RECORD OF SOCIETY OF ACTUARIES
1988 VOL. 14 NO. 4A

PENSION PLAN TERMINATIONS

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- o Practices and procedures in the termination of pension plans
  - -- Large plans
  - -- Small plans
- o PBGC requirements
- o Effect of new regulatory requirements on plan terminations

MR. PAUL B. ZEISLER: Dane Mitchell is going to provide an overview of the plan termination process. He will talk about the various aspects of the termination of the single-employer plan with sufficient assets. I will then address some more specific issues. There are some issues about which the answers aren't clear, but ones that practitioners will routinely encounter. Jim Hiner will then address the annuity purchase process, which can have a considerable financial impact for the plan sponsor. Jim's presentation is likely to yield some surprising results about the annuity marketplace and how it works. Finally, Allen Beard will talk about the handling of plan terminations within the PBGC -- the general procedure, what they look for, what the flags are, and so forth. This should be useful insight into the workings of this increasingly visible agency.

MR. DANE C. MITCHELL: In order to reinforce the concept of a plan termination and due to the particular time of year that we are meeting (near Halloween), I like to think of a pension plan as having a life span with the termination of the plan as the death. We are going to talk specifically about the death of a qualified, single employer, voluntary, standard, defined benefit, pension plan termination. Single employer, meaning we are not going to talk about multiple employer situations, unions, government, or church-sponsored plans. A voluntary termination is instigated by the employer and is not a PBGC-initiated termination. By standard termination, as opposed to distress termination, we mean that we have sufficient assets or we expect to have sufficient assets to cover all liabilities under the plan. We are dealing with a defined benefit pension plan and not a money purchase, profit sharing or stock bonus type of plan.

I would like to look at the process from four different perspectives: the employer, the plan participants, the IRS and the PBGC. To follow from the

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analogy of having a life and death of a pension plan, the plan will exist only as long as the employer exists. The plan depends on the employer for its life. If the employer dies or goes bankrupt or out of existence for some reason, the plan would cease to exist.

From the employer perspective, one of the first questions to ask is, "Why does the employer want to terminate the plan?" One of the reasons may be that a reversion is being considered. A hot topic these days, a reversion may be necessary due to the company's need to finance further growth, to pay off debt or for other reasons. A second reason why the plan may be terminating is regulations. This is especially true in the case of small employers where administration costs can become too expensive. A particular example of a regulation-related termination may be where you have a self-employed individual who is quite old. With the new minimum distribution requirements, the assets may need to be paid out and income may be too low to continue the plan. It's rather a de factor termination in that case. Another reason to terminate may be that the employer appreciates the defined contribution type of plan more than the defined benefit type of plan because the employees appreciate it more. A young work force may not really care about a defined benefit plan.

Also, from the employer perspective, there is the consideration of whether he would like to do a final filing with the IRS for a determination letter of qualification upon plan termination. This is always optional, but most often the employer wants to go for that final determination letter to protect prior deductions. He also needs to look at whether the plan is covered by the PBGC and therefore whether he needs to continue paying premiums until the point at which all liabilities have been settled, and whether he has to file with the PBGC regarding this termination. Generally, all qualified plans are covered by the PBGC with the major exception being professional service employers who have always had less than 25 participants in the plan.

Another consideration from the employer perspective is the overall timing of the termination. That may depend upon whether he has to file with the IRS and PBGC, when he wants to communicate with his employees, when he thinks he can have the data together to allow the enrolled actuary to do the necessary calculations, when he needs his reversion, and other factors.

Further employer considerations are plan amendments that might be necessary prior to termination. One set of amendments might be in regard to freezing future accruals. Even though you might set a plan termination date and follow through with the plan termination, it is always the safest approach to do a formal amendment limiting the accruals either at the date of the plan termination or possibly before. Another set of amendments that should be executed during the process of terminating the plan is to bring the plan into compliance with all of the current law. Currently, those amendments are major ones necessary to comply with the Tax Reform Act of 1986 (TRA 86).

