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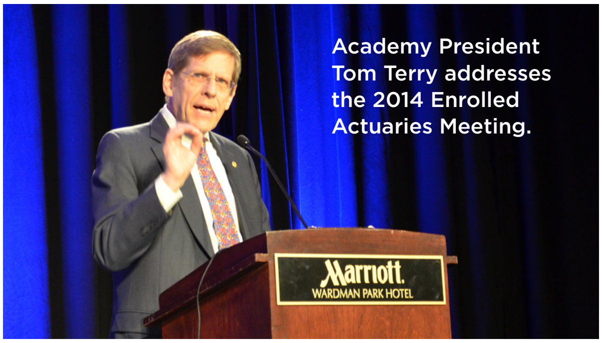
Retirement for the AGES Drives Discussion at Symposium

THE ACADEMY'S RETIREMENT for the AGES initiative served as the discussion framework at the 2014 Pension Symposium in March, leading to a wide-ranging dialogue on pension policies, practices, and changes that could help Americans better prepare for retirement.



Academy President Tom Terry addresses the 2014 Enrolled Actuaries Meeting.

"Retirement Security in the U.S." focused on potential improvements to help Americans boost their retirement incomes while millions of employers have shifted the risk of retirement income to employees by moving away from traditional defined-benefit (DB) pension plans.

The symposium was broken into four sessions that discussed the specific sections of the Retirement for the AGES initiative—**A**lignment, **G**overnance, **E**fficiency, and **S**ustainability.

The Academy's Forward Thinking Task Force designed Retirement for the AGES as a springboard for a larger discussion on retirement policy. The initiative originated as a follow-on from the earlier Retirement 20/20 effort, which brought actuaries together in an effort to design a new retirement system.

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Lifetime Income Options

A COMPREHENSIVE DISCUSSION of lifetime income was the subject of a session, "Lifetime Income Options," at the Enrolled Actuaries Meeting in Washington in March. Steven Vernon with the Stanford Center on Longevity, started off the session by reviewing the retirement planning environment, including risks facing retirees, current and future trends with employer-sponsored defined contribution (DC) plans, and methods to generate retirement income from savings.

Vernon listed several different ways to measure or evaluate retirement income generators (RIGs). One method—the A-LIFE rating system—is relatively simple. It measures amount of income, lifetime guarantee, inflation protection, flexibility and financial legacy, and exposure to market risk. But according to Vernon, there are trade-offs, and one type of RIG is not necessarily better than another.

Vernon also covered the pros and cons of staying in an employer plan or rolling over assets into an IRA, as well as retirement income strategies.

Products and approaches for lifetime income and how to encourage lifetime income were the primary topics of the second half of the session, presented by Noel Abkemeier, chairperson of the Academy's Lifetime Income Risk Joint Task Force.

According to Abkemeier, "full solutions" to lifetime income include Social Security, defined benefit pensions, and living benefit features on annuities. Partial or "imperfect" solutions include bond ladders, investment income, and structured withdrawal programs. Reverse mortgages, he said, should also be considered, since most people have the ma-

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Pension Insurance Policy Continues to Pose Challenges

WITH THE PENSION BENEFIT Guaranty Corp.'s (PBGC) $36 billion deficit and recent premium increases, pension insurance policy loomed on the minds of many at this year's Enrolled Actuaries meeting, held March 23 through 26 in Washington.

In a session called "Pension Insurance—How Should It Work," Doug Elliott of the Brookings Institution posed a challenging question, asking, "PBGC premiums have never been adequate for the risk it incurs, what to do?" Elliot noted that despite the obvious problems of this imbalance, politicians face pressure to keep rates low.

Fiona Stewart, senior financial-sector specialist with the World Bank Group, took it a step further, asking whether it is actually possible to cover systemic risk. In a world where underfunding and bankruptcy are correlated due to events like the great financial crisis of 2008, full coverage by the system itself would likely be too expensive for plan sponsors to bear, she explained.

According to Stewart, the arguments for pension insurance include the risk of market failure, the possibility that workers may not fully understand the trade-off between deferred wages and current income, and the risk of a lack of diversification, should workers find their retirement money highly exposed to the bankruptcy of their employer.

