E A R
ENROLLED ACTUARIES REPORT

The *Enrolled Actuaries Report* is a quarterly publication of the American Academy of Actuaries.
www.actuary.org

VOL.33 NO.2 SUMMER 2008

2008 Pension Symposium: Managing Pension Risk

At the completion of the 2008 Enrolled Actuaries Meeting, a group of attendees turned their attention from the immediate issues of Pension Protection Act compliance to emerging topics of pension plan management. During the fifth annual Pension Symposium April 9-10, 60 actuaries and investment experts engaged in a four-part forum on pension risk.

As companies continue to freeze their defined benefit (DB) pension plans or close them to new hires—a group that included 20 percent of *Fortune* 200 companies by 2006, according to a Mercer survey—one of the biggest reasons for exiting the DB system is the fear of unmanageable volatility. Symposium participants discussed cutting-edge methods to hedge against those risks. The format of discussion divided the symposium into four sessions: liability-driven investing and hedging interest rate risk, hedging longevity risk, lowering risk for plan sponsors wishing to continue their sponsor roles, and totally eliminating risk for plan sponsors wishing to move out of that role.

SYMPOSIUM, PAGE 6

Brian Donohue, chairperson of the Joint Program Committee for the 2008 Enrolled Actuaries Meeting, addresses the audience during the first general session. Donohue was also a presenter for the Pension Symposium.

Inside this issue

BRUCE GAFFNEY

Understanding Prefunding Balances and Discounting Contributions

AS TIME PASSES AND GUIDANCE APPEARS, actuaries continue to become more comfortable with the new funding rules under the Pension Protection Act of 2006. The exact workings of many provisions of the act were reviewed and debated at the 2008 Enrolled Actuaries Meeting. Two important new concepts that were discussed extensively are offsetting the prefunding balance when applying the shortfall amortization base exemption and discounting accrued contributions.

Offsetting the Prefunding Balance When Applying the Shortfall Amortization Base Exemption

Pursuant to Section 430(c)(5) of the Internal Revenue Code (IRC), a shortfall amortization base is *not* established if a plan's funded percentage is 100 percent or higher. (Special transition rules apply for plan years beginning before 2011.) In determining the funded percentage for this purpose, plan assets are *not* reduced by the funding standard account carryover balance but may be reduced by the prefunding balance.

When determining whether a shortfall amortization base

FUNDING RULES, PAGE 3

EAR

ENROLLED ACTUARIES REPORT

EDITOR
Tom Terry

CONTRIBUTING EDITORS
Andrew Eisner
Bruce Gaffney
James Kenney
Diane Storm
James Turpin

MANAGING EDITOR
Tim Dougherty
editor@actuary.org

MARKETING AND PUBLICATIONS PRODUCTION MANAGER
Cindy Johns

PUBLICATION DESIGN AND PRODUCTION
BonoTom Studio Inc.

AMERICAN ACADEMY OF ACTUARIES

PRESIDENT
William Bluhm

PRESIDENT-ELECT
John Parks

SECRETARY-TREASURER
Andrea Sweeny

VICE PRESIDENTS
Thomas Campbell
Robert Miccolis
James Rech
Kathleen Riley
John Schubert
Tom Terry

EXECUTIVE DIRECTOR
Grace Hinchman

DIRECTOR OF COMMUNICATIONS
Steven Sullivan

ASSISTANT DIRECTOR FOR PUBLICATIONS
Linda Mallon

MANAGING EDITOR, NEW MEDIA
Anne Asplen

JAMES KENNEY

The 2008 Gray Book

LIKE MANY GRAY BOOKS, the 2008 edition is a Pandora's box of guidance. A Q-and-A compilation developed after the annual meeting of the Treasury Department, the Internal Revenue Service (IRS), and the Enrolled Actuaries Joint Program Committee, the responses aren't official positions and reflect only the personal views of the government employees. At times, it even appears to contradict prior Gray Book pronouncements. It's quite dense and will reward careful study with a glimpse of the mental scaffolding the IRS is gradually erecting around the Pension Protection Act (PPA). However, since the aftermath of PPA's passage left pension regulators scrambling to play catch-up and pension practitioners scratching their heads wondering just what it all meant, this year's Gray Book is perhaps the best resource currently available for penetrating the murky waters of the enigmatic act.

