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Technical Concerns: Who Says Pension Benefit Guaranty Corporation Premium Audits Are Cost Effective?

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Summary: The PBGC has enthusiastically promoted its new premium audit program, describing it as very successful and cost-effective. Through this program, the PBGC has recovered what it considers significant amounts in underpaid premiums at a cost of only $1 for every $8 collected.

But plan sponsors see it differently because the PBGC is asking for six years' worth of information not readily available from a plan sponsor's files. Many companies are spending tens of thousands of dollars on professional fees and internal costs to gather this information. The PBGC acknowledges this burden and is working on alternatives to substantiate the premiums without undue hardship for plan sponsors.

In this session, we discuss the audit program, the experiences of companies that have undergone the audit, and alternatives proposed by the PBGC? What will the alternative program involve? Will it mean a significant increase in recurring work/professional fees? Will it require additional certification (exposure) for the enrolled actuary?

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Note: The chart referred to in the text can be found at the end of the manuscript.

Mr. Ronald Gebhardtsbauer: I'm with the AAA. Tony Calhoun is the deputy executive director and chief financial officer of the PBGC. Karen Kinol is a consulting actuary with Buck Consulting Inc. And Dick Barney is an assistant vice president at Mutual of New York, so he's not only an actuary, but the client, too. Each speaker will give his or her perspective on the premium audit.

We're going to talk about premium audits and whether there is a way the actuarial community can do something up front to ensure that our answers are correct. Then the PBGC will give us a way to do that, but the question is, "Will we use it?"

In 1996, a typical PBGC audit letter asked you to send in seven years of Form 5500s, Schedule Bs, and audited financial statements. The PBGC also wanted all the plan documents since 1986, actuarial valuation reports from 1990–95, IRS Employer Transmittal Form 6559 (which is something that says how many W-2s you sent in to the government), and a census listing from "19XX through 19XX." I don't know how many years that is, but it was probably a lot. You also had to send in a census listing for every different kind of group in the plan (including people who are not in the plan), the plan actuaries' worksheets for Schedules A, actuarial assumptions, and more. If you get one of these letters, you have to do an awful lot of work. After the PBGC audits you, if you find out that you didn't pay the full premium, there are some ways that you can get it down.

You can look at the PBGC Web site (www.pbgc.gov/premlist.htm) if you have questions on premiums. It also tells you who to call at the PBGC because they're very much interested in customer service. Tony is going to talk first about premium audits from the PBGC perspective.

Mr. N. Anthony Calhoun: The PBGC just reached a point in the last few years where, financially, it was able to get a clean audit and run a slight surplus. It just got in that position two years ago. It appeared insolvent if you considered the liabilities that it faced, primarily from plans that had already been taken over by the PBGC. In the early '90s, *The New York Times* ran a headline that said, "U.S. pension agency is in deep trouble, economists warn. A bailout may be needed."

When I got there about five years ago, the PBGC was faced with those problems and being heavily criticized by the General Accounting Office, which is an arm of Congress. It had been subject to several hearings on the premium system, one reason behind the financial and accounting problems, because it was not working.

The premium system started to go awry when the variable rate was put into effect because it was unable to keep up with the filing of the variable rate. There were a lot of problems. In some cases, bills were not sent out at all for several years. Then, as we started catching up, people got bills that were four and five years old with the penalties attached. Many of you and your clients were not happy, which I can understand because the delay ran the penalties up.

The penalties are high, 5% a month, but they're statutory. I won't deny that is extremely high. There is a problem in the sense that Congress, in setting up the penalties, was trying to make people think hard before not paying the proper amount. Also, there was no verification that people were paying the right amounts.

So, we had a situation where there was no way to determine whether the people who were filing were paying the right amount because we weren't verifying unless something came to our attention subsequently. We could do the calculation again, obviously, once you filed, but, even then, the basic information was all you provided. The General Accounting Office wrote rather long reports on PBGC prior to my getting there, and one of its questions was, "How do you know you're collecting the right amount of premiums?"

The PBGC does not receive tax dollars from the U.S. Treasury. We live off the premiums and investment earnings. That's how we pay our pensioners and operating expenses. The premiums are approximately $1 billion a year, but our payout for pensioners right now is about $820 million a year. And that will continue to go up because, although we're paying pensions right now for about 200,000 people, we have another 217,000 who are deferred vested and will be getting paid as they reach age limits for their particular pension plans.

Another complication is that, unlike Social Security, which has basically one set of rules, the PBGC has to follow the rules of the plan when it terminates. So, if you're in a plan that terminates, the rules to determine when you start getting paid and how your pension is calculated are the rules of that plan. There are some caps on how much we pay, but more than 90% of the people come under the cap. So, that's not usually a problem for most of the pensioners. But it does create a problem for us.

We want to be fair. Because most people are paying the right premiums, the fairness issue is that it's only fair to make sure that the people who aren't paying the right amount start to comply.

That's part of the impetus behind having some sort of verification program. We don't want to increase the premiums because everybody thinks they're too high already. Instead, we want to make sure that we're collecting the right amount.

