why does the Service have a problem with changing from one to the other? Maybe someone can help me understand that. I don't know why that would be an issue.

FROM THE FLOOR: Pension policy is driven by money. We have campaign contributions to politicians and IRS budget targets. Is there anybody from the IRS here?

MS. SIELMAN: I have heard at some other meeting that a big reason for not extending Revenue Ruling 85-29 was that not enough actuaries were doing the minimal amount of work that it required. There's an attachment in Schedule B and actuaries weren't even doing that, and so the IRS gave sort of a slap on the wrist—if you're not going to follow simple rules, then we're going to make you follow these more complicated rules.

MR. PARMENTER: Good point. Well, chances are none of us speaks for the IRS's train of thought. I'm not sure if it's revenue ruling or not. I think the gentleman was saying that we had automatic approval before they put in the user fees and as soon as it expired they didn't renew it. I kind of see that logic, but if it's $275 I don't know what the answer is. I don't know how much of the regulations are driven by abuses but there are many abuses. Probably 1% or less of the EAs cause these abuses. It penalizes all of us just like most of our laws, but the IRS claims that there are a lot of abuses and they want to keep control of the whole process in the automatic approval.

I guess our next thing was Revenue Procedure 85-29. So, for the 1994–95 plan years, we haven't had automatic approval. How many people, with the exception of those taking over a small plan, which we have heard from one gentleman can be a pain and a really significant increase in cost, noticed that not having it crimps your style? Many of you agree? Heads are nodding. We haven't noticed it that much at my shop, but, then, we're not selling that many or have not taken over that many new defined-benefit plans. So maybe that's the reason the issue doesn't arise that often. But, for our existing block of business, it doesn't arise that often.

FROM THE FLOOR: Revenue Ruling 85-29 was very helpful when we were doing all the Tax Reform Act (TRA) terminations. It was very helpful in that period. And, fortunately, we had it then because it made it very easy to switch from whatever funding method that you had to unit credit until you got the plan closed down.

MR. PARMENTER: Good point. So, when they pass the next TRA, we'll all need it.

FROM THE FLOOR: We had a "no brainer" request where the actuarial value of assets dropped down to like 83% of the market value and you're going to write it up—a one-time write-up of the same method going forward to say 90% of something, that used to be so easy. Now you've got to jump through all the hoops and for a "no brainer" like that.

MR. PARMENTER: Good point. You would miss it on the change in asset side.

Before we get into the case studies, does anybody have any other specific potential problem? Yes?

MS SIELMAN: I'm interested in what other people have done in a change-of-funding method with the amortization period, where, in fact, there's a change. It's my understanding that Revenue Ruling 85-29 contained the rules for the length of time to amortize it, and now that it has expired, we can do anything we want.

MR. PARMENTER: I don't know. We're still using those amortization periods in our shop.

MS. BRICKER: Has anyone done anything else?

FROM THE FLOOR: I thought the ten years stayed in effect regardless because it was written some place else. Isn't that in the core of ERISA? The change in assumptions and funding methods is a ten-year amortization. I thought that was a core part of the ERISA regulation from way back.

MR. PARMENTER: Right. Thirty and forty less the number of years.

MS. BRICKER: Unless it's a credit; credit is 30 years. I don't think that has changed. It seems that Revenue Ruling 85-29 is no longer effective. I think that methodology is still in place.

I think that, again, you're getting to the intent, and not necessarily the word or the letter of the rules or the law here.

FROM THE FLOOR: If it is something else, they'll let you know.

MS. BRICKER: Give it a try. I have a class rule that CIGNA just applied for and got on an asset change, and they are referencing 85-29 in terms of amortization period. What they come out with over the next few weeks, you know, may clear that up, but I think that's still in place. If you look at the word of the procedures, it isn't. I'm not sure if it specifically says that is how we're going to amortize. This is just a letter from the IRS stating that procedure should be followed. The question you have is, did we specifically say that in the request. I don't know the answer to that, but I can get it for you.

FROM THE FLOOR: On your list of changes in funding method, you listed change in plan assets?

MR. PARMENTER: Asset valuation method?

FROM THE FLOOR: No. Change in investments. The last one is change in plan investment vehicles. If you have all your money in an insurance contract or something, and then you take your money out of that and put it into stocks and bonds, is that going to cause you to make a change in your funding methods?

