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Late-Breaking Pension Developments

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Summary: The panelists discuss recent developments, especially governmental laws and rules affecting pension plans in the U.S. that are not being covered at other sessions. This session identifies areas of change that may affect your clients and helps ensure that you are giving your clients up-to-date advice.

Mr. Richard G. Schreitmueller: This session will discuss recent developments affecting pension plans in the U.S., especially government laws and rules. Most of our session will discuss pension news from the federal agencies, the courts, and the Congress, in that order. We'll also see what's been happening at the Actuarial Standards Board (ASB) and the FASB, and in the world of employee benefit consulting firms.

We'd like to get a sense of who is here. First, who are with consulting firms? Looks like about 47 of you are in the consulting business. How about insurance companies? Looks like about nine with insurance companies.

And, finally, other employment, such as government, inactive, or what have you? OK, we've got one, Bill Carroll from the ACLI.

I'm with Aon Consulting in Baltimore, on their national research and technical staff, which means I have a full-time job keeping track of current developments so our

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consultants and clients know what's going on. I've spoken on late-breaking developments at five or six recent actuarial meetings, and this is my second appearance with Paul Shultz, who is our principal speaker.

Paul Shultz is speaking at this meeting at four sessions, believe it or not. When he's not speaking at professional meetings, Paul is a partner at the law firm of Sutherland, Asbill & Brennan. Paul splits his time between his firm's Washington and New York City offices, working days, nights, and weekends. Paul graduated from Princeton University and Cornell Law School, where he was managing editor of the Cornell Law Review. Before joining Sutherland, Asbill & Brennan, Paul was with Continental Can Company, J.C. Penney, and Towers Perrin, where he was a research person like me before going on to bigger and better things. Paul is very active in the legal profession and Washington lobbying organizations. He is an author and speaker.

RECENT IRS GUIDANCE

Mr. Paul T. Shultz: I'll lead off by discussing recent guidance from the IRS, except funding matters, which Dick will cover.

First, let's talk about IRS guidance on minimum distributions under Subjopa. Does everybody know what Subjopa is? That's my own term for the Small Business Job Protection Act of 1996 (SBJPA) because the initials are SBJPA, and it's much easier to say than Small Business Job Protection Act.

You'll recall that SBJPA eliminated the age 70½ requirement for commencement of benefits for active employees. One question that we had very early on was what to do about someone who reached age 70½ in 1996. The IRS announced last year in Notice 96-67 that we did not need to commence benefits for that person in 1997. The IRS also requested advice from the public on whether an employer could eliminate that opportunity to start benefits at age 70½, suggesting that there might be a prohibited cutback in violation of 411(d)(6) under the Code should that happen. That issue is still outstanding. In fact, a couple of days ago, one Treasury person was bragging about all the wonderful regulations they've put out recently on the health insurance legislation, payroll taxes for deferred compensation, and so forth. I said, yes, but what are you going to do about the 70½ rule? And he said, we have good reason to be nervous, so that did not give me much comfort.

The Service also was asked to help practitioners by providing language for model Qualified Domestic Relation Orders (QDROs), Qualified Joint & Survivor Annuities (QJSAs), and Qualified Preretirement Survivor Annuities (QPSAs). And, in fact, the IRS went to work and, following up on some good work by the PBGC on QDROs, they issued Notices 97-10 and 97-11 earlier this year.

Another recent development is the material related to SIMPLE retirement plans, although I suspect SIMPLE plans don't have much interest for us in this room. Nevertheless, some of these plans are being sold, and the IRS has issued Announcement 96-112 which provides transition rules. The IRS also published some questions and answers in Notice 97-6. Finally, IRS has a model amendment for 401(k) SIMPLE plans in Revenue Procedure 97-9.

The next earth-shattering information I want to share with you relates to defined-contribution plans that are applying for a determination letter. I was startled to see in IRS Announcement 97-2 that we no longer need to file Schedule Q with Form 5300 for a defined-contribution plan. This is because of the change in Section 401(a)(26), which exempts defined-contribution plans from the minimum participation requirements based on 50 employees or 40% of all employees. Why am I saying this in such a kidding way? It's because when I've mentioned this to employee benefit lawyer groups, they've been surprised that anyone would dwell on such trivia. Nevertheless, I'm sure that it's an important issue if you are filing an application for a defined-contribution plan's determination letter.

The next item of interest is material related to adoption of the Veterans' Reemployment Rights Amendments, the so-called USERRA model amendment as set forth in Revenue Procedure 96-49, in which the Service told us how to take care of that complex set of amendments.

The IRS also extended the Tax-Exempt Voluntary (TEV) Compliance program through the end of 1998. As you may know, in the last few years the IRS has focused on tax-exempt organizations and the pension arrangements they use, particularly 403(b) tax-deferred annuity plans. The Service found a number of situations where people really haven't paid much attention to the rules, so they established a voluntary compliance program for tax-exempt employers, similar to the Voluntary Compliance Resolution (VCR) program established for qualified plans several years ago. Although tax-exempt employers have not yet made a lot of use of the TVC program, the IRS did decide to extend it through 1998 with the hope that people will begin to use it.

In early January, the IRS established the Alternative Procedure Regarding Self-Correction (APRSC). This has already been of great interest in its first few months and I expect it will continue to be.

