**RECORD OF SOCIETY OF ACTUARIES
1988 VOL. 14 NO. 1**

PENSION BENEFIT GUARANTY CORPORATION

Moderator: A. RICHARD LABOMBARDE
Panelist: C. DAVID GUSTAFSON*
Recorder: DAVID P. KENDALL

o This session will review proposals to modify the plan termination provisions of the Employee Retirement Income Security Act of 1974. Current projections of the corporate funding problems and the alternatives under consideration will be included.

MR. A. RICHARD LABOMBARDE: We're going to be discussing the Pension Benefit Guarantee Corporation (PBGC). This session will review recent modifications of the plan termination provisions of ERISA. We're going to broaden the scope beyond ERISA Title IV, to briefly examine pension funding problems, since these funding problems have become one of the PBGC's biggest problems. We will review the compromise solution of the recently enacted Pension Protection Act (PPA), touching briefly on several alternatives that were examined in the development of that compromise solution.

I am the research actuary from Milliman & Robertson in their Washington D.C. office. Dave Gustafson of the PBGC will more than adequately cover our topic.

Can I see a show of hands of how many people in the audience think that the PPA, or more broadly the Omnibus Budget Reconciliation Act of 1987 (OBRA 87) overall, represented good legislation with respect to pensions? OK. Not very many. Thank you for your courage and bravery. Can I see a show of hands of how many of you think that, with respect to pensions on whole, it was bad legislation? OK. Many more. Interesting. Since it's going to be the center of our discussion, I hope to at least educate you a little further about exactly what was behind this legislation, possibly not change your vote, but we will see about that. We are not here really to change that vote, but I think that we'll be going through a fair amount of material and I would be interested in those of you who think it was bad legislation, in making sure you know that your comments are welcome by the PBGC and other government agencies, and certainly feel free to ask questions or make any comments. I would like to believe that if I revise that question to consider the merits of the legislation without the new Full Funding Limitation (FFL) or the interest rate restrictions, the vote that we just took would be significantly different.

The PPA is frequently viewed as the PBGC rescue act, with its increased PBGC premiums, the variable PBGC premium, stricter termination provisions, and stricter funding rules. I would point out, however, that the two provisions I

* Mr. Gustafson, not a member of the Society, is Special Assistant to the Executive Director of the Pension Benefit Guaranty Corporation in Washington, District of Columbia.

singled out above, namely the interest rate restrictions and the FFL, are of a completely different nature than the provisions that are characterized as being the PBGC rescue provisions. I probably should isolate that just to the interest rate restrictions, because I think in most instances you will find that the FFL is primarily dangerous only with respect to the interest rate limit. Were it not for that interest rate restriction, the FFL would not be quite as much a problem. For the time being I will restrict it to those two issues, the FFL and the interest rate restriction. These two provisions are chiefly there for the purpose of raising revenue, and the people in Washington are not afraid to say so. Without speaking for the PBGC on those two provisions, I think it can be easily said that the PBGC would be stronger with those two provisions out, than with them in. If I am right in that, and if I'm also right in hoping that we would have a different outcome on the vote that we just took, then maybe I can say that our job in this discussion is going to be a little bit easier, because we're going to concentrate primarily on the PBGC provisions on the PPA. If you came here to hear anything on the new Budget Reconciliation Act and want to discuss full funding, or want to discuss the interest rate provision, you will find that we will touch on the interest rate provision, but while the FFL is of concern to the PBGC in a certain number of areas, we will not be concentrating on that.

How many of you hope that the PPA was the last you'll hear out of Washington D.C., namely out of the U.S. Congress, with regard to pensions for some time to come, say at least until the next administration?

FROM THE FLOOR: Does that exclude technical corrections?

MR. LABOMBARDE: OK, that's the first thing I was going to say. I would presume that there is a clarification here, that you will see a technical correction bill this year. So if you really thought that that was the last one, forget it. There is something coming along. But, if we exclude technical corrections, the first news that I have to give is that there is in fact another piece of legislation that is already back at the door that you should be aware of, HR 4111. HR 4111 would be a reversion moratorium. If you think that this is just another RoybalMetzenbaum reversion moratorium, take a closer look. This one has a slightly different touch to it than the reversion moratoriums that were offered in the past. It was cast as a fiduciary violation, to have a reversion to the employer within a particular period, I think it is until August of 1989.

MR. C. DAVID GUSTAFSON: It is October of 1989.

MR. LABOMBARDE: October of 1989, thank you. It would be a fiduciary violation to have a reversion to the employer during that period, and casting it as a fiduciary violation enabled the legislation to be referred only to the House Labor Committee, not to the House Tax Committee. Before the legislation fully passes all the way through to the President's desk, if it ever got that far, suffice it to say that there would be other fights within Congress on it, but the fact of the matter is right now it's only in the House Labor Committee, and the House Labor Committee is much more likely to report it out to the floor than any of the legislation before. So this bill will go further, or is more likely to go further than any of the reversion moratoriums before. The part of the danger, and in by saying danger I don't mean to say which side of the coin I am on in this, I think everyone can kind of guess that, but part of the danger with it is that the House Labor Committee is also on record for supporting a reversion gift, that is, when there is a reversion giving a portion of that reversion to the employees. That gift was originally a part of OBRA 87 until literally the last

minute. I think it was the weekend before OBRA 87 was passed that it was dumped out, and the House Labor people are still rather enraged over that and they will be using things like HR 4111 as a stepping stone this year to try to do some maneuvers on reversions. So even though HR 4111 may look like a minor bill this year, be careful. If you're hoping you don't see anything more on pensions for some time to come, I guess what I can say is that it might be a vain hope. You might see some major legislation on reversions this year, or at least an attempt on that with respect to reversions.

Now with respect to the technical corrections, I just want to summarize a couple of the major points you should be aware of. If you hadn't heard at one of the another meetings, the technical corrections do include a proposal to eliminate triennial valuations. For those of you who have been worried that the new FFL, or OBRA 87 in general, that is connected with tax reform would eliminate two-thirds of your client base, have no fear, now you will be doing the valuations of those three times during a three-year period, instead of one every three years, if triennial valuations were what you were primarily doing before. In any event for the smaller client, who were the principal ones using triennial valuations, this will be an increase in costs, and I am sure will be good news to all of them. The interest rate for missed or waived contributions would have to be no less than the interest rate used to value the Current Liability. So when we get on some discussions about interest rate, the technical corrections would clear up something on that.

There was a clarification of the effective date for gains and losses. For any of you who were not following OBRA 87 itself well enough to be fully up on this, there was some question on this. The effective date for amortization of gains and losses over 5 years was given in the bill as being 1988, but the way in which it was discussed in the conference report would lead one to believe that 1987 gains and losses that were determined by a valuation date in 1988 would not have to be amortized until 1989. Meaning the first effect you would see would be in 1989. That's been clarified in the technical corrections, but I need to say right off the bat that you are going to have to wait for the technical corrections themselves to be clarified, because what's there can be very easily misinterpreted. I don't think it is even an interpretation problem. If you just read it literally it says January 1, 1988 valuations still get the 15 years on gains and losses. But any valuation on January 2, or thereafter, like if you got a February 1 valuation date for your plan for a February 1 plan year, that gets the five years instead of the fifteen. Jim Holland yesterday mentioned that part of the interpretation that he had understood behind this, if I understood his explanation correctly, was that they might have intended that to be a first day of plan year thing. That is, if your plan year starts February 1, if you did a valuation on February 1 you would have the fifteen-year amortization of gain/loss. A valuation date for a February 1 plan year where the valuation date was anything after February 1 you would have 5 years, and so on for every plan year date. Presumably a December 1 plan year with a December 1, 1988 valuation date, would give you a fifteen-year amortization of gain or loss. Anything after that would give you a five-year amortization of gain or loss. That's the way Jim Holland was reading that, but not the way technical corrections are stated. The way technical corrections are stated right now, it would literally put January 1, 1988, in a class by itself.

There would also be a correction in the technical corrections that the reporting of funded status in the plan annual reports would be required only for plans with funded ratios less than 70%, instead of the 60%. Another point on that, the

way that OBRA 87 is literally written, when it says funded ratio of 60% (and now it's 70%), it was calculating the funded ratio without counting in the credit balance. If you had a funded ratio of 50% and you were going to have to report to your plan participants that your plan was only funded for 50%, under OBRA 87 as it was written, guess what? If you put the other 50% in the plan to try and give yourself 100%, the credit balance didn't count and you still have to report to them that your plan had a funded ratio of 50%, even though it had enough assets to cover all the benefits. Technical corrections would also clarify that. It would say this credit balance reduction is only for purposes of Internal Revenue Code (IRC) 412(l), unless otherwise stated by the IRS in its regulations.

I understand that also clears up a problem that Dave Gustafson in the PBGC had with their variable premiums. The same issue had originally held there, that if you had an underfunded plan and you were subject to variable premiums, if you tried to fund the plan fully, originally in OBRA 87 that additional amount would not have counted, and you would still have the additional premiums. In the PBGC's January notice they clarified that they would not be taking that stance and the technical corrections clear that up for us.