MR. PARMENTER: No. We've talked to them about that. He didn't have stocks and bonds and probably your valuation didn't say here's how we value stocks and bonds. If you all of a sudden get an investment vehicle of stocks and bonds and start putting it on your valuation report, presumably for the first time, it's implied that it's not a change, but it was there before but you didn't publish it because you didn't have that investment; that's the way they described it to me.

FROM THE FLOOR: What does that refer to then?

MS. SIELMAN: If you've gone from an insurance contract of some kind to stocks and bonds and you want to use a smoothing method that you haven't before, changes in the investments might trigger a change in the asset smoothing method.

MR. PARMENTER: Is it from five years to four years, or something like that?

MS. SIELMAN: Or from not at all to something?

MR. PARMENTER: It's kind of a nebulous area, I think. We've struggled with it whether it is or isn't a change. But, if you're talking about a change in losses in your funding methods and you get five years—

MS. BRICKER: I think that same process is still in place for minimum bases, like Section 412 bases. I think, in addition to that, it's interesting to go back through the process that we go through to determine whether there is a change base or not. You can work that through many of these revenue procedures that are no longer effective and find procedural issues on how to do something. I think it's important to look at some of the history, you know, you go back to the minimum funding rules in Section 412, you go back through where the reasonable funding method is, and you find pieces there. You find pieces in some of these extensions of automatic approvals. So, if you have a lot of history in your file, you can fill in the blanks.

MR. PARMENTER: We're going to do some case studies to precipitate some more questions.

MS. BRICKER: Assume the plan was effective prior to January 1, 1974, the effective date, basically, of the passage of ERISA. You would start out with a 40-year amortization period and basically, subtract from that the number of years that ERISA has been effective for your plan. So, for instance, if you were actually effective January 1, 1974, you've had 21 years under minimum funding rules, so you would take 40 less 21 to get 19. The answer to this one would be 19. Next is the minimum of 15 years or the weighted average future working lifetime. So since we're dealing here with the minimum of 15 or something, which might be smaller, the maximum would apply there. Basically, 19 years would be your period of time.

FROM THE FLOOR: I had always been under the impression that, if your plan was effective before January 1, 1974, you measured the number of years from 1976, which was the first year for ERISA.

MS. BRICKER: Yes, she's right. And that was my mistake. You start with January 1, 1976 because that's, basically, when ERISA became applicable to that plan. You would start with the period of January 1, 1976–95 and you get 19 years, so the amortization would be 21. Now, if your plan was effective after ERISA was in place, you would start with 30 years and subtract the period of time. A plan that was effective in 1990 would have funded for five years, so that would be 25 years. You'd use a maximum of 25 years or something which is smaller, to give you 25 years. The IRS is not stupid. All credit bases use 30. They don't want to allow you to fund a credit over a shorter period of time, so they make you use 30 there.

The question was, do short plan years count as a full year? What do you mean by that? I truly don't know the answer to that. The question refers to when you have a short plan year in the period that you're calculating. I don't know if that would be called a full year or a partial year. I think it would be full year. Does it make sense that it would be a full year for calculation purposes?

FROM THE FLOOR: Well, you'd have to look at, I think 79-237. Find out what is prorated in a short plan year and what isn't. And, if the thing whose amortization is being continued during the period ensuing after the change in funding method is or is not—I can't remember off the top of my head quite honestly, something that was prorated or not. I think that would dictate whether or not you counted the full year or a partial year in

computing the amortization period for the effect on the unfunded or the change in funding method.

MS. BRICKER: Does anyone want to challenge that?

FROM THE FLOOR: Actually, my recollection (I don't have anything here to check it against) is that it's the number of years or the number of plan years. So the way I do it, and I hope this is correct, is that I calculate the time period and just subtract that off and round it to whole number of years. I have one plan that has had several plan year changes for some reason. I don't even know why. But they've done it and I don't count each of those as a separate year if I were going to change their method right now. I would just calculate how many total years it has been since the effective date.

MS. BRICKER: So you're doing more like an elapsed-time calculation. That makes sense.

FROM THE FLOOR: On page 6 of Revenue Ruling 85-29, it says amortization period for charge bases. It talks about the 40 or 30 over the number of prior plan years for which Section 302 of ERISA or 412 applies.