Next we'll talk about guidance the Service has issued for governmental plans. The IRS has extended the deadline for compliance for those plans in Notice 96-64. They have extended the effective date for 401(k) and 401(m) testing to the first plan year beginning on or after October 1, 1997 or, if later, 90 days after the opening of

the first legislative session of the governing body on or after October 1, 1997. They have also clarified in Notice 96-64 the deemed satisfaction of 401(a)(4) and 410(b) nondiscrimination and coverage rules for purposes of references to those sections under 401(k) and 401(m). They have also provided a special option for applying 401(k) and 401 (m) nondiscrimination tests before 1999. And, finally, the IRS has allowed the use of reasonable good-faith interpretations of nondiscrimination rules until the plan year beginning in 2001. That has given governmental pension plans a longer lease on life. In fact, with all these extensions, some people are asking whether the nondiscrimination rules are ever going to apply to government plans.

Finally, I'd like to mention a project that's been going on in the IRS and the Department of Labor (DOL) for the last several years—redesigning Form 5500, the annual report form. I had expected the new form would be published earlier this year. I asked someone at the Service the other day, who indicated they're working furiously, and the proposal is slowly winding its way through the Office of Management and Budget (OMB). They might be able to publish the new proposed Form 5500 in June 1997, in time for use in the 1998 plan year, but I wouldn't hold my breath.

FUNDING AND ACTUARIAL ISSUES

Mr. Schreitmueller: While Paul gets a chance to catch his breath we will talk about a few actuarial issues that have come down the pike recently. First, we have a new Schedule B, as we do every year, which is being covered at another session in this time slot, so you may want to buy the tape of that session if you have an interest (69PD, Completing the 1996 Schedule B). I'll touch on some of the changes in Schedule B.

First, the form lists a couple of new entries you may have to make for disbursements where there's been an expected release of current liabilities. These can be current liabilities as defined under either the 1987 law for the Omnibus Budget Reconciliation Act (OBRA 1997) or the 1994 law for the General Agreement on Tariffs and Trade (GATT). Without going into too much detail, I'll just say these entries are sometimes required, and the instructions tell the actuary when to enter something on those lines.

Another change this year is that instead of being forced to calculate the current liability for every plan at the top of the range, you just have to do that if your current liability is funded under 90%. If it's funded 90% or more, the good news is that you don't have to calculate it. The bad news is you must be prepared to do it if the IRS ever asks you to, so you have to keep the data, but it seems like a long shot that you'd ever have to compute it in those circumstances.

Another Schedule B change is that if you have fewer than 1,000 active participants, you don't have to show average compensation data. Apparently, the government got enough complaints from people who believe such disclosure was an invasion of employees' privacy, especially for smaller plans to change this. The schedule of employee data has been moved from the 5500 over to the Schedule B, which seems like a more logical place.

Actuaries have had questions about disclosing changes in assumptions on Schedule B. What if you change the interest assumption for current liability? That question was posed to the IRS in preparing the Gray Book for this year's Enrolled Actuaries (EA) Meeting. The IRS answer was to talk to DOL, that's a disclosure issue, it's not our problem. The Service will take no position on it. There was a very interesting discussion of this disclosure issue in an EA Report based on a session at the EA Meeting, giving arguments for and against disclosing this as a change in assumptions. The prevailing opinion was that most actuaries do not seem to be disclosing it as a change in assumptions on the theory that the interest corridor automatically changes over time. There's no test of reasonableness. You can use anything you want within the corridor, and everybody knows it, so there doesn't seem to be much reason to disclose a change. It's just one more thing you'd rather not do, and it doesn't look as if the Service will come after you if you don't disclose it.

The Gray Book of Q&As from the EA Meeting is now available in electronic form. You can go back several years and search for key words. Given that we have so little guidance on details of funding, this can be helpful, although it has no standing in terms of laws, regulations, or revenue rulings—it's way down the food chain from all that. The Gray Book is something the Service can disclaim if push comes to shove, but it does represent the thinking of some of their top technicians and is better than nothing. That's the way you have to treat it.

In this year's Gray Book there are four major funding issues. First, the details of calculating the deficit-reduction contribution. They did answer some questions about what to do if there's a merger, for instance, do you use turnover assumptions? The IRS people said yes, you do use turnover assumptions, although it's a plan termination scenario. Also, there can be special handling of contributory plans and special considerations if you're phasing in preparticipation service.

A second major funding issue is mid-year collective bargaining changes. When and how do you recognize them? Nobody knows. The IRS people acknowledge there are various ways to do it, which differ between funding calculations and current liability calculations. Check the Gray Book. There's no one way to do these mid-year collective bargaining changes. We can't just push them off forever, but we do have different ways to recognize them.

A third funding issue is automatic approval of changes in funding methods. Official guidance currently is in Revenue Procedure 95-51, but the IRS business plan says they expect to put out further guidance in 1997. The current rules indicate situations where you can't get automatic approval. If you use the frozen initial liability method, as we old-timers call it, the IRS does not want negative unfunded liabilities, so they give you guidance on how to avoid them.

The fourth issue is liquidity shortfall, which creates interesting problems although it does not happen often. Does anyone have a client in this liquidity shortfall situation? Only one. Perhaps the rest of you will have one further down the road. As you know, you're supposed to keep enough plan assets on hand to cover expected payouts for three years based on recent disbursements, subject to adjustments. The Gray Book gives a little more guidance on how to adjust for things like lump-sum distributions or annuity purchases. To sum up, the Gray Book is becoming a useful and valuable tool because of its availability.

