RECORD OF SOCIETY OF ACTUARIES
1975 VOL. 1 NO. 3

PLAN TERMINATION INSURANCE

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CHAIRMAN JAMES A. CURTIS: What is plan termination insurance supposed to insure? Simply the present value of the vested accrued liability minus the assets. For an actuary, I don't think that's very complicated until you start breaking it down into its component parts, defining the term present value, and considering different actuarial assumptions.

First, you've got to understand what the vesting provision is. Then you must consider the accrued benefit, and this brings forth more problems because of such things as final pay plans. You must remember that the benefit that the PBGC is guaranteeing is the one that's been in existence for at least five years, taking into consideration the Law's 20% per year phase-in provision. Valuing the assets further complicates matters. So, calculating the vested liability minus assets has many different complexities.

Today what I hope we will be able to do is discuss some of these complexities.

MR. MARC M. TWINNEY: I would like to give you a little background about the Pension Benefit Guaranty Corporation. It is not like your usual insurance company or even like some special insurance corporations that have been given federal charters. For example, I like to draw the distinction between the PBGC and the Securities Investor Protection Corporation (SIPC), which insures the individual investor and his account at brokerage firms that might go out of business. The SIPC is at least in the neutral sphere outside the government. The PBGC is inside the Department of Labor.

The PBGC is housed with the Department of Labor people and most of the staff has come from Labor. It is run by the Secretaries of Labor, Commerce, and the Treasury, and an Advisory Council of seven members. I think it is interesting, considering our concerns today and the statements usually made about the need for actuaries to take more public responsibility, that there is not a single actuary on the Advisory Council. I found this a bit stunning when I read the list, because, if anyone should know how to terminate a plan, it should be an actuary. Vice versa, I do not know of anyone who knows how to terminate a plan without consulting an actuary.

The PBGC will be running by regulation. The regulatory process will be rather complex, because you will be getting Q and A's, interpretive bulletins, proposed regulations, temporary regulations, and so on. When you see proposed regulations, those are the ones that you can comment on and alter and perfect. Hopefully, you will take time to keep track of the proposed regulations and get your comments in if you think you have something to say on them. In the meantime, the PBGC has to go on with the business. So although we've already started the ballgame, the scorecards haven't been filled out all the way.

The most recent report by the Corporation people to Congress, earlier this month, indicated that the rate of plan termination is quite a bit higher than it was back when the plans for the Corporation were made in 1974. At that time, they were calculating that the annual rate of plan termination might be 1,200. That annual rate is now up to 4,000. This is partly due to the economy and partly due to the effect of the Law itself.

I think that the annual premium of one dollar per plan participant raised about $34 million dollars. The PBGC figured that for 1,200 terminations per year they'd have to have $30 million to provide a full reserve for the plan terminations. So with plans terminating at the rate of 4,000 per year in the first years, they're way short of funds. They're not short of cash though, because we're talking about the full reserve, not just the benefit payoff for one year.

The actual number of terminated plans filing is 1,600 post-enactment plans and 400 pre-enactment plans. How pre-enactments qualified I don't know, but I think there's a gray area about the effective dates of the Act. There was some back-casting by the Act that picked up a period of time prior to September 2, 1974.

The Corporation has closed 176 cases. Those include cases that they have determined are not covered under Title IV of the Act and a few cases where the assets are so clearly sufficient that they're not worried about the ultimate payment of the benefits even if there are some hard times in the funds.

They're committed, according to Mr. Schanes, the Director of the Corporation, to developing a program for insurance of the contingent liability on the employer, and I think that's something that's going to be very interesting to watch. It's one of the problems that everybody pushed out into the future instead of trying to face up to, and yet if you don't deal with it at all, I think you will scare the small employer out of private pensions, certainly the financially weak ones.

Another issue that's never really been faced up to is the whole retroactive effect of the Law. Obviously all the people who had plans, including the employer I work for, have profound questions. For instance, does the Law really have full force if you entered into the plan in a climate where there was no such Law, even though now the Law goes back retroactively in many areas.

I can't emphasize too strongly the fact that the Corporation is in the Department of Labor and of course the biggest client in the Department of Labor is the labor movement. This makes it quite a bit different from most of the federal insurance agencies which are not inside a department. These agencies might be subject to a great deal of control and advice from governmental departments, but they are not directly under the departments themselves.

