



4245 North Fairfax Drive, Suite 750
Arlington, VA 22203
P 703.516.9300 F 703.516.9308
www.asppa.org

Thomas Finnegan

The Savitz Organization

**Testimony Before the ERISA Advisory Council's Working Group
on Automated Benefit Statements**

On behalf of ASPPA

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Good afternoon. My name is Tom Finnegan, and I am a principal at The Savitz Organization, an actuarial firm in Philadelphia, Pennsylvania. My firm specializes in working with all types of nonqualified and qualified retirement plans.

I am here today to present the view of ASPPA, where I currently serve as the Chair of the Government Affairs Committee Defined Benefit Subcommittee and a member of the Board of Directors. ASPPA is a national organization of more than 6,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA unique insight into current practical applications of ERISA and qualified retirement plans, with a particular focus on the issues faced by small- to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-sponsored retirement plan system.

ASPPA applauds the Council's leadership in examining both defined benefit (DB) and defined contribution (DC) benefit statement issues pursuant to the Pension Protection Act of 2006 (PPA). I will focus my testimony today on defined benefit statement issues; ASPPA will also testify before this Working Group in September on defined contribution benefit statement issues.

Background

Prior to PPA, ERISA §105 provided that each plan administrator of an employee benefit plan shall furnish to a participant or beneficiary a statement of his/her accrued benefit and vested percentage (or earliest date of vesting) once every 12 months, at the request of the participant.

Proposed Regulations

On August 1, 1980, the Department of Labor (DOL) issued Proposed Regulations §2520.105-2 on the delivery of benefit statements under ERISA §105. While these regulations were never finalized, they currently provide the only guidance available to practitioners on how to comply with defined benefit statement requirements.

Proposed Regulations §2520.105-2 provided clarification of the content requirements for delivery of annual defined benefit statement to be furnished to participants and beneficiaries once every 12 months upon request. Among other things, the proposed regulations required that a defined benefit statement include the following items:

- Statement re: optional forms
- Statement re: QJSA benefits
- Statement re: benefit suspensions and other reductions
- Statement re: review of statement
- Statement re: availability of records and contact information

Current Practice

Prior to PPA, employers who chose to provide annual statements were not required to follow the proposed regulations. Inasmuch as providing an annual statement was voluntary, statements were designed to effectively communicate the level of benefits being provided to enhance employee appreciation of the benefits and to allow participants to begin long-range retirement planning. Common practices in furnishing defined benefit statements included:

Basic Content:

- A statement of the participant's projected benefit at Normal Retirement Age, assuming that the participant remains employed at the same pay level until retirement;
- A statement of the participant's accrued benefit, with an explanation of the difference between an accrued and a projected benefit; and
- A statement of the participant's vested percent or date of first vesting.

Other Content:

- Some statements will reproduce the core data used for the participant, including dates of birth and hire, normal retirement age and, less frequently, compensation history;
- Statements will often include an estimate of the participant's expected Social Security benefit at retirement age to allow the participant to estimate the income replacement provided by the plan and Social Security; and
- Cash balance plans will often produce a DC-like statement demonstrating activity in the theoretical accounts.

Marketplace—Frequency of Statements

The frequency of how often defined benefit statements are currently being provided depends somewhat on the size of the plan.

For very small plans (fewer than ten participants):

- Annual statements, at least to active plan participants, are standard practice;
- Provided by 90% + of plans.

For small plans (10-100 participants):

- Annual statements, at least to active plan participants, are standard practice;
- Provided by 75% + of plans.

For small and very small plans, statements are driven by software providers (Sungard/Relius, ASC, Datair, etc.). Generally, a standard participant statement (or a selection of statements) is embedded in the valuation software, with very little statement customization in this marketplace.

For medium plans (100-500 participants):

- Sharp drop-off in frequency of statements;
- Increased data issues, increased need for customization;
- Increased cost of statements;
- Limited access to technology; and
- Less than 50% of plans provide annual statements.

For large plans (more than 500 participants):

- Generally customized statements, if provided at all;
- Annual paper statements provided less frequently, except for Cash Balance plans; and
- Outsourced solutions provide Web calculators, on-demand statements, etc., as you move up-market.

PPA Requirements

PPA §508(a) amended ERISA §105 to require, for years beginning after December 31, 2006, that for defined benefit plans, statements to active participants be issued at least every three years. Alternatively, each year, the plan may provide a notice informing the participants of their ability to request a statement and the method for doing so (referred to herein as the Alternative Notice).

Among other things, PPA §508(a) requires that a defined benefit statement include, on the basis of the latest available information:

- The total benefits accrued;
- The nonforfeitable pension benefits, if any, that have accrued, or the earliest date on which benefits will become nonforfeitable; and
- An explanation of any permitted disparity under Internal Revenue Code (Code) §401(l) or any floor-offset arrangement that may be applied in determining any accrued benefit.

Content

The most important aspect of any guidance the DOL issues with respect to these statements is that, in the end, the participants must be able to understand the statements. The information provided not only must be correct, but also must be meaningful.

The biggest point of concern in this area is with respect to the disclosures for Permitted Disparity and Floor-Offset Plans.

Permitted Disparity

Plans often make use of permitted disparity in one of two ways. The first situation involves a plan with a benefit formula designed specifically to conform to the requirements of Code §401(l). In that circumstance, the availability of Social Security benefits or the disparity in taxation under FICA for higher-paid vs. lower-paid employees is part of the benefit formula. For instance, the plan may provide a benefit for each year of service equal to the sum of 1.0% of pay up to covered compensation plus 1.50% of pay in excess of covered compensation. In this situation, someone earning in excess of covered compensation is provided with a larger retirement benefit to compensate the participant for the fact that his or her Social Security benefit will be a lesser percentage of compensation than will a lower-paid employee's Social Security benefit.