A comment on one other thing that's upcoming, and then we will move on to the funding standards themselves. The Blessitt decision. I think a number of you are aware that the decision itself was rescinded or taken back by the court that made its decision. I've had some people think that's the end of it. That is not the end of it. The full court is rehearing the issue. We have hopes that since they took away their earlier decision and are rehearing it, it will now have a better outcome. For those of you who had not followed that, or had not read your EA Reports, that's regarding whether, if you have a plan with a surplus in it, whether you have to provide all benefits -- even those that are not yet accrued and possibly even based on future salary increases -- to participants before an employer can get a reversion. The court had originally decided that category six of the PBGC did include all unaccrued benefits. They are now going back and rehearing the issue. That is certainly critical for any plans that are anticipating reversions out there.

Now as to the funding standards. I think clearly a couple of years ago there were a number of people within the PBGC and within Congress itself who were looking at the Defined Benefit plan system and saying, frankly, we don't like the way things are going. There were some very, very infamous scare stories of plans that followed the minimum funding standards and wound up with zero money, essentially zero cash at the time that they were closed out, in spite of the fact that they had significant benefits that they had to pay off. Previous to the passage of OBRA 87, the PBGC did an extensive review of the funding standards and of different alternatives, and I can only say it was about as extensive as you could ever want to do on a study. And they were operating off of a number of objectives. The objectives of the funding standards that the PBGC sought to review and develop, the new funding standards, were to effectively, consistently, and in a timely manner address the four major deficiencies in the pre-PPA minimum funding standards. These four things were, principally, the major causes of any of the underfunding in any of the plans. Now I know a lot of actuaries had been looking back and saying that the funding standards work, and certainly for 90-95% of the plans they certainly did work. But I think we can all admit that in these four cases -- new unanticipated accrued benefit liabilities created by frequent significant benefit increases; experience losses generated by unanticipated adverse experience or overly

optimistic actuarial assumptions; insolvency caused by significant distributions; and nonpayment of minimum funding contributions -- that these four cases were creating a climate where some plans out there were being carried by the rest of the pension world. Without picking on any particular industries, there were certain industries in the U.S. that were basically coming to the point of using the PBGC as a social welfare fund in a sense. I think it was clearly not intended to be that, and the effort then was to try to take a look at the minimum funding standards and develop a new set of standards that would hit at these four areas, where it was clear the funding standards had a hold. In going to change these standards, it is not as though we were then trying to sit down and say let's try everything in the book. There was a certain direction; there were certain things that were desired of the new minimum funding standards. For instance we've heard it said, and we've all said many times, that the funding standards do work for the majority of plans. OK. We could clearly get rid of every single one of these four, if we would demand immediate payment at the beginning of the year from every single employer, and whenever a benefit amendment is passed, we could fund it all immediately. And obviously, going to an extreme, that's something that could be done. But obviously that would hit at the other 95% who, in the view of a lot of other people who were working on this, did not need to be affected. So the idea was to develop a set of funding standards that would be effective, that would be operational, that would be easy to apply, that would rely as much as possible on calculations that we already do for a living and that would attempt to hit the plans that are abusing the funding standards and abusing the PBGC through these four areas, hit at those plans without significantly affecting the others.

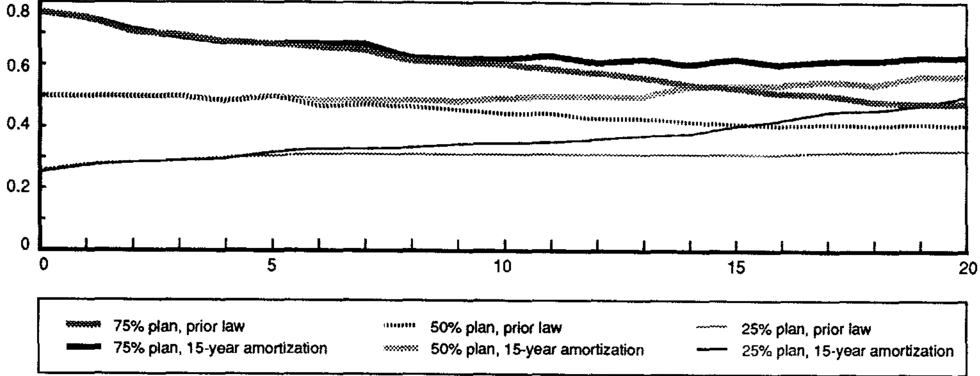
The effort to fix the funding standards took many different directions. But one of the tools that was used in the effort was looking at some projections that were carried out principally using the Academy groups that had been used for the 1985 study done by the Academy of Actuaries in connection with the FAS 87 project. Now that Academy project had ten different population groups. In the projections that we did we frequently even used groups other than the Academy groups; we sometimes using actual groups that were in practice, real live plans that had funding problems, or hybrids of the Academy groups. When I isolate just the Academy groups, understand that there were many other groups and many other scenarios that we were looking at. I would characterize Academy Group I as being a mild steel plan. Many of the steel plans that were in trouble out there were certainly more mature then Group I. Yet even with Group I you are seeing three different scenarios with three different starting funded ratios: 75%, 50%, and 25% (See Graph 1). And the bottom line with each of those figures, starting at 75%, for instance, the one that then goes lowest is under the pre-PPA minimum funding standards. The bottom line in each of the others is the same thing. So we had ourselves a set of funding standards, this is an Entry Age Normal cost method, and we looked at the other major cost methods that were here. We've got a funding standard that permits the plan to start out at a 75% funded ratio, and over a course of 20 years come down to a 45% funded ratio. At the bottom there, incidentally, are shown the contributions. I don't think I will be making any comments about that, unless there are some questions. I am going to isolate most of my comments on the funded ratio. What you are seeing on Graph 1 is a simple first pass by changing the funding standards. What if we say, well we know that amortizing some of these increases over thirty years is simply carrying it too far. For a mature group like the steel plans, part of the reason they may be underfunded is that they are amending the plan frequently and amortizing those amendments over thirty years. So what this does is look at amendments and say that we're going to amortize them

GRAPH 1

PRE–PPA MFS WITH 15-YEAR ON AMENDMENTS

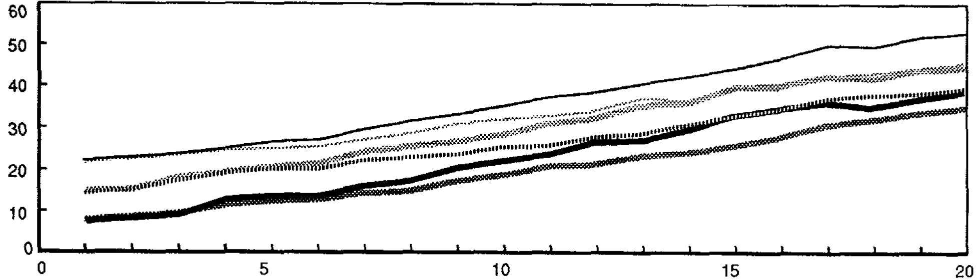
ACADEMY GROUP I (1.0) EAN (JIA3I1 4/12/88)

CURRENT LIABILITY FUNDED RATIO



CONTRIBUTIONS

$ MILLIONS



over 15 years. As you can see, it does improve the situation, but it doesn't really improve it significantly enough. It is not really fair, I think, to look at this and say that that has fixed the funding standards, that that has put the funding of these plans back on a target where the PBGC is not going to be at any kind of risk.

I would point out that Graph I looks at only 15-year amortization on the new amendments. There was a lot of discussion in Washington about what we do about cleaning up the past. Do we say, well, with the past stuff they were using the previous rules, we can't really accelerate that. That's what Graph I does; it simply leaves the past on exactly the amortization they had started with, the past service liability as of the OBRA 87 effective date. If you were to take the liability as of the initial effective date and amortize more quickly with respect to that amount, again you see a similar kind of situation. You can only go so far with lowering the amortization period till you start to get to the sublimely ridiculous, like five years, or three years, or something like that. And you have to go pretty far before you start getting a situation where it cleans up the negative cash flow that's showing up in this particular plan. So clearly the efforts to fix the funding standards had to look beyond this kind of an example. I'm not going to show you all of the other groups here on this particular scenario, but one of the other ones that I would concentrate on would be Academy Group A. It's your typical, ordinary, run-of-the-mill type of population, and with that one the funding standards as they exist right now work pretty well. If you lower the amortization periods to 15 years in an effort to try to clean up Group I here, you wind up hurting those other plans, requiring higher contributions from those other plans that we can all agree don't really need higher contributions. So we needed to have a funding standard that was sensitive to some of these differences in maturity between the groups and differences in the behavior of the groups, vis-a-vis amendments.

I am going to start with Group A under the PPA as passed. The codes -- A or B -- indicate whether contributions are offset by the deficit reduction rule (See Graph 2). As you can see, the 25%, 50%, and 75% lines that are the old law go generally in a reasonable manner. If you are going to strengthen the funding standards that hit at Group I, this is one of the chief first hurdles that you come to. Whatever you apply to the Group Is, to the steel plans, when you go back and apply it to the rest of the pension universe, does it come up with a charge that doesn't really touch them all that much? According to the way that the compromise solution came out in the final bill, basically with Group A there is very little difference, and the only difference you see at the end is because of the five-year amortization of gain or loss rule applying to all others. There was consideration given to applying the five-year gain or loss only to underfunded plans. That would have created new complexities to our work, I am sure, but outside of that, if you applied that to only unfunded plans on the gains and losses, then you would see a chart where the old funding standards and the new would be virtually identical. The only difference that you would see there is primarily from the gain or loss thing.

