

## Enron Energizes Pension Hill Visits

**T**HERE WAS A LOT TO TALK about this year as members of the Academy’s Pension Committee, along with others in the Academy leadership, met with congressional staff and policy-makers in their annual Capitol Hill visits on Feb. 4.

The meetings focused on the 30-year Treasury replacement rate, leveling the playing field between DB and DC plans, and, not surprisingly in light of multiple Enron hearings, the importance of pension diversification.

“Enron has sharply focused people’s attention on the relative treatment of DC and DB plans and the tax code,” said John Parks, the Academy’s vice president for pension issues.

In this year’s meetings, Academy members met with higher levels of staff who came prepared with substantive knowledge and very specific questions. “There is a lot of respect up there for what the Academy does,” said Parks.

But the meetings worked both ways, allowing Academy visitors insight into potential legislative action. “One of the big values [of Hill visits] is to find out what is on the minds of key staff and, hence, their bosses,” said Academy President Dan McCarthy, who participated in the visits.

Parks said Republican and Democrat staffers offered com-  
**HILL VISITS** continues on Page 8 ►



John Parks, Don Segal, Bridget Flynn, and Ron Gebhardtbauer (above, left to right) talk before meeting with policy-makers.

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## Academy Seeks Guidance on SFAS 87

**T**HE ECONOMIC GROWTH and Tax Relief Reconciliation Act (EGTRRA) enacted last year includes a provision to increase the limits on retirement benefits payable from defined benefit plans (under section 415(b) of the Internal Revenue Code). The legislation also includes a sunset provision, which takes effect after the year 2010.

This provision has raised a number of questions on the application of benefit limits in funding and accounting for pension plan obligations. In December, the Academy’s Pension Accounting Committee sent a letter to the Financial Accounting Standards Board (FASB) requesting guidance on appropriate methods of interpreting the provision when stating pension benefit obligations under Statement of Fi-

nanacial Accounting Standards No. 87 (SFAS 87).

The committee’s letter points out that when conducting pension plan valuations, actuaries must estimate the benefits payable in all future years, taking into account benefit limits under section 415(b). For qualified defined benefits to be paid in years through 2010, it is relatively clear how to reflect the EGTRRA increases in benefit limits. What’s not clear, however, is how the sunset provision should be interpreted for events after 2010.

In its letter to FASB, the committee suggests at least three alternative interpretations:

- 1** TREAT THE SUNSET PROVISION AS HAVING FULL IMPACT. That is, calculate the benefit as if EGTRRA had never increased the section 415(b) limits.

SFAS 87 continues on Page 2 ►

# Minimum Funding for DB Plans: Seeking a Better Rate

**O**N JAN. 30, THE TREASURY DEPARTMENT announced that because of the suspension of the 30-year bond, it will no longer supply the Federal Reserve Board with an estimate of the 30-year Treasury constant maturity yield for publication in the H-15 Selected Interest Rates. The announcement was made as part of Treasury's February 2002 Quarterly Refunding Statement.

Beginning on Feb. 19, Treasury instead submitted to the Federal Reserve a long-term yield based on a basket of long-dated securities. This basket consists of all Treasury securities with remaining terms to maturities of 25 years and older. Treasury is also providing an extrapolation factor to the Federal Reserve to allow interested parties to obtain a proxy estimate of a 30-year yield.

The Internal Revenue Code specifically stipulates that the 30-year Treasury rate (not some approximation of it) be used for several purposes with respect to defined benefit plans, including in determining minimum funding contributions under section 412 of the code. Reacting to the publication of a more imprecise rate, advocates in the employer-sponsored plan community are urging Congress to enact legislation replacing the 30-year Treasury rate. Reps. Rob Portman (R-Ohio) and Benjamin Cardin (D-Md.) plan to introduce stand-alone 30-year Treasury legislation in the near future. That legislation is expected to be substantially similar to the rate relief passed by the House in the economic stimulus bill last year.

— Bridget Flynn, pension policy analyst

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## SFAS 87 *continued from Page 1*

**2** TREAT IT AS BEING SUBJECT TO THE ANTI-CUTBACK PROVISIONS OF SECTION 411(d)(6). In this case, the participant would, arguably, be entitled to the greater of the pre-EGTRRA benefit limit and the post-EGTRRA benefit limit for 2010.

**3** TREAT IT AS HAVING NO FORCE. That is, calculate the benefit as if the EGTRRA increase in section 415(b) limits were permanent.