Pensions for approximately 42 million people are covered by PBGC. Although the number of plans has almost been cut in half in the last 15 years, the number of people covered has gone up slightly, partially, because of a combination of small plans dropping defined benefit (DB) plans, large plan mergers and acquisitions, etc. Most of the larger employers are still maintaining DB plans, though, because that's where most of the workers are and where most of our premiums come from.

Last year, we had a surplus of about $3.7 billion, but that was only the second year the PBGC ran a surplus. The $3.7 billion is our accumulated surplus, and it was about $800 million the year before. Before that, the PBGC had 22 years of deficits. We were similar to the United States budget, I guess. It's not the way to go, particularly if you're running a pension plan.

The Retirement Protection Act of 1994 helped us turn around some of this problem, but it also results eventually in a gradual reduction of our premium income. The premiums will automatically go down unless there's a major reversal in the economy causing some of these plans to become underfunded. But, because they started the calculation at 80% of the Treasury rate, and it does go to 100%, that's going to force the variable premium rate to come down anyway, if we do nothing, and our payouts are going to continue to go up. So, we're very dependent on earning as much as we can on our investments and so forth over the next several years.

We began a pilot compliance review program in 1996 and expanded it in 1997. We've collected more than $7 million. How people are chosen to be audited is a question that many people ask. We do have a process. It's not a totally random sample. Probably about 3,000 plans pay the vast majority of our premiums, so, out of the total 45,000 plans, obviously it's going to be skewed toward the larger ones. I'm not going to lie to you about that.

The other issue is participant-count fluctuations. P-count is very important because errors often are made there, particularly if there are changes in the corporate structure, such as mergers, acquisitions, or spin-offs. Sometimes, whoever does the filing uses the same paperwork from the year before, forgetting that a division went away, a division came in, or something else changed. Somebody might not think that this means several hundred or several thousand employees need to be added to this plan.

For us, it's been cost-effective to conduct the audits because the amount of money we spend is a lot less than what we collect. But the issue for us is compliance, not making money. The idea is to try and get people to comply more fully and pay the appropriate premium. Compliance is critical for the system as a whole, so we want you to know somebody is out there and that there is some hassle involved in the process.

Now, we have made some customer friendly changes over the past year and set a new scope for our initial reviews. When we started out, nobody had done this before. It was totally new, and we learned some things. We asked a lot of questions from people like yourselves, and had a lot of issues that we knew were going to have to be ironed out. Nobody likes to have a review done and we understood that. One of the things our incoming executive director David Strauss did was cut the six years of data to three, and that seemed to make life a bit easier for people. We still reserve the right to ask for more than three, but if we don't find anything major, we'll stop. We did listen.

There are some common mistakes that we're finding. Some administrators are not including all the subsidiaries, divisions, or groups that belong in the plan. There are instances in which some employees may have been ineligible under the plan provisions last year but have since become eligible and clearly need to be included in the count. Terminated participants who have not yet been paid need to be included, as do terminated nonvested people for an additional year, as applicable.

In addition, retirees receiving a portion of their benefits from an insurance company and the PBGC need to be included. It's a portion. The auditors also have found examples of overpayment of premiums by administrators that have mistakenly included premium payment for multiple beneficiaries.

We see problems in the overstatement of plan assets. The flag here, particularly, is real estate. Sometimes it's valued once. Then for many years that value's carried, even though the value's changed. So, even if it was valued right the first time, over time the value may not be the same and cause a problem. It's vital that plan assets are properly stated, particularly when we're talking about the variable rate premium.

There are some mathematical errors transferring numbers from IRS Schedule B to Schedule A, and things like that. Sometimes numbers are transposed, digits are dropped, or Form 1 is not filed for spin-offs, mergers, or consolidations. And, occasionally, plans fail safe harbor rules. We'd like to make some policy changes on safe harbor because sometimes a small amount of variation can cause a big problem.

In terms of the current status of the program, some of our employees and auditors work under contract to the corporation. The contract auditors are in five different parts of the country to cut down on travel costs. They each have an area, which seems to make sense from a cost-benefit management standpoint.

We collected approximately $1.4 million in billings so far this year, but we need cooperation and compliance for the system to work. We have to have an enforcement program, and the work of an insurer is perilous even in heady economic times. I can give you examples like Lloyds of London and some of the problems it has had after many hundreds of years in the business of insuring ship cargoes.

Mr. Paul T. Richmond: It seems to me that your compliance review program has not been successful. Collecting $1.4 million—or double that, $3 million, in one year—does not seem to indicate widespread abuse. It indicates common errors that people make, not people trying to avoid compliance. And if you consider the $3 million that you collect versus the cost to the clients to prepare this information, it seems as though you're collecting less than the total cost of the program.

Mr. Calhoun: The idea is not to recover your cost and mine. There's no question that If you have to get this done, it's going to cost you something. And, except in very rare instances, no one ever gets any money back. The selection criteria has been pretty good, though. About 65% of the people that we look at owe us money. Only in two cases, have we owed money, which we paid. In about a third of the cases, nobody owed anybody anything. I hit two times and only miss once, so that's reasonable. I don't expect to get huge amounts of money, unless people are just not filing at all. We've had a few small plans where that's happened, but it's rare.