The employer would also want to look at which participants he is going to allow to receive distributions from this plan termination. That's a very big issue right now due to General Council Memorandum 39310 (GCM 39310) and sometimes it is very difficult to determine which participants to include. How far back do you want to look? Whether you look back just into the most recent plan year to see who has not incurred a one-year break-in-service or whether you go back further and whether the data exist to go back further are all factors.

Another major issue is communication and in this case I am talking about the communication with participants. There are certain required communications, but it is always the best approach to communicate as soon as possible and with as much information as possible so that the plan participants are more at ease with the whole process. Certainly, it would be best to communicate termination of one plan along with the enhancing of benefits from other plans. If you are changing because you like the defined contribution concept, you might be instituting a 401(k) plan and if you properly communicate that, then employees will not be as upset about losing their defined benefit plan.

A few final considerations from the employer perspective are some technical matters such as determining the accrued benefits that are payable to participants as of the plan termination. This determination may be complicated since the data may be difficult to obtain. You may have to determine with a final average plan whether you want to include compensation for a partial plan year and issues like that. Both assets and liabilities should be looked at currently; that is, as of the plan termination date, and also as of your projected distribution date.

Regarding the distribution itself, you should set a distribution date far enough in the future by which you think you can accomplish all of the filings that are necessary, communicate with the employees, do the calculations and present information to employees to allow them to make any decisions that they may be eligible to make. In addition, the employer will have to think about what forms the distribution might require. In some cases, you may pay lump sums only to individuals with small benefits and in other cases the employer may decide that he would like to offer lump sums to other employees. The final comment on distributions is that certain final notices must go out: some to employees, some to the IRS, and some to the PBGC. A final notice that you might send to employees is the notice of qualifying distribution, giving them information on the tax implications of payment in the lump sum form.

From the participant's perspective, the types of notices you may give to a participant depend on what filings you are doing. A notice to interested parties would be necessary if you are going to file with the IRS for a final determination letter. This form is required to be hand delivered to participants between 7 and 21 days or mailed to participants between 10 and 24 days before the filing of the plan termination with the IRS.

The notice of intent to terminate and the notice of plan benefits are necessary if the plan is covered by the PBGC. The notice of intent to terminate goes to the participants at least 60 days before the proposed termination date and informs them that a termination is intended and indicates the proposed termination date. The notice of plan benefits goes to participants and beneficiaries on or before the required notice is sent to the PBGC and is intended to supply them with all of the information as to how you calculated their benefits, what the results were in regard to the benefits they have accrued under the plan, and any options that they may have.

If you intend to allow employees to elect various optional forms of payment, you would supply them with all the forms necessary for those options (i.e., a tax-withholding form and, if applicable, a spousal waiver form). The notice of qualifying distribution must be sent to employees receiving lump sums within two weeks after the distribution occurs. This notice informs the participant about rollover options, special tax treatment rules, and other tax consequences of a lump sum distribution from a qualified plan. In many cases, it might be more

convenient to actually enclose all of this information to the participants when you send the notice of plan benefits to them. For anyone who is eligible to receive a lump sum distribution, you could include the notice of plan benefits and qualifying distribution information to them at the same time to help them decide whether they would like to take the lump sum distribution.

From the IRS perspective, the filing for a determination letter is always optional and that is one way in which the IRS may be notified of the plan termination. This filing is done on IRS/PBGC Form 5310 and IRS Form 6088. The filing could be completed before the termination date or any time after the termination date.

The two required notices to the IRS regarding plan termination would occur at two points in time. The first point would be when filing the IRS Form 5500 package for the plan year in which the termination date occurs. You would notify the IRS by indicating on the IRS Form 5500 package that the plan has terminated during the year. Also in that Form 5500 filing, there would be a final Schedule B completed by the enrolled actuary.