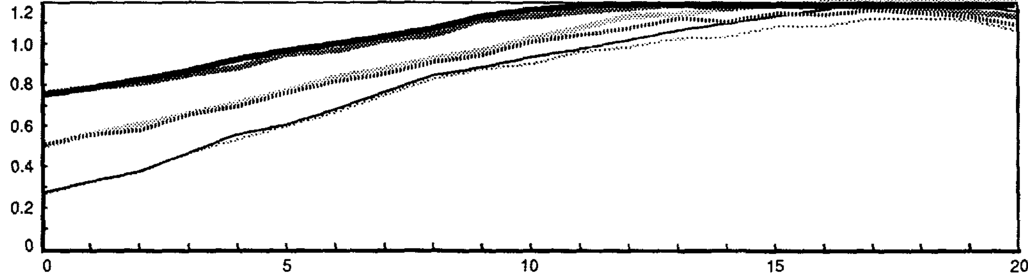
Let's look at Group I under the new funding standards (Graph 3). I want to comment on that crossover at years 17 and 18. It is a little bit peculiar, I think, to find that the lower funded plans would ultimately be higher funded than the plans that started out higher funded. That was a glitch that attention was given to throughout the process. It was one of the more difficult problems to try to work through. I won't get into why that happens; let me just say that the only time you will ever really see it in practice is if you truly have Plan A

GRAPH 2

COMPROMISE FUNDING OPTION (STANDARD)

ACADEMY GROUP A(1) EAN (F8V1A1 12/21/87)

BENEFIT LIABILITY FUNDED RATIO



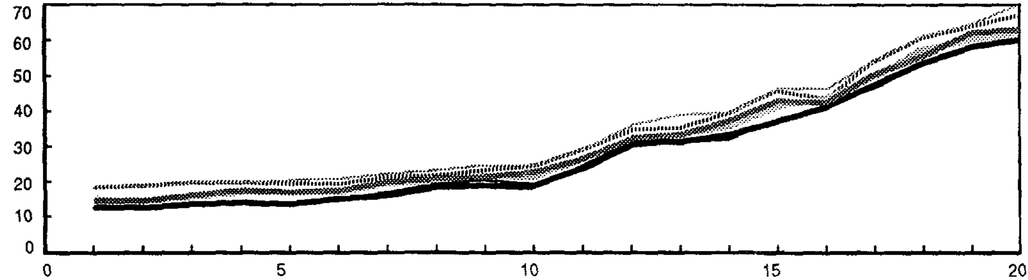
75% plan, prior law — 50% plan, prior law — 25% plan, prior law
75% plan, deficit reduction rule — 50% plan, deficit reduction rule — 25% plan, deficit reduction rule

75%:	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A
50%:	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A
25%:	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A

Codes: A = Regular IRC 412 B = Deficit reduction contribution rule

CONTRIBUTIONS

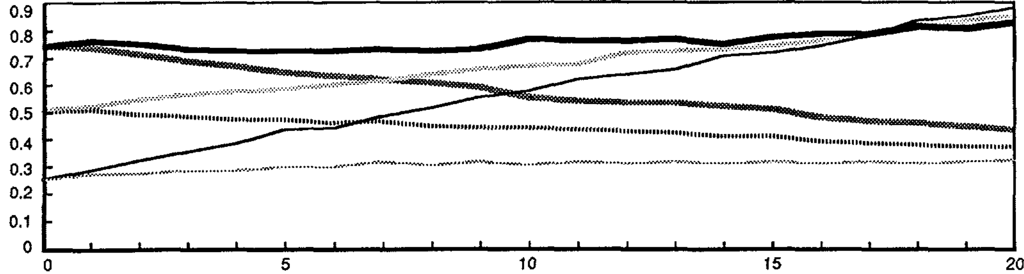
DOLLARS



COMPROMISE FUNDING OPTION (STANDARD)

ACADEMY GROUP I (1) EAN (F8V1I1 12/21/87)

BENEFIT LIABILITY FUNDED RATIO



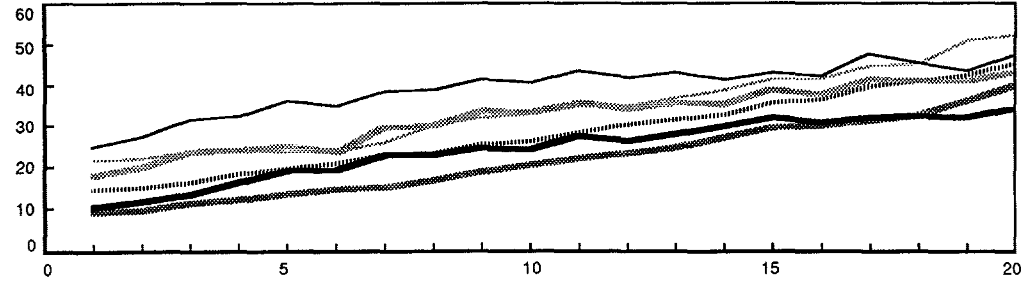
75% plan, prior law — 50% plan, prior law — 25% plan, prior law
75% plan, deficit reduction rule — 50% plan, deficit reduction rule — 25% plan, deficit reduction rule

75%:	B	B	B	B	B	B	B	B	B	B	B	B	B	B	B	B	B	B	B	A	A
50%:	B	B	B	B	B	B	B	B	B	B	B	B	B	B	B	B	B	B	B	A	A
25%:	B	B	B	B	B	B	B	B	B	B	B	B	B	B	B	B	B	B	B	A	A

Codes: A = Regular IRC 412 B = Deficit reduction contribution rule

CONTRIBUTIONS

DOLLARS



at 75% and Plan B at 25%, and they are fully comparable plans. The assumptions that are behind this set are the kind of thing that is somewhat artificial in terms of the crossover that I am showing here, albeit, the assumptions that are being used for this are really a standard run-of-the-mill kind of scenario. But outside of that, what we see is that the funding standards have, in fact, improved pretty significantly. And in the objectives that we reviewed before, it was not just that we wanted to fix the mature populations, like the steel plans, without touching the Group As, but when we go to Group I there were certain objectives, such as we wanted to take the 25% funded plans and get them to a certain funded level, 50%, 60%, 70% within ten years, and to be up at a level in say the 85-90% range by the twentieth year under the assumptions that were in this particular scenario. Now you can get into a discussion whether you ever really want to be at 100%. It's kind of like any discussions that you get, does the country really ever want to be in full employment, because you've always got people in transition. This plan always has amendments that are currently in progress and, outside of having a funding requirement that says every amendment is funded immediately upon day of passage, you would never and should never really hit 100%, unless you had asset gains or things of that type. This particular scenario was one that cleaned out the assets gains or losses so that the 85-90%, at least in my view, I know Dave may want to comment on this later, but I think this is something that at least is ball park for the kind of thing that was being sought, as opposed to the way the old funding standards were.

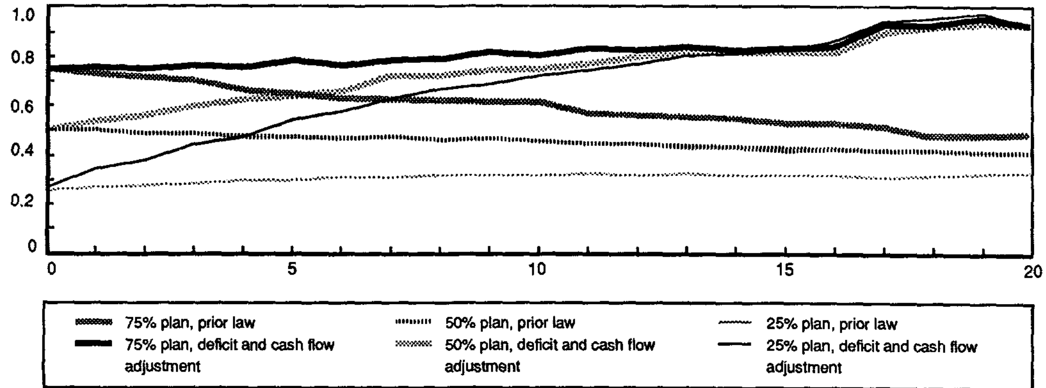
There was one question that I think really got a lot of attention throughout the process. The 75% funded plan really kind of stayed level for about 5, 10 or 15 years, and in some cases even declined. There was a lot of attention given to a cash flow rule. The original administration proposal that was introduced in February of 1987 had a cash flow rule that simply looked at disbursements out and cash in and said you've got to put in what you took out. The revised compromise solution, right up to virtually the last day, included a different tailored version of that, that took the cash flow and multiplied it by one minus the funded ratio (Graph 4). So for instance, for a 75% funded plan you would take 25% of the benefit payments and that would be an add-on to the deficit reduction contribution calculation. There was a lot of beef about this. A lot of companies didn't like idea, certainly a lot of the plans that were in the 75% funded cases would have preferred to see funding standards that were not as stiff as this. We heard a lot of beef from within the actuarial community itself. My own personal view on this is that when I hear these scare stories of the plans, like the Allis Chalmers that wound up with virtually zero cash at the tail end, I like to think back about those retirees in the year before Allis Chalmers terminated, or two years before, or three years before, and we were treating their retirement benefits as though they were 100% funded, when in fact the plan was 25% funded, 10% funded or less. And this one-minus-funded-percentage cash flow rule is kind of like an accounting kind of inventory rule that says whenever you are moving any of the inventory out consider that as no better funded then all the rest of the benefits. You are not doing this first out, you know -- the first guys out the door walk out with all the cash, and the people who are remaining are left with a less well funded plan. It is a solvency type of rule that says if people were going to walk away with their benefits and you're only 25% funded then consider those benefits payments as though they were only 25% funded and come up with the extra cash out of your pocket. And the only comment I would make to that is that if you would really sit down with all these scenarios, and I mean we ran thousands of tests through this and looked at literally hundreds of alternatives, and as much as we heard negative comments about cash flow solvency rules, I have to say, if you give yourself the