Some plans have had to pay $100,000. Depending on the size of the plan, that can be a lot of money, and the company is not happy about it. But I didn't expect to find $100 million. Something would be really wrong if I did. By the way, that was a criticism the General Accounting Office had written in one of its reports that it thought the PBGC was undercollecting hundreds of millions of dollars. We disagreed and, I think, have proven that criticism wrong, but we didn't have any proof at the time.

From the Floor: The complaint that I'm getting from clients, though, is that it's costing them $100,000 to find a $50,000 problem. They spend $100,000 to collect all the information, send it in, talk to the PBGC, etc., and find out that the premium I owe is far less than that. It wasn't that I was trying to abuse the program or avoid paying. Mistakes happen. So, it seems as though the program is not very cost-effective.

Mr. Calhoun: But if I have a 100 people that owe me $50,000—and those are people's pensions—should I not try to collect that money? We have trust funds with people's pension money to pay. We have come up with a self-review program to help companies avoid that problem.

From the Floor: I remember you talking about retrieving tens of millions of dollars in the past, which would have made the cost-benefit ratio better. Perhaps you were getting more in the past because maybe it was a new thing, and now people are much more careful. Have you noticed the amount you're getting coming down?

Mr. Calhoun: It's coming down a little bit, but it's more that I got slowed down in how I did some of the number of audits and the way we recovered the money. Plus, I only had limited resources to spend on the problem. Low-hanging fruit is always easy when you start something. But people get a little wiser and, hopefully, some of the stuff gets cleaned up. I have no problem with that. As we gain experience, we try to focus differently and only target companies where we think we have a very good likelihood to find something. However, some self-review, particularly by the larger plans where the record keeping is more complex would make the audit process easier.

From the Floor: From the macro public policy perspective, does it make sense for the American economy to spend $2 of total resources to try to find $1 at a shift? I recognize that, as a trustee of a fund, you have a different perspective. But, if we look at the total cost of collection, Including the cost to the plan sponsor of going through the audit and compare that with the payback, are we really serving public policy?

Mr. Calhoun: You could make the same argument about IRS audits or any other compliance mechanism. The issue is that compliance is important, and I don't think any of you disagree with that. Those of you whose clients are paying the right amount want to make sure everybody's paying the right amount. Otherwise, everyone's premiums will be raised because some people aren't paying what they're supposed to pay. How can you arrive at compliance without cost?

From the Floor: I want to make a couple of points about this process. Most people would agree that it's important to conduct some audits so we can be sure people are paying their fair amount. But most other government agencies audit a year at a time, not three years or five years. A second point is that the contractors that the PBGC uses tend to be arrogant, fail to return phone calls for clients, and conducted themselves in an unprofessional way. The process itself could be a lot simpler. I have had clients that spent $100,000 to find $200 worth of errors during the six-year period, and it doesn't make any sense. If you limited it to one year, I think there'd be less of a concern. Then, if you found a problem, you could look further. I also question the randomness of the audits. It seems that virtually any plan that has more than 5,000 participants has been audited, but I'm not sure that's exactly the case.

Mr. Calhoun: It's not.

From the Floor: Out of six clients, I've had four audited, so it can't be that random.

Mr. Calhoun: We don't do it by actuaries.

From the Floor: It might be random, with 80% of the large plans selected, and data on that would be useful.

Mr. Calhoun: I said that up front. There's a universe of 45,000, but most of the dollars are in a smaller number of companies. It's natural to hit more big companies, but there also were fluctuations in p-counts and other changes that caused people to make the list.

From the Floor: Regarding your comment that penalties are statutory, isn't it true that the PBGC does have the authority to ameliorate the penalties and reduce them with reasonable cause? If a person is found to have made an honest arithmetic error, generally the IRS does not throw the book with maximum penalties at the person.

It's become of great concern to many of us in the profession that an insensitive attitude is permeating the agency. Many agency people think it's OK to hit a plan sponsor with the 100% penalty because it has deep pockets. It is assumed that the sponsor will recoup the loss from someone else; after all, it's covered by some type of malpractice insurance. But, as anyone who works in this field knows, errors and omissions coverages generally have large deductibles. Premiums are based on past experience. Effectively, whoever is held "responsible" for a mistake ends up paying for it. When a large penalty is extracted from a firm, in my experience, the firm will look for a scapegoat, and somebody will be retired or terminated. You're playing with people's careers, and I haven't seen any sensitivity to that.

Mr. Calhoun: I'll give you the policy issue. We have people working for us who are not perfect. Regarding this arrogant stuff, I don't know what you ran into, but I don't like to hear that and we'll try to correct it.