The book is especially helpful regarding the issues created by the new Internal Revenue Code (IRC) Section 436, which restricts when benefits can be paid, when amendments can take effect, and even whether participants may accrue benefits. Eleven of the 48 questions included in the 2008 Gray Book deal with that section.

For instance, Question 19 asks whether mandatory lump sums (under $5,000) could be paid even though other lump sums would be considered "prohibited payments." The IRS may want to be able to answer "yes" to this question, but the best it could offer was a hope that the technical bill pending in Congress would permit it.

Question 21 is a frightening question, with a frightening answer. We have known for some time that the IRS considers changes in the 415 limit to be a plan amendment—because amortization bases should theoretically be established whenever an increase in the limit results in an increase in a participant's accrued benefit, and it's amortized over a much longer period than ordinary gains and losses. As a practical matter, many large-plan actuaries lump this in with their experience gains instead. (This won't matter in the future, due to the demise of Section 412.)

In order to alleviate the nuisance of annually amending the plan to provide for that year's 415 increase, most plans "track" the change automatically. In doing so, it's easy to forget that the IRS considers each such change as a plan amendment. It's hard to agree that it's an "amendment" as discussed in the PPA, since the clear language of the plan already provides for such increases to be recognized when they are made. The answer to that question makes it clear that if a plan has an adjusted funding target attainment percent-

GRAY BOOK, PAGE 8 ⇢

should be established, plan assets are reduced by the prefunding balance when the plan sponsor elects to use any of that balance to satisfy all or a portion of the minimum required contribution for the plan year (see Section 430(f)(4)(A) of the code). If the sponsor elects to use any of that balance, then the plan assets are reduced by the *entire* prefunding balance. However, if a plan sponsor is not going to use the prefunding balance to satisfy any portion of the minimum required contribution, the balance is not deducted from plan assets when evaluating the plan's funded status to determine if a shortfall amortization base must be established.

The following example highlights the application of this rule:

VALUATION INFORMATION, AS OF JAN. 1, 2011	
Funding target:	$1,000,000
Plan assets:	$1,050,000
Prefunding balance (PFB):	$200,000

Scenario 1

The plan sponsor will *not* use any portion of the prefunding balance to satisfy all or part of the minimum required contribution:

Applicable Percentage	Plan assests not reduced by PFB / Funding target	$1,050,000- $0 / $1,000,000	= 105%

In this case, plan assets are not offset by the prefunding balance for purposes of determining whether the shortfall amortization base exemption applies.

Scenario 2

The plan sponsor will use $50,000 of the prefunding balance to satisfy all or part of the minimum required contribution:

Applicable Percentage	Plan assests reduced by *entire* PFB / Funding target	$1,050,000- $200,000 / $1,000,000	= 85%

In this case, even though only a portion of the prefunding balance will be used, the entire balance is offset from the plan assets when testing to ascertain whether the shortfall amortization base exemption applies.

Discounting Accrued Contributions

Pursuant to IRC Section 430(g)(4), for plan years beginning after 2008, contributions made during the current plan year but that are attributable to a prior plan year (accrued contributions) are included in plan assets but on a discounted basis. The discounted value is determined using the effective interest rate for the year to which the contributions are attributed. This means that accrued contributions included in a given year's plan assets are discounted using the prior year's effective interest rate. (For 2008 only, accrued contribution need not be discounted.)