GRAPH 4

PPA WITH (1-FR)* CF ADD-ON

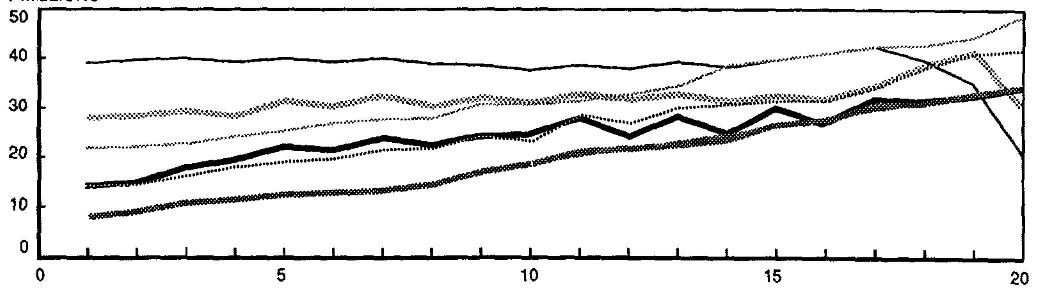
ACADEMY GROUP I (1.0) EAN (JIA2I1 4/12/88)

CURRENT LIABILITY FUNDED RATIO



CONTRIBUTIONS

$ MILLIONS



intellectual exercise of trying to come up with a new funding standard that solves the problem with a mature group, such as Group I, and does not increase the contributions for Group A, you sooner or later have to come back to some kind of a cash flow rule, because shortening the amortization periods simply doesn't do it and it just doesn't cut it. It doesn't recognize the maturity of the plan. And that was something in the original administration proposal that did not get picked up in the final bill. When I say watch out for HR 4111, and I say be aware that the technical corrections are out there, I for one would still like to see further legislation on the minimum funding standards, because in my opinion, they're better than they were in the past, but they are not as good as they could be.

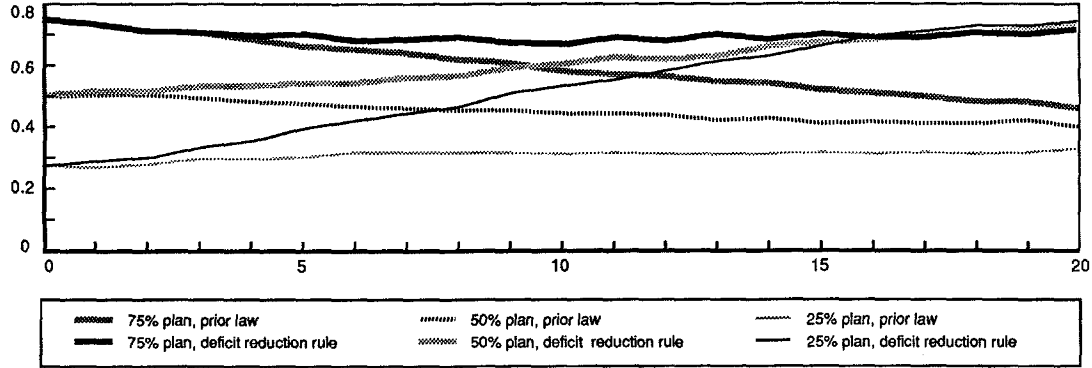
Now there is one other thing with the minimum funding standards. There was something that was included that was not anticipated to be included during most of this process. That was the interest rate corridor on the Current Liability. Most of the discussion and most of the grief that we have heard on this has concentrated on the FFL to this point. Suffice it to say that the interest rate corridor is a problem that's of grave concern to the PBGC as well. We now have new minimum funding standards, but those new minimum funding standards reference a measure, Current Liability, that uses an interest rate that is a lot higher than most of us have used in the past. With that higher interest rate, doesn't that simply work against the funding standards that were just passed? The answer is yes. If instead of the 7.5% interest rate that was used throughout for cost, the regular Section 412 costs are run at 7.5%, but the Current Liability is calculated at 8.5%, and if that situation were to persist for 20 years, the funding ratios at the 20th year mark come out in the seventies instead of the eighties (Graph 5). Particularly for the groups that are 75% funded and above, in the higher funded ratio brackets you can actually have an erosion of the funding standards over the first 10 to 15 years. I know the PBGC shares a concern about the interest rates restrictions here, so it is not just a full funding problem. I would point out that if this interest rate restriction had been in effect for the past 6, 7, 8 years, and even if the new funding standards had been in place, plans such as some of the worst LTV plans would not have been required to make an additional contribution or would have only been required to make a negligible additional contribution beyond what they have already made right now. Given the situation that is clearly the case with the LTVs and the Allis Chalmers, the cases that generated the concern of the funding standards, I think it has to be said that while the rules themselves were fixed to a certain point in a way that could clean up the funded ratios and lift them up, when you have interest rates that are as high as the ones that we have seen in the past, and they would let LTV off, then clearly there are some remaining holes that need to be closed up. We closed up some of the holes, but a couple more were opened up at the same time. I guess that that is the way things work in Washington sometimes, create two new problems for every one that you solve.

I've taken a look at what a number of relevant interest rates found under OBRA 87 would have been if these requirements had been in place in the past. I did that because I know that there have been a lot of people that concentrate on what are the interest rates for a January 1 valuation, and when I hear for Current Liability you will probably be able to use 8.25%, we are sure all going to say well, we don't like the invasion of our turf of our actuarial responsibility, but after all, 8.25% is hard to argue today. What I want to point out is, if this same interest rate restriction had been in effect in the past, this is what you would have been looking at from 1982 on. The two solid lines in Graph 6 are the 90-110% corridor. Back in 1983, 1984, and 1985 the lowest edge of that

PPA WITH CL @ 8.5%

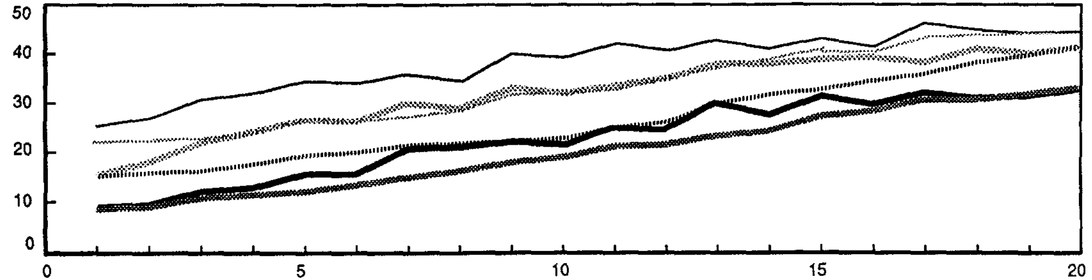
ACADEMY GRP I (1.0) EAN (JIA5I1 4/13/88)