I'm not targeting actuaries, and I'm not trying to hit everybody with a 100% penalty. You have to understand the world that I have to work in. We have something called inspector generals, Washington's junkyard dogs, to deal with. They go after everything. We do negotiate penalties, and I charge almost nobody 100%, unless someone is real nasty. We have worked with people and tried to be reasonable. Yes, they must pay something, partially because I'm paying somebody to go out and do a review. Remember where our money comes from investment earnings and premiums. We're in a funny position. We have two sets of customers, the people that pay the premiums and the people we have to pay and have to balance both sides. I must have enough money to pay the pensions. That's one of our primary missions. And I have to treat the people that pay the premiums with some respect because that's where the money comes from. I do think the 5% is a rather usurious penalty. There's no question that it is an issue.

If you find an arithmetic error and come to us before we come to you on an audit, I'll only charge you a 1% penalty instead of 5%. So, I don't want to hear that I'm very insensitive to people's careers and all that. Even when we do hit you, we don't hit you usually with the maximum penalty. If we go over the results and you disagree, you can talk about it. Most people don't disagree with the auditors' findings, by the way.

The real issue is that some people don't want to pay any penalty at all, even though I just had somebody spend several weeks looking into the plan and coming up with a finding. I'm going to pay them, so the penalty serves that purpose, if nothing else. And, hopefully, people will be a little more careful in the future because of the process, but that's what we want. Compliance is the issue. Sometimes you get a bill for the whole amount, but that's not what you end up paying. I don't want to scare those of you who haven't been audited yet.

I did run into a problem when I suggested we not bill the full amount if we are not going to charge the full penalty. The Inspector General came down on my head and said, "No. You can negotiate, but you've got to bill them the amount." He wanted to be able to follow what I was doing and establish a paper trail showing that no one was given any special breaks. So, you can understand that I get watched, too. In looking at past-due filing notices, we do try to negotiate and be reasonable.

We have a problem resolution officer anyone can contact by phone or e-mail. We'll be glad to hear from you and try to respond. But we have to deal with the whole United States and a few foreign corporations. The PBGC has a staff of about 700 people. That's it. We're in court in every jurisdiction in the United States dealing with bankruptcies and various issues. So, we cover a lot of ground with a small number of people and some contractors. We also try to send out these premium forms earlier, which was a complaint a lot of people had. So, I've tried to be responsive to things that you needed and, at the same time, be responsive to the General Accounting Office, the Office of Management and Budget, and others. We have to respond to a variety of people and also fight in court to get assets and returns, but we try to avoid that. We want all your plans to stay healthy and get fat, and we hope we never see them.

Mr. Gebhardtsbauer: It looks like we already heard a lot of good comments from an employer in the actuarial field, but now Dick Barney's going to talk from the employer side.

Mr. Richard J. Barney: To preempt the issue of whether the premium audit was cost-efficient, in our case, it was. We paid a six-figure penalty for the six years that were audited. It revolved essentially around a single issue. We had a class of employees that we called "dual capacity." These were sales managers working on salary as well as override commissions. Our salary plans give benefits to these people on their salaries, and our field underwriter agent plans provide benefits on the commission income.

The question was, once a person went from being a sales manager to only a field underwriter who was no longer salaried, did his or her service with the company continue for vesting purposes? This is not a black-and-white issue. In a recent court case involving New York Life, an agent tried to sue for benefits, and the court ruled he was not an employee. It really comes down to a judgment at each company.

In late 1995, one of the people in the benefits administration area asked what should be done about these dual capacity people? As we started looking into it, we discovered that we had about 1,100 people who, if we counted their service as field underwriters, had become vested, either because of continuing service or the fact that we had started making 420 transfers of excess pension assets in 1992, which leads to vesting of everyone in the plan. If you're dealing with an insurance company, make sure you understand the nature of the contract with the field agents, whether they're independent contractors or employees.

We had started these discussions late in 1995, but the PBGC nudged us along in 1996 when it came in to audit the premiums. At that point, our legal department had determined that the services of dual capacity employees did continue for vesting purposes under ERISA. Therefore, we had to go back and count them because they had been participants in the plan. Most of these people had been salaried for a year or two. The failure rate as a sales manager or an agent in an insurance company is about 25% in the first year, 50% in the second year, and 20% in the third year. To retire as a field agent, you have to work very hard. Probably one in a thousand will have the career that you may have with one company. When we brought in these 1,100 people it resulted in a fairly substantial increase in our premium counts.

Our audit was a six-year audit, which actually meant seven years of information. I'm very happy that they have come down to three-year audits. We were not audited for the variable premium. Our salaried plan has been fully funded since long before I came, and I suspect it will be fully funded on the day I retire. We currently have a surplus of over $100 million. So, the assets were never in question. The variable rate premium was never in question.

The PBGC letter that Ron talked about asks for documents you've already provided to the IRS or the Department of Labor: the Form 5500s for the years in question(1988 through 1994), copies of the plan documents and amendments, actuarial valuation reports, and the IRS Employer Transmittal Form, which is basically the W-2 counts. Then the PBGC wants the census listing for each of the categories in the reconciliation—those who had terminated, those who had terminated vested, those who retired, those who died—as well as a similar reconciliation of ineligibles.