The following example highlights the discounting methodology:

VALUATION INFORMATION, AS OF JAN. 1, 2011		
Market value of assets:	$1,000,000	
Employer contributions:		
Date	Amount	For Plan Year
March 1, 2011	$50,000	Attributable to 2010
May 1, 2011	$75,000	Attributable to 2010
Oct. 1, 2011	$100,000	Attributable to 2011
Effective interest rate:		
2010 valuation	6%	
2011 valuation	5%	

Plan assets (including accrued contributions) as of Jan. 1, 2011, for use in determining contributions as of that date, are developed as follows:

Market value, as of Jan. 1, 2011		=$1,000,000
March 1, 2011, contribution (discounted)	=$50,000/(1.06)2/12	=$49,517
May 1, 2011, contribution (discounted)	=$75,000/(1.06)4/12	= $73,557
Plan assets (including accrued contributions) as of Jan. 1, 2011		=$1,123,074

BRUCE GAFFNEY *is a principal and consulting actuary in the Benefits Consulting Group at Ropes & Gray in Boston, a member of the Academy's Joint Program Committee for the Enrolled Actuaries Meeting, and a contributing editor of* EAR.

MITZI MCLEAN

PBGC Premiums After PPA

AS A RESULT OF THE PENSION PROTECTION ACT OF 2006, the Pension Benefit Guaranty Corp. (PBGC) has made significant changes concerning the annual premiums it collects from the pension plans it insures. These changes, which were explained during Session 303 of the Enrolled Actuaries Meeting, will affect the filing deadlines for some plans, the format of the information required for filing, and both flat-rate and variable-rate premium (VRP) calculations.

Filing deadlines are dictated by plan size, and the PBGC has developed three classifications based on the number of participants as of the last day of the prior plan year: small plans (fewer than 100), midsize plans (between 100 and 499), and large plans (500 or more). The due date for flat-rate and variable-rate premiums for small plans has been extended to the last day of the 16th month after the plan year-end (April 30 for calendar-year plans). For midsize and large plans, the variable-rate premium is still due the 15th day of the 10th month of the plan year (Oct. 15 for calendar-year plans). The flat-rate premium is due the same day for midsize plans; however, for large plans, this premium is due the last day of the second month of the plan year (Feb. 28 for calendar-year plans).

Electronic premium filing is still mandatory for all plans. However, there are no longer any actual forms since everything is electronic; Form 1/Schedule A and Form 1-EZ are now things of the past. All large plans must submit estimated flat-rate filings by the last day of the second month of the plan year, and plans of all sizes have to submit their comprehensive filings by the applicable final due dates listed above. Large plans can continue to reconcile estimated flat-rate premiums at the final due date, but they now also have the option to reconcile estimated VRPs at a later date—the small plan due date.

The 2008 flat-rate premium has increased slightly for single-employer plans to $33 per participant, and multiemployer plans are still subject to a $9-per-participant rate. The computation of the VRP calculation has changed, although the underlying premium rate remains at $9 for every $1,000 of unfunded vested benefits (UVB). UVBs are measured as of the funding valuation date for the current plan year and equal the excess of the premium funding target over the fair market value of plan assets. The premium funding target is extremely similar to the funding target used for minimum funding purposes, applying most of the same assumptions, including mortality. However, it includes only vested benefits and may be calculated under a different discount rate.

Plan sponsors have an initial choice in the discount rate to use to calculate the premium funding target. For the standard premium funding target, sponsors use the three segment rates for the month preceding the month in which the plan year begins. (December spot rates are used for a calendar-year plan.) These standard rates will be posted on the PBGC website. Alternatively, a plan sponsor may elect to use the same segment rates that were used for the minimum funding calculation to compute the alternative premium funding target. This election, once made, is irrevocable for five years.

The fair market value of assets reported should be the same as the value reported on the Schedule SB. For the 2008 plan year, prior-year contributions made after the UVB valuation date can be included in this asset value without adjustment. For plan years beginning after 2008, these contributions should be discounted back to the UVB valuation date using the plan's effective interest rate, as is done for minimum funding purposes.

Starting in 2008, there will be no alternative calculation method or full funding limit exemption for plans; only plans with no vested participants, Section 412(e)(3) plans, and plans terminating in standard terminations will be exempt from the VRP. All other single-employer plans will be subject to calculating and reporting a VRP. Certain small employer plans are subject to a maximum VRP of $5 multiplied by the square of the plan's participant count. A plan is considered to be a small employer plan if the total number of employees of all contributing sponsors of the plan and all members of their controlled groups is no more than 25. For these plans, the VRP due is the lesser of the amount determined under the UVB formula or the maximum formula. If the comparison is done, the components of the UVB formula need to be disclosed and certified by an enrolled actuary. Small employer plans also have the option of just paying the amount derived from the maximum formula rather than doing the comparison.