I'd like to talk briefly about what benefits are covered. The biggest issue that the PBGC is facing up to first is the question of what a basic benefit is as opposed to a non-basic benefit. Again, the Law, in trying to get a fast and feasible program of plan termination insurance into effect, came up with basic and non-basic benefits as a way to divvy up that which is compulsory with regard to the guarantee and that which can be insured at the option of the plan sponsor. The problem is that the definitions are not complete in the Law.

Clearly excluded, by the way the Law defines basic benefits, are the ancillary benefits that are forfeitable for any reason, benefits that are nonforfeitable because of the plan's termination, benefits in excess of a certain level (initially $750 per month), and portions of benefits provided through recent plan amendments.

One problem that occurs, concerning the definition of a basic or non-basic benefit, is where the benefits are already in payment at the time of termination. The plan termination date is to be established by the plan sponsor or, if it's disputed, in agreement between the Corporation and the plan sponsor. That date established is quite important for many of the decisions involved with the evaluation of a terminated plan, such as the benefit status, etc. So far as I know, we don't have any precedent yet for how the PBGC is going to handle the intricacies of establishing that date. Normally I would think the employer would announce, before the fact, the prospective date of plan termination.

The position that I've taken is that it makes sense to say that, if you retired prior to the termination date, you should be able to receive your more valuable early retirement benefit to the extent that it's clearly nonforfeitable. However, if you haven't retired and don't choose to submit an application between the time you received notice of plan termination and the plan termination date, and you wish to keep on working, then you shouldn't be entitled to the early retirement benefit.

There have been different estimates of how much cost might be added in covering the early retirement benefit. Taking the whole private system, one estimate is an increase of about 40% in the total undertaking of the Corporation. This is important because when they set up the program in Congress, they were talking about 1,200 terminations and insuring the deferred vested benefit payable at age 65, if you weren't retired yet. For plans in the automobile industry, with the kind of early retirement provisions they have, the increase in coverage could easily be 100%. This is quite an increase in the total of the vested benefits that we have to determine we're either committed to paying or to insuring.

MR. WILLIAM S. THOMAS: I think it's very important to recognize that the Corporation is guaranteeing the payment of the minimum benefits to the people who are eligible for them. I think it's important that the employees who are affected by the termination be given sufficient and satisfactory notice and have a clear understanding of where to look for their benefit rights.

Also, I think that the Pension Benefit Guaranty Corporation can transfer some of its liability. It can elect to insure part of it, I think, if you read the Law carefully. I think you'll agree with me that they have the obligation to make sure that insured pension benefits are paid.

There are many people who think that the portions of the Law concerning the PBGC are confusing. I found that the premium rate section was very clear. In essence it says that the premium should initially be a per head premium. That's the easiest kind of premium to determine with a dollar per head for the single-employer and fifty cents per head for the multiple-employer plans. In addition, the Law says that, after awhile, the PBGC should consider having a premium that is related to the risk. The Law states two ways to determine the risk, one based on the present value of the unfunded liability for the guaranteed benefits, the other based on the present value of the total guaranteed benefits. The Law goes on to say that the premium should be divided equally in the aggregate, from those two sources. The part of the premium related to the total present value, not just the unfunded portion, was designed to produce a bigger premium from the richer plans. The Law does not say that, but that's what it does.

So there is an attempt to have a premium which is half related to the risk directly and half related to the scope of the plan so that the larger, sophisticated plans pay more than the other plans.

It concerns me now because I feel that a lot of people think the per head basis should be continued indefinitely. It's simple and it doesn't require any extra valuation. That intrigues me no end. I had no idea that the valuation of plans was that difficult or that expensive.

I think it's important for actuaries to have a measure of what that unfunded vested liability is, recognizing that the valuation of the unfunded vested liability is really a function of two things. One is the unfunded past service liability, and the second is the fluctuation of assets. In times like these, assets can depreciate substantially from year to year.