We also want to say a few words about the ASB. A few months ago, the ASB released final guidelines for selecting economic assumptions to measure pension obligations. This was an eight-year process with three exposure drafts. They finally distributed it in February 1997, bearing a date of December 1996. It takes effect for measurement dates starting July 14, 1997. In most cases, you'll start using that standard for 1998 valuations. That standard is for economic assumptions, and it supersedes the economic part of Standard of Practice (SOP) Number 4, which deals with assumptions for measuring pension obligations, which you'll keep using for demographic assumptions. The principal change is that the standard for pension economic assumptions has been updated to deal with the controversial PBGC issue, in which people were playing games with some assumptions to reduce PBGC premiums. Anyone who wants to do that in the future has to be prepared to justify what assumptions they're using. From now on, every assumption is supposed to be within a best-estimate range. You don't have to show what that range is, but you have to be comfortable that it's within such a range. If an external source such as management is dictating any assumptions, you're supposed to disclose that as well.

Finally, before we leave the world of actuarial calculations, let's note that slight changes in Financial Accounting Standard (*FAS) No. 87* and *FAS No. 106* disclosure rules will take effect in mid-December 1997. The FASB recently voted to make these changes, and they'll be issuing a formal announcement and exposure draft soon, so you can look for that. As best we can tell, it's going to include only minor changes, and it will be a forerunner or template for changes that the FASB will make in other disclosure rules that are outside the pension field.

PBGC NEWS

Mr. Shultz: We will now turn to issues relating to the PBGC. The most important news is that the PBGC finalized the reportable events regulations late in 1996, following what seems like several years of a negotiated rule-making process. Nell Hennessey, who is the deputy executive director of the PBGC, frequently has discussed how this process has unfolded over the last couple of years, bringing together various interested individuals from different sectors. The PBGC got them all together over a period of time and worked out how the regulations would be revised to reflect new reportable events and changes in the existing ones.

The new regulations create four new reportable events. First is the breakup of a corporate group. Second is the liquidation of a corporate member. Third is when the corporation announces an extraordinary dividend or a stock redemption. And fourth is when there's a transfer of at least 3% of the pension benefit liabilities outside the control group. Reporting to the PBGC must be done either in advance of the event or after the fact, depending on the type of transaction or the type of company.

Two more events that all employers covered by the PBGC have to report from now on are applications for funding waivers or certain types of defaults on loans. These regulations also explain the conditions under which waivers and extensions of waivers would be granted for both old and new reportable events, and what information must be reported. The PBGC issued Technical Update 97-4 which relates to those regulations.

As you no doubt have read in the press, the PBGC has achieved its first yearly surplus since it was created by ERISA of 1974. A number of organizations suggested that perhaps this might call for a reduction in premiums, but the PBGC was quick to point out that one year of surplus is not the basis for a reduction in premiums, and they will watch the experience over the future.

The PBGC also has what they call a new premium program. They have proposed a rule to require companies to submit information to the PBGC within 30 days of a request concerning their premiums and premium calculations. They have also issued a policy statement indicating when they will assess penalties for failure to submit information related to premiums, as the PBGC continues to try to hone their collection process and assure they get the premiums they think they need.

Next I'd like to mention a renewed effort by the PBGC in the last several years, and I refer to it by shorthand as the 4062(e) issue. Under ERISA Section 4062(e), the PBGC can come to an employer in certain circumstances and ask them to post a bond or pay into escrow an amount equal to the unfunded liability. Section

4062(e) covers situations in which an employer shuts down a facility and, as a result, there's a decrease of more than 20% in the total number of employees. In that case, the PBGC can require the employer to fund the unfunded liability pay into escrow, or post a bond for a period of five years.

In fact, back in the late 1970s a number of companies were concerned that corporate transactions they were contemplating might be seen by the PBGC as a basis for the assertion of 4062(e). They went to the PBGC at that time and obtained a letter indicating that the PBGC would not assert 4062(e). My recollection is there were two or three transactions about which this became public. In other words, the type of transaction was economically viable and not the type they thought would come under 4062(e). In the 1990s, I believe 4062 (e) was resuscitated by one person at the PBGC, and under the Clinton administration it has received a lot more attention. The PBGC has, in a number of cases, come to companies they have learned were in the middle of a transaction, or had just done a transaction, and asked for evidence as to why the PBGC should not require the posting of a bond or payment into escrow. Some people have been surprised and taken aback, but so far no one has litigated it.

Another initiative by the PBGC, which caused some consternation and changes in negotiations of business transactions, has been the effort to make sure that plan assets and liabilities being transferred in connection with a merger, acquisition, or sale of business satisfy the 414(l) requirements for spinoffs. One transaction had the PBGC looking at the interest rate being used to calculate the unfunded liability and the amount of assets being transferred, where the PBGC felt that assets were insufficient and a possible violation of 414(l). It would also be a potential violation of fiduciary duties under Title 1, and they threatened to pursue this with both the IRS and the DOL unless the nature of the deal would change. In fact, everybody quickly got together and changed the interest rate significantly so more assets were being transferred. This satisfied the PBGC. I've asked if they've had similar situations, and I understand they haven't. The PBGC believes that the word got out and everyone has fallen in line. As one person at the PBGC said, "All the boats rose at the same time." Nobody tried to fool with that issue any further.

I've talked to the PBGC about the standard they would follow on this, and I think you simply have to look at Section (b)(9) of the 414(l) regulations. It defines present value and gives the PBGC interest rate as a safe harbor. But they are quick to agree it is only a safe harbor and, if you use another interest rate that the actuary believes is reasonable and that they find is reasonable, that also would be satisfactory.