Before I go any further, notice that this is all based on W-2 information. I have a question for those of you who either are on the employer side or on the consulting side. If you have a client of 500 or more lives, how many of you start to derive your pension census by going to all the W-2s issued in the year by the company and whittling that down to your active pension count? Let the record show that I see no hands at all. This is the way the reconciliation is done for the purposes of the PBGC premium audit, though.

You start from all the W-2s that were issued, deleting various categories such as duplicates, retirees, term-vesteds, deceased, terminated, and excludable and ineligibles. This means going through a completely different process from that which you may have gone through to derive your counts in the first place. This, by the way, was the form that we were given by the CPA firm that was contracted by the PBGC to do the reconciliation required a reconciliation of each category of participants from the beginning of each year to the end of the year. However, because of deficiencies in their form, we had to add several lines: deceased retirees, deferred, etc. There are term vesteds who have now retired and have started to receive payments: those who were cashed out with lump sums, paid monthly annuities as they retire, and those who die. We had a comment section, for example, for vested terminators, where they cashed out, did they get a lump sum? Was a person ineligible? For what reason was that person ineligible?

We did give the auditors everything they asked for in their letter and all the information on each employee who was in the census. They felt this was adequate and that they were actually getting better data from us than they were from some of the other audits they were doing at the time. Therefore, they never asked us to actually verify any of the data we gave them. Perhaps the fact that we were giving them the right to collect a much larger premium than we had actually paid over that six-year period moved them to be lenient in terms of how much more effort they would put into the audit. They could go back to Tony and say, "We collected over six figures from this company. Didn't we do a good job?"

At the end of the audit, we received a form from the contractor, and the only point at which we saw anyone from the PBGC was when they came in to sign the final settlement. They gave us their participant counts, the premium rates, and basically went through how the penalty was calculated. They never told us how they got to the participant counts that they used; we only knew they were not the ones we gave them in our reconciliation. However, we felt that, given what we thought we were going to pay, it looked like a fair settlement, so we never asked them to show us how they did it. So, one of the questions I put to Tony by e-mail was, "Is it common practice for the PBGC not to show how it arrives at its reconciliation of the data?

From the Floor: Are you intimating that the contractors had the authority to negotiate on behalf of the PBGC as far as what they would charge or how much they would ask for?

Mr. Barney: No, that was the one point at which we did see someone from the PBGC. After the contractors did the audit and came up with their own counts, the PBGC had to come in and sign off on the final settlement. So, it's not that they were completely absent in this process.

From the Floor: I'd also be interested in knowing the basis of compensation for the auditors and what type of quality controls the PBGC has in place. How would you know that it was OK that the auditors didn't actually look at any of the source data, but just took the employer's word for those head counts?

Mr. Calhoun: There's no question that some people cooperate more than others, and I will spend less time on them. We started out compensating the auditors based on the return that we got and ran into some hassles on that. Now they are basically on a fixed price contract with an hourly rate and so forth. So it doesn't matter anymore whether they collect more or less. However, in terms of the controls, our staff does keep in touch with the auditors all the time. You may not see them out in the field because the auditor often is in the area of the person being audited. Our folks from Washington might show up towards the end for negotiations, but we are looking at what the auditors have provided. We do review how we came up with the p-count now, although we didn't always initially.

Mr. Barney: I also asked Tony why we were audited. We had been in some litigation with the IRS over back taxes for the corporation as a whole, and, given that we won that suit, I wasn't sure whether that played a role in being selected.

Mr. Calhoun: No, I am not a tool of the IRS or the Labor Department for any actions you may or may not have with them, whether you won or lost.

Mr. Barney: I was told later that the reason was that we were part of an insurance company. In general, the PBGC was targeting a whole block of insurance companies for audits.

Mr. Calhoun: If we see a common type of problem, there's no question that it might run through an industry. We've had issues with medical centers attached to universities and some things with the insurance companies. We've seen certain trends in certain areas and, generally, have been successful in finding something. As time goes on, we do adjust our selection criteria. Your guys did an excellent job in terms of your responsiveness. But most people didn't respond as quickly or thoroughly. Those of you who have experience dealing with auditors know that when you give them what they ask for, they tend to go away. When you don't give them what they ask for, they tend to dig in their heels and look for more stuff or try to verify more things.

Mr. Barney: Let me just finish up with a few of the complications of doing this when you're within a larger company. I will say the outside CPA contractor was very good about giving us additional time. We were originally given 14 days to provide six years of information, but they were very good about giving extensions. At that time, we also were in the last throes of a downsizing program and had a lot of the benefit calculations and other things going on that we needed our people for.

We also had some issues with getting the data. You have people with multiple W-2s, for example. They may have a W-2 as an agent, a W-2 as an employee, or different types of compensation that derive multiple W-2s.

We also have multiple systems for coming up with the people. We have a single system that we use for the active lives. Our retired lives were an amalgam of a payment system and some manual systems for paying survivors because we had just brought a survivor benefit out of the life insurance program into the pension program. Our terminated vested file was a total mess, and this was where we discovered the 1,100 lives that we didn't even have. So, we had multiple systems that we had to deal with to come up with these numbers, not just one big computer system that we could go to and generate the numbers very quickly.