I think it's important for actuaries to face up to this problem of the premium basis. Even a dollar a head is not a perfect answer. I felt quite strongly that we shouldn't pay the dollar a head on anyone that an insurance company had guaranteed the payment for, be it a retired life or a person who had terminated with a vested right. I think that there is no risk there. The full assets of the insurance company are behind the risk and I don't know why we should pay a premium. I speak now not only for an insurance company, but as an employer of 60,000 people where we fully fund our plan. I'm not asking for an active employee exemption. I'm just asking for a reasonable solution on the retired lives.

Another matter is the question of contingent employer liability. The Law provides that the Corporation shall work out a system to relieve the employer of the contingent liability and it also provides that there may be a contracting-out provision whereby an insurance company can relieve the employer of that obligation. In my view, in order for contracting-out to be practical, the insurance company would have to take the full risk, not just that of the contingent liability.

MR. EDWARD H. FRIEND: I'd like to begin by pointing out that any new agency in a situation such as the PBGC is going to get a lot more criticism than approval. I would like to spend a few minutes in defense of what seem to be many problems not dealt with. They are working hard at the PBGC, but there are a lot of problems. You've heard of some of them, and the Corporation has to be very careful to consider all the approaches and come up with reasoned judgments. There are going to be regulations released in proposed form and we're all going to get a chance to comment on them.

The Corporation is so low-key that some people don't realize that it already has actuaries working for it. Recently the Corporation has put out a call for some twenty additional actuaries to work for a year to help get rid of the backlog. I don't know if they're going to get them.

I want to focus on a main problem which we have been confronted with, and that is the problem of how big the liability is that is the difference between the value of insured benefits and assets.

Title IV of the Act has a paragraph which says "The Corporation shall by regulation define the terms 'value of the assets' and 'present value of the benefits of the plan which are guaranteed'...". Now, if I were to have wanted to choose the side of the problem I could be on, the person who drafted the language or the person who implemented it, you can see it's an awful lot easier to write language like that than to implement it. What is the value of the assets and what is the present value of the benefits of the plan which are guaranteed?

The value of the assets, I'm inclined to believe, is likely to be at market and so we're going to be seeing a full market appraisal. Again, this is not final, it's just an impression I have that market value of assets will apply here. Of course, if you're going to have market value of assets, you've got to have market value of liabilities.

Consider a plan with a bond portfolio that is sufficient one day and then consider the possibility that, on the next day, interest rates rise dramatically causing the value of the portfolio to drop. A plan that might have been sufficient one day would be insufficient the next day unless something was done to value the liabilities in terms of investment return assumptions which reflect the changing conditions. I believe that fixed investment return assumptions are impossible in this environment. I believe you must use variable investmest return assumptions, and the way in which they're to be implemented is being struggled with right now.

I end my comments with this observation. Please go easy on the criticism of the Corporation because I think that they're doing the best possible job that they can under the circumstances.

CHAIRMAN CURTIS: The first three speakers had a few areas that I thought they might want to discuss. Bill Thomas alluded to the fact that he thought there ought to be some part of the premium that bears some relationship to the risk. It seems like we've heard that before as actuaries. I'm not sure that everybody agrees with it. Now Ed, do you feel that, from a practical standpoint, it would be possible to have all or a part of the premium based on the liability that exists or do you think we're going to have a head tax premium forever?

MR. FRIEND: I call the per capita premium a tax, which may be too harsh a word, but my feeling that it is a tax comes from the fact that there is no reference in Section 4006(a)(1) to what is normally deemed to be actuarial balance with respect to basic benefits. There is, in 4006(a)(1), reference to taking into account reasonable anticipated experience in guaranteeing non-basic benefits, but such language cannot be found in the basic benefit area. The premiums are supposed to keep the Corporation sufficient, but I see nothing in that first paragraph of Section 4006 which essentially would require, for example, that the Corporation not build up some reserve against an adverse experience.

Now as soon as you get into that kind of reasoning, it would suggest that equity is not the cornerstone of the premium structure and one might look to per capita rates as a reasonable basis for proceeding. There are some problems that are created by per capita rates. Bill Thomas asks "Why should we pay a per capita tax on an insured life for which the premiums have been paid and the contract issued"? But legally one could argue that the insurance company could become insolvent. At any rate to answer Jim's question, yes, I think it would be perfectly possible to base premiums in part or in whole on unfunded vested liabilities.