The second point would be in the plan year in which all assets are distributed. A final notice to the IRS regarding the plan termination would also be filed on the Form 5500 series indicating to them that all of the assets have been distributed from the plan. This may be in the subsequent plan year subsequent to the termination date or two years subsequent depending upon when the assets are actually distributed.

Finally from the PBGC perspective, they are only concerned about plans that are covered by the PBGC. If it is a covered plan, premiums must continue to be paid until the last liabilities of the plan have been settled.

The PBGC also requires that you notify them of the plan termination using the IRS/PBGC Form 5310 and the new PBGC Forms 444 and 445. PBGC Form 444 is the enrolled actuary's certification, and PBGC Form 445 is the plan administrator's certification for the plan termination. This package of forms is to be filed as soon as practicable after the notice of intent to terminate is given to participants. I believe the proposed rules indicate that the filing could be made within 60 days after the termination date shown in the notice of intent to terminate.

The delivery of a notice of noncompliance for the plan termination is an action that may be taken by the PBGC within the 60-day period from the date you have filed with them. It could be issued for several reasons. One reason it may be issued is because of improper filing procedures. If that was the case, you can simply file again. Now this could very well change your plan termination date, but you can simply go through the same approach again and file for another standard termination. If a notice of noncompliance is issued because assets are determined to be insufficient for not having taken all the liabilities into account that should have been taken into account or for whatever reason, the plan could then file for a distress termination with the PBGC.

The final distribution report that the PBGC requires is, in essence, to have the plan administrator provide the PBGC with the name of the insurer with whom you have chosen to purchase a group annuity contract, if that has been the case, and the location(s) where the plan records will be held for a certain number of years in the future and also to have the plan administrator certify that the distributions have been made in accordance with the regulations. This final

distribution report is to be filed within 30 days after the distribution of assets. In conclusion, the settling of the estate of a pension plan is a complicated and difficult matter in many cases. I am now going to turn the program over to Paul to talk about some of those difficulties.

MR. ZEISLER: As I mentioned, I am going to take advantage of my position as moderator for this discussion to talk about some of the open issues for practitioners terminating plans. The first of these issues I have termed the legacy of William Clay and Howard Metzenbaum. It is something which most of us still have to deal with. Just to briefly go through the chronology, on March 9, 1988, Congressman William Clay, a Democrat from Missouri, introduced HR 4111, which would place a moratorium until October 1, 1989 on asset reversions to employers from pension terminations where a notice of intent to terminate was filed on or after March 9, 1988. At the same time, Senator Howard Metzenbaum, a Democrat from Ohio, promised to introduce similar legislation in the Senate. The idea was to have surplus assets from pension plan terminations occurring during this period handled in accordance with the law in effect on October 1, 1989. This seems to assume that the Congress would have passed some sort of major legislation on the subject prior to that day. Quite an assumption!

As of June 22, 1988, there had been no action on HR 4111 and a lot of us were beginning to breathe a sigh of relief. But on June 23, 1988, the moratorium provision was included in HR 4783, which was the Labor, Health and Human Services and Education appropriations bill in the Senate. This was added by the Senate Appropriations Committee and would have applied to notices of intent to terminate pension plans filed on or after June 21, 1988. Thus, employers who had gotten their notice of intent to terminate a pension plan filed in the period between March 9, 1988 and June 21, 1988 were in pretty good shape.

On July 26, 1988, the moratorium provision was dropped from HR 4783. In its place, a nonbinding Sense of the Senate resolution, sponsored by Metzenbaum and Senator Lloyd Bentsen, was passed urging Congress to impose a 50% excise tax on reversions from pension plan terminations where the notice of intent to terminate was filed in the period July 26, 1988 to May 1, 1989 (currently, a 10% excise tax is imposed on reversions). The net result of this, assuming a corporate income tax of 34%, was that 94% of any reversion would have been paid to the IRS. This was effectively the same as prohibiting reversions, but the IRS would have benefited instead of the participants. This would, therefore, pretty well guarantee that no one would terminate a pension plan in a surplus position in that period.