MS. BRICKER: She's saying that 85-29 specifically references plan years. Well, I think that gives us another question to address. I think that there are some open issues here. I'm not sure I'm completely content with what we're doing, so maybe we can try to get some answers to that and get back to you. I wanted to simply address the class ruling that CIGNA applied for. I wanted to get into it and why we had originally asked for that request.

Well, basically, you have the approval letter. I have some more detail on what we actually were asking for. We had a number of financial institutions that are included within a CIGNA Alliance. When someone wants to invest money with CIGNA, we do the actuarial work and also invest the money. There are investments within CIGNA products and there are also investments in, let's say, Fidelity or Invesco, or some other mutual funds. What happened here is CIGNA basically accounts for the investment expenses and management fees differently from the way our alliance partners specify them. We wanted the asset method that we're using to be more standardized throughout the alliance partners and to be able to more easily get the information that we wanted to use within the asset method.

Basically, we're trying to determine an actuarial valuation of assets at Point T and we're taking the prior year value of assets, adding contributions, adding investment (dividends and an interest earnings) on these and subtracting disbursements. Then we're comparing that to a market value. We take a portion of that as moving up toward the market value, as additional appreciation. Now the difficulty in calculating this asset valuation method with some of our alliance partners is that the investment income and the expenses were not necessarily accounted for similarly. So we went to another method. I'm just going to talk through the other method. We, basically, took our actuarial value of assets at T minus one and increased it for interest, at the assumed valuation interest rate, we added contributions and subtracted all disbursements, and the disbursements did not include investment management fees. We grew that at the valuation interest rate for the period of time that those monies were in the fund, and then we compared that to market value. So we're

going to an asset method that is easier to use, reflects appreciation at the valuation interest rate, and reflects the difference between that and what the market value is next year. So we think it's more appropriate, but it also is easier and allows us to avoid incurring the expense of having to come up with some of the investment management fees that are not declared on the financial statements.

Has anyone done anything similar to this on an asset method? This might be peculiar to financial institutions like CIGNA that also are investing the assets.

FROM THE FLOOR: Do you have any specifics?

MS. BRICKER: We have one example. Let me see if I can find it here. It's one actual case. We say only what the accrued liability changed by, so it's difficult to say whether that made a big difference without knowing what the total accrued liability is. The change was $92,000 in accrued liability and unfunded accrued. So, to get a perspective on that, you have to see what the big numbers are.

I was going to go through some hypothetic examples. Let's take a company, automatic bank check plan (ABC) Company. I don't know how many of you were encountering this, but I'm seeing a lot of the plan sponsors basically saying, "My plan is not meeting my expectations. It's too expensive; my employees don't appreciate it, and I'd like to terminate." So what many of those organizations are doing, if they want to terminate a plan, is implement a freeze. And ABC Company implemented a freeze. The plan was effective January 1, 1976, so they implemented a freeze as of October 1, 1994, because they wanted to monitor liabilities and assets in a way that is similar to what is done on a plan termination basis. So what they did was go to a market value of assets and a unit-credit funding method. The change would be to implement a change as of January 1, 1995. How many other people in the room are seeing this sort of situation occurring? They want to get a handle on the cost and many of these organizations have downsized. As enrolled actuaries, we get a little nervous about this because plans are terminating right and left, but it makes business sense, if the company wants to eliminate the plans, to move to a unit-credit funding method and to use the market value. So the cost method was entry-age normal. They moved to the unit-credit method, and they had a three-year average value of assets for their asset method and they moved to market value. No other changes were contemplated.

We have financial information. The present value of benefits is $18.5 million. The present value of accrued benefits is $11.5 million. The actuarial value of assets is $9 million. The market value is $10 million. The present value of future entry-age normal cost is $6.5 million. Entry-age accrued liability is $12 million, as of January 1, 1995 (Table 1). We're going from entry-age to unit-credit. We're going to be decreasing our unfunded liability by $500,000.

Basically, it's a credit, so it's for 30 years. So we don't have to deal with determining what a charge base would require for an amortization period.

TABLE 1
ABC COMPANY CALCULATIONS
ACTUARIAL FUNDING METHOD (VALUES IN MILLIONS):

| | Entry-Age Normal | Unit Credit | Difference |
|---|---|---|---|
| Accrued Liability | 12.0 | $11.5 | |
| Actuarial Value of Assets | -9.0 | -9.0 | |
| Unfunded Accrued Liability | 3.0 | $ 2.5 | $(0.5) |
| Credit Base: $0.5<br>Amortization Period: 30 years | | | |

Table 2 is a change in the actuarial funding method or the valuation method. I'm piecing that together with the change in asset method, which also produces a credit, because market values are higher than their average asset values. So with the aggregate change, it's $1.5 million on an unfunded liability basis and that's a credit that's going to be amortized over 30 years.