Midsize and large plans now have the option to file and pay an estimated VRP if they are unable to calculate the final premium funding target by the due date. The estimate must use actual assets, as well as a reasonable estimate of the premium funding target that's certified by an enrolled actuary and determined using generally accepted accounting principles. The filing must indicate that the value is an estimate, and a reconciliation must be completed so that an amended comprehensive filing can be submitted by the small plan due date. Plans that use this option will be able to claim the original amount paid as a credit, but they will also be assessed late-payment interest charges based on the rate imposed under the Employee Retirement Income Security Act (federal short-term rate plus 300 basis points). The PBGC will automatically waive its late payment penalty for these trued-up variable rate premiums if the plan sponsor correctly follows the payment and filing rules.

MITZI MCLEAN *is an assistant vice president for Aon Consulting in Winston-Salem, N.C.*

BRUCE GAFFNEY

Navigating in a Retirement Ice Age

ACCORDING TO VARIOUS SURVEYS, traditional defined benefit (DB) plan sponsors continue to close their plans to new hires or freeze their plans to all participants at alarming rates. While frozen plans forced their way into the conversations of a number of sessions at the 2008 Enrolled Actuaries Meeting, Session 804 "Benefit Freezes!" focused entirely on issues related to this cold, hard retirement reality. Presenters Lisa Larsen, an actuary with Milliman, and Victor Harte, a consultant with Milliman, provided various perspectives on benefit freezes with respect to DB plans.

Initially, discussion centered on the lack of complete information regarding the prevalence of—and underlying reason for—benefit freezes. There have been many studies, but projection to all plans is difficult because few of the studies are based on random samples and the definition of "freeze" differs from study to study. (Representatives of the GAO noted that they have conducted a more robust and comprehensive survey that they hope will be available this summer.)

The next phase of discussion was on reasons employers are choosing to freeze benefits. One major factor is the notorious "perfect storm," the combination of decreasing interest rates (causing liabilities to increase) and market drops (causing plan assets to fall)—resulting in increased plan underfunding. Add to this complicated funding rules and the (hopefully eliminated) lack of clarity in the law regarding hybrid plans, and the current DB environment is a chilly one.

The presenters then reviewed steps the actuary or plan sponsor must take, options that should be considered, and issues that may arise when implementing a benefit freeze.

First, sponsors need to decide what kind of benefit freeze should be adopted. Options sponsors can consider are to:

- Freeze all benefits;
- Close plans to new entrants;
- Allow a grandfathered group to retain the "live" DB plan but freeze benefits for the remaining population;
- Freeze service but allow benefits to increase due to pay growth;
- Offer an "opt-out" or "choice," in which the participant is given a choice between the DB plan and an alternative defined contribution (DC) plan.

Once sponsors understand their options, a so-called "winners and losers" analysis should be performed to evaluate the impact of changing from a DB approach to a DC plan with respect to benefit levels for various employee categories. That analysis should identify the shift of benefits between such categories. (Conversion to a DC plan often shifts benefit dollars from older to younger employees.) Sponsors should consider the likelihood of favorable investment performance in participant-directed accounts and the impact of the necessity for participants to make deferrals—under a 401(k) or 403(b) plan—in order to receive matching benefits.

Next, the actuary should be aware that a plan freeze, when coupled with either a grandfathering approach or an alternative DC plan benefit, can result in unexpected issues when testing for compliance with nondiscrimination rules. Further, over time, the demographics of a partially frozen plan can change, resulting in unexpected nondiscrimination failures or difficulties.

Finally, the plan sponsor should review the plan's administrative rules with respect to continued accrual for vesting, early retirement subsidies, or other benefit options—as well as rules with respect to how rehired employees will be treated—to ensure that the benefit freeze is properly implemented. Further, the plan sponsor should anticipate the impact of the plan change on employee relations, recruiting, and retention.