The letter also notes that last November, the IRS issued Revenue Ruling 2001-51, which states that for purposes of calculating the required minimum calculations each year as well as the maximum tax deductions, the sunset provisions of EGTRRA should be disregarded. This guidance seems to be in accordance with the third alternative mentioned in the committee's letter.

— Bridget Flynn, pension policy analyst



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# Academy Briefs GAO on Retirement Issues

Investment risk, inflation risk, and longevity risk are no longer just words for more than 100 employees of the General Accounting Office (GAO) who attended a Dec. 18 presentation on DB and DC plans by Ron Gebhardtshauer, the Academy's senior pension fellow.

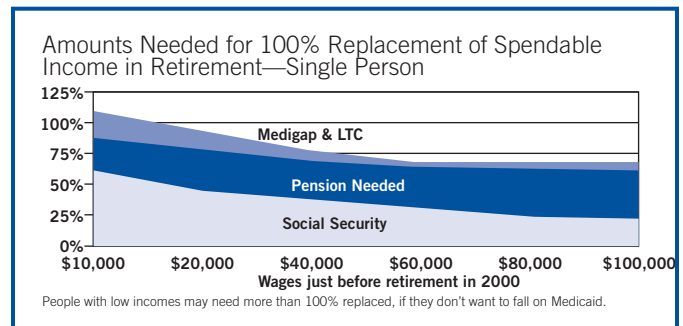
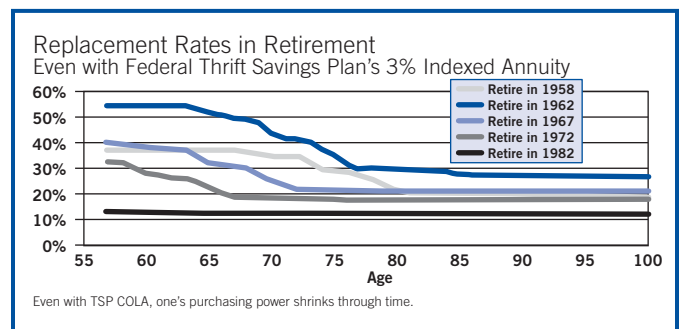
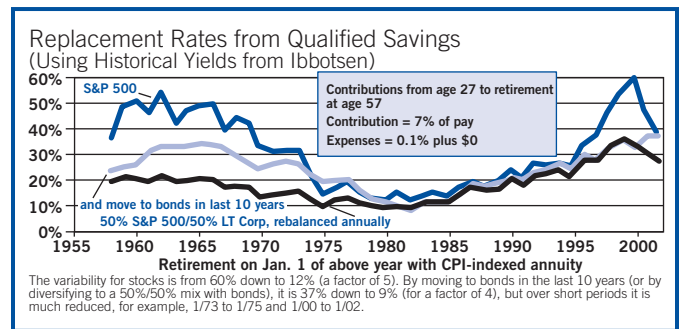
Gebhardtshauer personalized his presentation by referring to the benefits that GAO employees receive from the Federal Employee Retirement System (FERS), a DB plan, and the Federal Thrift Savings Plan (TSP), a DC plan. His examples illustrated the variability that can be expected from a DC plan, particularly when compared to DB plans that guarantee benefits no matter how assets perform.

For instance, Gebhardtshauer projected that a GAO employee who retired at age 57 after 30 years of work would have 30 percent of his or her pay replaced by FERS, and anywhere between 12 percent and 60 percent replaced by TSP. Thus, Gebhardtshauer said, the employee could see anywhere from 42 percent to 90 percent of his or her wages replaced in retirement.

Gebhardtshauer noted that these calculations assumed the employee contributed 3 percent of pay for 30 years to the TSP and got the 4 percent match from the federal government and invested in stocks in the Standard & Poor's 500 index. As shown in the chart below, the 12 percent replacement rate was based on the economic environment from 1952 to 1982, while the 60 percent replacement rate was based on the period of 1970 to 2000 (see top graph on the right).

As part of his presentation, Gebhardtshauer also discussed the importance of electing indexed annuities as part of any retirement package. The statistics are stark. About half of retirees live beyond their life expectancy, Gebhardtshauer said, and about one-fifth of women will live beyond age 95. By age 95, inflation could reduce a retiree's purchasing power by 60 percent, assuming 3 percent inflation.