The second type of permitted disparity use does not take into account Social Security or covered compensation in the plan's benefit formula, and Code §401(l) is not relevant in determining plan benefits. For purposes of discrimination testing, however, the plan may impute permitted disparity under Code §401(l) in determining benefit accrual rates for such purpose. In this regard, the use of Social Security information is not part of the benefit itself, and the amount the participant receives does not relate in any way to Social Security benefits or FICA taxes. This is only a technique of nondiscrimination testing.

For the first type of formula to properly explain the impact of Code §401(l), the statement would need to contain a description of the concept and reasoning behind permitted disparity and then contain a glossary to define the concepts of covered compensation and the Social Security taxable wage base. It is likely that this "explanation" will make the participant statement unintelligible or, at best, too long to hold the interest of the average participant.

ASPPA recommends that, to the extent the plan's benefit formula directly references permitted disparity, the participant statements include a paragraph to the effect that "The plan's benefit formula takes into account Social Security. For details on the calculation of your benefit, please refer to your Summary Plan Description."

Guidance should clarify that no disclosure is needed for plans that take permitted disparity into account only for nondiscrimination and coverage testing, as the benefits provided by these plans do not relate to Social Security benefits in any way.

Floor-Offset Plans

Floor-Offset plans provide that benefits under the defined benefit plan will be reduced by the benefit provided under a defined contribution plan. Thus, when, the plans are combined, the participant gets the greater of the benefit provided by the defined benefit plan or by the defined contribution plan. Statements are often provided separately for the two plans. This is expected to continue or increase with the new PPA statements (commonly because the statements for the two plans have different due dates, different service providers or other similar reasons).

ASPPA recommends that, in order for the defined benefit statement to be meaningful, it must disclose the net benefit after the offset. Otherwise, the employee may be misled into double-counting the defined contribution benefit. The common disclosure for this type of plan is to disclose the Gross Benefit, the reduction due to the defined contribution Plan Offset, and the Net Benefit.

Timing

On February 15, 2007, ASPPA, along with the Small Business Council of America, the US Chamber of Commerce and the National Federation of Independent Business, jointly submitted a comment letter to the DOL related to the timing of providing benefit statements to trustee-directed defined contribution plans. In the comment letter, the organizations set forth the problems and cost issues regarding plan asset valuation and the timing of contributions for trustee-directed plans if annual benefit statements were required within 45 days after the end of the plan year.

With respect to defined benefit plans, the data reconciliation processes necessary to complete a plan valuation are at least as complex as those of trustee-directed defined contribution plans. The ability to prepare statements within 45 days after the end of a plan year is especially problematic for small plans that frequently perform valuations as of the last day of the plan year.

As a result, *ASPPA recommends* that the deadline for releasing statements be extended to the date for distributing the summary annual report to participants. Guidance should also note that the statements may be prepared as of the valuation date for the plan year, or any later date during the year.

This due date extension should also apply to the Alternative Notice. This differs from the guidance in Field Assistance Bulletin 2006-03, which indicated the due date for 2007 Alternative Notices would be December 31, 2007. As a result, if a plan fails to give the Alternative Notice by December 31 of this year, it will be forced to provide a “three-year” statement not later than the 2009 plan year.

Data quality

PPA §508(a) provides that a plan administrator can furnish plan participants information based on “reasonable estimates” determined by DOL regulations.

ASPPA recommends that in formulating this guidance, the DOL should specifically authorize that the use of valuation-quality data will be deemed to satisfy the “reasonable estimates” standard for periodic statements.

To impose a data standard beyond that required for valuations would, by necessity, increase the cost of plan administration and drive plan sponsors to the use of the Alternative Notice rather than periodic statements.

Final guidance also should clarify that the use of reasonable estimates is allowable for both periodic statements and participant-requested statements.

Frozen Plans

In determining the three-year period for providing defined benefit statements, PPA §508(a) provides that years in which no benefits accrue are excluded.

ASPPA recommends with respect to frozen plans that the DOL develop guidance to provide that, if the plan is frozen in relation to only some (but not all employees), the three-year rule is suspended for the group that accrues no benefits.

This change will place frozen participants on par with other inactive participants. For instance, PPA requires that terminated vested participants be given the right to receive statements only upon request. Continued provision of statements to frozen participants discloses no additional information, and should only be provided upon request.

Closing Remarks

It is important that the guidance with respect to defined benefit plan statements further Congress' goals in passing PPA. In this area the goal is to improve participant communications. To accomplish this, any guidance should:

- Ensure that statements provide meaningful information in an understandable manner, especially as it relates to permitted disparity and floor-offset plans; and
- Encourage the issuance of a defined benefit periodic statement by encouraging simplicity, limiting the cost of compliance, and providing reasonable due dates for issuing statements.

Biography of Thomas J. Finnegan, MSPA, CPC, QPA

Tom is a principal of The Savitz Organization in Philadelphia, PA, and holds a Bachelors degree in Mathematics from St. Joseph's University.

Tom is an actuary with more than 20 years of experience working with all types of qualified and non-qualified retirement plans. Prior to joining The Savitz Organization, Tom served as a senior actuary for a major employee benefits consulting firm and as the director of retirement plan services for a mid-sized regional consulting firm.

Tom is a credentialed member of ASPPA and a member of ASPPA's Board of Directors. He is also a fellow of the Conference of Consulting Actuaries and a member of the American Academy of Actuaries. He is a frequent speaker at regional and national benefit and actuarial conferences and has authored articles for national actuarial publications as well as regional newsletters. Tom has also taught semester-long EA exam preparatory classes at Temple University as well as ASPPA exam courses.