



WORKING WITH  
PLAN SPONSORS

# Client Communication: The Key to Success

TPAs and outside actuaries share a vested interest in communicating well with plan sponsors — and with each other.

BY KAREN SMITH

**N**ot long ago, I wanted to better understand our computer network. I asked for some reports, and when they arrived in my email inbox, I opened them eagerly. But I could not make any sense of the reports at all. They appeared to be written in a foreign language that relied a lot on acronyms. There were a lot of numbers, but I was not sure if high or low numbers were better. After a few minutes of frustration, I had to laugh. Is this how my clients feel when they read my actuarial valuation reports?

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Many of us use commercial software or our own worksheet that automatically produces an actuarial valuation report. It is tempting to issue that report with as little modification as possible in the name of efficiency and keeping fees low. However, Precept 4 of the Actuarial Code of Conduct and Precept 3 of the American Retirement Association Code of Conduct require that professionals communicate in a manner that is appropriate for the intended audience. That automatically produced actuarial report may not always be appropriate without modification or supplemental communication.

#### THE RANGE

In the post-PPA era, one of the communication challenges is the extremely broad employer contribution range, particularly with the interest relief provided by MAP-21 and HATFA for minimum required contributions.

As a plan matures, the difference between the minimum required contribution and the maximum

deductible contribution becomes so wide that I have had clients call to ask me if there was a typo in the actuarial valuation report.

At a 30,000-foot level, the tax code sections that define the minimum required contribution and the maximum deductible contribution each serve different policy purposes. And, even more confusing to employers, the funding-related tax code sections do not always seem aligned with the plan qualification requirements. Actuaries and TPAs need to provide employers insight in how to make sense of these seemingly conflicting code provisions.

#### DON'T PUT IN TOO MUCH!

It is particularly important to explain to plan sponsors that contributing the maximum deductible contribution may lead to a defined benefit plan that is overfunded on a plan termination basis reflecting the Section 415 limits for the owners.

At a very high level, the maximum deduction rules provide for a cushion amount that will allow a plan sponsor to be roughly 50% overfunded. In an ongoing plan, there is a strong policy rationale for the cushion amount. The cushion allows plan sponsors to fund the plan when times are good so that contributions will be less in lean times. Additionally, it allows for an employer to fund a defined benefit plan in anticipation of a benefit increase and to better manage income taxes.

However, if a defined benefit plan is overfunded when the plan terminates, the plan sponsor may end up with unexpected taxable income and a reversion tax of up to 50%. While there are strategies to mitigate this, a plan sponsor may be unhappy about being in the situation where mitigation is necessary.

Any plan can be at risk for being overfunded under a perfect storm. For example, if interest rates were to increase quickly and equities were to hold their values, many plans could go from underfunded to overfunded

status. An unexpected employer contribution, positive asset return or increase in interest rates could take an adequately funded plan to an overfunded status.

However, I have had the most trouble with plans where the Section 415 limitation is nearly or fully phased-in, particularly those where the Section 415 compensation limit is applicable instead of the Section 415 dollar limit. An actuarial report (including supplemental communications) that does not address this issue may not be meeting the needs of the intended audience.

#### DON'T PUT IN TOO LITTLE!

On the other end of the spectrum, it is important to explain to plan sponsors the risks of having an Adjusted Funding Target Attainment Percentage (AFTAP) of less than 80%. The AFTAP is a particular ratio of the plan's liability to its assets. When a plan's AFTAP is less than 80%, a plan's ability to pay lump sum benefits is limited. A plan's AFTAP can be less than 80% even if the minimum required contribution has been satisfied every year — which can be confusing to plan sponsors.

Additionally, when there are multiple HCEs in a small plan, it may be necessary to maintain a 110% funded status to avoid problems when an HCE retires or terminates employments and wants to receive a lump sum. There is a nondiscrimination requirement that the 20 highest HCEs may not receive a lump sum unless the plan is 110% funded after the distribution is made. It may be necessary to explain this early, often, in writing and in multiple documents including the actuarial valuation report and summary plan description.

#### FUNDING POLICY

To help clients understand the wide employer contribution range, actuaries and TPAs can help clients develop a funding policy. For small plans, a funding policy may

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contemplate a 100%-120% funding ratio of assets to funding target. It may be necessary for there to be a discussion about whether the funding target should be calculated using the regular segment rates or the HATFA segment rates.

Another approach may be for a small plan to fund such that the plan is funded close to the plan termination liability.

For both smaller and larger plans, using an old-fashioned reasonable, funding method allowed prior to PPA for developing a customary contribution may be appropriate. Just because PPA mandates the use of essentially a unit credit method for both the minimum required and maximum deductible contributions, the entry age normal funding method and individual aggregate are not dead as funding methods. For many plan sponsors, these funding methods may be more appropriate as a funding method (particularly when paired with long-term reasonable assumptions) for developing a customary contribution.

#### **PBGC PREMIUMS**

For PBGC covered plans, it may be appropriate to include information about the PBGC premiums in the annual valuation report or supplemental communication. There are two portions to the annual PBGC premium: a fixed portion based upon the participant count and a variable portion based upon the plan's funded

status. Both of these portions increase over time, and in many cases PBGC premiums are dwarfing the plan's administrative and actuarial fees. So employers may appreciate planning information for PBGC premiums.

#### **TRENDS**

Sometimes it may be appropriate to include information in an actuarial valuation report on demographic changes that will affect the plan. For example, it may be appropriate to include information about a large group of new entrants that will increase the plan's minimum required contribution or a plan trending toward top heavy status.