MR. TWINNEY: One of the points that I think should be made is that there is a great deal of variability in these concepts, even to get them defined. I mentioned earlier about the additional variabilities that would be possible because of early retirement provisions. One of the other things to consider is that if you start taxing the unfunded vested liability, you may deter benefit improvements. I can see problems and everyone could see problems then, but I think if you look at the legislative history, they definitely anticipated a combination of the two approaches.

CHAIRMAN CURTIS: One thing that Marc mentioned to me previously that I thought was interesting was that the automobile companies have interpreted the law to say that this premium can be paid from the fund as opposed to being paid by the employer. I think that's consistent with multi-employer plans that have no other source of obtaining this money.

MR. TWINNEY: The point is that the Law does not say that explicitly. The Law very explicitly says who's to pay the premiums for the other kinds of coverage and usually mentions the plan sponsor, not the plan. We're only talking here about the premium for the basic benefit. Our attorneys believe that, if the Law does not say that you cannot pay the premium from the plan and carefully states who is to pay the premium regarding the other coverages, it was intentionally allowing a plan to pay the premium itself.

CHAIRMAN CURTIS: In the area of employer liability equal to 30% of net worth, there's a big concern among employers in multi-employer plans. If you read the law, it talks about a substantial employer. For a second, put yourself in the place of a large construction company which has signed a contract to build a dam. They go to the local unions and they sign labor contracts. At the termination of the contract, they may find themselves in the situation of being a substantial employer in a small area. What are their liabilities? It has them quite concerned.

MR. THOMAS: I think it's important to recognize that the legislative history is such that Congress really gave a lot of consideration to the premium question. As a matter of fact, when the Ways and Means Committee produced their bill, they had the premium as fifty cents per head plus a certain percentage of the vested liability. The dollar per head was worked out by the staff just to get the thing rolling. I think it should be stressed that there was a lot of discussion, and a lot of sophisticated congressmen fully expected to have part of the premium related to the liability.

I think if you can work it out on the basis of the contracting-out provision where insurance companies can take on the risk for the employer, subject to all the covenants we have to work out with the employer, then I can see where the life insurance business could be involved. For instance, we fully insure plans and for those plans there is no reason why we can't remove all the contingent liability from the employer and take that upon ourselves.

MR. FRIEND: It's my personal opinion that contracting-out is not going to work for the simple reason that the residue, those that would not contract out, are going to be the poorer risks and it would be impossible for these poor risks to sustain themselves. I think we're going to have to see a pooling of the premiums paid by every plan either to the PBGC as the contingent liability insurer or to private insurers with a reinsurance premium paid back to the PBGC. It just doesn't seem to me to be workable otherwise.

MR. TWINNEY: I would hate to see the contingent liability provision worked out so that we're back to where we were many, many years ago when only the well-to-do could afford private pension plans. I think if we go back to that kind of situation, we've really taken a step backward in private pensions.

CHAIRMAN CURTIS: Do you think there might be some kind of pooling?

MR. TWINNEY: Yes, I think what Ed said about pooling is our only hope so that the small operation, after it's on its feet and thinks it's going to continue as a business, could undertake a pension plan. Pensions, of course, are one thing that you don't have to have the day you open your door. After you've been in business awhile, you can always create a plan and include past service.

I also think it's important that we look at what really happened with this bill. It puts the right of the employees with regard to the pension commitment ahead of the right of the stockholders, and that's an amazing piece of social legislation when you think about it.

CHAIRMAN CURTIS: One of the interesting and difficult parts of ERISA concerns pension plan mergers. We're fortunate this morning in that Richard G. Schreitmueller has written a short actuarial note for this session.

Following is the text of Pension Plan Mergers Under ERISA, an actuarial note by Richard G. Schreitmueller.

Pension plan mergers are subject to some new requirements under the pension reform law. The principal sections of the Law which impose new requirements on mergers are Section 208, Section 1021(b) and Section 1031(a). The first two of these sections contain similar wording, to the effect that the rights of participants to receive benefits are not to be diluted at the time of the merger, and the third section requires an actuarial report to the Internal Revenue Service certifying that a dilution has not taken place. However, Section 4044(a) contains new rules as to the allocation of pension plan assets in priority order at plan termination, rules which seem difficult to reconcile with the merger rules. This discussion will present a viewpoint on how the merger rules and asset allocation rules might be reconciled, and the practical effect of these rules on plan mergers.