TABLE 2
ABC COMPANY CALCULATIONS
ASSET VALUATION METHOD (VALUES IN MILLIONS):

| | 3-Year Average | Market Value | Difference |
|---|---|---|---|
| Accrued Liability | $11.5 | 11.5 | |
| Actuarial Value of Assets | -9.0 | 10.0 | |
| Unfunded Accrued Liability | $2.5 | 1.5 | $(1.0) |
| Credit Base: $1.0<br>Amortization Period: 30 years | | | |

MS. SIELMAN: Both of the changes that you made were credits, so you don't have an issue. What if one of your changes were a credit and one were a charge? Would you combine them or would they be separate?

MS. BRICKER: I would combine them. What is everyone else doing? If you're making a change in the funding method, it includes a number of changes; it's an aggregate. Does anybody do anything different? Good.

FROM THE FLOOR: A corollary question is, when you make an application for a change, are you making two requests at once? Two separate requests? When you go through your Revenue Procedure 78-37 request to make a change in funding method are you making two separate requests—one for a change in the methodology and one for a change in the assets?

MS. BRICKER: I would make one. What would be the rationale for doing it twice?

MR. PARMENTER: We would make one.

FROM THE FLOOR: Can you file that as one change or does it have to be filed with two?

MS. BRICKER: I think you could file it as one change.

MR. PARMENTER: We would file as one because the asset valuation method is part of the cost method.

MS. BRICKER: You're changing the funding method. If you would change the date on which you value the assets and liabilities, and you change the funding actuarial valuation method and you change the asset method, and you go from disability term cost to valuing it similarly to retirement benefits, I would just put that altogether on one request.

MR. PARMENTER: I think that's the consensus.

MS. BRICKER: Again, we're not the experts here. We're giving a presentation.

MR. PARMENTER: We've made applications where we've changed the liability side and the asset side in funding method and done it together; it's just one change, one amortization, one base, and it has been approved.

FROM THE FLOOR: Under a plan freeze, if you were valuing an entry-age normal and the plan was amended to freeze the benefits, why would you feel compelled to apply for a funding method change for unit credit?

MS. BRICKER: If you're using an entry-age normal method at the freeze, why would you feel compelled?

FROM THE FLOOR: If you have people that are not accruing benefits under an entry-age normal valuation, I think the normal treatment is to value them as unit credit people with no normal cost.

MS. BRICKER: They don't have a normal cost. But your accrued liability is a different number than your unit-credit accrued liability, unless things have changed since I passed my EA exams. There's no normal cost. How do you determine accrued liability on the entry-age normal funding method? Present value of benefits less present value of future entry-age normal costs. Does everyone agree on that? Then the answer is, you wouldn't need to. I'm not sure if that isn't a different number.

FROM THE FLOOR: Well, I guess it seems to me, on the entry-age normal, you'd have accrued liability that you could be spreading over a different period and you haven't paid it off.

MS. BRICKER: Isn't there a difference. I know your normal cost is zero, but you're saying that means your accrued liability is what? Present value of future benefits.

FROM THE FLOOR: The benefits that have been accrued?

MR. PARMENTER: The distinction is probably individual entry-age normal as opposed to some of the entry-age normal methods that use an average entry age and stuff like that.

FROM THE FLOOR: Well, yes.

MR. PARMENTER: Yes, OK. I didn't hear you use the word "individual."

MS. BRICKER: OK. Then what you're saying is there is no reason to change the funding method.

FROM THE FLOOR: You are not going to pay a user fee.

MS. BRICKER: Wouldn't you want to go to market value of "market value of assets?" Why would you want to use an averaging? I would change it just for the assets. You want to know how close you are.

FROM THE FLOOR: I use market value for every case.

MS. BRICKER: But many of us don't. How many people use market value? Is this getting more common? OK. So maybe there is really no reason to do that.