Gebhardtshauer said that for GAO employees that purchasing power would fall even though FERS has a COLA (CPI minus 1 percent) and even if the retiree purchased a 3 percent indexed benefit from the TSP (see middle graph on right). For example, Gebhardtshauer said, a retiree's purchasing power at age 95 would fall from the 42 percent replacement rate mentioned earlier to 32 percent. Retirees who did not elect the 3 percent indexed annuity in the TSP would see those numbers fall much more.



Gebhardtshauer also talked about health-expense risks that can be avoided by buying long-term care insurance and Medigap insurance. Unfortunately, he said, the cost of these two types of insurance is often beyond the reach of low-income retirees, who might need replacement rates of more than 100 percent in order to purchase them (see bottom graph above).

"Employers often don't provide these benefits, so many retirees end up relying solely on Medicaid," Gebhardtshauer said. "This only increases the government's budget problems."

To view the slides from Gebhardtshauer's presentation, go to [www.actuary.org/pension/index.htm#4](http://www.actuary.org/pension/index.htm#4).

INVESTMENT ALLOCATIONS	REPLACEMENT RATES		VARIABILITY (3)/(2)
	1952-1982	1970-2000	
100% in S&P 500	12%	60%	5
100% in S&P 500 and moves to bonds over 10 years before retirement	9%	38%	4
50% in S&P 500 and 50% in long-term government bonds Index	9%	38%	4

# Revenue Ruling 2001-62: A New Mortality Table

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BY ED BURROWS

**R**EVENUE RULING (REV. RUL.) 2001-62 prescribes a new mortality table for use in calculating minimum permissible lump sum settlements under section 417(e) and maximum permissible benefits under section 415 (b).

The ruling comes as no surprise. The law provides that this table will be automatically updated each time there is a change in the "prevailing commissioners' standard" table. The prevailing table is the mortality table the state insurance departments use in determining adequacy of insurance company group annuity reserves. As soon as the 26th state adopted the 1994 Group Annuity Reserving Table, it became the prevailing table. Hence, Treasury and the IRS had little choice but to promulgate a new table under sections 417(e) and 415(b). The new table is unisex and replaces the 1983 Unisex Group Mortality Table set forth in Rev. Rul. 95-6.

## MAGNITUDE OF THE CHANGE

Contrary to earlier concerns among practitioners, the increases mandated by the new table are generally quite modest. The percentage increase depends on the "applicable interest rate." The lower the interest rate, the greater the percentage increase. Exhibit A compares rates where there is a lump sum payable at normal retirement age in lieu of a lifetime annuity payable from the same date.

Lump sum settlements are often paid before the participant reaches normal retirement age. Here, the percentage increases are a bit more significant even though the dollar amounts may be smaller. Exhibit B compares rates for early settlement where the normal benefit is payable from age 65 and settlement factors reflect pre-retirement mortality decrements.

Many smaller plans, and nearly all cash balance plans, provide pre-retirement death benefits equal to the value of the accrued benefit immediately before death. With these plans, early termination settlement factors often do not reflect pre-retirement mortality decrements. In these cases, the percentage im-

pact of the new table on early settlement is the same as the percentage impact on settlement at normal retirement age.

## EFFECTIVE DATES

Use of the new table is mandatory for distributions with annuity starting dates on or after Dec. 31, 2002. With lump sum settlements, the date of distribution is generally the annuity starting date. Notice that the operative wording is "on or after," not just "after." Optionally, a plan sponsor may specify an effective date earlier than Dec. 31, 2002. The earliest permissible effective date is Jan. 1, 2002. In any event, there must be a single effective date for both section 417(e) and section 415(b) purposes.

## AMENDMENT DEADLINES

The ruling refers to the effective date for use of the new table as the "94 GAR effective date." A plan must be amended by the last day of the plan year containing the 94 GAR effective date. This means that if the plan year is a calendar year, the amendment must occur by Dec. 31, 2002, no matter when the 94 GAR effective date occurs.

But suppose the plan year ends June 30. If the sponsor elects a 94 GAR effective date that occurs during the second half of calendar year 2002, the amendment deadline is June 30, 2003. If the sponsor elects a 94 GAR effective date that occurs during the first half of calendar year 2002, the amendment deadline is June 30, 2002. As long as the amendment is in place by the last day of the plan year containing the 94 GAR effective date, there is an extended remedial period to correct any errors. This extended period ends with the end of the EGTRRA remedial amendment period. That period ends no earlier than the end of the first plan year beginning in 2005.