Section 208 reads as follows:

> "A pension plan may not merge or consolidate with, or transfer its assets or liabilities to, any other plan after the date of enactment of this Act, unless each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger, consolidation or transfer which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation or transfer (if the plan had then terminated). This paragraph shall apply in the case of a multiemployer plan only to the extent determined by the Pension Benefit Guaranty Corporation."

Several points can be noted with respect to Section 208. First, a specific dilution-of-benefits test is to be applied at a single point in time, the date of the merger. Thus, it appears that the intent and effect of Section 208 are to allow some plan mergers, and to prevent others, depending on whether or not they pass the test. Second, the test is whether or not a participant would "receive a benefit" under hypothetical conditions of plan termination. There is no mention of plan assets. Thus, in determining the benefits which would be "received," it appears reasonable and perhaps necessary to count any unfunded benefits insured by the PBGC, i.e., both the plan assets and the PBGC appear to be potential sources of benefits in the Section 208 test.

The other half of the merger problem, Section 4044 which applies at plan termination, provides for specific priorities of asset allocation, in six classes, apparently on a plan-wide basis. The first four of these classes include all of the benefits insured by the PBGC; class 3 also may include certain benefits in pay status which are not insured by the PBGC, e.g., benefits over the $750 per month limit, temporary early retirement supplements, etc. Section 4044(b)(6) provides for the possible establishment of subclasses within one of the six classes pursuant to regulations.

With these principles established, it seems theoretically possible to test each plan which is to be merged, by allocating the assets in priority order and determining which classes of benefits would be received if the plan were then to terminate. Table 1 contains six simple examples of such an allocation, labeled plans A through F, respectively, representing identical plans with $100,000 of liabilities but with plan assets covering a range from zero to $105,000. In each case, Table 1 indicates the classes of benefits which would be received before the merger if the plan were then to terminate.

Then, assuming that two of the plans in Table 1 are to be merged, Table 2 indicates the benefits which would be received after the merger in each case. It can be seen from column (7) that in certain cases the merger test has been met, i.e., no benefits have been lost at the time of the merger; in most of these cases, the plan assets are not sufficient to fund the PBGC-insured benefits. Column (7) indicates that in other cases, the merger rule cannot be met; for example the merger of plans A and D would clearly result in the loss of benefits to participants in Plan D. Finally, column (7) indicates that in some cases the establishment of a subclass would be required in order to pass the merger test, for example in the merger of Plans E and F.

The test described above cannot be applied precisely until regulations are available as to the benefits insured by the PBGC, the measures of liabilities to be used at plan termination and any special rules as to the measurement of plan assets. In preparing any actuarial statement in advance of a proposed merger, some prudence appears needed to consider possible changes in data as to plan participants and plan assets before the merger takes place.

Columns (8) and (9) of Table 2 indicate that a plan merger will generally not increase the immediate risk to the PBGC; this risk is closely related to the plan sponsor's contingent liability risk in event of plan termination. In several of the Table 2 cases, if multiemployer plans were involved, the PBGC appears to have the power to permit mergers which would otherwise be prohibited. In the process the PBGC could reduce its risk if the entire plan were to terminate soon afterward, while at the same time adversely affecting the benefit security of participants under one of the plans involved. However, other cases are possible in which the PBGC's risk, and the plan sponsor's contingent liability, would be increased by a plan merger because of allocation of assets in class 3 to benefits not insured by the PBGC; the simple examples presented here do not include such cases. Multiemployer cases are further complicated by Section 4082(c), whereby the PBGC may decide whether or not to insure benefits for plan terminations which occur before 1978.