DEFINED-CONTRIBUTION PLANS

Let's move away from the PBGC and talk about defined-contribution plans. Many things are happening on that front. SBJPA, of course, made a number of changes in the nondiscrimination rules, participation rules, and other defined-contribution plan rules. Earlier this year, the IRS issued Notice 97-2 providing guidance on how the nondiscrimination rules would apply to 401(k) plans as a result of SBJPA changes. They indicated that you can use the nonhighly compensated employees' Average Deferral Percentage (ADP) and Average Contribution Percentage (ACP) for the prior year. In other words, you can use the current year data for 1997 and then the prior year data for 1998 without permission from the IRS. That Notice also described the new method of calculating the reduction in excess deferrals. You recall that previously, when we had excess deferrals by the highly compensated employees (HCEs), we reduced the highest percentage amounts first and then worked our way down. After SBJPA we now are required to reduce the highest dollar amounts first. The result is that the most HCEs will now suffer reductions before the less highly paid HCEs, whereas previously the lower paid HCEs typically took the reductions first.

The Service has also issued model amendments that can be used to make changes in defined-contribution plans to preserve optional forms of benefits. Revenue Ruling 96-55 gave the model language for protecting benefits following a transfer of assets/liabilities from a money purchase plan to a profit-sharing plan to comply with the previous ruling on this, 94-76.

Another issue that attracted a lot of interest in the last few months was a private letter ruling, number 9635002 issued late in 1996, that said an employer could contribute unused vacation pay to a profit-sharing plan. That would not constitute a qualified cash or deferred arrangement and, therefore, it was not subject to the $9,500 limit of 402(g). I personally did not find this ruling to be particularly startling because I think it simply confirmed that an employer's nondiscriminatory contribution to a profit-sharing plan is permissible, and in this case it happens to represent unused vacation pay. In fact, there were three rulings in the late 1970s involving that type of arrangement where an employer had a lot of banked vacation pay and wanted to change that program and get out of it. They simply took the value and explained to employees that they were going to do away with that banked vacation pay, but they were going to contribute it to the plan and the Service had agreed. I think the reason the 1996 ruling got a lot of interest is that many senior executives started looking at whether they might be able to have it for their plan. On examination, I don't think any companies have moved ahead with that because I think they all found that only a limited amount of money could be contributed. But, more importantly, the change could be discriminatory if the only people involved in contributing vacation pay were the senior people.

Next on the list of defined-contribution plan developments is the Travelers proposal to contribute stock options to their profit-sharing plan in lieu of a previous match. This employer would do away with that match and contribute stock options on a nondiscriminatory basis for all employees based on the first $40,000 of their compensation. The DOL proposed a prohibited transaction exemption, published in December 1996, to permit this. Even though the options do not qualify as employer securities under ERISA, DOL would give an exemption. The Service issued a private letter ruling in late March, number 9712033, which approved an identical transaction that we later learned was, in fact, for Travelers. Much publicity and discussion followed. In fact, shortly after the letter ruling was published, the IRS indicated they wanted to reconsider that ruling, and we understand the DOL is also having second thoughts about the proposed prohibited transaction exemption and it is not yet final. Right now it's being looked at by the agencies.

The proposal raises a number of questions. First, when Travelers contributes the options, they would obtain an immediate tax deduction for a value of those options that would be derived by using one of the valuation models such as Black-Scholes or the binomial model. Also, that amount would be used for 415 purposes. This is in contrast to the Service's long-standing position that you cannot put a value on employee stock options. The Service tried to do that in 1976 under the direction of Congress, but they were unable to do it, and Congress backed off with the Revenue Act of 1978. Another concern is that these options when granted would have 20% per year vesting for all employees covered under the plan. Some people fear that might not satisfy the vesting requirements of the Code and ERISA. Another concern is that these options disappear when the individual terminates employment.

One of the drivers behind this proposal was that not only would the employer get a current tax deduction for contributing the options, but also there would be no accounting charge because the stock options would receive the common stock option accounting treatment. That was a strong incentive for to the employer. I note there that there's a bill in Congress by Senators Levin and McCain to limit the deduction in the case of a stock option to the amount for which you take a charge against earnings. If there was no charge against earnings, there would be no deduction allowed for the options. If a bill like that were adopted, it could change the attraction of this particular approach and of stock options generally, although I think we're a long way from having that bill imposed on us.

In another development for defined-contribution plans, there was a proposal by Banc One to offer the use of credit cards in connection with 401(k) plans so that employees would be able to take out a loan just by using the credit card. In fact, Banc One, as I understand it, was trying to get that approach patented. I'm not sure why they thought they could get it patented, but they apparently thought they could

and that they could have the exclusive right to use these in connection with 401(k) plans. But I understand that idea has been dropped. Perhaps Dick knows something more about that.

Mr. Schreitmueller: There was a lot of publicity a few months back when Banc One announced they were going to offer this new way of dealing with loans under 401(k) plans. Soon there were a couple of articles by one of our actuarial colleagues in *The Journal of Pension Benefits* about why this was such a good idea, although there was a divergence of opinion about how good an idea it was. Recently, I happened to be at a meeting with an official of Banc One, and I asked him how the credit card loan proposal was coming. He told me they killed the whole proposal because they needed an exclusive to make this idea work, but found that it was open to competition from others. Still, the idea is out there.

Mr. Shultz: A final item in the 401(k) area. People are often troubled by the language in 401(k)(10) that basically applies the "same desk" rule to 401(k) plans in many different kinds of business sales transactions that seem inappropriate. This has been a real debating point of a number of private letter rulings. In fact, one recently came out, number 9715017, which illustrates some difficulties of having to keep the 401(k) rules going for a 401(k) account, even though the individuals have been sold to another company. The employees are deemed to basically be continuing in the same job and, therefore, the 401(k) plan continues to have the same restrictions. One bill now in Congress is intended to relax that particular requirement.

RECENT COURT CASES

Let's now turn to recent court cases. I included the ones that were the most interesting and might be the most significant, 15 of which I'll describe briefly.