Of recent concern is the threat that several potential plan failures could bankrupt the PBGC's multiemployer insurance fund. Once considered a niche issue, this possibility has garnered national attention with the publication of articles such as "**Thought Secure, Pooled Pensions Teeter and Fall**," which ran April 12 in the *New York Times*.

That issue came up in a session called "Multiemployer Plans for Single-Employer Actuaries," which sought to educate a broader audience about the basics of these plans.

Sometimes called "Taft-Hartley pension plans" or "union pension plans," multiemployer plans provide portable benefits in a pooled fund within a certain union, geographic area, or industry. But the pension insurance fund that covers these plans remains sorely underfunded, with a deficit of $8.3 billion and up to $36.7 billion for "reasonably possible claims," according to Jim Donofrio of the PBGC.

The looming crisis has led many to consider changes to the system, a focus of the "Potential Legislation for Multiemployer Plans" session. In particular, the National Coordinating Committee for Multiemployer Plans (NCCMP) has proposed comprehensive reforms, including a rule that would allow plans to reduce retiree benefits to forestall insolvency in specific circumstances.

Neela Ranade, an actuary with the PBGC, presented the corporation's analysis of several proposed changes, including benefit adjustments proposed by the NCCMP report. The PBGC projects that, without changes, plans covering 1.5 million people will fail. PBGC analysis found that 600,000 participants could be saved by NCCMP's benefit adjustments, and 800,000 more participants could be saved using additional partition authority and resources.

—DAVID GOLDFARB

Talking Ethics With EAs

VALUABLE DISCUSSIONS on ethics often are prompted by situations that challenge our abilities to determine the right thing to do, carry out effective ethical action, or lay out an appropriate approach for avoiding ethical impediments in the future.

These types of situations were discussed through case studies at the 2014 Enrolled Actuaries (EA) Meeting sessions on ethics. Case studies were geared toward providing the audience with a wide range of ethical dilemmas in day-to-day actuarial work situations.

Drawing upon personal anecdotes from audience members, the two-part sessions focused on how to create and foster a culture of ethical behavior while being compliant within the actuarial profession. "Actuaries have to be careful. Anything we say is our own words, and remember that we're not always representative of our employers," said panelist Scott Miller, principal and consulting actuary for the Actuarial Consulting Group Inc. and current member of the Academy's Council on Professionalism.

One particular case study encouraged attendees to explain their views on maintaining professional integrity while adhering to employer demands. Participants cited the suitable application of Precept 1 and how most actuaries recognize the Code of Professional Conduct as the gold standard of practice.

Other topics ranged from building and sustaining public trust in the actuarial industry and its institutions to managing the ethical challenges that emerge from advancement and innovation in practice areas.

—DAVID BLANCO

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The initiative comes at a time of uncertainty because of dwindling numbers of DB plans, freezes on some plans, and some multiemployer DB plans facing serious challenges. Eli Greenblum, Academy vice president and chairperson of the Academy's Pension Practice Council, noted, "It's not clear what America's retirement policy is."

Governance topics sparked vigorous comments, especially around public pension plans, and policies designed to keep them properly funded. Robert May, principal at Rudd & Wisdom, explained that the Texas Pension Review Board watched the pension fund of a large Texas city incur higher risks of underfunding because city officials failed to make full contributions, but it couldn't do anything because the board lacked enforcement powers.

"In my mind, this is the biggest problem in public pensions – not contributing what the actuary has recommended," said May, who sits on the Texas board.

Academy President Tom Terry, who helped direct the symposium's discussion, acknowledged that city officials responsible for approving contributions to public pensions faced conflicts from competing needs. "What about a choice between funding policy versus pensions?" he asked.

Additionally, the financial ability of plan sponsors to make full annual contributions to retirement plans must be considered, said Academy Secretary John Moore. But public officials who make contribution decisions and the general public should be fully aware of the ramifications of those choices, he said. "Is it clear that you're using a loan from employees to fund a bridge or police?" he asked.