All of our systems were geared toward company ID numbers, not W-2s, and a lot of people had more than one company ID number. Every time they went to a subsidiary, we gave them a new ID number; when they left the subsidiary to go back to the parent company, in the system they would have been considered vested terminated. So someone could came back to the company in a regular capacity under the original ID number and retire 10 years later. We could end up having two numbers on the same person: one indicating the person is retired and the other indicated that he's vested terminated. So, we had a number of issues with trying to reconcile the systems.

No reconciliation had ever been done in this plan before with the January 1, 1995 valuation. Like most large plans, at least in my experience with working with Milliman & Robertson, we had just a slice of data from the firm at that point in time. We did not go back and try and justify how we got from January 1, 1993 to January 1, 1994 to January 1, 1995. I guess another question I might ask is, "How many of you with a thousand lives or more in your plan, do a data reconciliation from one year to the next within your valuation report?

I've seen cases where the reconciliation is not done, especially when you get into larger numbers. To try and do this detailed reconciliation to get from point A to point B is often very difficult. Thankfully, we were not involved with a variable rate issue. Karen is here to talk on that issue.

Ms. Karen S. Kinol: The PBGC's now giving you 45 days to provide the information, rather than 14, and you can request an extension. In one case, as soon as our client notified us about the audit, we requested an additional 45-day extension, which we got, and started working on the process. A month down the road we got another letter saying the PBGC needed very detailed reconciliation sheets filled out, which cleaned up some of the problems that Dick pointed out where there were gaps in the original participant reconciliation. These forms are part of the proposed self-audit procedure that we'll go through later. At that time, we sent another letter to the PBGC saying, "This additional request came a month after the original request. We don't have electronic W-2 information available for some of the earlier years. We have to get the hard copy listings keypunched so we can compare it to the valuation data. Can we please have 30 more days?" That request was denied, but we ended up meeting the 90-day time frame. We heard from the PBGC contract firm about a month later because the auditors had a couple of questions. Two months after that we received a letter saying we only needed three years' worth of data, not six.

Mr. Calhoun: That's when the policy changed. Sorry.

Ms. Kinol: So that was our experience with it. We were in a pretty good situation because the client had one plan that covered almost all employees. We were able to do the reconciliations by person and provide all the listings at a cost of about $25,000 to the client. We have not heard a word from the PBGC since. We're assuming no news is good news because we reconciled everything. But, that was a huge expense to the client and the PBGC gained nothing, as some of the other people have pointed out.

The PBGC now requests information on the variable premium calculation, but only if you use the general rule. If you use the alternate rule, I presume they're looking at your Schedule Bs to see if you did the roll-forwards correctly. But, if you use the general rule, they're requesting backup on the actuary's worksheets, the detailed assumptions that we used, and so forth. Just be careful about the assumptions and methods you use.

Chart 1 shows some of the changes that have occurred over time and that will occur in the future with respect to the interest rates, mortality tables, asset valuation method changes, and so forth. This is a handy thing to have to make sure that you follow these procedures.

Another thing to be aware of if you're using the general rule is that all of your calculations are still supposed to be based on your assumptions, your methods, and your plan provisions, as of the last day of the year preceding the premium payment year. I'm aware of some instances where things have happened, such as a change in asset valuation method in the premium payment year, but you can't use that change to do your PBGC premium for the year. You use the method in effect at the end of the prior year. Changes in assumptions that you make in the valuation year also can trip you up. I think we all know the general process for the variable premium calculation, so let's move on to the self-audit program.

From the Floor: If I understood you correctly, the six-figure premium was related to people who have probably had trivial benefits. They didn't have enough to vest before they left or to vest later.

Mr. Barney: Yes, to a certain extent, although this went all the way back into the 1980s, prior to the Tax Reform Act. So, some of these people could have had up to eight or nine years of service before they left the salaried service.

From the Floor: Mr. Calhoun gives us a very rational explanation about his problem with junkyard dogs and everything, we explain it to the human resources people who understand it, and then when it's all over and you pay the six figures, the financial guys come down and say, "What are we doing with a defined benefit plan anyway? Every time I have to explain something like this that makes no financial sense, I get a lot of pressure to switch to 401(k) plans. Did you feel any pressure of that nature?

Mr. Barney: No, for two reasons. First, we're overfunded by $100 million plus, and the company has been looking for ways to use that money, everything from 420 transfers to 414(k) accounts. Second, our higher managers are in their late 40s and early 50s and have begun to realize the benefit of DB plans. So, no, I've had no pressure. We've looked at changing possibly to cash balance or something like that but not to get away entirely from DB plans.