The first case is Inter-modal Rail Employees Association vs. Atkinson, Topeka and Santa Fe Railway Co. This is a Supreme Court case that I believe came down two weeks ago. I was startled by it, but I'm not sure whether I should be. The reason I was startled is that it involved the outsourcing by Atkinson, Topeka and Santa Fe of the jobs where employees would transfer cargo from railcars to trucks. The railroad outsourced these jobs. These employees were represented by labor unions, and whether they would still have jobs would depend on the outsourcing company. They were offered new jobs with the outsourcing company but at significantly reduced benefits. The employees brought an action that said the company was interfering with their rights to employee benefits in violation of ERISA Section 510, which makes it unlawful to discharge, fine, suspend, expel, discipline, or discriminate against a participant or beneficiary of an employee benefit plan for the purpose of interfering with attainment of any right in which such participant may become entitled under the plan. The lower court said no, that's not what this is about,

they're just simply outsourcing the jobs and it has nothing to do with the benefits. It has to do with where the jobs are going.

The Supreme Court happened to agree with the plaintiffs. They said that the major purpose of this outsourcing was to reduce benefit costs and, therefore, it violates 510 and you can't do it. That is what startles me. Does that suggest that every time we outsource where benefit cost is one of the objectives, or every time we shut down a plant where reducing benefit costs is one of the objectives, we're going to have a violation of 510? It seems very contrary to business practices. This is going to go back to the lower court for a trial and perhaps those issues will be further defined. Perhaps there will be a rationale as to when 510 applies. But if you look at the case and its various statements, it seems to go much further than we ever thought the law would go.

Second is another Supreme Court case, California Division of Labor Standards Enforcement vs. Dillingham Construction, dealing with preemption issues relating to a state apprentice plan law. That situation in California required payment of prevailing wages to employees in nonstate-approved apprenticeship programs. The court held that wage rule was not preempted. I think they felt that the preemption provisions didn't reach that far.

The third case is U.S. vs. Reorganized DF&I Fabricators of Utah. This is a Utah Supreme Court case. The issue is whether in bankruptcy the excise tax for failure to meet the funding requirements constitutes a penalty or a tax. That becomes important when you try to determine what priority it has in bankruptcy. The lower court held that this was more in the nature of a penalty and was not to be treated like an excise tax and, therefore, it would share as a general credit.

Our fourth case is one you may have heard discussed, Lockheed Corporation vs. Spink. The Circuit Courts held that an employee's granting of a waiver to the employer of all claims for age discrimination in exchange for receiving early retirement benefits from the ERISA plan constituted a prohibited transaction. Since many companies have waivers in many different early retirement programs over the last 10 or 12 years, this caused a lot of consternation that getting such a waiver would constitute a prohibited transaction. The Supreme Court decided it was not a prohibited transaction, and that was seen as beneficial to employers. They held that the employer was acting in its settlor role, as an employer, not as a fiduciary, when it was amending the plan to provide for such benefits in exchange for waivers.

Another part of that case dealt with whether pre-1988 service has to be used in calculating retirement benefits under the age discrimination provisions that had been added to the law. The requirement that the employer use pre-1988 service

years in calculating employees' retirement benefits need not be retroactive, because OBRA Section 92-04A1 expressly provides that amendments to ERISA and the Age Discrimination in Employment Act of 1967 (ADEA) would not be effective with respect to plan years beginning after January 1, 1988. There had been some argument that the rule must reach back, but the IRS regulations made clear that it was prospective, and the Utah Supreme Court agreed.

The fifth case is Boggs vs. Boggs, dealing with the issue of preemption of community property laws. That's with the Supreme Court now and will probably come down very soon. The lower court held that the community property laws are not preempted by ERISA. The dispute in this case was over the pension benefits of a deceased participant between the first wife and the children of the second wife. That should be a significant case.

Sixth is DeBuono vs. NYSA-ILA Medical and Clinical Services Fund. It's a New York-based case dealing with the New York health surcharge. The question is whether preemption would apply to New York State's tax on hospital receipts with respect to a medical clinic owned by a collectively-bargained multiemployer health-benefit trust fund.

Another case dealing with waivers of ADEA rights and early retirement window plans is Long vs. Sears Roebuck. The court held that the employee may pursue a claim for violation of the ADEA even though the waived claims are in exchange for enhanced severance benefits where the employee failed to offer to give back the benefits to the employer. The employee claimed that the release was invalid because it failed to satisfy the strict ADEA requirements concerning how a waiver is obtained and how much review time the individual is supposed to have. The court ruled that in spite of a waiver, he can still pursue the claim because he's also alleging that the ADEA had not been followed. It's not a particularly surprising case.

Another potentially scary case is Jacobson vs. Hughes Aircraft, which involved the use of surplus in a contributory pension plan for salaried employees. The court held that participants in Hughes Aircraft's contributory plan could pursue a claim that the employer had violated the exclusive benefit requirement. Hughes amended the plan to use the surplus to fund an early retirement program for existing employees and to create a noncontributory plan for new employees. The court stated that the facts if proved would mean that the employer had used the surplus for its own benefit, reducing its labor costs while effectively increasing the new employees' wages. Note that they apparently didn't pursue a Section 510 claim. They're looking at an exclusive benefit violation.

Almost half of the plan's surplus was generated by employee contributions. The court held that because both employer and employees contributed to the plan, the employer did not have sole discretion to use the portion of the surplus derived from employee contributions. We know that. The court further stated that the employer's alleged conduct triggers the exclusive benefit rule regardless of the fiduciary obligations. The court also stated that the employer has a fiduciary duty to employees who wanted to amend the plan to use surplus assets. That's a startling statement and one I'm sure will be challenged in further litigation. That's a case to watch because it suggests that if you've got surplus that is in part related to employee contributions, you can't amend the plan to use it for some other purpose like an early retirement window plan.