Technical Corrections to TRA 86 had not yet been passed and was clearly the only piece of tax legislation to which the increased excise tax could have been added. A dark cloud remained on the horizon up until the Saturday morning of October 22, 1988 when Technical Corrections to TRA 86 legislation was passed. Still, a slightly less dark cloud remained after Technical Corrections, because the only indication was that there would now be a 15% excise tax on reversions. It is not clear because no one has seen the bill -- whether the 15% excise tax is in addition to or in lieu of the existing 10% excise tax on reversions. It is also unclear under which section of the Internal Revenue Code (IRC) the additional tax will apply. As I'll mention momentarily, that leaves a lot of questions for us.

From the point of view of practitioners, are we then still dealing with the unknown? The current 10% excise tax under IRC Section 4980 does not apply for

not-for-profits. One question was: under which section of the Code would the 60% excise tax apply? The questions I think for practitioners today is under which section of the Code does the 15% excise tax apply? The possibility exists that the 15% excise could be imposed under another IRC section that would apply to not-for-profits; however, this is unlikely to happen. Regardless, since this does remain a possibility, a contingency notice should accompany notices of intent to terminate. In our office, we have recommended issuing contingency notices to participants to accompany the notices of intent to terminate in situations where plan sponsors have indicated that the termination would be aborted were the 60% excise tax to be payable. It seems clear that issuing a notice of intent to terminate in no way obligates the plan sponsor to go ahead with the plan termination, but from an employee relations viewpoint, having issued the contingency notice makes it a little more comfortable to subsequently go back and explain that the plan is, in fact, not going to be terminated. As a practical matter for many consultants, this type of notice is not new. A lot of us used this same sort of notice last year when the many pieces of legislation were pending that would have very much affected the distribution of assets of pension plan terminations.

Another key question that faces plan sponsors and practitioners who work to terminate plans is GCM 39310 and the way in which it interacts with the Retirement Equity Act of 1984 (REA). GCM 39310 states that "a partially vested participant who terminates service and who will not suffer a forfeiture of his non-vested accrued benefits under the terms of a qualified plan until he incurs a one year break-in-service must be vested in his accrued benefit, to the extent funded, if the plan terminates prior to his incurring a break-in-service." Well, in English this means that the sponsor of a terminating defined benefit plan needs to look back to determine the participants who terminated in the one-year period immediately preceding the termination date and to pay out or annuitize the benefits accrued by these individuals on the same basis as participants who are actively employed at the time of the termination. This is fairly straightforward, but it can be a very expensive proposition.

Even before GCM 39310 was issued in April of 1984, sponsors of terminating plans often used a one-year look-back and fully vested those participants who had terminated but had not incurred a one-year break-in-service. Since April 1984, however, most practitioners have relied on GCM 39310 for guidance in the absence of any regulations. It is clear that the IRS has considered GCM 39310 when issuing determination letters upon plan terminations. It should be noted, however, that some law firms with whom I have worked have objected to the so-called "tortuous logic," of GCM 39310, while others have sought to distinguish between defined benefit and defined contribution plan terminations. (I'm sure many people will recall that GCM 39310 actually deals with the termination of a defined contribution plan.) That much notwithstanding, it is clear that the IRS has considered GCM 39310 when issuing determination letters on plan terminations.

Looking back one year can be a very time-consuming and expensive activity for an organization with high turnover in the period immediately preceding termination. Many organizations have experienced just that sort of high turnover in the year prior to termination. For plan sponsors, it can often be an unpleasant surprise (or rude awakening) in the plan termination process. The key point that we will get to now is that REA modified the break-in-service rules under ERISA by providing that a non-vested participant is considered to have a break-in-service, for which prior service may be disregarded for vesting

purposes, only if the break exceeds the greater of five consecutive one-year periods or the total number of years of service with the plan. Now if one applies the logic of GCM 39310 to REA, one might conclude that the look-back period should be five years or at least back to the beginning of the first plan year commencing after REA if that is shorter.