Mr. Calhoun: That is a concern. I'm one of the finance guys, so I do understand. You do have a vehicle, the 401(k), that is currently, as the DB world was prior to ERISA, unregulated. That doesn't mean it'll stay unregulated forever. The Labor Department is starting to look at increasing numbers of abuses. Mainly, the abuses are found at smaller companies, but there is some growing concern about how the investment decisions are made. There was the situation with Color Tile, where several people had rolled money into the 401(k) plan, and it was invested virtually all in company stock. Then the company went under and the employees lost not only what they had earned from Color Tile, but also the money they brought with them from another company.

Another problem you said a lot of your clients are running into is that many employees, particularly those under ages 40–45, don't necessarily understand the religion of DB plans or appreciate them. A 401(k) is something they can see accumulating very quickly, so that is a problem.

Mr. Gebhardtsbauer: Now we're going to talk about the premium self-audit. The Academy and different organizations in Washington were becoming concerned about the audits and talked to the PBGC about simplifying the process. The PBGC came up with a self-audit idea that we've been spending a lot of time on. The only thing is, after reading it, we thought, "This self-audit is an awful lot of work, and the worst audit is not as bad as it used to be. Instead of six years, it's three, and they give you 45 days instead of 14. And the auditors are getting better." Now there's a concern that people are not going to do the self-audit. In fact, the Academy told the PBGC that we don't think people are going to use it unless they make certain changes. The ERISA Industry Committee (ERIC) sent a letter to the PBGC with some suggestions, as did Ethan Kra of William Mercer, who is in the audience. As we talk about the self-audit, think about whether you would encourage your clients to do it. Even if you don't' do the self-audit, I think this is a great document to have because you can find out what the PBGC does when it audits you. Go through this once and figure out if you have any holes in your own calculations. You don't have to spend all the money to get a second actuary or have it audited by an auditor, but at least go through it quickly to make sure you're doing everything right.

Mr. Calhoun: With the self-audit program, we hope to come up with some additional agreed-upon procedures that would give the auditors some assurance that the calculation was done correctly. If you volunteered for the program, which you would have to do in advance, we'd no longer have to ask for original source data. If they found that you owed us some money, we would not charge you the penalty at all. So, if you agree to be in this program and find a problem, you file the amended filing and we waive the penalty. You do have to pay the back premiums and interest. We obviously have to see the report. And, if you don't file the amended filing that's due, we could revert back to the 5% penalty.

The plan would be required to preregister, complete the participant reconciliation and variable premium reconciliation worksheets, use independent auditors, and forward the report to us. We've talked about this with the American Institute of Certified Public Accountants and the Financial Executive Institute, in addition to the actuaries, and some concerns have been expressed about whether it will be worthwhile. Companies still have to pay some extra money, whether it's to the actuary or the auditor. We're trying to come up with a program that's simple, but we need reasonable assurance of accuracy there because, again, we're trying to get to compliance. However, no matter how we do this, there are some costs involved.

People can decide to pay the price when we come knocking on their door, and pay nothing for the years we don't come knocking. I don't know if that's the wisest plan, though.

I'd love to do the proposed premium self-review as a pilot if there is sufficient industry interest. Ted Winter has been heavily involved as a contact person. Like the compliance program itself, as it gets into the field and practiced, we will find things that need to be tweaked and fine-tuned. We've already received some feedback and made adjustments. We're trying to work with people here so we can meet our objective without inconveniencing you or your clients any more than necessary.

Ms. Kinol: For the variable rate premium aspect of the self-audit program, the criticisms fall into three main categories. The first is that significant procedures are outlined in here for the independent auditor to go through and review your variable rate premium calculation. I read comments from people in the actuarial community saying that this requirement had been negotiated with the PBGC and was likely to be removed, but it still is in this proposed package.

The second criticism involves the certification of the preparing actuary, which requires a signature of a reviewing actuary. Many firms do reviews of premium calculation Schedule Bs as a matter of company policy. I know Buck does. But I don't know how our reviewing actuaries would feel about putting their signature on something like this. It's never really been their place to back up your work with their signature. The Academy and ERIC have both commented that if a double signature is not required on a Schedule B, why should it be required for a premium calculation? It undermines the actuary's professional conduct.

The third criticism is that the self-audit proposal outlines some issues that have not really been addressed in premium regulations. One of the things you must fill out is a reconciliation from your current liability to the actual amount of vested benefit that you show on Schedule A. You subtract out from your current liability amounts that aren't vested: non-vested and partially-vested retirement benefits, disability benefits, subsidies, death benefits, contingent benefits, subsidies, and other non-vested liabilities. Then is also a list of what each of those categories represent: What's a disability benefit? What's a death benefit? When aren't death benefits included in vested benefits? The problem is that those issues are not addressed anywhere else.

If you look at the premium regulations right now, they say, generally, that the vested benefit liability is based on vested current liability. We all know that there are still a lot of issues on current liability that have not been resolved. The only additional guidance in terms of that is that unpredictable contingent event benefits are not taken into account until the event upon which the benefit is contingent occurs. That gives you a little bit of guidance. The only other thing that's out there is that, in the preamble to the October 1988 proposed premium regulations, the PBGC stated that: "Contingent benefits such as 30-and-out and disability benefits and determining the value of vested benefits by stating that unless a participant has met the requirement for and become entitled to receive a contingent type benefit, the benefit is not a vested benefit." That's it. None of these other issues—death benefits, early retirement subsidies, temporary retirement supplement, etc.—have addressed previously, and now they show up in the self-audit procedure. That's a big criticism of this program, and if you have comments on that, I'm sure the PBGC would like to hear them.