The ninth case is Fisher vs. Philadelphia Electric. This is one of those cases that deals with the question, how soon and how much do you have to tell an individual who's thinking of retiring? At what point do you have to tell him that there'll be an amendment that could benefit him? Here the court held that the employer did not violate its fiduciary duty by misrepresenting facts when it failed to disclose to the employee that the company was thinking about an early retirement incentive plan. The court held that the employer did not give the early retirement incentive plan "serious consideration" until a senior management meeting at which there was a specific proposal. That proposal was discussed by senior management who had authority to implement such a proposal. In other words, it had to be much further along than, "maybe we'll do something like that," so in this case the employer prevailed.

The tenth is Howard vs. Shay, which deals with fiduciary reliance on consultants, something I'm sure will be of interest to many of you. In this case the fiduciaries were held to have breached their duty when they accepted without question statements from an independent valuation of stock held by an Employee Stock Ownership Plan (ESOP) before they sold it to another ESOP fiduciary. The fiduciaries had a conflict of interest with regard to the stock's valuation. Securing an independent assessment from a financial adviser is not a complete defense for the charge of imprudence. Fiduciaries in this case failed to meaningfully review, discuss, or question the valuation and, thus, reliance on the expert's advice was not reasonably justified under the circumstances. I think the message here for fiduciaries is, you can use a consultant, but also question what they say, look it over, and consider whether it's valid or appropriate. Exercise some due diligence.

The Microsoft case is next. I'm sure you've all heard of Vizcaino vs. Microsoft Corporation. It came out of the Ninth Circuit Court of Appeals, which held that independent contractors should be treated as employees, and therefore must receive

the benefits they would have received had they been employees. Not a well-reasoned decision, many of us think, and in fact, it has been reheard. I don't know the result of the rehearing, but it has caused a lot of consternation throughout the industry. Many employers are giving more attention to how they should be treating people who fall in the independent contractor status in the work they do with their companies.

Another case may be near and dear to your hearts, dealing with disclosure of actuarial reports. The court, you'll be glad to know, told the plaintiffs that actuarial reports are not among the types of documents that ERISA requires to be disclosed to plan participants. The case is Board of Trustees of the CWA/ITU Negotiated Pension Plan vs. Weinstein, a New York case in the Second Circuit.

Our thirteenth case deals with a backloading issue, DeVito vs. Pension Plan of Local 819 I.B.T., another New York case. I read this a couple of times because I was startled. Apparently, they had a formula that effectively resulted in backloading. If you were with the plan 25 years, on reaching the 25th year you would suddenly have a much higher benefit. It would accrue 2% per year as a career pay plan up to the 25th year, where upon it suddenly turned into a final average pay plan in the 25th year. The court said that was effectively a backloading violation, which seemed obvious. You wonder how it ever got that far, but perhaps there's more to that story.

In our fourteenth case, EEOC vs. Crown Point Community School Corporation, the court held that a decrease in early retirement benefits directly attributable to increasing age violates ADEA. We know that provision exists in ADEA. We also know that early retirement incentives decrease in value as one gets older and approaches normal retirement age. In this case the plan seemed to have been designed to provide an early retirement benefit that would decrease as someone approached age 65. I haven't looked at it that closely, but I believe they did not do it in a way that would have met the requirements of the law. Therefore, the court held that the benefits being offered had a direct decrease as you approached normal retirement age, violating the ADEA. It needs to be looked at in more detail and perhaps will be appealed.

Our fifteenth and final case is one that indicates that if you want to make age 67 your normal retirement age, in conformity with what will be social security retirement age in the near future, you can do that as long as you follow appropriate procedures. This case, Lindsay vs. Thiokol Corporation, had a summary judgment holding that ERISA does not prohibit a pension plan from setting a normal retirement age greater than age 65.

PROPOSED LEGISLATION

Mr. Schreitmueller: We'll now move from the courts over to the Congress and talk about proposed laws. They haven't passed any new pension laws since the famous SBJPA last summer, but a number of bills are in the pipeline and we need to know what they would do for us and to us.

Suddenly we're seeing a lot of pension bills. After many years of not caring about pension legislation, everybody wants to help small employers sponsor plans and to protect workers' pensions. These are key elements in the political strategy for the administration and for Congressional Democrats. When you look at the core of these proposals, sometimes there is not much of substance. We're talking about an administration that announces revenue rulings from the White House. Most people don't know much about pensions, so you don't need much substance to create a lot of spin.

Perhaps the main bill we've seen thus far comes from Senate Democrats, with four major features of interest to us. First is a provision introduced last year by Senator Boxer of California to limit the amount of employer stock held under defined-contribution plans. We saw one or two horror stories, particularly involving Color Tile Company, which had a 401(k) plan invested heavily in employer securities. The employees lost their jobs and their retirement savings; it was a double whammy. Senator Boxer asked, why don't we have the same 10% limit on employer securities under 401(k) plans that we have for defined-benefit plans? That caused an uproar because many of these plans wouldn't be there, at least not in their present form, had those limits always applied. Senate Democrats made a very important but simple change. They said this limit will apply only to money where the employee has no choice about how it gets invested. If you give the employee any choice to get it out of the employer securities, then you're OK. If you've got a company with high-flying stock, and employees are happy to invest it there, that's their own business. At least they have the chance to move their money out. That principle seems well-settled, and we can look for it to become law in the next year or two.