In the remainder of the session, the presenters reviewed case studies highlighting some of the tribulations of adopting a benefit freeze.

Ken Steiner, Academy Pension Practice Council member and resource actuary for Watson Wyatt Worldwide in Arlington, Va., speaks during a session of the 2008 Enrolled Actuaries Meeting.

BRUCE GAFFNEY *is a principal and consulting actuary in the Benefits Consulting Group at Ropes & Gray in Boston, a member of the Academy's Joint Program Committee for the Enrolled Actuaries Meeting, and a contributing editor of* EAR.

SYMPOSIUM, FROM PAGE 1

Each session had discussion facilitators who briefly introduced ideas and then opened the floor for a robust exchange of ideas and experiences.

Interest Rate Risk

Beyond purchasing long-duration bonds, a staple of liability-driven investing, symposium attendees discussed newer methods to hedge interest rate risk—namely interest rate swaps, agreements between two counterparties to exchange cash flows in the future.

In a swap, a pension plan receives payments equal to the swap's notional amount multiplied by a fixed swap rate; meanwhile, the pension plan makes payments to the counterparty equal to the notional amount multiplied by the prevailing floating interest rate. The swap's fixed rate is written into the swap's contract, which can be customized to meet the needs of the counterparties. One attendee described swap investments as "creating synthetic bonds."

One potential marketplace barrier in using the swap as an investment tool is its perceived novelty. A few attendees feared that their clients would have to be the first major players to make that move. However, those concerns were partly assuaged at the symposium as some attendees revealed that they are very supportive of swaps.

Mortality Risk

While most risk-hedging discussion has centered on interest rates, pension plans face other uncertainties, like constantly rising human life expectancy and the larger financial liability that comes with it. One executive at a major global investment bank showed attendees how a capital market for longevity risk may be emerging. While pension plans and annuity providers look to hedge their longevity exposure, there are natural counterparties (insurance companies, hedge funds, endowments, asset managers, etc.) who see longevity as a new way to earn a risk premium that they can invest. For instance, the presenter explained, earlier this year, the bank formed a deal with an insurance company to take on longevity risks for frozen pension plans in the U.K. by utilizing a mortality swap—locking in its mortality risk by swapping a floating profile for a fixed one.

Unlike interest rate hedging strategies, there are no preconceived concepts of how to hedge longevity risk. Therefore, the market doesn't have the same psychological barriers in breaking away from traditional methods.

Staying in the Game

Though many plans have been frozen, the plan termination rate is still relatively low. An overwhelming number of plan sponsors who have frozen their plans have stayed in a holding pattern of sponsorship. For these plans, it may make more financial sense to fully fund ongoing plans. Still subject to interest rate, investment, and demographic risks, the ability of the plan to hedge liability risk becomes more important. Just as underfunding the plans could lead to Pension Benefit Guaranty Corp. (PBGC) premium hikes, overfunding the plan is also problematic because it is difficult to get those funds back in from a frozen plan.

Future of Pension Buyouts?

While the annuity purchase route is a well-known method for moving out of the sponsor role, symposium attendees discussed a new alternative to terminate plans—complete plan buyouts. Instead of purchasing annuities to cover a portion of the plan—usually retirees receiving previously accrued benefits—financial institutions would buy out entire frozen plans, enabling pension sponsors to remove those associated risks from their books. Several participants indicated that this setup could lead to lower termination costs for the pension plan, as more available options increase market competition.

Session presenter and PBGC Executive Director Charles Millard said that there could be resistance from labor unions, which might argue that the proposed arrangements would provide pension sponsors an incentive to freeze their DB plans. At the same time, Millard said, this setup could give better options to companies whose plans have high default risks, which present benefit security risks to employees if the plans otherwise would have to be absorbed by the PBGC. Another question that needs to be addressed is whether the buyout firm would be considered the employer of the plan beneficiaries. Since the Employee Retirement Income Security Act (ERISA) applies to plans sponsored by employers, the definition of the employer relationship could have an impact on how ERISA applies to pension buyouts.