If a plan is relying on the professional employer exemption for PBGC coverage and is getting close to the 25 active participant limit, or if a plan is getting close to the 100/120 participant limit for being exempt from the CPA audit requirement, it may be appropriate to include a comment in the actuarial valuation report.

#### **CHANGES IN REQUIRED ASSUMPTIONS**

The PPA requires that mortality tables be updated at least every 10 years. Within the next couple of years, the IRS will issue updated mortality tables. While it is impossible to know what the tables will be before they are issued, there is an expectation that the tables will materially increase the life expectancy of pension plan participants. This will

potentially increase the minimum required contribution, lump sum values and PBGC premiums.

Additionally, as HATFA interest rate relief phases out, minimum required contributions may creep up. Ideally, the actuary and TPAs are helping clients anticipate these changes now.

#### **MISSING PAGE**

While it is acceptable for communications to be issued in different pieces, either each communication should stand on its own or it should be clear that each piece is part of a whole. In addition to the precepts regarding communications, Precept 7 of the American Retirement Association Code of Conduct and Precept 8 of the Actuarial Code of Conduct require that we take reasonable steps to make sure that our work product is not misused.

The probability of misuse is higher when actuarial communications are issued in multiple pieces because it allows another party to pick and choose which information they share.

A contribution letter and the actuarial valuation report may both be prepared to fully explain the client's option and a plan's funded status. But if the contribution letter and report get separated in the client's file, neither may tell the complete story. In such as case, it would be appropriate for both the letter and the report to reference the existence of the other.

#### **ASOP 41**

If the enrolled actuary is a member of any of the five U.S.-based actuarial organizations, including ASPPA/ACOPA, the actuarial valuation report is subject to all of the requirements of Actuarial Standard of Practice 41 (ASOP 41). The party preparing the report, whether it be the actuary, TPA or actuary's internal staff, need to make sure that the report meets all of the requirements of ASOP 41. The full text of ASOP 41 can be found at [actuarialstandardsboard.org](http://actuarialstandardsboard.org).

An easy requirement that I see missing sometimes is the required acknowledgment of actuarial qualifications. And perhaps of more concern, I see reports missing the identification of the responsible actuary. For particular assignments, other ASOPs may require information in addition to what is listed in ASOP 41.

## DEADLINES

It is important that somehow we communicate to plan sponsors the funding deadlines and the consequences for not making required contributions. For example, employers need to understand potential excise taxes for missed or late employer contributions.

In addition to final and quarterly funding deadlines, actuarial valuation reports or related actuarial communications need to communicate the implications and deadlines for making funding elections to burn, apply or increase pre-funding balances.

## INDIRECT COMPENSATION

Some providers offer revenue sharing for TPAs or actuaries in connection with both the 401(k) plans and defined benefit plans that they administer. This often will trigger 408(b)(2) notice requirements, but not always. Either way, it may be appropriate to disclose this in the actuarial valuation report or in a supplemental communication. Precept 9 of the American Retirement Association Code of Conduct and Precept 6 of the Actuarial Code of Conduct require disclosure of the sources of material direct and indirect compensation.

If the amount of the indirect compensation is insignificant, I like to include a statement that I did not feel the amount created a conflict of interest. While parties may disagree, I like to provide information so that plan sponsors can make inquiries if they have any concern at all.

If the amount is significant enough that it may create a potential

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or actual conflict of interest, then additional disclosure and consent by the plan sponsor is needed outside of the report.

## DOCUMENTS AND DATA

When a TPA works with an outside actuary, the TPA and actuary each have a vested interest in communicating well with each other to serve the plan sponsor’s needs. Within the actuarial valuation report, the actuary probably should be clear for what items he relied on the TPA. For example, the actuary may wish to disclose that the participant data was provided by the TPA. Additionally, the actuary may wish to be clear that he has received the plan legal documents and plan provisions from the TPA. However, such disclosures do not absolve the actuary from all responsibility for reviewing the data and other documents for reasonability under the ASOPs.

## THE KITCHEN SINK

At some point, when we consider all the things that may need to be in an actuarial valuation report, it becomes tempting to write a nice long boilerplate list of disclosures where we throw in all of the issues: overfunding, underfunding, deadlines, risk — in other words, “the kitchen sink.” Such a list may have a place in an actuarial valuation report, but the Codes of Conduct require that communication be appropriate for the intended audience.

Unfortunately, a single laundry list of issues to consider will not meet the needs of all employers. If

we include such a list in the actuarial valuation report, it may be appropriate to direct the client to particular items or include an executive summary in the front of the report.

## LOST IN TRANSLATION

In many cases, the actuary may not be in direct contact with the plan sponsor. This could happen when either a TPA uses an outside actuarial firm or where a client primarily deals with a consultant at the actuary’s own firm. In such cases, additional care must be taken that the actuary receives really accurate information about the plan sponsors intentions. The actuary and TPA (or internal consultant) need to really make sure that the correct and complete information gets to the client.

Drafting a perfect actuarial valuation report that strikes the right balance between brevity and comprehensiveness to perfectly communicate with the plan sponsor is probably never going to happen. There is no perfect checklist because clients’ needs and expectations differ so much, as well as the nature of professional agreements. It comes down to professional judgment.

As our understanding of client communication needs deepens, we do not need to be bound by the actuarial valuation report we issued in prior years. We can periodically update our practices and model actuarial valuation reports to better meet the aspirations of Precept 4 of the Actuarial Code of Conduct and Precept 3 of the American Retirement Association Code. **PC**



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