Another important issue has come back from last year—repealing the limited-scope audit. This involves pooled funds held by insurance companies and banks, which do not have a normal one-on-one kind of audit. Instead you have a limited-scope audit, which supposedly involves more risks. Democrats and the accounting profession are in favor of repealing limited-scope audits. There has been strong opposition to repeal on the grounds that these are arrangements primarily for smaller employers, and the change would increase costs. This proposal was defeated last year, but it has been resubmitted.

Then you get into the so-called women's proposals, a panoply of them, which often are not very substantive. These proposals begin from the concept that women tend to have more job turnover and lower pay, and are on the receiving end of spousal benefits more often than not. Anything you can do to improve benefits for such workers becomes a women's issue, although there's nothing explicit about women in the legislation itself. Perhaps the main proposal is to vest 401(k) matching contributions after three years, and you can see why that would help people who change jobs often.

A more controversial proposal would affect primarily defined-benefit plans. There's a strong movement afoot to phase out integration of defined-benefit plans ("permitted disparity" is now the official term) over a period of several years. We've seen that proposal before. It's been around for more than 20 years, with various forces inside the Beltway trying to do away with integration. In recent years they've defined this as a women's issue, on the theory that women tend to be lower-paid. We haven't seen much of opposition to this change yet, but I think we will in the future.

Just this week the SAFE bill was introduced in the House. Last year we had the SIMPLE plan, and this year we have the WISE plan and the SAFE plan. The SAFE plan interests us because it's a simplified defined-benefit plan, so, of course, you need an actuary. In this simplified defined-benefit plan you have your choice of three benefit accrual formulas. It can be 1% per year, 2% per year, or 3% per year, based on final average earnings. You can also put in past service benefits up to ten years. There is no PBGC insurance—to keep it simple, the tradeoff is that you have conservative funding. You must use conservative assumptions, by and large, so that people do not lose benefits, such as a 5% ceiling on interest rates. Finally, there is full immediate vesting, so you can call it a women's proposal too.

We're seeing other proposals for simplified defined-benefit plans besides the SAFE proposal. The American Society of Pension Actuaries (ASPA) has their own simplified defined-benefit plan. The U.S. Chamber of Commerce is behind that idea. It seems like an oxymoron, a simplified defined-benefit plan, but who knows, we may live long enough to see one.

This month the balanced budget has been in the headlines. Republicans and Democrats have been looking for a plan to balance the budget by the year 2002, which is five years out. They were having a problem because everything the liberals wanted to do, the conservatives wanted to do the opposite. Meanwhile, the 5-year budget showed a gap between income and outgo of a couple of $100 billion. Lo and behold, the Congressional Budget Office (CBO) updated its budget estimates and said, we just found a couple $100 billion that we didn't know was there. That

brought the numbers together without anybody feeling any pain. They all declared victory, and they now have a Balanced Budget Agreement (BBA) speeding down the tracks as detailed legislation is taking shape. We don't know all the provisions, we're a long way from that, but they've agreed that the balanced budget legislation is going to happen this year with very little pain for everyone. Experience shows that major budget legislation often includes changes in pension rules.

One of the key budget proposals involves Medicare. Medicare Part A was having big problems and was due to go broke in a few years, so Congress did a very simple thing. They took a piece of benefits and moved it over to Medicare Part B. These happen to be the home health-care benefits, and the shift extends the life of the Medicare Part A fund quite a bit. Unlike Part A, which is financed mainly by payroll taxes, Medicare Part B is funded by general revenue and has an unlimited life span. Congress has managed to put off the Medicare financing problem until later. Meanwhile, we know that Social Security financing issues are important, and Congress is in no hurry to fix them either.

The 1997 budget bill will have some tax features. They have to raise some revenue because a number of tax cuts have been promised by all parties to the agreement, involving such things as capital gains tax rates, credits for having children, and estate taxes. We probably won't know how those are going to work until July 1997.

In response to the BBA, the bond market started out being relatively happy. When we say the bond market is happy, it means bond prices are rising because interest rates have gone down. Lower interest rates indicate that investors believe there's some long-term substance to this balanced budget and it will really make a difference, that is, there won't be such vast amounts of government borrowing. Maybe investors believe that the government is finally getting its act together.

Shifting gears, let's talk about the CPI, which has been in the news lately. The Boskin Commission report a few months ago said that inflation as measured by the CPI is overstated by 1.1 percentage points. Politically it seems impossible to make a change close to that, not so much in the CPI itself, but in our basic measure of inflation. The government technicians at the Bureau of Labor Statistics (BLS) all say that the CPI never was intended to be a measure of inflation. It merely measures the price of a fixed market basket over a period of time. It's been difficult to get any consensus on a better measure of inflation, and so the conventional CPI that we've come to know and love remains the official measure of indexing—for government benefits such as Social Security and for indexing federal income tax brackets.

BLS is making some slight changes in the CPI. They'll update the basic market basket in January 1998, a routine updating which should cut down increases in the

CPI. Then, in January 1999, BLS is expected, although it's not official yet, to begin using a variable market basket, which, within a narrow range, allows for some variation in the market basket. This recognizes that consumers are smart shoppers and if the price of product A goes up, they might buy product B. BLS is recognizing that so-called substitution effect only in a very limited way. The Budget Agreement does not have anything in it explicitly about CPI changes, but the budget assumptions recognize small changes in the CPI that will decrease inflation. As actuaries it's probably premature to recognize any CPI changes in your economic assumptions, but those of you who have real sharp pencils may want to look at this more.