Past bad-governance policies have come back to bite pension boards, said Donald Segal, who has retired from Aon Hewitt. At least one state pension used annual investment surpluses to pay benefits rather than to save in order to offset poorer investment returns in other years, he explained. The silver lining from the 2008 recession was that many public pension plans were forced to make governance improvements, Segal said.

Panelists gave substantial attention to alignment of stakeholders' skills with their responsibilities—especially the concern that consumers may be ill equipped to plan and manage their retirement money. Most consumers do not create long-term plans on when to retire or how to set their investment strategies, said Evan Inglis, a task force member. "Maybe there's a problem with our system that makes people develop a retirement plan when that's not their strength," he said.

Part of that issue is that many consumers view their 401(k) plans or IRAs as investment vehicles rather than consumption vehicles, said Tom Toale, senior VP at MetLife. Plan sponsors should start educating workers early in their careers about volatility, longevity risk, and the advantages of annuities, he said. Informing workers how much they would receive per month in retirement could help them make better long-term plans, he said.

A related issue arose about consumer fears that insurers might go insolvent and not be able to pay annuities. This concern exists despite the fact that only a few, relatively small insurers failed in the aftermath of the 2008 recession, said James Holland Jr., chief research actuary at Cheiron. "That's why people like lump sums. They only feel confident when they have that lump sum," he said.

While Social Security has remained a major component of retirees' incomes, the program faces its own long-term challenges. A key question is how to sustain Social Security benefits as the worker-to-beneficiary ratio drops, said Stephen Goss, chief actuary at the Social Security Administration. Without raising additional revenues, Social Security will have to cut benefits in the long term, said Goss. "We'll have to put more money on the table. Will we, as a society, be willing to do that?" he asked.

Also speaking at the symposium were Ellen Kleinstuber, vice chair of the Academy's Pension Committee; Thomas Finnegan of the Savitz Organization; Dylan Tyson of Prudential Financial; and Cynthia Levering of the Forward Thinking Task Force.

—DOUG ABRAHMS

A Preview of Mortality Tables and Projection Scale

IT'S BEEN ALMOST 15 YEARS since actuaries had new pension-related mortality tables and projection scales to work with, but the wait is about to come to an end, attendees of the 2014 Enrolled Actuaries Meeting in Washington learned in March.

David Kausch of Gabriel Roeder Smith & Co. and Timothy Geddes of Deloitte Consulting LLP presented a session, "The New RPEC Pension Mortality Study." They reviewed of the highly anticipated RP-2014 mortality study that, when finalized, will likely become a new basis for the measurement of retirement program obligations in the United States, subject to standard materiality criteria, including Actuarial Standard of Practice (ASOP) No. 35, *Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations.*

Attendees also learned about the new projection Scale MP-2014. It will replace both Scale AA, which was finalized in 1995, and the interim Scale BB, which has been in use since 2012.

Kausch and Geddes are members of the Society of Actuaries' Retirement Plans Experience Committee (RPEC), whose work on the new tables and scale is reflected in exposure drafts. Comments on the drafts were due by May 31, 2014.

Kausch provided highlights of RP-2014, and Geddes reviewed MP-2014, for EA Meeting attendees.

For RP-2014, data were collected from 120 private plans and three public plans from 2004 to 2009. "It did turn out that the public plan data was different enough that it warranted separate review," said Kausch. Data for public and private plans were not combined; private plan retirees were the base population.

Multivariate analysis resulted in development of separate tables for the bottom and top quartiles for employees and healthy annuitants, as well as for disabled retirees. RP-2014 does not contain a table analogous to the "combined healthy" table of RP-2000, because of differences between annuitants and employees.

"We left them separate so you, and we as practicing actuaries, can use more judgment in constructing our own tables," Kausch said. Another key difference in RP-2014 is that disabled lives reflect future mortality improvement, an area for which data were incomplete when RP-2000 was developed.