CURRENT LIABILITY FUNDED RATIO



CONTRIBUTIONS

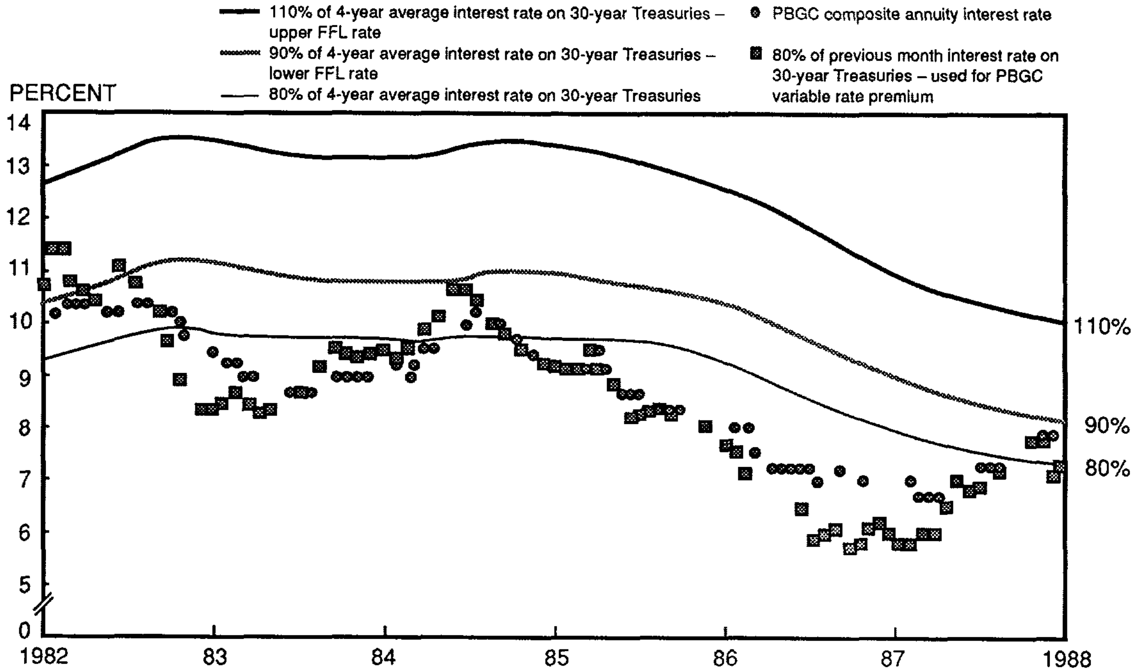
$ MILLIONS



GRAPH 6

PPA INTEREST RATES

As if in effect in previous years



corridor would have clipped along the 11% border. So for Current Liability you would have been using 11%. Now the dashed line below that is the 80% corridor at about 10%. You might be able to say, well, 11% is terrible, I mean we were all using 7.5%, 8%, back then, but after all maybe we could have gotten away with 10%. Don't necessarily bet on it. The IRS will only lower that to 80% if the IRS finds reason to believe that the 90% amount is "unreasonably high." Although a lot of us might think that that is unreasonably high to begin with, the IRS is going to judge reasonability on the basis of annuity purchase rates. And if they either can't get sufficient data, or if they judge the annuity purchase rates in the way that I've heard some of the comments to date, they might look at that 90% and say that 11% is entirely appropriate there. From things that I have been hearing to date, I think that you had better count on looking at the 90-110% bracket for some time to come. Don't rely on the 80% bracket. If it comes along, fine, it would be good for all of us, but count on the 90-110%.

Now the crosses on that chart are at the PBGC composite rate, that is 50 basis points less than the PBGC immediate annuity interest rate. It happens to be a reflection of the composite rate of interest on PBGC liabilities. For the annuity purchase rate for any of your clients, the interest rate under the PBGC would likely be somewhat less, using PBGC interest rates, but then since PBGC rates themselves are generally recognized as being somewhat conservative, the annuity purchase rate for your actual plans might actually wind up being somewhat higher than the rates that are shown there by the crosses. But, you can do whatever feels best for you, add 50 basis points, 100 basis points, whatever would get you to where you believe that the typical insurance company would be, and even still those crosses indicate that you are probably going to be riding the low end of the corridor. The interest rates for Current Liability under OBRA 87 have got to be within the corridor, but you are not permitted just to say, well I'm doing an LTV valuation here, I'm going to use 13.5% in 1982. Now if annuity purchase rates are down below the corridor there, then it is not just that we've got a corridor, we effectively have a specification of the single interest rate that is going to be used. For all intents and purposes, for much of this you can look at that 90% line, the lower solid line as though that is the interest rate that will be used for Current Liability. The blocks that are on there are the interest rate that's to be used for valuing unfunded vested benefits for PBGC variable premium purposes. And I show that not only in comparison with the other rates, but to point out that most of our discussion has been on the minimum funding standards and Dave is going to discuss some of Title IV. Dave will discuss the PBGC variable premium to some extent. I want to make one comment. Not only is the rate for variable premiums somewhat more volatile then the others, because of the basis that is used, but I like to point to January 1, 1987. For any of you who really haven't fully yet realized some of the absurdities of this law, it's because of January 1, 1987 that I will normally vote that I don't like OBRA 87. You look at January 1, 1987, presuming that the IRS left the interest rate corridor the place that it was supposed to be. For valuing the Current Liability for full funding purposes, the lowest rate you could have used would be about 9% using the 90% bracket. So you go to do your Current Liability for full funding using 9%. You might have a plan where you say, OK, we've hit the 150% FFL, we can't put anything more in the plan. Now you turn to the PBGC to pay your variable premiums, and they say that the interest rate to use is somewhere around 5.9%. You say, "Uh-oh, we've got unfunded vested benefits." You have to pay a variable premium, but you're not permitted to put any deductible contributions into the plan to get rid of that variable premium. Now to me that's a totally absurd result. I can't believe that

Congress had any purpose in mind in really doing that. I think that there is simply some clean-up work that we need to do with respect to these interest rates.

On that note, on the interest restriction note, I want to turn this over now to Dave Gustafson. I hope that Dave has some time to go a little bit into the interest rate provisions. I would be interested myself in hearing what the PBGC's view on that is. Dave will also be doing some discussion on the Title IV provisions of OBRA 87 itself. If he has the time, unless he puts this first, I think he also anticipates saying a few words to us on shutdown benefits. For those of you who think that the Mesta Machine, the Buck lawsuit, was left far behind us, no; the Buck lawsuit was settled in favor of a report that was to be put together by an ad hoc committee of the Academy of Actuaries. If you saw that in your in-box some months ago and just tossed it to one side, take another look. That is the infamous actuarial malpractice suit that was brought by the PBGC in connection with the Mesta Machine case. The paper that came out from the ad hoc Committee of the Academy is the result of that, and I think that there is a fair amount of material in that, and anyone with shutdown benefits should take a close look at it. Even if you don't do shutdown benefits, you should take a look at it, because as I understand it, there are provisions in there that if you've got subsidized retirement benefits, or other benefits of that nature, then in certain situations there is treatment that is advised.

With that let me turn it over to Dave. Dave is an EA. He has a Masters in Actuarial Science from the University of Michigan, Ann Arbor. I think you will find that he is very knowledgeable in the topics that he is discussing. He is the manager of actuarial policy with the PBGC. He is a special assistant to the Executive Director, Kathy Utgoff, of the PBGC. He has been extremely closely involved in all of the development of OBRA 87. If you have any questions whatsoever on OBRA 87, this is the man to ask and now is the time to ask them. And I would point out that I've heard of situations in which Dave has appeared in front of an audience of steelworkers right after the PBGC dropped their benefits, and so I think he has probably faced worse audiences than anything you can throw at him.

MR. GUSTAFSON: The situation that you referred to was a Congressional hearing before seven Members of the House Steel Caucus who were seated in front of me, and about two hundred steelworkers seated behind me who had just had their $400 monthly supplements cut back. I was very glad to get out of that room after about two hours of high anxiety.

I'd like to comment on this interest rate issue which is very troublesome to PBGC. The history of the origin of the 30-year Treasury rate might be helpful to review. When it became clear that we had a good chance of getting a variable rate premium provision enacted, several large employers and industry groups went to Hill staffers and said, "If PBGC is going to have a variable rate premium, we don't want them setting the interest rate and thus determining the exposure for the variable rate premium. Let's find an index that could substitute for the PBGC rates." So the Hill staffers asked us to come up with an index, and we responded with an index that we thought was appropriate -- 2/3 of the Moody's Corporate Bond interest rate plus fifty basis points. This rate was highly correlated to the PBGC composite rate, which is our immediate annuity rate less 50 basis points to reflect the lower deferral period interest rates. We took the Moody's rate back to the Hill staffers and they suggested that this rate was also something that somehow could be manipulated, and that they really

needed a rate based upon U.S. government securities. So we analyzed all the U.S. government securities rates and arrived at 80% of the 30-year Treasury rate, which is much less well correlated with the historic PBGC composite rate than is the Moody's rate and which produces results that we're not completely satisfied with.

After the rate was agreed upon for variable rate premium purposes, it was then applied to other purposes. In addition to the PPA provisions of OBRA 87, there was a separate OBRA 87 track that dealt with revenue concerns -- that is, the $3.7 to $3.8 billion derived from the FFL changes. Neither the PBGC nor any of the other pension agencies in the government was asked to comment on or approve this separate revenue track.

There was concern from Hill staff that the anticipated revenue of $3.7 or $3.8 billion might be vulnerable to manipulations of interest rates by plan actuaries.

Exhibit 1 is the primary document that was used by the revenue estimators in deriving their numbers for budget purposes. This chart was developed by the Pension and Welfare Benefits Administration (PWBA) from 1983 Schedule Bs brought forward to December 31, 1986, for single employer plans. And as you can see, about 48% of all single employer plans were funded at above 150% according to the projection, both in terms of percentage of plans and percentage of assets.

Exhibit 1

Funding Status of Single Employer Defined Benefit Plans, 1986

Funding Ratio	Percent of Plans	Percent of Assets
Less than .25	1	Less than 1/2 of 1%
.25 - .49	2	1
.50 - .74	6	4
.75 - .99	10	7
1.00 - 1.09	5	7
1.10 - 1.24	9	7
1.25 - 1.49	18	25
1.50 - 1.99	27	32
2.00 or higher	21	16
Total	100	100

Total assets - $794 billion
Total plans - 22,500

Source: DOL/PWBA/Office of Research and Economic Analysis. Distribution only includes single employer defined benefit plans with 100 or more participants. Estimates are for December 31, 1986.