Of course, this would place an extraordinary burden on plan sponsors since records are often not maintained in sufficient detail to reconstruct plan earnings histories and service records. Indeed, I was not aware of any situations where a full REA look-back was used prior to this year. It seems that the IRS had felt that this issue was sort of muddy as well, since they temporarily suspended rulings on defined benefit plan terminations where this was an issue. According to remarks made by Marty Slate of the IRS at a recent conference, the suspension has now been lifted, but there is still no national policy on this issue. The IRS is planning to meet with the PBGC and the Department of Labor to resolve this issue. In the meantime, however, it is left to the district offices to decide the issue. Different district offices have different ways of dealing with the issue. Some are requiring a full REA look-back and that, of course, makes life that much more difficult for sponsors terminating defined benefit plans and for those of us whose business it is to assist them. As a practical matter, however, only the one-year look-back has historically been incorporated in the plan termination process.

Contributory pension plans present a particular challenge on termination. Employee contributions in defined benefit plans have always been rather complicated, and this is particularly true in the case of a plan termination. This is even more complicated now since the Omnibus Budget Reconciliation Act of 1987 (OBRA 87) has now rewritten the rules at least in part. Prior to the passage of OBRA 87, the calculation of the benefits attributable to employee contributions in a contributory defined benefit plan was a simple matter. Upon termination of such contributory defined benefit plans, contribution balances were projected forward to retirement age at 5% and then divided (i.e., annuitized) by the appropriate factors to determine the accrued benefits attributable to such contributions. The present values of these accrued benefits were then calculated. Most sponsors elected to return to participants a percentage of the surplus based on the ratio of the present value of employee-paid accrued benefits to the present value of all accrued benefits.

The reason for using this method was because it resulted in the smallest portion of the surplus being allocated to participants. This was because projecting the contributions forward at 5% to retirement age, annuitizing in accordance with regulations and determining the present value of accrued benefits using PBGC or the plan-specified actuarial basis effectively guaranteed that the present value of the benefits being provided by an employee's contributions would be less than the contribution balance. Hence, at least from the plan sponsor's financial standpoint, this was the best way to allocate the surplus assets.

It all became a little more complicated in December 1987. Effective for plan years beginning in 1988, IRC Section 411(c)(2) requires employee contributions to be credited with interest at a rate equal to 120% of the Federal Midterm Rate in effect in the first month of the plan year at least for purposes of determining the benefits attributable to such employee contributions. Thus, when we terminate, we need to project the employee contribution balances to retirement age using the Federal Midterm Rate in effect in the first month of the plan year of termination to determine the accrued benefits attributable to these employee

contributions. Then, we need to calculate the present value of these benefits. The present value of benefits is almost certain to exceed the contribution balance because 120% of the Federal Midterm Rate is almost certain to be higher than the discount rate we use to calculate the present value of these benefits. In addition, OBRA 87 required that we distribute to participants the surplus according to the same formula that sponsors had voluntarily used prior to the passage of OBRA 87, but for exactly the opposite reason. This would guarantee that the participants will get the biggest share of surplus assets. Clearly, using 120% of the Federal Midterm Rate to project contribution balances to retirement age results in higher benefits attributable to employee contributions and a higher present value, and this means that more surplus will be returned to participants.

Here is an interesting twist! The timing of the termination of a contributory plan can be very important in that it can affect the amount of surplus assets we return to participants. The Federal Midterm Rate we use to project the contribution balances to retirement age is the one in effect on the first month of the plan year. I have done some sample calculations for a variety of different participants that have yielded some very interesting results. A 1% drop in the Federal Midterm Rate can result in a 30-35% reduction in the value of benefits deemed attributable to those employee contributions. Hence, if one was looking at a termination at December 31 but elected to delay it one month, one might very well find that the amount of surplus remaining for the sponsor was much larger (or much smaller) depending on the movement of the Federal Midterm Rate. It is an obvious result that as the average participant age decreases, the impact of a change in the Federal Midterm Rate increases.

