

Appendix 2

Illustrations of Allocation Methods

Note: This appendix is provided for informational purposes, but is not part of the standard of practice.

Basic Information

The plan provides a retirement plan benefit equal to 1% of the final year's compensation multiplied by years of service. Accrued benefits vest after 5 years of service, and participants are eligible to retire early at age 55 if they have completed 10 years of service. Normal retirement is at age 65. The covered party joined the plan at age 25, was married at age 29, and is age 40 at the allocation date. The covered party's historical service, compensation, accrued benefit, and vested accrued benefit are shown in the following table.

Age	Completed Years of Service	Prior Plan Year's Compensation	Accrued Benefit	Vested Accrued Benefit
26	1	\$11,500	115	0
27	2	\$12,500	250	0
28	3	\$14,000	420	0
29	4	\$14,500	580	0
30	5	\$15,000	750	750
31	6	\$15,500	930	930
32	7	\$16,750	1,173	1,173
33	8	\$18,000	1,440	1,440
34	9	\$19,000	1,710	1,710
35	10	\$20,000	2,000	2,000
36	11	\$23,500	2,585	2,585
37	12	\$25,000	3,000	3,000
38	13	\$27,500	3,575	3,575
39	14	\$29,000	4,060	4,060
40	15	\$33,000	4,950	4,950

Direct Tracing Allocation Method

In the direct tracing method, the portion of the retirement plan benefit that is often considered to be marital property is equal to the actual benefit accrued during the allocation period (typically the period from the date of marriage to the allocation date). For example, in applying direct tracing to a defined benefit pension plan, the portion of the retirement plan benefit included in marital property would generally be the increase from the accrued benefit, if any, at the marriage date to the accrued benefit at the allocation date. If the direct tracing method were applied to the data given in the table above, subtracting the \$580 accrued benefit at the date of marriage from

the \$4,950 accrued benefit at the allocation date would give the portion of the accrued benefit that is marital property: \$4,370.

Alternatively, the direct tracing method could be applied to the covered party's vested accrued benefit. Under this approach, the entire \$4,950 is marital property because the vested accrued benefit was \$0 at the date of marriage.

Fractional Rule Allocation Method

The fractional rule method allocates the retirement plan benefit by multiplying the retirement plan benefit by a fraction. The fraction may be based on compensation, contributions, benefit accrual service, plan participation, employment, or other relevant historical data. The numerator is equal to the selected measure accrued during the allocation period (typically the period from the date of marriage to the allocation date). The denominator is equal to the selected measure accrued during the total period in which the retirement plan benefit is earned. When the selected measure is an elapsed time period, this method is commonly referred to as the *time rule*.

If the fractional rule method based on benefit accrual service were applied to the data in the table above, the \$4,950 accrued benefit at the allocation date would be multiplied by the fraction ($11 \div 15$) because the covered party was married for 11 of the 15 years over which the benefit was accrued. The portion of the accrued benefit that is marital property is \$3,630.

If the fractional rule method were based on compensation instead, the numerator of the fraction would be compensation earned from the date of marriage to the allocation date (\$242,250), and the denominator would be the covered party's total compensation earned from employment date to the allocation date (\$294,750).

When the \$4,950 accrued benefit is multiplied by the fraction ($\$242,250 \div \$294,750$), the portion of the accrued benefit that is considered to be marital property is \$4,068.

Allocation Method for Age- or Service-Dependent Benefits

Under both the direct tracing and fractional rule allocation methods, the allocation of age- or service-dependent benefits must be defined. Age- or service-dependent benefits are benefits for which the amount or timing of benefit payments depends on the covered party's age or length of service. Subsidized early retirement plan benefits are often age- or service-dependent. For example, a retirement plan might provide that the benefit payable upon early retirement at age 55 is 100% of the accrued benefit if the participant has completed at least 25 years of service, and 50% of the accrued benefit otherwise.

If the covered party has not satisfied the eligibility requirements at the allocation date but remains employed by the plan sponsor, alternative approaches are available. One approach would exclude from marital property any age- or service-dependent benefit that is available only

if the covered party remains employed after the allocation date. A second approach would include such benefits in marital property under the assumption that the covered party will remain employed by the plan sponsor until eligibility conditions for the higher benefit level are satisfied. These two approaches may produce quite different results. Under the early retirement provision described above, including the value of the 25-years-of-service subsidy in marital property could double the value of the retirement plan benefit.

As these examples illustrate, retirement plan benefits included in marital property can vary substantially depending on the allocation method used. This highlights the importance of the point raised in the last paragraph of section 3.3.2. An actuary working in an adversarial situation where different approaches have been proposed or used should inform the actuary's client of the nature of those differences and the financial consequences of choosing one approach over another.