Number of plans with fewer than 100 participants - 185,000
Assets in plans with fewer than 100 participants - $82 billion

---

As of December 31, 1986 the PBGC immediate annuity interest rate was 7.5%. The Hill staffers believed that it was necessary to protect the 7.5% from abuse

and therefore constructed an interest rate corridor that assured that the 7.5% interest rate floor would be protected. The 90-110% corridor more than protected the 7.5% rate. It provides a 1.5% buffer based on the rates in effect at (1-1.5) that point for the 4-year average without weighting.

Throughout the legislative development process PBGC opposed the use of the interest rate corridor. We felt that the shortened gain/loss amortization period plus the individually reasonable assumptions standard in IRC 412 were quite adequate over the long term to restrict the abuses of the doctor/dentist plans that were of such concern. We also felt that the corridor approach would produce undesirable contribution volatility for both full funding and minimum funding purposes to the point that plan sponsors could not plan their contributions beyond the current year. A number of plan sponsors are now finding that they are on a contribution holiday which may be very difficult to return from once the holiday is over. We were also concerned that the corridor plus the FAS 87 requirements would influence investment decisions in unhealthy ways. And finally, we were concerned that a corridor based upon current yields ignores the very significant reinvestment needs of most plans to support their long-term liabilities -- the corridor approach is not theoretically sound.

Exhibit 2 was developed from some of Rich's numbers and from some other numbers that I gathered. Two columns are the calendar-year corridor rates, at the 90% and 110% level, using the 4-3-2-1 weighting that is likely to be the basis in the IRS notice on this matter. As Rich pointed out, the 90% rates beginning in 1982 have been very high.

EXHIBIT 2

INTEREST RATE CORRIDOR

			1987 Wyatt Survey		
	Current Liability		Cash Funding		FAS 87
Year	90% Rate	110% Rate	Mean Rate	% of Plans Below 90% Rate	% of Companies Below 90% Rate
1982	10.33%	12.62%	6.8%	100%	
1983	11.09	13.56	7.0	100	
1984	10.91	13.33	7.2	99	
1985	10.99	13.43	7.6	99	
1986	10.39	12.70	7.7	99	99
1987	8.96	10.95	7.8	94	
1988	8.25	10.08			

The adjacent columns are cash funding columns. The Wyatt Company issues a survey each year on cash funding actuarial assumptions, showing both the distribution and the movement of the interest rate assumptions. The third column is the mean interest rate for the six years 1982-87, which has steadily progressed upwards. The Wyatt Survey also shows the *distribution* of the cash funding interest rate. In comparing this distribution to the 90% corridor rate, we found that at very best (in 1987) 94% of all plans in this survey had a rate that was below the 90% rate, or only 6% above that rate. A final comparison is made with the FAS 87 discount rate from another Wyatt Survey. The final column shows that, in 1986, 99% of the plans who complied early with the FAS 87

requirements were using a discount rate less than the 90% corridor rate. All this seems to say that the corridor rates are overly protective of the 7.5% budget rate.

The corridor rates, from a minimum funding standpoint, as I think Rich has ably pointed out, can produce an unintended transition period for very unhealthy plans, especially when interest rates are at levels similar to those experienced in the early 1980s. In this interest rate environment, our studies have shown that several of the underfunded LTV Steel plans would have escaped the new IRC 412 funding requirements. That is a very unfortunate result. The corridor provision produces rates that can significantly defer the effectiveness of the new minimum funding requirements -- the result of a last-minute change to funding provisions of the PPA that were inadequately researched and discussed. That is the end of our discussions of the minimum funding standards.

The PPA outline available at the meeting was distributed within PBGC for staff training both in the Legal Department and elsewhere in the Corporation. Therefore, one could consider this outline to be straight from the horse's mouth, or possibly if you don't like it, straight from another part of the horse. There were some very significant, very beneficial changes to the insurance program that came about under OBRA 87. Some of them are very complex and implementation will require meeting and coordinating with the other pension agencies in the Government. We have met on several occasions with both the IRS and PWBA to discuss technical corrections, which came out March 31, and regulations or notices required to implement the PPA. In particular, we met with the IRS last month to discuss our respective implementation schedules and prioritize the areas where we need guidance from the IRS in order to administer Title IV. As you may know, the PPA transfers responsibility for defining several key plan termination provisions from PBGC to the IRS. The areas where we have agreed that early guidance is needed include the following:

1. What benefits must be included in Current Liability, in Benefit Liability and in Unfunded Vested Benefits?

2. How are these benefits to be valued, especially in determining the amount of a lump sum distribution?

3. What does an Unpredictable Contingent Event benefit encompass?

4. How is the benefit provided by employee contributions affected by the new interest requirement? That clearly has an impact on our Priority Category 2 (PC 2) calculations as well as the reversion aspects of the new law relative to PC 2 Plans.

5. What changes must be made to the 1988 Schedule B to implement the variable rate premium changes of the PPA?

And, finally, there are numerous open questions relative to the lien on missed contributions and to the security requirement when an underfunded plan is amended. A lot of these, as I think you have heard if you have gone to any of sessions with the IRS, are being addressed by the Service. Resolving these issues will take time, but we hope to be making substantial progress on these particular matters in the near future.

One area where I can provide some guidance is in the variable rate premium area. PBGC submitted a bill to Congress in April of last year which contained a proposal to increase the level of our premium and to change the structure of that premium from a flat rate basis to a variable rate basis. Our April 1987 submission recommended keeping the flat rate premium at $8.50 but increasing the variable rate portion, such that the maximum that any plan might pay would be $100 per participant. That proposal produced a somewhat higher level of revenue than what we actually got under PPA. However, our primary focus was on trying to shift responsibility for financing the PBGC to the plans that are creating the problems, and to give them some incentive to start funding their plans more responsibly.

The PPA premium increases are effective for plan years beginning after December 31, 1987 and provide for a $16 per participant premium plus a variable rate assessment, with a maximum per participant. This assessment is, as I am sure most of you know, $6 per thousand of unfunded vested benefits under the plan, divided by the number of participants. The unfunded vested benefits are to be calculated as of the last day of the preceding plan year. On a calendar year plan basis, for instance, that would be a December 31, 1987 determination for the 1988 premium. The variable rate portion is to have a cap of $34, and there is a special $3 per year reduction in the cap available through 1992 for plans that for any of the five years prior to 1988 made the maximum IRC Section 404 contribution. That reduction only applies to the variable rate assessment; it doesn't apply to the flat rate premium. Thus, the maximum bill per participant can go from $50 to $35, but the $16 per participant premium is not affected if you made the maximum deductible contributions.

The unfunded vested benefits for this purpose are defined differently than for purposes of reporting on the Form 5500. They include the vested portion of the unfunded Current Liability, as defined in the statute. The Current Liability is valued at 80% of the 30-year Treasury yield for the last month of the preceding plan year. In our illustration that would be December of 1987 for calendar year plans. That particular rate is 7.30% for 1988 calendar year plans. The unreduced interest rate can be found in Federal Reserve Statistical Release G13 or H15. The PBGC plans, in the very near future, to include this rate in our monthly announcement of the PBGC rate set (so you don't have to subscribe to the *Federal Reserve Statistical Release).*

On January 22, we issued a couple of guidelines and notices that addressed a couple of implementation issues. The notices stated that the due date for the flat rate premium for the large plans, the 500+ life plans, would be the end of February, but all other premiums would be due as of 8 1/2 months after the end of the plan year. This is a shift from current regulations, which required those amounts to be paid for the smaller plans after 7 months. The larger plans, the 5600 plans that have over 500 participants, have filed their estimated flat rate premium as of February 29, and so we have started to receive a little bit of the additional income.

In the new premium structure, the variable rate assessment causes actuaries some pause as to how it is to be determined, particularly since it is effective immediately, and the amounts upon which it is supposed to be determined are not yet defined. Nobody yet knows what Current Liability is, or vested Current Liability. However, we've done a fair amount of work in drafting an interim premium regulation. What I can describe are the draft regulation provisions that are under consideration within the PBGC. I have to caveat my remarks by

saying, it's all "under consideration," there is a very lengthy clearance process, things can change over time. But I think it is important to be able to give you some idea as to the basic structure of what we have put together here, and what we hope will emerge as a regulation to give you some early guidance in determining this variable rate assessment.

In devising the interim regulation, we were guided by three objectives. One objective is to keep the administrative costs of the plans as low as possible. This is something that our Executive Director, Kathy Utgoff, has wanted to do from day one and particularly with regard to the smaller plans. In the PBGC April 1987 proposal, we exempted plans with fewer than one hundred lives from this variable rate assessment calculation, but unfortunately that didn't end up in the law. We also must produce the total premium revenue anticipated under the Act. I think that probably goes without saying, but some people tend to forget that objective. And finally, we have tried to maintain equity among premium payers. There are many ways to divide the pot, but we want to try to be as equitable as possible.