Some plans have been drafted with the objective of avoiding amendments each time the IRS publishes a ruling, such as Rev. Rul. 2001-62, calling for a new table. These plans incorporate references to the prevailing commissioners' mortality table with the expectation that when the IRS adopts a new table, the plan will automatically follow suit. However, Rev. Rul. 2001-62

## Exhibits A and B—Impact of Change in Mortality Table

### EXHIBIT A—Lump sum at normal retirement age

Normal Retirement Age	5¼% Interest			6% Interest			6¾% Interest		
	Old Rate	New Rate	Increase	Old Rate	New Rate	Increase	Old Rate	New Rate	Increase
55	13.98189	14.19357	1.51%	12.96915	13.14930	1.39%	12.07861	12.23284	1.28%
60	12.73679	12.93967	1.59%	11.90452	12.07829	1.46%	11.16352	11.31285	1.34%
65	11.30016	11.54932	2.20%	10.64635	10.86573	2.06%	10.05688	10.25050	1.93%

### EXHIBIT B—Lump sum at early settlement age where normal retirement age is 65

Early Settlement Age	5¼% Interest			6% Interest			6¾% Interest		
	Old Rate	New Rate	Increase	Old Rate	New Rate	Increase	Old Rate	New Rate	Increase
35	2.19353	2.27686	3.80%	1.67011	1.73111	3.65%	1.27687	1.32175	3.51%
45	3.69452	3.83143	3.71%	3.01995	3.12743	3.56%	2.47754	2.56232	3.42%
55	6.33174	6.51307	2.86%	5.55651	5.70757	2.72%	4.89152	5.01784	2.58%

All rates assume the normal benefit is a life annuity of \$1 per year payable in monthly installments with no benefit for death before or after normal retirement age.

offers the sponsor a choice of effective dates. For this reason, the sponsor who fails to adopt an explicit amendment will be left, at best, with an unacceptable ambiguity. At worst, the plan could be in conflict with Rev. Rul. 2001-62. The new mortality table became the prevailing table when the 26th state adopted it. This occurred well before the earliest permissible 94 GAR effective date. It would appear that all plans should be amended.

### MODEL AMENDMENTS

Rev. Rul. 2001-62 provides two model amendments. The first is designed to fit those plans that only use the statutory mortality table where its use is required. For example, a plan might use factors entirely unrelated to the statutory table to calculate early retirement benefits or optional benefits not subject to section 417(e). It might even use unrelated factors to calculate lump sum settlements, referring to the statutory mortality table only in defining minimum required and maximum permissible levels. Model 1 is designed to fit this plan.

The second model amendment is more expansive. It is designed for plans that use the statutory table even where its use is not required. For example, a plan might specify that early retirement reductions and adjustments for optional benefit forms are all based on “actuarial equivalence.” Then, it might define actuarial equivalence for all purposes using the statutory table as its mortality base. Model 2 is designed to fit this plan.

### CUTBACK ISSUES

The law prohibits amendments reducing benefits already accrued. In general, this rule against cutbacks includes protection of adjustments for optional forms or optional retirement dates.

The principal focus of the statutory change in mortality tables involves lump sum settlements. It would take a bizarre set of facts to produce lump sum equivalents under the new table that are lower than those under the old. A lump sum settlement at age 90 would do it. But lump sum settlements at age 90 are simply not an issue.

The question becomes less academic with adjustments from one form of income benefit to another. For example, consider a plan with normal retirement at age 65 and a normal benefit payable for 10 years certain and life—a design that is still fairly common. Conversion from the normal form to a lifetime-only benefit could be slightly less attractive under the new table than under the old. But even here, the difference is infinitesimal. Many administrators use adjustment factors that lack the decimal point precision to capture the difference.

For another example, consider a plan with normal retirement at age 65 and a normal benefit payable for life. Suppose this plan offers an annuity that increases at 3 percent per year as an actuarially equivalent option—an option that is not common. Here, too, conversion from the normal to the optional form could be less attractive under the new table. Here, too, the difference would be very minor.

An interesting special case of cutback issues, not at all academic, involves cash balance plans. These plans often use section 417(e) rates to calculate annuity yields from their hypothetical account balances. The new table does generally produce a modestly higher lump sum benefit equivalent to any given income benefit. Conversely, it produces a modestly lower income benefit equivalent to any given lump sum amount. In this case, the hypothetical account balance is the given lump sum amount.