Appendix 3

Comments on the 1998 Second Exposure Draft and Committee Responses

The second exposure draft of this proposed actuarial standard of practice (ASOP) was issued October 1998, with a comment deadline of April 1, 1999. (Copies of the first exposure draft, and the second exposure draft, which contains comments on the first, are available from the ASB office.) Thirteen comment letters were received. The Pension Committee of the ASB carefully considered all comments received. Summarized below are the significant issues and questions contained in the comment letters, printed in standard type. The committee's responses to these issues and questions appear in **boldface**.

General Comments

A number of commentators expressed the view that the second exposure draft was an improvement over the first exposure draft.

A number of comments were received that clearly reflected practices and rules relating to only certain jurisdictions. **The committee feels strongly that the standard must be relevant to all jurisdictions. Therefore, the text was not changed.**

One commentator felt that the standard should include an explicit discussion of remarriage rates. **The committee believes that a detailed discussion of remarriage rates would be beyond the scope of the standard.**

Transmittal Memorandum

In the transmittal memorandum for the second exposure draft, the committee requested comment on the following:

1. Does the text added to sections 3.3.3(b), Mortality Assumption, and 3.3.3(f), Disability Assumption, regarding the health of the covered party and spouse, place an unreasonable burden on the actuary to inquire as to the health of the covered party and spouse and make underwriting judgments based on this information?
2. Does the revised text of section 3.3.3(i), Growth of Individual Account Balances, adequately address the valuation of cash balance plans and floor-offset arrangements?

There was little direct reply to these questions. One commentator did approach the issue by describing his practice of cursory investigation of health factors when making mortality assumptions for section 3.3.3(b), but did not seem to feel that the standard was imposing additional burden.

One commentator expressed approval of section 3.3.3(i) in its present form. **The committee accordingly made no substantive changes in these sections.**

Section 1. Purpose, Scope, and Effective Date (now titled Purpose, Scope, Cross References, and Effective Date)

Section 1.4, Effective Date—One commentator felt that a three-month lag between Board approval and required implementation was not long enough for the profession to adjust to the changes. **The committee agreed and changed the effective date to March 31, 2000.**

One commentator requested clarification on whether the effective date refers to the performance of the assignment or to the engagement for the assignment. **The committee modified the wording to clarify that the standard refers to the time when the actuary is first engaged to perform an assignment and does not refer to the time the work is performed.**

Section 2. Definitions

Section 2.6, Allocation Period—One commentator suggested substituting *coverage period* for *allocation period*. **Since the coverage period is not always the allocation period, the committee chose to retain the term *allocation period* as defined.**

Section 2.17, Spouse—One commentator objected to the nonstandard use of the term *spouse* to include children. **This definition also received comment after the first exposure draft. On revisiting the issue, the committee reworded the definition to improve clarity, but retained a “nonstandard” usage.**

Section 3. Analysis of Issues and Recommended Practices

Section 3.2.2, Disclose Any Conflicts of Interest—As after the first exposure draft, a number of letters again reflected concern about the broad language dealing with *personal relationship* and conflicts of interest. Some new language was suggested. **The committee discussed the matter at some length, but ultimately decided not to change the language. The committee notes that the term *personal relationship* is not intended to encompass casual acquaintance.**

Section 3.2.3, Determine the Nature and Scope of the Engagement—One letter suggested that paragraph (g) be amended to indicate that the actuary was assisting legal counsel. **The committee did not agree. The actuary may be assisting a court or judge.**

Section 3.2.5, Be Familiar with Applicable Law—One commentator suggested that *applicable law* be expanded to include significant case law. **The committee noted that *applicable law*, as defined in section 2.7, already includes case law.**

One commentator asked whether the discussion of assumption selection applies to calculations of the final annuity benefit amounts payable from a plan under a QDRO. The commentator expressed the opinion that this discussion should not apply to such calculations, because the

terms of the plan, including its provisions regarding the basis of actuarial equivalence, would govern these calculations. **The committee agreed and added language to clarify that this section does not apply to the review or implementation of a DRO.**

Section 3.3.1, Information Requirements—One commentator suggested more general language to avoid suggesting that the list of circumstances was fixed. **The committee edited the text to clarify that the list is not all-inclusive.**

One letter suggested adding the phrase *that are within the actuary's purview to judge* after the phrase *the actuary is responsible for reviewing, when practicable, the reasonableness of the data supplied*. **The committee believes that the current text gives the actuary sufficient discretion regarding data review.**

One commentator argued that the direct tracing allocation method ought to be the only one endorsed. **The committee disagreed and maintained the inclusion of the fractional rule method. The committee had reached a similar decision earlier, in response to comments on the first exposure draft.**