Millard insisted that if these developments came to fruition, each transaction would be reviewed on a case-by-case basis, and the PBGC would step in if it didn't think the counterparties and the PBGC would be better off post-transaction. "The critical question isn't 'Does it meet standard practices?'" Millard said. "The question is 'Is this better than the status quo?'"

Session presenter Bradley Belt, chairperson of Palisades Capital Advisors in New York and former PBGC director, echoed that sentiment:

"Everyone wants to make sure this is done the right way, to ensure it makes business sense and meets legitimate public policy goals."

AMY SULLIVAN

Consultation on Post-PPA Funding Strategies

THE PENSION PROTECTION ACT (PPA) has taken away much actuarial flexibility in determining methods and assumptions for funding measurements. However, as discussed during Session 502 on PPA funding strategies at this year's Enrolled Actuaries Meeting, there is still a great deal of consulting left to do.

Evan Inglis, a consulting actuary for Watson Wyatt Worldwide in Arlington, Va., and Ellen Kleinstuber, a vice president for AON Consulting in Radnor, Pa., presented some basic strategies related to funding and credit balance use for both overfunded and underfunded plans. Also included in the session was a discussion of plan sponsors' PPA election options and early thoughts on plan sponsor decisions.

Inglis began by noting that the new rules will drive plans toward 100 percent funding, causing plan sponsors to rethink their asset mix and turn their focus to funding policy. Four basic strategies in funding policy were discussed:

- Minimum requirement—a reasonable method in which volatility will be dependent on the mismatch between liabilities and investments;
- Fixed percent of pay—a method that may not be feasible because of the difficulty of its long-term application and the unnecessary acceleration of funding;
- Setting investment risk to cover normal cost—a method that would match assets and liabilities with an additional return potential intended to equal the normal cost of the plan;
- Funding to 100 percent immediately—a strategy that would minimize Pension Benefit Guaranty Corp. (PBGC) premiums but could add to the carryover balance for 2007.

Following the discussion of alternative funding policy strategies, contribution illustrations were presented for three different scenarios. The first focused on how much, if any, carryover balance a sponsor could waive and how such a decision would affect total contributions, PBGC premiums, and the pattern of contributions. The second illustration introduced the concept of making contributions at a value that recognizes the plan sponsor's cost of capital. The last set of illustrations showed how low asset returns can affect the ability of both well-funded and poorly funded plans to stay "above water" (i.e., to have no shortfall amortization). The discussion turned to whether it's important to stay above water since the net cost of doing so in a low-return environment is greater than the cost experienced for falling below. Therefore, Inglis noted, it's not clear that staying above water is the best approach.

After reviewing these cash contribution strategies, Kleinstuber pointed out that there are tactical considerations in determining contributions. Among these considerations were the avoidance of benefit restrictions, quarterly contributions, disclosing at-risk status, PBGC 4010 reporting, and triggering debt-covenant requirements. Kleinstuber then gave four examples illustrating the effects of waiving credit balances and making small contributions. One example showed how an overfunded plan can actually be at-risk. A question was raised from the floor regarding the ability to provide a cover letter explanation with the notice to participants that shows at-risk status. The speakers commented that communication will be very important under PPA and that consultants should be discussing these matters with their clients' human resources and finance departments.

Discussion then moved to reasons for and against advance funding and possible uses for a plan's surplus assets. Inglis cautioned against funding such that a sponsor ends up with too much surplus.

The remainder of the session discussed upcoming election options. When asked how many consultants were using the full spot yield curve, only a few raised their hands. The speakers referred to the Actuarial Standards of Practice when discussing appropriate mortality assumption decisions. Although actuaries have a free pass, so to speak, on the prescribed table, it may not be the appropriate table to use. When the discussion turned to actuarial asset values, only four audience members raised their hands to indicate they have clients that would be using the averaging method. One said that the client simply likes smoothing, and another noted that the plan was well-funded so the plan sponsor was interested in protecting against a drop in asset values.

As was discussed throughout the session, actuaries now have a set of funding calculations that are one-size-fits-all. Kleinstuber said that this provides a framework to begin discussions with plan sponsors about what makes sense for their individual plans.

