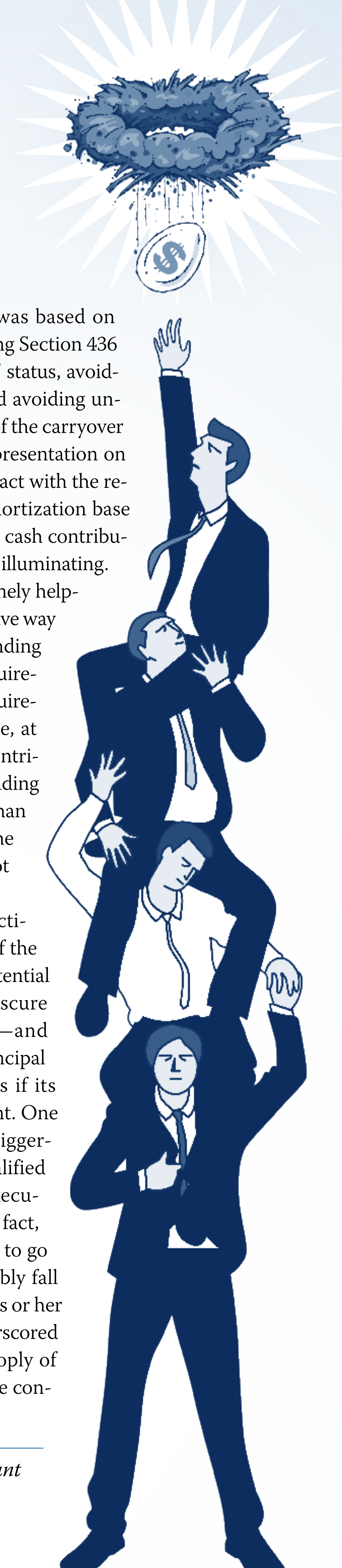
JAMES KENNEY

Actuaries Armed with Strategies for PPA Compliance



The Enrolled Actuaries Meeting is an excellent source of information about the technicalities and minutiae of regulations and restrictions facing the profession. As the current crisis reminds us, regulation can be a good thing, or perhaps it is more accurate to say that the lack of regulation can be a bad thing. Nevertheless, regulations are often frustrating and confining, so it was refreshing to enjoy a session devoted not to what we can't do, but to how we can do what we want to do: help our clients deal with their ever-threatened defined benefit plans.

Session 502 at the EA Meeting, presented by Ellen Kleinstuber and Gloria Lesmeister, was a welcome discussion that delved into the mysterious realm of creative PPA compliance. The session explored many strategies related to carryover balances and prefunding balances, including whether to preserve your carryover balance, whether to establish a prefunding balance, how to get the most use out of your prefunding balance in managing minimum-funding requirements, and tactics for waiving a portion of the prefunding balance in order to preserve the carryover balance. Also discussed was the interaction of all this with the Internal Revenue Code Section 436 benefit restrictions, requirements to issue a Section 101(j) notice, the possible need to file a Pension Benefit Guaranty Corp. (PBGC) 4010 form and whether an employer can fund its non-qualified deferred compensation plan.

In her presentation, Kleinstuber, a managing consultant with the Savitz Organization Inc. in Philadelphia, focused on the investment strategy of immunization as a means of controlling volatility in contribution requirements and accounting hits to the balance sheet and shareholder equity. She referred numerous times to the disastrous effects on plan sponsors caused by the plunge in equity values. Her comments were timely and interesting—especially her discussion of the materiality of this decline as a percent of shareholder equity, bringing to mind John Wooddy's old study note on Ruin Theory: It is to nobody's advantage if the hit to shareholder equity or the need to contribute desperately hoarded cash essentially wipes out the plan sponsor.

Lesmeister, an actuary with Buck Consultants in Houston, focused primarily on the creative use of the carryover balance, but even more importantly, the new prefunding balance. Her approach was based on tactical considerations such as avoiding Section 436 benefit restrictions, avoiding "at-risk" status, avoiding the need to file a PBGC 4010 and avoiding unintentional elimination or reduction of the carryover balance or prefunding balance. Her presentation on how the prefunding balance can interact with the requirement to establish a shortfall amortization base when a sponsor is trying to minimize cash contribution requirements was masterful and illuminating. The charts she presented were extremely helpful in understanding the counterintuitive way in which attempting to use the prefunding balance to reduce a contribution requirement can result in *increasing* that requirement instead. It became clear (to me, at least) that the strategy of managing contributions through the use of the prefunding balance is much more complicated than the strategies associated with use of the carryover balance, something I had not appreciated before.

Both presenters pointed out practical pitfalls as they went along. One of the most significant seemed to be the potential for a small plan belonging to an obscure member of the controlled group—and which is unknown to the client's principal actuary—to cause serious problems if its funded ratio were less than 80 percent. One major consequence could be the triggering of rules against funding non-qualified deferred compensation plans for executives. If this were discovered after the fact, there would be no shortage of blame to go around, and most of it could inevitably fall on the hapless actuary who advised his or her client in good faith. The session underscored the need to understand the full panoply of benefits offered by all members of the controlled group.

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