In putting together this interim regulation we have attempted to use 1987 Schedule B entries and not to require a special valuation where we could avoid it, which clearly would be unduly burdensome, particularly for the small plans. What we've put into the draft interim regulation are three methods for determining the unfunded vested benefit for variable rate purposes. First there is a general rule, which involves an actual calculation of the unfunded vested benefits which must be based on the plan's population and provisions as of last day of the plan year. The valuation itself must meet the triennial requirement under 103(d) of ERISA and Code Section 6059, and it must be the most recent within the last three years. All assumptions except the interest rate should be the same as in the regular valuation for minimum funding purposes. You may also use valuations as of the first day of the premium payment year with adjustment for any material difference from last day values such as may occur with benefit provisions or demographics. In other words, you may be able to use a January 1 valuation shifted back to December 31 for this purpose. Actuarial value of assets should not be reduced by the funding standard account credit balances, as we announced in the January 22 *Federal Register* Guidelines. And finally you must adjust the assumptions in this valuation to reflect the occurrence of what we are calling "significant events," or other events with a material impact on vested benefits. We will get into these "significant events" shortly.

The actuary will have to certify that the determinations made are consistent with generally accepted actuarial principles. Under all three methods, we are looking for some sort of actuarial certification to give us some comfort. Under the draft interim regulation, there are several open questions in both the general rule and in the other two methods. One is, what can be used as the value of assets -- can you use a value other than the actuarial value? The actuarial value of assets is specified in the law. We believed that it would smooth the year-to-year fluctuations, it was readily available on Schedule B, and it was consistent with minimum funding requirements. However, there are counter arguments that the market value of assets would be more appropriate -- arguments that we are now considering. Market value of assets and liabilities historically has followed pretty much the same pattern of increases and decreases. The employer's liability to PBGC in a distress termination is determined on a market value of assets basis. Because we are using the last of the plan year for these premium calculations, it may be that the market value of assets is more readily determinable by the actuary at that point.

We are also considering, and these are items that will probably be addressed in the proposed regulation as opposed to the interim regulation, the use of assumptions other than minimum funding assumptions. For instance, actuaries have asked, "May we use the UP-84 mortality with the setbacks that PBGC uses rather than the funding mortality assumption?" We have concerns that the premium revenue might be adversely affected by use of another mortality table. We know that changing the UP-84 Table to a mortality table such as the 1983 Group Annuity Mortality (GAM) Table can produce a change in table values comparable to an interest rate swing of approximately 150 basis points. If we were to consider such a change, it might also require the use of PBGC's expected retirement age assumptions, so that we would have the entire set of PBGC valuation assumptions if we were to permit a non-minimum funding mortality table to be used.

I have described the general rule. Let me now describe briefly the other methods that we are proposing in this interim regulation. The alternative method, the first option, uses values from line 6 and line 8 of the most recent year's Schedule B. That is -- the present value of vested benefits as of the beginning of the plan year divided into retired participants and beneficiaries receiving payment, and other participants; and the value of assets as determined for the funding standard account. These values are then adjusted by standardized formula to reflect differences in interest rates and the passage of time to the end of the plan year. The adjustment methodology that we've outlined in the interim regulation has been adopted from similar approaches that we've used over the last ten years to convert Schedule B values and actuarial report values to estimate plan asset insufficiencies as of the date of plan termination and as of fiscal year-end. The method can only be used if the line 6 values and the asset values are determined on Schedule B as of the same day. As under the general rule, the assets must be adjusted for credit balances and also increased to reflect contributions paid subsequent to the beginning of the year.

Plans with 500 or more participants may only use this alternative method if there were no significant events during the plan year and the actuary so certifies. If there were significant events, the plan actuary must make appropriate adjustments to Schedule B data to reflect the occurrence of these events. The significant events listed in the draft interim regulation are somewhat similar to the events that were included in the IRS 1982 proposed regulation on minimum funding standards. They include such items as a significant increase in contributions attributable to plan amendments, increases in average age, mergers and consolidations, shutdowns, and cost-of-living increases. Finally, we are going to propose special rules for plans with fewer than 100 participants. These plans are not required to make entries on line 6 of Schedule B. The special rules would be available only for those plans that didn't make those entries. One special rule permits a plan to obtain and EA's certification that there are no unfunded vested benefits using the statutory interest rates. Alternatively, the plan may elect to pay the average composite premium of $21 -- $16 plus $5, which is the average variable assessment. This type of relief was necessary given the effective dates of PPA and our previous commitment to minimize the impact of this law on the small plans. These special rules may be in effect for a limited period of time under these interim regulations. We are going to review them in light of a number of factors, including the annual valuation requirement proposed under technical corrections.

I must repeat that all my comments about the content of this interim regulation are preliminary to the internal and external clearance process. The interim

regulation first must be approved within PBGC at all levels. It then goes to PWBA, the IRS, Treasury, and the Department of Commerce for comments and approval. Finally the Office of Management and Budget (OMB) must clear the regulation, and the PBGC Board of Directors must approve it. If all goes well, the interim regulation should be through the entire clearance process and published in the *Federal Register* by the end of June, according to our current schedule. The regulation plus the new PBGC Form 1 will then be distributed to the 100,000+ premium payers during the month of July. After we've issued the interim regulation, we plan to issue a proposed regulation covering the premium payment rules for years after 1988 -- the main difference between the interim and proposed regulations being in the area of the special rules for plans with under 100 participants. The proposed rule, according to our schedule, should become final early in 1989.

What benefits must be provided when you close out a pension plan? The PPA added a new concept -- benefit liabilities. Previously, PBGC was master of its destiny in determining what must be provided when a pension plan was terminated. We defined under Title IV what went into PC 1-6. Now the law says that this will be determined under IRC 401(a)(2), and the legislative history further states that it will include fixed and contingent benefits that are and are not protected under IRC 411(d)(6), which seems to include a lot of items. We have had some preliminary discussions with the IRS on this issue and we've had a number of discussions in-house as to what benefit liabilities might mean.

Exhibit 3 summarizes where we stood internally on a pre-PPA basis. This chart is a listing of those benefits that are most troublesome to us in determining whether or not they should be included in benefit liabilities on a post-PPA basis. The middle column describes what our position has been, prior to the PPA, as to whether or not the benefit would have had to be provided if there were sufficient assets to go through PC 6. Probably the most troublesome benefits are the Social Security supplements and thirteen-week vacation pay where there is a chance for post-date of plan termination (DOPT) entitlement. The supplements arise on completion of either an age and service or a service requirement and structurally they are similar to the early retirement subsidies that are REA protected; yet, they were explicitly excluded in the statement of managers under REA as not being retirement-type subsidies. However, the statement of managers under the PPA suggested that they should be included in Current Liability (CL), as I have indicated in the Comments column.

Another issue is the Qualified Preretirement Survivor Annuity (QPSA) subsidy. Plans have to provide a QPSA but whether the subsidy has to be provided is not entirely clear, except that the statement of managers says that "survivorship subsidies" must be included in determining Current Liability.

Current Liability and Benefit Liability, the Title IV term, may not be equivalent. There is a statutory implication that they are substantially similar, but they don't necessarily have to be one and the same. In PBGC's determination of what was in benefit liabilities prior to the PPA, we were guided by a number of principles. We felt that it was necessary to include vested and nonvested accrued benefits and exclude ancillary benefits not protected by the anti-cutback rules, such as temporary supplements that are not payable for life. We also felt that any benefit that is in pay status should be included, although a number of these benefits, including disability benefits and temporary supplements payable on a post-shutdown basis, can be amended out of the plan prior to termination if they are not REA protected. Finally, we've also been guided by the principle

EXHIBIT 3

	Pre-PPA PC 1-6	Comments
Social Security supplement and 13-week vacation pay		
Pre-DOPT pay status	YES	
Post-DOPT entitlement	NO	Included in CL but is not retirement-type subsidy
Lump sum death benefit	NO	Not retirement-type subsidy
QUIPSA subsidy (Post-DOPT death)	NO	Included in CL
Qualified disability benefit (Post-DOPT disability)	NO	Not retirement-type subsidy and is annuity purchase problem
Lump sum > present value annuity		
Alternate form of distribition	YES	
Optional annuity form	YES	
Shutdown benefit		
Pre-DOPT shutdown		
E.R. subsidy	YES	
Temporary supplement	YES	
Post-DOPT shutdown		
E.R. subsidy	NO	Not included in CL
Temporary supplement	NO	Not included in CL and is not retirement-type subsidy
Window period open at DOPT (Elected post-DOPT, E.R. subsidy)	YES	
CREEP provision open at DOPT		
Pre-DOPT shutdown		
Eligibility	YES	
Accrual	NO	
Post-DOPT shutdown	NO	
C.O.L.A. provision (Post-termination increase)	YES	Annuity purchase problem

that benefits that are payable only upon the occurrence of a post-termination event, such as shutdown or death or disability, are not included in PC 1-6 on a pre-PPA basis. In other words, we would include only those contingent benefits arising as a result of post-termination age and service. We think it is appropriate to distinguish between contingencies related to the passage of time and those related to a future event, particularly when that event is within the control of the plan's sponsor.

In the interest of time, I will leap ahead to one more area that may be of interest, and that is the limitations on reversions. The PPA included a provision that a plan amendment permitting an employer reversion or increasing the amount thereof is not effective until the end of the fifth calendar year after adoption of the amendment. This rule does not apply to a plan that has had a reversion provision since the plan's adoption or with respect to amendments adopted before December 18, 1987. There is a transition rule that says that a plan with no employer reversion provision on the effective date of this section may adopt such a provision before December 18, 1988, and the five-year delay will not apply.