FROM THE FLOOR: Do you have any kind of an affirmative duty to change methods if you have a frozen initial liability (FIL) method where the base collapsed, for example, in a similar scenario? His question dealt with entry-age normal. But I see more often that you suspend benefit accruals and you're using an FIL method. Of course, you're going to zero out your base and then you really have an anomalous method left. It's not a true anything at that point. Is that a change? Or do you just put in a collapsed FIL. I wonder if they force us to change in that situation. There's no cost anyway; the Schedule B is going to end up with zero anyway. I've wondered about that. I filed a couple with a collapsed FIL method on the Schedule B and wondered what they thought of it.

MS. BRICKER: Did you get a response back from anyone? Was there any objection?

MR. PARMENTER: Yes, from personnel.

FROM THE FLOOR: Your initial amortization base, due to the change, may, in fact, zero out if you create a new one. If you have a full-funding credit caused by the suspension of benefit accrual, you'll wipe out your original amortization base. And then your method isn't really a true FIL anymore; it's kind of modified; it's still an aggregate, but kind of a modified version because your asset valuation method is different between them. So it's not an aggregate, and it's not an FIL anymore.

MS. BRICKER: Well, what is it?

MR. PARMENTER: It's a collapsed FIL.

MS. BRICKER: Are your saying that just because you're going to a negative unfunded?

MR. PARMENTER: Yes.

MS. BRICKER: When you develop a negative unfunded and you move to an aggregate type calculation, you are changing the funding method. Paulette Tino said that.

MR. PARMENTER: No. You still do the method exactly the same way. You just wiped out the base.

MS. BRICKER: Have your wiped out the base or have your gone to a negative base?

FROM THE FLOOR: You haven't gone to a negative base. A full-funding credit just eliminates the base.

MS. BRICKER: You've gone to zero.

FROM THE FLOOR: Yes.

MS. BRICKER: OK. You're still applying the same method; you've just moved your bases to zero.

FROM THE FLOOR: The collapsed FIL is aggregate, correct?

MS. BRICKER: The collapsed FIL is aggregate. If you have a deficiency and also, if you develop a negative normal cost under an FIL, you have to go to a change in funding method.

MR. PARMENTER: Interestingly, when we went from an in-house method to Lynchval, we requested sort of a class ruling. We never before, as part of our entry-age normal FIL, had a negative unfunded frozen initial liability (UFIL) or a negative normal cost scenario, and so we asked in that class ruling for approval to go to aggregate and to go to zero when assets were greater than the total present value of benefits. All that was granted, but we had not done that before, so we changed the cost method for the way we handled negatives. We used to use negative bases and all those things that Paulette said we shouldn't use. And so we lumped all that stuff in there and then did it like you say.

MS. BRICKER: And what you're saying is, when you changed the method, you made a request for change. You incorporated that language within that method in case you develop a negative normal cost.

MR. PARMENTER: Go aggregate.

MS. BRICKER: Yes. And, as long as that's part of your funding method, that's OK.

MR. PARMENTER: We had to request it once and now we don't have to do it on our plans; it's just automatic.

MS. BRICKER: Does everyone understand what we're talking about? Any more questions about ABC Company? I'm going to look at another simple example or hypothetical situation where you might want to change a method. You're not supposed to change your cost method simply because the employer is experiencing difficulty in making payments and you want to have a cheaper method. I hear some chuckles. I think we've all had that—maybe we talked to employers in the past who have wanted to do that, and we found another approach for them. But, theoretically, there's supposed to be another reason for changing a cost method. I don't know if this would satisfy or not. But I'm saying, basically, if you're looking at a controlled group and one is acquisition minded and wants to simplify the process and have the same cost method for all subsidiaries and use the same asset valuation method for all subsidiaries, I'm sure you can poke holes in that, but,

again, it's a sort of a hypothetical situation where you might come up with a reason to request a change.

You've got, basically, two different calculations because you have acquired two plans and they're making various changes. The one has an aggregate funding method and the other has entry-age normal; we're going to FIL. One is averaging on five years going to a three-year average, the other one has market value going to a three-year average. And they're also changing the way they value the disability benefits. You're going from a term cost to, I guess, a more rational way of calculating those benefits.

Here's some financial information on the two companies. And they're going to make a change effective January 1, 1995. A Corporation is going from basically a methodology, an aggregate methodology which does not develop an accrued liability, to one that does develop an accrued liability. Now you might say, wait a minute, FIL is not one that develops an accrued liability, but it's presumed to be that kind of method when you make a change such as this. In the first year you use the entry-age normal. We are developing a charge base of $1.4 million for A Corporation. And the amortization period is 25 years because the effective date is January 1, 1990. That is thirty less five.