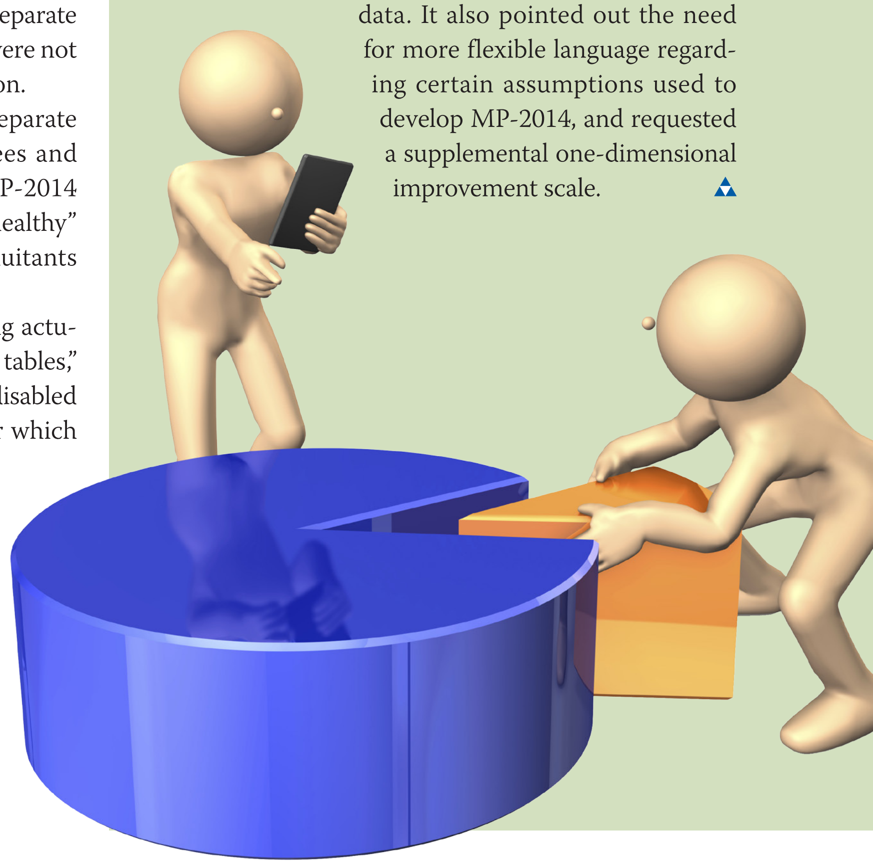
Geddes reviewed the development of Scale MP-2014. It includes smoothed mortality improvement rates for historical data, the selection of a long-term mortality improvement rate (1 percent) and convergence period (20 years), and a smooth transition between near term and long term.

Geddes explained RPEC's assumptions and decision to use a mathematical extrapolation technique, rather than an explicit cause-of-death model, to forecast future improvement. While the scale includes "committee-selected assumptions," he noted that ASOP 35 gives individual actuaries responsibility for the selection of the mortality/improvement assumptions. An appendix of the exposure draft "provides a framework for actuaries to construct alternate project scales with individually selected long-term rates and convergence periods."

—DAVID MENDES

Pension Committee Concerned About Data Elimination

IN A MAY 29 comment letter on RPEC's exposure drafts, the Academy's Pension Committee raised several issues regarding the elimination of blocks of data used to produce the RP-2014 mortality table. "We urge the RPEC to review the data that was eliminated to ensure that valid data, which by its nature might have tended to show higher rates of mortality, was not inappropriately excluded," the letter says. The Pension Committee provided a detailed list of concerns about the eliminated data. It also pointed out the need for more flexible language regarding certain assumptions used to develop MP-2014, and requested a supplemental one-dimensional improvement scale.



Viewpoint

The 2014 Gray Book

By James Kenney

THIS YEAR'S GRAY Book is surprisingly tame.

Gone are the flamboyant questions about adjusted funding target attainment percentages (AFTAPs), and how they should be calculated in situations that would make a contortionist look like someone bending over to tie her shoes. Gone, the arcane inquiries about funding-based benefit restrictions under Internal Revenue Code Section 436.

The mundane nature of the questions shows that the conundrums raised by the Pension Protection Act (PPA) of 2006 have largely been solved, rather like Oedipus answering the riddle of the Sphinx.