An amendment that increases the amount of the reversion has caused some people some consternation. We do not believe that the five-year delay in effective date should apply to amendments that remove the non-411(d)(6) protected benefits and thus may indirectly increase the amount of the reversion. Our belief is that the PPA amendment to Section 4044(d) was intended to deal with the plan that was either silent about reversions or specified that x% would go to the employer and that y% would go to the employee. Therefore, we don't believe that taking out nonprotected benefits was intended to trigger the five-year delay under the statute.

There are a number of other sections of Title IV that were substantially modified by the PPA. The rest of the outline contains descriptions of the changes in the presumptive rule for reversions under contributory plans; the new distress termination standards, which were among the most contentious of all the provisions, given our situation with LTV; and some rather technical changes relating to such matters as distress criteria in Chapter 7 versus Chapter 11, and expanding fiscal responsibility to all members of a controlled group as opposed to just substantial members of a controlled group.

MR. GERALD RICHMOND: The outline says "lump sum greater than present value of annuity." Is that included in PC 1-6? I was told that the PBGC was only responsible to pay annuitized benefits if they took over a plan.

MR. GUSTAFSON: Yes. I think what you have to do is to distinguish what we guarantee from what we would require if there were sufficient assets to cover all benefits. You are correct, the PBGC does only guarantee pension type benefits in categories 1-4. The liability of the plan sponsor was for benefit commitments, which in essence was PC 1-5; PPA now says that the plan sponsor is liable for Categories 1-6.

MR. RICHMOND: So this is a requirement for a sufficient plan but not an insufficient plan?

MR. GUSTAFSON: On the pre-PPA basis, this would be a requirement for a sufficient plan to get a reversion.

MR. RICHMOND: Supposing that it's a distress termination and the PBGC takes over, would they consider part of the unfunded benefit liabilities to include the lump sum amounts that could be greater than the present value of annuitized benefits?

MR. GUSTAFSON: One of the major changes that was made by the PPA was to make both distress termination and standard termination sponsors liable for the very same amount, which is Benefit Liabilities. We still guarantee only Categories 1-4, but yes, excess lump sum values would be included in the determination of what the sponsor owed under a distress termination. We would file a claim for that amount and there is a new concept called a recovery ratio that we would use in allocating assets attributable to the claim. We would file for this additional amount above guarantees to provide benefits to participants for non-guaranteed types of benefits.

MR. RICHMOND: I don't have a problem with the liabilities side, but I do in the asset side for determining the unfunded vested benefits. Am I correct that the law says that you use the value of plan assets, not the actuarial value -- it just says the value of plan assets?

MR. GUSTAFSON: I think that the law did say the actuarial value of assets for determining Unfunded Vested Benefits. PPA referenced the section in IRC 412 that defines the actuarial value of assets. The notice that we put out on January 22 confirmed that, and also stated that the credit balance reduction was not applicable.

MR. RICHMOND: Is IRC 412(c) the lesser of the fair market value or the actuarial value?

MR. GUSTAFSON: 412(c)?

MR. RICHMOND: You said with regard to the value of assets that you referenced some section.

MR. GUSTAFSON: Yes. And I think it was clarified in PPA's statement of managers too, that the actuarial value of assets was to be used in determining Unfunded Vested Benefits for premium purposes.

MR. RICHMOND: Now with regard to the actuarial value of assets: I am an EA for an insurance company. We have a deposit administration contract under which, if the plan should terminate, the liquidation value can never exceed 95% of the contractual fund, and then that can only be paid out in a series of installments. There could be other adjustments if it was an immediate lump sum. In the absence of any specific guidelines, or regulations, our intention is to use 100% of the contractual value. Do you have any problem with that?

MR. GUSTAFSON: Is that the value you were using for the actuarial value of assets when you filed Schedule B?

MR. RICHMOND: Yes. Schedule B has always permitted insurance companies to use the contractual value of assets if no market value is readily available and most insurance companies do not routinely calculate a market value, because it's an added expense and it cuts into the services you can provide at a given cost.

MR. GUSTAFSON: Then that is a safe harbor for you.

MR. DAVID P. MCLEAN: I have a quick question on the variable premiums. The general rule is that you have to do a complete calculation at the prescribed interest rate. But there are some exceptions to that under the alternate method; using some formulas which you've derived, you can adjust previously determined numbers on the Schedule B. To determine this value, however, if there have been some material events that have taken place, you can no longer follow that process. I guess the concern that I have is that there will be many plans which will be affected by the maximum funding limitations, and just by almost looking upon them, on the face, there is no way they can be affected by these variable premiums. Will they be potentially faced with having to do all these calculations on an individual basis, because some material event has taken place?

MR. GUSTAFSON: Is your question, if somebody doesn't have any unfunded vested benefits, do they have to perform the calculations?

MR. MCLEAN: Basically correct. If they are affected by the full funding limits they presumably are quite well funded and they do not have unfunded vested benefits.

MR. GUSTAFSON: I wish I could say that were true. For instance, the interest rates that are used for determining whether or not you are at 150% of your Current Liability may be somehow related to the PBGC surrogate rate, but they are not the same. One is a monthly rate, the other is a four-year weighted average. So you can find yourself in a situation, unfortunately, such that you may be at the full funding limitation and still owe a variable rate premium.

MR. MCLEAN: I understood that to be the case under some exceptional circumstances, but if we have the Schedule B numbers, for example, determined at 8%, and, for example, assets are double those liabilities, are you saying that if there has been some significant event which may be not overly material to that set of circumstances, that you still have to redo all these numbers at 7.3% if they are as of January 1, 1988?

MR. GUSTAFSON: I think it is clear that you have to redo all the numbers on a 7.3% basis, that's right. That's the only way that you can demonstrate that you don't have unfunded vested benefits.

MR. MCLEAN: OK.

MR. GUSTAFSON: Except if you can take advantage of the very special rules for the under 100 life case. Those would be the only exceptions.

MR. MCLEAN: No, I am more concerned with plans that may involve 100,000 employees and maybe have 50 or 100 different benefit structures under them, which, you know, we could spend a great deal of money. There would be absolutely no question as to the outcome of it, but you're just saying we have to do that.

MR. GUSTAFSON: Well no. Maybe I didn't describe the general rule clearly enough. I'm not suggesting that you have to do a specific valuation as of December 31, 1987 for that 100,000 life case. The general rule says you can take the results from the most recent actuarial valuation and the actuary makes his own adjustments. There can be sampling, there can be whatever you want to reflect changes in demographics, in benefit structures, and the significant events. It does not have to be a precise calculation, a specific seriatim, full blown valuation. But we do need to have an expression of a number calculated under generally accepted actuarial principles that approximates what this would be in your best estimate, as of December 31, 1987. We do need that.

MR. MCLEAN: So we could also estimate the impact of going from a seriatim valuation at a known interest rate to the safe 7.3%.

MR. GUSTAFSON: Exactly.

MR. LABOMBARDE: You would have to certify to that I take it.

MR. GUSTAFSON: That's right.

MR. MCLEAN: That would be no problem.

MS. MARGARET M. WARNER: Dave, I had a question on early retirement subsidies and including them in lump sums. What's the PBGC's position on including early retirement subsidies in lump sums on plan termination? Do you have to

include them, and if you do can you use the withdrawal decrements to calculate them?

MR. GUSTAFSON: Are you asking about the annuity purchase or about the EA certification?

MS. WARNER: Well, when you actually hand people lump sums on plan termination, standard termination, I don't care really which form you're filling out, but kind of when you calculate them, do you have to reflect the subsidies in that lump sum calculation?

MR. GUSTAFSON: Our regulation says that, if you're determining an alternative form of distribution, you can value the normal retirement benefit and ignore the early retirement subsidies. In practice, however, if the plan's lump sum provision includes early retirement subsidies, they must be provided in closing out a plan with assets to cover PC 1-6. Although the subsidy is part of the REA-protected benefits, the PBGC hasn't offered much guidance in valuing them. I think the IRS has been much more specific than we have, so it has not been necessary. Harvey Lebson, who is the person in charge of these matters at PBGC, has told me that he tells the case officers to instruct the actuary to do whatever is "reasonable" in valuing these subsidies. We don't have specific valuation standards on them, but we believe that you can't ignore them.

MS. WARNER: OK.

MR. MICHAEL E. STROTHER: Am I correct in thinking that there is a security requirement with respect to implementing a plan amendment when after the plan amendment there is a 60% funded ratio?

MR. GUSTAFSON: That's correct.

MR. STROTHER: And there is not a security requirement with respect to new plans which are being formed granting credit for past service?

MR. GUSTAFSON: Right. There is a $10 million de minimis amount and not too many plans have past service liabilities at that level. The provision was not expressed as clearly as it might have been either in the statute or in the legislative history. PPA was supposed to indicate that there was a grandfathering, as of the effective date of the law, of all old Current Liability in determining the plan's funded ratio for application of this security requirement. Further, the provisions relative to new Current Liability which offer some relief for five years of pre-effective date participation are to be used here, so some of the past service is ignored for the new plan determination.

MR. STROTHER: OK. Good. Thank you.

MR. LABOMBARDE: OK. In closing, if you feel strongly about the passage of the PPA, I would encourage you to send your comments to Dave or to other people in Washington D.C.