Table 1

Examples of Asset Allocation Under One Plan Before Merger [1/]

Class of Benefits Per Section 4044(a)	Plan Liabilities	Allocation of Plan Assets at Termination, Per Section 4044(a)					
		Plan A (Zero Assets)	Plan B ($5,000 Assets)	Plan C ($20,000 Assets)	Plan D ($45,000 Assets)	Plan E ($80,000 Assets)	Plan F ($105,000 Assets)
Classes (1) and (2) - Benefits Derived from Employee Contributions	0	0	0	0	0	0	0
Class (3) - Benefits in Adjusted Pay Status (All are Assumed to be Insured)	$ 10,000	0	$5,000	$10,000	$10,000	$10,000	$ 10,000
Class (4) - Other Insured Benefits	20,000	0	0	10,000	20,000	20,000	20,000
Class (5) - Other Vested Benefits	30,000	0	0	0	15,000	30,000	30,000
Class (6) - Other Accrued Benefits	40,000	0	0	0	0	20,000	40,000
Residual Assets [2/]	-	0	0	0	0	0	5,000
Total Assets	$100,000	0	$5,000	$20,000	$45,000	$80,000	$105,000
Classes of Benefits Payable If Plan Were to Terminate		Classes (3) & (4)	Classes (3) & (4)	Classes (3) & (4)	Classes (3) & (4) plus $15,000 in Class (5)	Classes (3), (4), (5), plus $20,000 in Class (6)	All Classes

1/ For simplicity, assumptions are that two plans are merging with identical benefits and liabilities, no employee contributions, no benefits are subject to adjustment per Section 4022(b)(3), (5), (6), or (7), or Section 4045. Thus all nonforfeitable benefits are insured basic benefits except as reduced for amendments in past 5 years.

2/ It is assumed that the plan contains language pursuant to Section 4044(d)(1), whereby residual assets would be returned to the employer(s) sponsoring the plan after all plan liabilities have been satisfied at plan termination.

Table 2

Examples of Effect of Sections 208 and 4044 on Merger of Two Plans
(Assuming Merger of Two Identical Plans, Each With $100,000 of Liabilities Per Table 1)

Example No. (1)	Two Plans Being Merged Per Table 1: First Plan (2)	Second Plan (3)	Plan Assets After Merger (4)	Effect of Section 4044 Asset Allocation Rule (Classes of Benefits Payable if Plan Were to Terminate Just After Merger): To Participants in First Plan (5)	To Participants in Second Plan (6)	Apparent Effect of Section 208 Merger Rule (7)	Unfunded PBGC Liability at Termination: Before Merger (8)	After Merger (9)
1.	Plan A	Plan A	0	Classes (3) and (4)	Classes (3) and (4)	Merger is OK. 1/	$60,000	$60,000
2.	Plan A	Plan B	$ 5,000	Classes (3) and (4)	Classes (3) and (4)	Merger is OK. 1/	55,000	55,000
3.	Plan A	Plan C	20,000	Classes (3) and (4)	Classes (3) and (4)	Merger is OK. 1/	40,000	40,000
4.	Plan A	Plan D	45,000	Classes (3) and (4)	Classes (3) and (4)	No merger allowed. 2/	(Absent Section 208 rule, would be $30,000 before merger, $15,000 after)	
5.	Plan B	Plan B	10,000	Classes (3) and (4)	Classes (3) and (4)	Merger is OK. 1/	50,000	50,000
6.	Plan B	Plan C	25,000	Classes (3) and (4)	Classes (3) and (4)	Merger is OK. 1/	35,000	35,000
7.	Plan B	Plan D	50,000	Classes (3) and (4)	Classes (3) and (4)	No merger allowed. 2/	(Absent Section 208 rule, would be $25,000 before merger, $10,000 after)	
8.	Plan C	Plan C	40,000	Classes (3) and (4)	Classes (3) and (4)	Merger is OK. 1/	20,000	20,000
9.	Plan C	Plan D	65,000	Classes (3) and (4), plus $2,500 in Class (5)	Classes (3) and (4), plus $2,500 in Class (5)	No merger allowed. 2/	(Absent Section 208 rule, would be $10,000 before merger, zero after)	
10.	Plan D	Plan D	90,000	Classes (3) and (4), plus $15,000 in Class (5)	Classes (3) and (4), plus $15,000 in Class (5)	Merger is OK, but illustrates need for subclass. 3/	0	0
11.	Plan D	Plan E	125,000	Classes (3), (4), and (5), plus $2,500 in Class (6)	Classes (3), (4), and (5), plus $2,500 in Class (6)	No merger allowed. 2/	(Absent Section 208 rule, would be zero before and after merger)	
12.	Plan E	Plan E	160,000	Classes (3), (4), and (5), plus $20,000 in Class (6)	Classes (3), (4), and (5), plus $20,000 in Class (6)	Merger is OK, but illustrates need for subclass. 3/	0	0
13.	Plan E	Plan F	185,000	Classes (3), (4), and (5), plus $32,500 in Class (6)	Classes (3), (4), and (5), plus $32,500 in Class (6)	Merger is OK only if subclass established. 4/	0	0
14.	Plan F	Plan F	210,000	All Classes	All Classes	Merger is OK. 1/	0	0