Mr. Barney: I've seen two drafts of the self-audit proposal—one from October, I believe, and the other from February. I put the two of them side-by-side, and one of the big differences I saw was a lot of language that went into when a person is included as a terminated vested in terms of cash-out provisions, deemed cash-out, and so on. I'll tell you frankly, again, based on our own law department judgment, that, because we do 420 transfers at the end of the year—that is, we transfer excess pension assets out of the plan to pay retiree medical benefits—we vest everybody in the plan. This means we have a great number of people who come and go during the year who become vested at that point in time. We pay them out as soon as possible thereafter under the $3,500 cash-out provision, but that often means they don't get paid out until some time in January the following year. We do not include these people in our PBGC counts. If I look at the new wording in the February draft, I'm not sure the PBGC would agree, but our lawyers, in looking at ERISA, said this is where they come down.

I'd like to get to a proposal that Ethan Kra made, that we seem to be talking past each other on the issue of sampling. I'm on the Pension Committee of the Academy with Ron and Ethan, and we wrote a letter suggesting that one way to get around some of the cost to the employer is to do sampling, and ERIC came up with the same comments. In the February proposal, the PBGC seemed to be saying, "Sampling's not such a bad idea. After you do your reconciliation and all that, then your auditors can sample." But, folks, 95% of the employer cost of doing these premium audits is the reconciliation. By the time you've done all that, I would be amazed if your auditors went back and looked at every life independently anyway. If they do, you probably should find yourself a different auditor. So, what Ethan was trying to say, and he can correct me on this, is that we'd rather see the PBGC's CPA auditor look at a sample of the W-2s to make sure that they correctly found their way either into the PBGC count or not, based on reasonable grounds. That is a way of sampling what employers have done without putting them through the whole reconciliation process.

Mr. Ethan Kra: I know that there are different practices among different actuaries in different actuarial firms, but in many instances, the participant count will come from an actuary based on some summary number off a database. So, if the actuary produces, in machine form, the participant file that matches to the number, say that there were 13,724 active participants, we produce an Excel or dBase file with 13,724 records again to find the people that represent the number. That file is then handed over to an auditor who randomly samples the W-2 base and determines whether or not each of those randomly sampled people should be in the plan. If the answer is yes, they should appear on the actuary's database. Finally, if after sampling the requisite number of lives, you haven't found any mistakes or the error is deemed to be within an acceptable statistical range, you close the file and go on to the next situation.

Mr. Gebhardtsbauer: One thing I saw in the letter that ERIC sent to the PBGC was that some of the administrative costs doubled if they had to go through the whole reconciliation, particularly because they have to hire another actuary to review the first actuary's work. Plus you have to get the auditor to do all this auditing. All that could be more expensive than playing roulette and just hoping you don't get audited. Are there people here who would not do the self-audit?

Mr. Calhoun: Right now, you don't have procedures that anybody has agreed to, so you're asking them if they would jump off the cliff. I don't' have a problem with some of the things Ethan is talking about, but we're trying to come up with a procedure that the auditor can do, that we can live with, and that somebody's willing to pay for—because there is a cost no matter what they do. And remember, we're trying to tie it to the time they're auditing the plan anyway, you're not calling somebody in to do a separate review. We're trying to come up with a mechanism by which we can meet our compliance burden and you don't have too much of an extra burden. Accountants go through peer review all the time, so that double-checking was something they came up with. Actuaries don't like that, and I understand. But accountants go through it all the time. To them, somebody checking their work is not anathema.

Mr. Gebhardtsbauer: We do check our work. As an actuary, I sign off on the work, but I'll have someone else check it before I do. Maybe we should continue refining this self-audit proposal to come up with something that will work and that people will use.

From the Floor: I'd like to hear Mr. Calhoun's response to Ethan's sampling suggestion. What are your objections to that process as opposed to what you're doing now?

Mr. Calhoun: I'm not totally objecting to it. The state of the files, though, do vary from company to company. It's harder to get information from some companies because of multiple mergers, how they do their payroll, etc. So it may not be a one-size-fits-all situation. I don't know. But we've been talking about sampling for a long time now. It's just a matter of coming to some agreement between the auditors and the actuaries and determining what costs the client might agree to. It's coming to an agreement that's been the issue, but I have no problems with some sort of sampling. It's just a matter of how we work that out.

Mr. Jon L. King: I like Ethan's idea, but you need to go one step further to protect your client. The auditor also has to randomly sample the W-2s to make sure they showed up on the actuary's list.

Mr. Calhoun: That's absolutely right. We brought up sampling some time ago, and people said no, so we stopped. Then it came back up again and I have no problem with it.

CHART 1
CHANGES FOR PBGC PREMIUMS