There's a session on Social Security reform, so we're not going to say much about it here. The Social Security trustees issued their annual report about a month ago and repeated their annual warnings that the financing has problems. In fact, they were the identical warnings from last year because the findings of both reports were the same. I've been told that the trustees dictated that the basic numbers for 1997 would come out the same as in 1996, regarding when the trust funds would run out, which they did.

Meanwhile, we had a report about Social Security reform from the quadrennial advisory commission, the final commission of this type that we'll ever have according to the law. This commission split into three groups which proposed three alternative reform plans, involving everything from minor changes in the current program to personal security accounts using IRA-type arrangements. Those of you interested in Social Security can learn more at that session.

There are basically two schools of thought on Social Security reform. Elected officials who have the job of changing Social Security don't appear eager to do anything about it because they dread all the grief they'll get from various supporters who want to preserve Social Security the way it is for as long as they can. On the other hand, many of us might prefer to see them move more promptly because we know that the sooner they fix Social Security, the less painful it's going to be. We also know that deciding on the reforms will allow workers and employers to plan for their retirement much more effectively if they have a good idea what they'll get from Social Security. And, finally, young workers would begin to have more faith in Social Security than in the existence of UFOs.

MERGERS OF ACTUARIAL CONSULTING FIRMS

About 40 of you indicated you're from actuarial consulting firms. Can I just ask if your firm has been in a big merger in the last six months? It looks like at least half of the 40. Well, that's why we're talking about this. In the first half of 1997, we've seen four big mergers involving U.S. consulting firms that have pension actuaries.

Of course, all these firms also do other employee-benefit consulting and operate internationally.

First, Foster Higgins is now part of William M. Mercer, which was already the largest actuarial and employee-benefit consulting company. This merger came about because their parent companies, both of them giant insurance brokerage firms, joined forces. That is, Marsh & McLennan, which is Mercer's parent company, bought Johnson & Higgins, the parent company of Foster Higgins.

A second merger also involved two big actuarial firms that were owned by insurance brokers. At the parent company level, Aon Corporation bought Alexander & Alexander Services. At the consulting level, Aon Consulting took over Alexander & Alexander Consulting. As a result, Aon Consulting is now one of the five or six largest actuarial consulting firms.

In a third merger, perhaps less dramatic, Kwasha Lipton was acquired by Coopers & Lybrand, one of the Big Six accounting firms. Kwasha is a highly regarded consulting firm and has retained its identity as the employee-benefit consulting arm of Coopers.

Finally, Buck Consultants, one of the oldest and largest firms, is now a division of Mellon Bank. Earlier Buck had acquired another firm with a large actuarial consulting practice, W. F. Corroon.

Like many of you, I've recently gone to work for a bigger firm without even moving. If you're a typical consultant who bills your time out on clients, it usually won't make much difference in your job to be involved in a merger, whichever end of it you're on. But you may well get a new boss or get moved to a different part of town. To management folks, a merger can be quite a change—maybe good, maybe bad, certainly different. A researcher like me may also feel a major impact because, for example, a firm that's twice as big will not need twice as much research. One reason for these mergers is to save money on duplication of costs, and any positions that have duplication are likely to be cut back. Consultants by and large are not considered duplicative, so that doesn't happen. Another reason underlying some of these mergers was the consulting firm's need for capital to support expansion into such areas as outsourcing.

Mr. Donald J. Segal: I just wanted to comment on the proposed legislation that you described as three-year vesting for the match. If you read the bill it's three-year vesting, period. I mean their description of it was three-year vesting for the match, but in the text of the bill they have changed the five-year vesting to three-year

vesting so it will apply to all plans, both defined contributions and defined benefits. That's in S14.

Mr. Daniel P. Nicholas: Could you confirm the requirement to notify the PBGC if you miss a quarterly contribution? Something came out recently about how that works for small plans.

Mr. Shultz: I think you're talking about the missed contributions. I meant to mention that. PBGC came out about a week ago with a form and a provision, telling you how to make your contributions if you miss them. I don't have all the details, but I'm sure this was covered at the PBGC session by Nell Hennessey (33IF, Dialogue with the PGBC). I think there is relief if you get your contribution in before the reporting deadline, so that you ordinarily don't have to report it, with a special rule for smaller plans.

Mr. Schreitmueller: Yes, I do recall it now. The general rule which would apply to a big plan is that when you miss a quarterly contribution, you're supposed to report it right then. But if it's a small plan you can report it as part of your annual reporting for your PBGC premium. One interesting thing about this rule is that PBGC says this is the policy only for 1996 and 1997. They haven't told us what's going to happen after 1997. We may get further change, or those who are cynical might look for yet another announcement of relief next year to help make the administration look like they're providing relief.

From the Floor: For those who didn't go to the EA Meeting do you know how you get a copy of the Gray Book?

Mr. Schreitmueller: I'm sure it's available from the EA Meeting staff. The CCA administers the EA Meeting now, so you should contact the Conference office. Each year's Gray Book has been released on a standard diskette, and I believe they also have a CD-ROM that goes back ten years or so.

Mr. Shultz: I think you can buy it for $50, with 7 years of Gray Books on it now.

Mr. David M. Lipkin: Did you mean to imply that no Schedule Q is required for defined-contribution plans, or is it just that one demo is no longer required?

Mr. Shultz: My recollection is that the announcement indicated you did not have to file Schedule Q for a defined-contribution plan.

From the Floor: That doesn't make sense to me. For a new comparability plan, where you have to show that you're passing the general test, you would accomplish

that on the Schedule Q. Maybe on Demo 6, but maybe like a Demo 2 or 1 of those for the 401(a)(26) would no longer be required. I'm not sure.

Mr. Shultz: I'll look at it with you later.