1/ No special plan provisions appear needed to accomplish merger.

2/ Apparently there is no way to establish subclasses to keep the amount needed in Class (5) or (6) to prevent loss of benefits by participants in the second plan if merged plan were to terminate just after the merger. The result is the same if assets in the second plan are higher than in the example, unless the assets under the merged plan are so high that all accrued benefits under both plans are funded.

3/ No subclasses are needed because the two plans are assumed to be funded precisely the same. In practice, if the second plan had another $1,000 of assets, regulations could permit establishing a subclass per Section 4044(b)(6) to allocate the first $1,000 of assets within Class (5) to participants in the second plan, in order to avoid loss of $500 of their benefits if plan were to terminate just after the merger; merger appears to violate Section 208 without this subclass.

4/ If regulations permitted, subclass could be established per Section 4044(b)(6) to allocate the first $40,000 of assets within Class (6) to Plan F participants. Then if plan were to terminate just after the merger, Plan F participants would not lose benefits, and Plan E participants would receive $5,000 more of benefits than before the merger.

What does this all mean? Did the people in Congress who drafted ERISA really have in mind a "go, no-go" test of the type described above? The Committee Reports are vague as to just what was intended, but in some ways the viewpoint presented here makes sense, despite the complexities of the Section 4044 asset allocation rules, or any new rules which may replace the present Section 4044. The Section 208 test seems to say that two (or more) plans wishing to merge are at a crossroads, and can proceed on a common path only if the merger light is green; once the green light has been passed, there is no need to look back. Obstacles to mergers are presented mainly by the apparently insurmountable barriers between classes 4, 5 and 6 as defined in Section 4044(a); the establishment of subclasses within one of these classes may occasionally help. Section 110 gives the Labor Department the power to waive Section 208 in hardship cases, and perhaps the IRS would accept plan wording under Section 1021(b) which allows for such a waiver.

In practice, the few plan merger problems we have seen involve some plans with modest benefits, not very well funded, and thus good candidates for passing the test described here. However, applying the test to such plans can be quite difficult technically, even after the necessary regulations are available. Plans which are funded partway down into class 5 or class 6 may find the merger tests complicated to attempt, and difficult or impossible to pass; any such plans which include employee contributions are especially poor merger candidates. The only easy cases appear to be single-employer plans whose combined assets are sufficient to fund all accrued benefits, and whose residual assets belong to the plan sponsor, not to the participants.

In passing the test of Sections 208 and 4044, there would not seem to be much use for any "segregation of assets" procedure, whereby the plan assets would not be co-mingled or subject to a plan-wide allocation of assets in event of subsequent termination of the <u>entire</u> plan; a segregation of assets may, however, be useful to provide for possible future partial termination.

The merger rules have other implications in event of spinoffs, transfers, etc., which generally follow from extension of the merger test to these situations. The Act provides for the actuarial statement to be submitted to the Internal Revenue Service rather than to the PBGC or to the Labor Department; presumably this rule is imposed because the IRS would want such information in order to issue a determination letter as to qualification of the merged plan, and the PBGC would protect its interests in the matter through application of the reportable events rule in Section 4043(b)(8).

In summary, the actuary who attempts to determine whether the ERISA merger light is red or green is confronted with some significant technical problems. Depending on circumstances, the likely end result will be to delay, discourage, or prevent mergers of pension plans which were possible before enactment of ERISA.