MS. SIELMAN: Janice, do you have a special situation when your aggregate cost method has some Omnibus Budget Reconciliation Act (OBRA) bases?

MS. BRICKER: Yes. There are certain bases that don't disappear. Some that you'd have to maintain throughout all of these changes are waiver bases, alternate the minimum funding standard account. Does anybody use a shortfall method? Shortfall gains and losses. Have you made a change from the shortfall to a regular funding method that is not shortfall? Have you ever done that?

From what I understand then, you develop one net gain or loss and that is recognized over a year. I've never used a shortfall method, but that's what I understand; you collapse the gains and losses and amortize them over one year.

Now B Corporation. We showed the calculation for A Corporation. We, basically, see what happens on the asset method. And, again, we've increased the charge base another $0.6 million. Now B Corporation is going from entry-age normal to FIL, so there is no change in the valuation method the first year. Now the way the normal cost is developed for the first year would be different. We're also changing the asset valuation method, and we have a 19-year period for amortization.

Does anyone manage or have a client that's a controlled group that is acquisition minded or divests itself of subsidiaries on a regular basis? Do I see anybody shaking their head? I'm wondering if this is customary, if this is what you might do in those situations. Might you try to coordinate that? No one has any experience with that.

FROM THE FLOOR: I discussed this last year, maybe merge a smaller plan to a larger plan. The bigger plan was using the projected unit credit and the smaller was using the entry-age normal, and they changed the whole plan to get a projected unit credit. The questions arose, do you have to change the funding method for the smaller plan because it

merged into the larger plan? You have no further B on the smaller plan. I have been talking to the IRS on this.

MS. BRICKER: Then we have two different answers. They were both from IRS agents.

MR. PARMENTER: I would think you could just put an attachment on your large plan Schedule B for the next year and explain what happened to the small plan and how you combined credit bases and so on, and they would accept that. It's not a change in cost method.

MS. BRICKER: I would think that, also. I would tend to agree with the first agent that said you don't have to put an attachment on the Schedule B because the plan is not in existence.

MR. PARMENTER: It's not continuing.

MS. BRICKER: Of course, that's logic ruling here.

FROM THE FLOOR: Well, we've got a couple of mergers like this where we just basically merged the smaller plans into larger ones, and it is all part of the merger process and not a change in funding method. The smaller plan no longer exists and the larger plan is using the same method.

MS. BRICKER: Right.

FROM THE FLOOR: We have had no problem with the IRS. I don't know if they noticed what happened or not, but they haven't said anything about it.

MR. PARMENTER: The law gets really hairy when the plan years are different, and then you have a part year B for the small plan.

FROM THE FLOOR: I think your question has to be, if you say no to the approval, how do I maintain two different methods inside one plan?

MS. BRICKER: I think we all agree with you.

An interesting follow-up question for Paulette, would be why she was taking this particular stance.

Everything you need to develop your remaining amortization bases is in your valuation report, and we don't have to necessarily calculate these. But, to go through the process, it might be an interesting mathematical exercise to see if you can still do it. When I got this question from Hartford, I asked our research actuary if he could give me some examples to use, but he "shot down" the EA questions. We have gone from unit credit to entry-age normal with an effective date of January 1, 1990, a valuation date of January 1, 1995, which is the change date. The original accrued liability is $280,000, and the interest rate 8%. Everybody get your calculators out. There was an increase in accrued liability. We had a plan amendment January 1, 1992, so that has been in place three years. As of the change date, we have an experience gain for 1993 of $4,000. We have a credit balance of

$2,500. And the unfunded entry-age normal accrued liability at the change would be $320,000.

Now, basically, what would you do? How would you calculate this? I'm sure everybody knows that. Develop your unfunded accrued liability from your original unfunded. You have to figure out what the remaining balance is. You have to calculate the amortization and develop a remaining balance on January 1, 1995. You look at your gain, which has been in place for one year. That would be offset. Your remaining balance is over four years. You look at your plan amendment, which was in place January 1, 1992. And so that would have gone three years to January 1, 1995 to develop that balance. And then you subtract out your credit balance. And the result is $298,536. You subtract it from your entry-age normal unfunded accrued liability and you have a charge base of $21,464 to amortize over 25 years.

I think it's fun to go through that. I wanted to see if I could still do it. You all may want to try it.