Section 3.3.3(a), Discount Rate—One letter suggested replacing the words *low-risk* with *risk-appropriate*, implying that investment aggressiveness or investment acumen of the covered party or spouse is a factor to be considered. **The committee disagrees. References to *facts and circumstances* are intended to be references to the nature of the plan and its provisions, not references to the investment expertise of a covered party or spouse.**

Section 3.3.3(b), Mortality Assumption—One commentator wanted the leeway to choose the mortality table to use. **The committee believes that the text gives the actuary the leeway to choose the mortality table.**

One commentator invited the committee to make a choice between unisex mortality tables and sex-specific tables, and also suggested replacing the word *participant* with *covered party* in the last line. **The committee declined to take a stance on mortality table preference, but agreed to adopt the wording suggested.**

Section 3.3.3(c), Annuity Purchase—One commentator questioned the use of commercial annuity purchase rates as an alternative to explicit selection of mortality and discount rates. This commentator considers it inappropriate to use rates loaded for expenses and profits. **The committee decided not to exclude this generally accepted alternative to explicit selection of mortality and discount rates.**

Section 3.3.3(d), Retirement Assumption—One letter suggested that section 3.3.3(d)(5) be amended to specifically take into account when the receipt of retirement benefits is most valuable. **The committee believes that the current text encompasses this concept.**

One commentator objected to the idea that statements concerning anticipated retirement age should not be given undue weight and instead called for the “utmost respect” for such statements. **The committee disagreed.**

Section 3.3.3(e), Automatic Cost-of-Living Adjustments (now titled Cost-of-Living Adjustments)—One commentator disagreed with the idea that it might sometimes be appropriate to assume future ad hoc cost-of-living adjustments. **The committee did not clarify the circumstances under which it might be acceptable to assume a nonautomatic cost-of-living increase, but the title of the section was changed to show that both automatic and nonautomatic cost-of-living increases are covered.**

Another commentator noted that the word *however* at the beginning of the last sentence suggested a contrast that was not present. **The committee agreed and deleted the word.**

Section 3.3.3(h), Compensation Scale—One commentator suggested that the standard include a direct reference to the Social Security Administration wage index. **The committee declined to make a change in this section.**

One letter suggested that the section was too limiting and suggested language similar to that used in the first exposure draft. **The committee expressed satisfaction with the current language.**

Section 3.3.4, Valuation Process—One commentator wanted codification of the procedure of looking to the plan assumptions and methods, suggesting that the standard’s requirements would introduce too much subjectivity. **The committee considers it inappropriate in this context to calculate present values by automatically using assumptions inherent in the plan’s basis of actuarial equivalence. As stated in section 3.3, the goal of performing an actuarial valuation is to provide a reasonable and objective assessment of the value of retirement benefits that are marital property. The plan’s actuarial equivalence basis may or may not be reasonable or appropriate for the specific circumstances.**

Section 3.3.5, Computing After-Tax Values—One letter expressed concern that this section, as well as the standard as a whole, would be interpreted as prohibiting the actuary from providing services in this area. **The committee does not believe the standard is open to this narrow construction.**

Section 3.3.7, Consistency with the Actuary’s Previous Actuarial Valuations—One commentator objected to, and others expressed concern about, the requirement of consistency because it limits the ability of the actuary to advocate for the client. **This topic also received comment after the first exposure draft. The committee reviewed the matter extensively and reiterated its strong position that the credibility of the profession is paramount. The committee made no changes.**

Section 3.4.4, Providing Expert Testimony—One letter objected to the requirement that the actuary state when a valuation prepared using dates, methods, or assumptions prescribed by applicable law does not necessarily reflect the actuary’s own expert opinion. **After much**

discussion, the committee agreed, removed the requirement, and softened the wording generally.

Section 3.5, Providing Guidance on the Division of Retirement Plan Benefits—One commentator suggested raising the standard of required actuarial expertise to include knowledge about the “tax consequences of various approaches to division of retirement plan benefits.” **The committee did not agree.**

Section 4. Communications and Disclosures

Section 4.3, General Disclosures—A number of letters protested that disclosure requirements were unnecessarily onerous. The first exposure draft met a similar response. **The committee agreed with those commentators who argued that disclosing the legal jurisdiction was not necessary for services such as reviewing or implementing a DRO. Section 4.3(e) was moved to become section 4.4, Actuarial Valuation Results, subparagraph (a), and the phrase *if applicable* was added at the end (after *domestic relations action*). The remaining subparagraphs were renumbered accordingly, as were the subparagraphs of section 4.4.**