This is not to say that the Gray Book is boring, or that there is nothing useful in it, merely that the guidance is more an understandable signpost than a conjuring trick performed by a particularly talented magician.

What a relief!

My favorite code section is 415, probably since it is so complicated, and nearly a quarter of this year's Gray Book is devoted to esoteric inquiries about 415. I had thought that the passage of 401(a)(17), the limit on plan compensation, had essentially crippled Section 415 as an effective constraint on plan benefits. The Gray Book shows otherwise.

It is a cornucopia of questions mixing suspension of benefits, cost-of-living-adjustment (COLA) increases, benefits, rights and features testing, actuarial increases, and reasonable actuarial adjustments. What's not to like?

Question 23 is a perfect illustration of just how messy this can be.

Part (b) of this question concerns non-discrimination rules for participants who have reached the 415(b) dollar limit in a plan that does not provide for suspension of benefits but gives actuarial increases instead. The plan in question has a normal retirement age (NRA) of 62. The question asks whether the nondiscrimination rules apply differently because the participant has hit the dollar limit instead of the compensation limit.

The answer shows that even though the fog of the PPA has dissipated, our field is filled with hidden land mines left over from forgotten wars. The government opined, "For the 415(b) dollar limit in a plan with a normal retirement age of 62 that does not suspend benefits, plan benefits would need to begin to be paid soon after normal retirement date to individuals hitting the 415(b) dollar limits, because the 415(b) dollar limit is not increased from age 62 to 65. The affected individuals are likely to be HCEs [highly compensated employees]. Thus an earlier commencement date would be available to such participants than would likely apply to NHCEs [non-highly compensated employees]. To satisfy BRF [benefits, rights, and features] testing, a plan could be written (before benefits accrue) to suspend benefits between ages 62 and 65 for participants hitting the 415(b) dollar limit or the plan could provide for in-service distribution of benefits at age 62 for all (or a non-discriminatory group of) participants."

Translating this answer into everyday English, such a plan *must begin paying*

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jority of their assets in their homes.

Abkemeier explained that a variety of actions—both in-plan and outside of the plan—would help achieve greater utilization of lifetime income guarantees. Most have significant hurdles to adoption, but the ideas should be on the table. "The more you can get the idea of lifetime income into the conversation the better," Abkemeier explained. In terms of education, two options that would help would be a safe harbor to insulate plan sponsors from fiduciary liability for educational materials they provide, and standardization of information. He also mentioned education on lifetime income risk—which is poorly understood—and particularly income estimates on DC statements as valuable options.

Additional in-plan features could include:

- Require a lifetime income option in DC plans
- Simplify rules for partial annuitization
- Relax rules for full retirement age
- Update mortality for lump sum valuation

Outside-plan incentives to annuitize could include:

- Institute tax incentives
- Recognize longevity annuities (QLACs) as required minimum distributions (RMDs)

Changes in governmental standards could encourage lifetime income. Among these options are increasing the maximum Social Security deferral age and increasing the RMD start age.

Finally, Abkemeier stressed the importance of increasing awareness of guaranty association coverage, which provides significant protection of annuity benefits. Noting that not everyone can afford retirement planning advice, Abkemeier also emphasized the importance of making planning education available to all employees.

—BILL RAPP

benefits to a participant who has reached his or her 415(b) limit at 62, because it is not possible to give such a participant an actuarial increase instead. This is *not* because of the plan (which might well use plain vanilla language granting actuarial increases to active participants after age 62); it is because there is no change in the 415(b) dollar limit between 62 and 65, and it is therefore *impossible* to give an actuarial increase. (Note there is a special circumstance here, namely the plan's age 62 normal retirement date.) This requirement to commence payments (not a feature of the plan) then triggers a nondiscrimination issue involving benefits, rights, and features, because non-HCEs will not receive in-service distribution of benefits, resulting in the possible disqualification of the plan.