## Exhibits C and D—Impact of Change in Interest Rate

### EXHIBIT C—Lump sum at normal retirement age

Normal Retirement Age	5¼% Rate	Raise 5¼% to 6%		Raise 5¼% to 6¾%		Raise 5¼% to 7½%	
		New Rate	Decrease	New Rate	Decrease	New Rate	Decrease
55	14.19357	13.14930	7.36%	12.23284	13.81%	11.42451	19.51%
60	12.93967	12.07829	6.66%	11.31285	12.57%	10.62987	17.85%
65	11.54932	10.86573	5.92%	10.25050	11.25%	9.69495	16.06%

### EXHIBIT D—Lump sum at early settlement age where normal retirement age is 65

Early Settlement Age	5¼% Rate	Raise 5¼% to 6%		Raise 5¼% to 6¾%		Raise 5¼% to 7½%	
		New Rate	Decrease	New Rate	Decrease	New Rate	Decrease
35	2.27686	1.73111	23.97%	1.32175	41.95%	1.01329	55.50%
45	3.83143	3.12743	18.37%	2.56232	33.12%	2.10680	45.01%
55	6.51307	5.70757	12.37%	5.01784	22.96%	4.42498	32.06%

All rates assume the normal benefit is a life annuity of \$1 per year payable in monthly installments with no benefit for death before or after normal retirement age. The caption “raise 5¼% to 6%” shows, for example, the “new” annuity rates at 6% and the percentage decrease from the 5¼% rate to this new rate.

### WAIVING THE CUTBACK RULE

In any event, the IRS has the authority to waive the anti-cutback rule. Rev. Rul. 2001-62 waives it respecting benefits that begin on or after the date the plan is amended. Except for possible decreased section 415 (b) limits, there is no waiver respecting benefits that begin after the 94 GAR effective date but before the amendment date.

In the unlikely event the new table reduces a benefit because of section 415(b) limits, benefits that begin after the 94 GAR effective date, but before the amendment date, will commence at the limit dictated by the old table. Then, it will be permissible (in fact, mandatory) to reduce benefits upon the amendment date. After this reduction, total benefits must be actuarially equivalent to the total that would have been paid if the reduced level had been in place since the 94 GAR effective date.

The bottom line is that cutback issues are almost but not quite nonexistent in connection with a swing to the new table. They come much closer to being nonexistent where the application is the limited one defined in Amendment Model 1 rather than the more expansive one defined in Model 2.

In considering cutback issues, it is worth remembering that mandatory use of the new table is not restricted to lump sum calculations. For section 415(b) applications, the new table is mandatory for all forms of settlement. For section 417(e) applications, the new table is mandatory for all forms of settlement other than nondecreasing annuities payable for life. The only exceptions to the nondecreasing-annuity rule involve joint and survivor forms of annuities and annuities designed to dove-

tail with Social Security or disability benefits.

The only way to make cutback issues totally nonexistent is to be certain the 94 GAR effective date does not occur before the amendment date.

In evaluating the cutback waiver of Rev. Rul. 2001-62, it is important to emphasize its limitations. The waiver is available only where the change is from the old statutory table, published in Rev. Rul. 95-6, to the new table. A change substituting the new statutory table for any other mortality base does not qualify for the waiver. A change substituting the new statutory table with pre-retirement mortality decrements for the old table without such decrements probably does not qualify.

The effective date for any nonmandatory change from the old to the new statutory table presents an interesting issue. The IRS has stated, informally, that in order to avoid cutback issues, a sponsor should establish an effective date for nonmandatory changes that coincides with the effective date of those changes required by section 417(e) and section 415(b).

### SECTION 204(h) NOTICES

Title 1, section 204(h), of ERISA dictates that sponsors of certain types of retirement plans must provide advance notice of any “significant reduction” in future accrual rates. In general, these notices must be provided to participants and certain other interested parties. Rev. Rul. 2001-62 makes no mention of this notice requirement. The IRS has confirmed that in its view a change from the old statutory table to the new will not cause a “significant reduction” even where there is a modest cutback

in the normal benefit. The possibility of a modest cutback in annuity yields has already been discussed in the context of cash balance plans.

It would appear that section 204(h) notices are not required in connection with changes from the old statutory mortality table to the new.

## IMPLEMENTATION STRATEGY

Sponsors will need to decide whether to establish an early 94 GAR effective date or wait until the mandatory Dec. 31, 2002, date. The difference between old and new is so minor that there is no persuasive answer favoring either approach.

Some sponsors with benefits and deductible contributions impacted by section 415(b) may prefer to establish an early date. With an appropriate amendment date, their 2002 valuations can reflect the change. But suppose a sponsor fails to establish an early effective date. In most cases, amounts not deductible in 2002 will become deductible in later years.