MR. TWINNEY: I'd like to ask a question about terminating a plan. If you wanted to wind up a plan, could you just buy annuities for all the benefits?

MR. GEORGE R. CHADWICK: As I understand it, the question is, if the employer wants to buy all vested benefits under the terms of the plan from an insurance carrier, would there be a problem with the PBGC? We're settling some cases in that manner now. I think that certainly in the case of covering all vested benefits, there should be no problem. Some employers will go even further and buy annuities for all accrued benefits, whether vested or not. Hopefully, we'll be able to solve a number of cases in that way.

At the PBGC we have many areas to look into: the problems of phase-in, maximum benefits, valuation of assets, liabilities, etc. We do have many different voices to hear from: labor, business, and the general public. But, I think if you'll bear with us, you'll like our final product.

MR. PHILIP M. SCHATZ: Concerning the continuation of benefits that are in payment status and the payment of administrative fees, I've got a copy of a letter written to the PBGC asking if we can have fees paid from the trust. The answer is essentially that, while the PBGC is ruling on the propriety of the plan termination, it is permissible to continue benefit payments and it is also permissible to pay from the trust or other funding vehicle reasonable administrative fees.

MR. FRIEND: There are going to be cases when a terminating plan is going to want to operate what the Act calls a wasting trust and a wasting trust is probably going to be acceptable to the PBGC if the assets more than cover those liabilities which it would have to guarantee.

However, the PBGC must also be concerned with the possibility that this wasting trust might subsequently become insufficient even as to the guaranteed benefits, and it would have to have some kind of protection against this possibility.

MR. LAWRENCE N. MARGEL: I'm glad someone introduced the merger problem. I think the problem of how Section 4044 affects the rest of this Act is a very major problem. There's one situation I think people should consider--the company which tends to acquire other companies and has a policy of bringing all of their newly acquired employees into their general company-wide plan. Under Section 208, it's almost impossible to do this unless both plans, the major company plan and the one they're acquiring, are significantly over-funded, because even if each were exactly 100% funded, the second you merge them and the employees of this acquired company get an increase in benefits due to extending the parent company's plan, you immediately have a dilution of the guarantees or the assets backing the other employees' benefits. I see no way to accomplish the merger without either significant overfunding or a continuation of separate assets.

A question I have is, how can the premium basis of the PBGC possibly turn out to be any less conservative than the most favorable non-participating rates that any insurance company is prepared to use?

MR. ROBERT J. MYERS: I want to put in a plea for the PBGC to do an adequate job of research, and then publish the results of their analysis, with regard to the characteristics of terminated plans, including the extent of reinsured loss. Unfortunately, sometimes governmental operating agencies only look at their current and future problems, and not at what had happened in the past.

I was fearful of termination insurance when it was being considered because of the possibility of antiselection, even abuse, against the program. Published research should show whether this is occurring, and if so, then perhaps steps can be taken to plug any loopholes.

MR. CHADWICK: Perhaps our most pressing concern is what kind of rates the PBGC will come out with and what will be published and in how much detail. I can assure you that the PBGC realizes that this is a problem for many pension plans that have terminated or are thinking of terminating. Certainly current purchase rates from insurance companies would measure very closely the liability.

Of course, there is also the question of what is meant by basic benefits. The regulations are to come out very soon. I'm sure there will be some discussion as to some of the benefits that are proposed to be covered, but, in the meantime, the problem is under close scrutiny.

CHAIRMAN CURTIS: I would like to see the PBGC take a little bit more seriously the life insurance industry's suggestion that they be involved.

MRS. SUSAN J. VELLEMAN: How are the IRS and the PBGC tying their efforts together in terms of plan termination?

MR. FRIEND: I don't know the answer to that question.

MR. MURRAY L. BECKER: In the area of contingent liability, it seems to me that the purpose of making the employer or the plan sponsor liable is to prevent selection whereby an employer could terminate the plan and leave someone else holding the bag. It seems to me that, if insurance for contingent liability enabled that same employer to pay a small premium and then walk away from the plan, the problem re-emerges. Therefore, somehow or other, contingent employer liability insurance has to be narrowed down to prevent antiselection and only pay off in the event of insolvency. A number of our clients and their creditors are concerned about this problem.