AMY SULLIVAN *is an actuarial consultant with Watson Wyatt Worldwide in Wellesley Hills, Mass.*

GRAY BOOK, FROM PAGE 2

This year's Gray Book is perhaps the best resource currently available for penetrating the murky waters of the enigmatic Pension Protection Act.

age (AFTAP) of less than 80 percent, that year's increase in the 415 benefit can't be taken into account when determining the accrued benefit of any participant. "The increase in the limit is deferred until such time as the plan is sufficiently well-funded to allow it to take effect," the Gray Book says.

The same is true of an increase in the 401(a)(17) limit, namely that it is a plan amendment. In this case, however, since it doesn't create an increase in accrued benefits, it would not be a prohibited amendment, even if the plan's AFTAP is less than 80 percent. In this case, the IRS notes that "the amount of the Section 436 contribution that would be required for the amendment to take effect is zero." In other words, a zero contribution has to be made before the 401(a)(17) compensation increase can be effective. (One wonders whether we need a cancelled check in case of an audit.)

The meat and potatoes of the rest of the Section 436-related questions all pertain to how to handle our new responsibilities as enrolled actuaries to issue AFTAP certifications by April 1 of every year (for calendar-year plans), or at the latest, by Oct. 1. Unfortunately, the 2008 Gray Book was not widely available until after April 1.

Section 436 makes it clear that unless an enrolled actuary certifies to an AFTAP by the first day of the fourth month, then the AFTAP is presumed to be 10 percent less than the prior year's AFTAP. What is less clear is just what this means—what such a certification must include to be valid and how to determine the AFTAP itself, on which the certificate is based.

Several of the questions in the Gray Book make it clear that we are allowed to use estimates for the components of the AFTAP—namely the funding target, the actuarial value of assets, and the carryover balance (which used to be called the credit balance). This is demonstrated by Questions 22 and 24, in which the plan's actuary estimates valuation results and then issues a "range certification" that the AFTAP is "80 percent or more."

Fortunately, the IRS has smiled upon us and given us the benevolent invention of a "range certification." By closely reading the assumed facts under Question 22, the math doesn't even have to work out for us to issue such a range certification. In this question, the estimated AFTAP would come out to 79 percent, but "based on this estimate, the actuary is confident that the final 2009 valuation results will show assets of at least 80 percent of the funding target." This question is well worth reading to get an idea of the leeway we have under this slippery concept of a range certification.

The answer to Question 24 was equally surprising. Here, the sponsor puts in an additional contribution toward the prior plan year, before April 1, 2009, but the actuary discovers later that "due to an unexpected experience loss," the AFTAP would be 79 percent, not 80 percent, as expected. The actuary discovers this fact in July but waits until Oct. 1, 2009 (after the plan sponsor has made a second additional contribution toward 2008, in an amount sufficient to bring the assets up to the level needed to reach 80 percent), to make a final AFTAP certification. The IRS response indicated this wouldn't even be a "material change" and the plan would avoid benefit restrictions for 2009. This question raises the specter of "What did the actuary know, and when did he or she know it?" as well as many ethical issues about the possibilities of gaming the system.

While all the Gray Book questions are worth reading (if too numerous to discuss), my favorite question was Question 42, which asks what constitutes a prohibited reduction in a participant's accrued benefit. If a benefit goes down due to an increase in a Social Security offset, is this acceptable?

In the 1992 Gray Book, Question 25, the response to this question was that "even if an amendment is not involved, a plan provision that would have the effect of allowing accrued benefits to reduce would be in violation of 411(b)(1)(G), whether a plan is…a [primary insurance amount] offset plan or other type of defined benefit plan."

This year, the IRS opined that an accrued benefit could decrease during continued employment due to increases in a Social Security offset "to the extent the offset meets the restriction specified in Rev. Rule 84-45 and is in keeping with the qualification rule stated in IRC 410(a)(15)."

As Gray Book session presenter Don Segal said, "That's why they call it the Gray Book!"

JAMES KENNEY, *a pension consultant in Berkeley, Calif., is a contributing editor of* EAR.