Other sponsors will wish to postpone the date when increased minimum lump sum settlements under section 417(e) become effective. For these sponsors, the mandatory Dec. 31, 2002, date appears appropriate.

There is currently a good deal of uncertainty regarding possible congressional action on the interest component of the section 417(e) minimum rate basis. Treasury has discontinued issuance of new 30-year bonds. (See story on Page 2.) This means an amendment to the statute is inevitable. Some other basis will need to be substituted for the interest rate on 30-year Treasury securities now referenced at section 417(e). Some advocates are lobbying for an index likely to produce higher rates. If these advocates prevail, the result would be a reduction in section 417(e) minimums. Conversion from the old to the new mortality basis means a modest increase. It would be good for employee relations if the increase and decrease could be netted out. Whether or not the new interest index produces higher rates, making both changes effective at the same time would reduce administrative costs.

Sponsors who believe there is a realistic possibility of a legislated section 417(e) change this year may prefer to postpone adoption of the new mortality table in hopes that the two changes can be incorporated at the same time.

In general, most sponsors are likely to opt for the Dec. 31, 2002, effective date. The exceptions will involve plans impacted by the benefit and deduction limits related to section 415(b).

## MORTALITY IMPACT VERSUS INTEREST IMPACT

In underscoring the relative modesty of the mortality change, it is useful to compare its impact with the impact of interest rate changes. These changes could be automatic, as the interest index fluctuates. Or they could be legislated, as Congress replaces the 30-year bond index. Exhibits C and D show the impact of

interest rate changes, holding the mortality component constant. These exhibits use the new mortality table throughout. Exhibit C compares rates where there is a lump sum payable at normal retirement age in lieu of a lifetime annuity payable from the same date. Exhibit D compares rates for early settlement where the normal benefit is payable for life from age 65.

Clearly, the impact of a change in the mortality base is small compared to the changes, either automatic or legislated, that might occur in the interest base.

## IRS REQUEST FOR COMMENT

The new mortality table is intended to be “generational.” As published, it includes a set of projection factors: Scale AA. These factors are designed to be applied to the basic rate for each age, each year, to reflect ongoing mortality improvements. The version of the table published in Rev. Rul. 2001-62 reflects basic 1994 rates brought forward eight years to 2002. The IRS has requested comments on the frequency with which the ruling should be revised, presumably by the reapplication of Scale AA. In the extreme, the ruling might be revised annually. The table for 2003 would reflect basic rates brought forward nine years.

In reacting to the IRS request for comment, sponsors might find it useful to consider the magnitude of further projections by Scale AA. For example, the new age-65 immediate annuity rate in Table A at 6 percent interest is up by 2.05 percent. Suppose the table had been projected another five years to 2007. The increase would have been 3.15 percent rather than 2.06 percent. Sponsors might wish to encourage the IRS to balance administrative issues with the desire to keep the table up to the minute.

Ed Burrows is a member of the Academy's Pension Practice Council and Pension Committee.

## Pension Alerts

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## Hill Visits *continued from Page 1*

pletely different solutions to the problem of 401(k) diversification in his meetings with them. Still, “it was interesting to hear the spectrum of opinions,” Parks said, adding that while both sides felt there would be obstacles to any legislative solution, it was clear that the fallout from Enron’s demise would force some sort of congressional action.

In addition to McCarthy and Parks, the Academy delegation included Immediate Past President Larry Johansen; Pension Practice Council Vice Chairperson Ethan Kra; Pension Committee Chairperson Don Segal; Senior Pension Fellow Ron Gebhardt-bauer; and Pension Committee members Chet Andrzejewski, Dick Barney, Ed Burrows, Allen Gorrellick, Dave Kass, Lisa Larsen, Christine Mahoney, Brian O’Konski, and Larry Sher. ▲▲



Academy members converged on Capitol Hill on Feb. 4 to discuss pension issues with congressional staff. Top left: Christine Mahoney, Larry Sher, Bridget Flynn, and Don Segal below the rotunda of the Cannon building. Bottom left: Immediate Past President Larry Johansen, President Dan McCarthy, and Rick Lawson in front of the Capitol. Top right: John Parks, Ethan Kra, and Don Segal on the Capitol grounds. Middle right: Ed Burrows, Dan McCarthy, Todd Tuten, Lisa Larsen, and Brian O’Konski confer before a meeting. Bottom right: Dick Barney, Allen Gorrellick, John Parks, and Rick Lawson en route to a meeting with House Ways and Means Committee staff.