Hence, for a plan where most participants are close to retirement age, this need not have a very big effect. But for the termination of a plan covering a relatively young work force, the effect can be very great indeed and can have a significant financial impact for the plan sponsor. It seems to me that there is an opportunity for plan sponsors to use this aspect of the law to their advantage.

There are two final issues I would like to discuss, the first being keeping participants whole. This is a very serious problem for plan sponsors and one which can have very serious employee relations consequences. The extent to which participants lose benefits depends in large part on the reason for the plan termination and the nature of the successor plan, if there is a successor plan at all. One way in which plan sponsors might go about keeping participants whole is with a defined benefit successor plan which includes a grandfather provision to assure the participants (or a certain group of participants) that the benefits that they will receive will be no less than what they would have been entitled to had the existing plan continued unchanged.

There are many instances where defined benefit plans are terminated but are replaced by defined contribution plans or at least where the plan sponsor would prefer to go to a defined contribution plan. Adoption of a defined contribution plan could result in a significant loss of benefits for a large group of participants. In our office, we have had a couple of situations where sponsors have elected to go to an account-based or so-called cash balance defined benefit plan instead of a defined contribution plan to provide benefits that look a lot like those under a defined contribution plan, but allow for easy grandfathering of prior defined benefit plan benefits.

Another issue (and a tough one) is that often a plan sponsor has a history of providing ad hoc cost-of-living increases to retirees. The plan sponsor then terminates a plan and purchases annuities for all the participants. In these sorts of cases, retirees may never again receive an ad hoc cost-of-living increase either because their former employer has been sold, because of a change in management or for a variety of other reasons. It is certainly possible, but expensive, to provide for periodic cost-of-living adjustments (COLAs) in annuity contracts based on any one of a number of different indices. This is obviously not an obligation of the plan sponsor unless the plan previously provided for such automatic increases. (I don't think there are very many of these plans left.) This is an obligation the plan sponsors may wish to consider to the extent that they have had major asset runups and were smart enough to get out of the market last October 18 and are now looking at a fairly significant reversion.

Finally, regarding the issue of keeping participants whole, there are situations where an employer insists on going to a defined contribution plan. In such cases there are ways to set up formulas to provide greater benefits for long service and older employees, who are the ones that usually lose large benefits as the result of the termination of a defined benefit plan. For example, the annual contribution may be varied by service, subject to non-discrimination requirements. In all cases, it is much to the plan sponsor's benefit to communicate very clearly with participants prior to the termination of the pension plan to set the stage for whatever action is taken.

The other issue I had planned to discuss was the availability of assets on plan termination. However, I am going to turn the podium over to Jim Hiner who is a principal with Mercer-Meidinger-Hansen in Chicago where he heads the insured products consulting practice. Jim is going to talk about the very important process of annuity placement, an often overlooked aspect of the termination process that can minimize the plan's shortfall or maximize its surplus assets.

MR. JAMES R. HINER: Paul asked me to talk a little bit about the annuitization process because of the excellent experience our practice has had in trying to increase the amount of reversion available to the plan sponsor. We have found that there have been many different issues during the annuity placement process that have really made a big difference in the final results. I have broken down the discussion into three parts. First we're going to talk about the inefficient marketplace and what that really means. Next, we're going to spend time talking about preplacement planning. This is a step that we strongly encourage anybody that is controlling a placement situation to adhere to. This means getting all the various parties involved in the entire placement scenario and discussing what should be done prior to soliciting bids. This would include the plan sponsor, the attorney, the actuary and possibly others. Finally, we're going to spend time talking about a structured placement process. In short, this is nothing more than an organized approach to handling a very complicated transaction.