The frightening clause in this response is "before benefits accrue." No Gray Book would be a true Gray Book without a truly frightening answer that hints that there is no way to actually cure a particular defect, and this question is one of those. What if the plan is *not* changed *before benefits accrue*? Is there a solution? Or is there no answer but to go to the IRS and say, "We made a mistake, and we think we've just disqualified our plan"?

Sometimes it is worth a detailed analysis of possible options. Could we somehow extend this option to a nondiscriminatory group? That would mean forcing active employees to begin taking benefits at age 62, just to be on the safe side. We can't go back and force people to start benefits. Or can we?

Maybe we could add a retroactive payment provision to our plan, coupled with a requirement to begin payments at NRD, and then bring "missed payments" forward (using the plan's actuarial equivalence interest rate, "after considering 417(e)(3), Section 415(b) or any other applicable provisions" (quote taken from the answer to Question #26: "Section 415: EPCRS Correction of Failure to Start Payment").

But isn't the right to defer payment of your benefit beyond NRD part of your accrued benefit? Can the sponsor change a plan *after benefits accrue* to require that these benefits go into pay status before the participant retires? Doesn't 411(d)(6) protect a participant's right to choose when her benefit shall begin, especially a participant who is still actively employed? Arguably, the answer is no.

The first paragraph of the government's answer to Question 23(b) is a marvelous illustration of how to use nondiscrimination rules from the 1.401(a)(4) to avoid a plan failure. It is logical, clean, and very creative. This is definitely worth reading by anyone who does nondiscrimination testing.

Unfortunately, that paragraph deals with the compensation limit, not the dollar limit. It is the second paragraph of the answer (about the dollar limit) that creates an apparently insoluble problem, or possibly a problem that can be solved only by retroactively beginning benefits for NHCEs over age 62—it is not completely clear which.

Question 24 continues in a similar vein. The government's response points us to IRS reg. 1-411(a)-4 "Forfeitures, suspensions, etc." This regulation states: "A right to an accrued benefit is considered to be nonforfeitable at a particular time if, at that time, and thereafter, it is an unconditional right." It also says, "Certain adjustments to plan benefits, such as adjustments in excess of reasonable actuarial reductions, can result in benefits being forfeitable." Question 24 goes even further by saying that "actuarial increases would be protected by Section 411(a) to the extent necessary to satisfy the rule in 1.411(a)-4 about reasonable actuarial assumptions."

What are "reasonable actuarial assumptions"? Many large plans have actuarial factors that were adopted in the early 1980s after the *Norris* decision, handed down by the Supreme Court in mid-1983. Employer discretion in actuarial assumptions was eliminated by law shortly afterward, and plans were then amended to specify such assumptions.

Thus many plans have actuarial reductions that represent the economic circumstances in the mid-1980s, which probably would be considered outdated in comparison to today's standards. This is especially true of interest rates, which in the early to mid-'80s were in flux, to say the least. Is an 8 percent interest rate "reasonable"? Naturally, no one wants to confront this issue, but times have definitely changed. Once an assumption is embedded into a plan document, it is extremely difficult to change it.

The answer to Question 24, in a backdoor way, would seem to allow changing such assumptions, even if it would result in lower benefits, without causing a "forfeiture," since it discusses 411(a) protection for actuarial increases "to the extent necessary to satisfy the rule…about reasonable actuarial reductions." Could a plan be modified to provide for lower post-NRA increases using the argument that the old actuarial factors were too high? What about plans that simply give factors to be applied, and don't specify the assumptions underlying those factors? Are these factors subject to the "reasonableness" standards of 1.411(a)-4?

Another consideration is the funded status of the plan. Amending plans to increase benefits can only be done under certain funding-based circumstances, or by payment of (possibly) prohibitive contributions. What if it's too late to go back and undo an HCE's receipt of benefits after age 62 that exceed the applicable 415 limits, and we want to "cure" that by adding a group of NHCEs who must retroactively start benefits, but doing so would increase the funding target and the plan's FTAP is below 60 percent?

This year's Gray Book demonstrates that, eight years after the enactment of PPA '06, the pension plan community has largely figured out what it meant, but it also reminds us that the PPA has many pitfalls and that the code prior to its enactment had many unresolved "gray areas" as well.

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