INEFFICIENT MARKETPLACE

What do we mean by an inefficient marketplace? First of all there are over 40 insurance carriers that currently offer a single premium group annuity contract. That's up dramatically from a couple of years ago when you had a tough time finding maybe 10 or 15 carriers. Most of the new people coming into the marketplace are focusing on immediate annuities versus deferred annuities. Most of

the insurance carriers have an A+ rating from Best & Co., but other quality ratings can differ dramatically from carrier to carrier.

Let's talk about deferred versus immediate annuities. There is a difference! One big difference is the number of carriers that are willing to quote. Most insurance carriers like immediate annuities. For the longest time, a lot of carriers wanted immediate annuities only. That left you in the lurch on a plan termination because you usually have some deferred annuities that are going to have to be handled as well. We then started to see some flexibility where many of the carriers were looking for a large portion of the total liability to be attributable to immediates; in many cases up to 50%. More recently, we have found a couple of carriers that are actually specializing exclusively in deferred annuities. The quality characteristics of those carriers specializing in deferred annuities are considerably different than the rest of the universe and that can have a major bearing in the final placement decision.

Quality and Price

There is not a consistent pricing differential for quality. We are continually amazed at the inefficiency of this marketplace. We have seen a triple A carrier being absolutely number one in a bidding process versus somebody of a much lower quality and vice versa. This is why competitive bidding is truly a must. If you do not go to the entire marketplace, the one thing that I can guarantee you is that you are going to leave money on the table! It is not the same players that are always competitive. The pricing of the annuity is a function of the mortality assumptions, the investments used to back the annuity and the goals and objectives of that particular insurance carrier. Goals and objectives differ from month to month for the same carrier. The only way to capitalize on these differences when you are trying to purchase an annuity is to go to the full universe. If half of them turn you down, fine, they turn you down, but at least you have covered the market.

Competitive Bidding

What do you mean by pricing in efficiencies? Take a look at Exhibit 1.

EXHIBIT 1

PRICING SPREADS
SINGLE PREMIUM GROUP ANNUITY PLACEMENTS

Lowest Bid	Spread Between First and Second Lowest Bid	Spread	Spread Between Highest and Lowest Bids	Spread
$1,920,667.00	$ 11,133.00	0.58%	$ 356,737.00	18.57%
70,331.00	5,500.00	7.82	10,501.00	14.93
1,810,200.00	7,918.51	0.44	203,338.10	11.23
16,600,000.00	251,578.00	1.52	1,494,800.00	9.00
72,303,990.00	575,010.00	0.80	2,831,010.00	3.92
2,844,000.00	131,496.14	4.62	427,104.29	15.02
4,678,956.00	237,419.00	5.07	1,991,044.00	42.55
6,908,956.00	410,608.00	5.94	1,066,644.00	15.44
4,675,000.00	1,714.00	0.04	192,933.00	4.13
10,917,000.00	32,950.00	0.30	1,101,693.00	10.01

In the left-hand column, we see the lowest bid for ten different annuity placements we did in the first half of this year. All placements were of different sizes and combinations. Some of them were immediate, some of them were deferred, some of them were mixes and so forth. The second column is the spread between the first and second lowest bid. In other words, the differable differential between the lowest and the next lowest price. On a percentage basis, you are seeing a spread that goes on the low side from 4 basis points and on the high side to 782 basis points. That can be dramatic! Then, you go over to the next column which is the spread between the highest and the lowest bids and that gets even more dramatic. The percentages there go from 392 basis points to 4255 basis points. Somebody in the insurance industry said to me that they should be ashamed of themselves with that big of a spread. The point I am trying to make to you is that unless you go to the marketplace, you are not likely to get the best bids. We regularly see a spread between the highest and lowest bids of between 1000 and 2000 basis points on the placements that we do. Significant spreads exist for immediates, deferreds or mixed placements; however, immediates tend to be priced much more closely. As soon as you get deferreds into the process, you start seeing much wider spreads. Spreads also widen once you start seeing plan provisions that many carriers don't care for.

PREPLACEMENT PLANNING

Preplacement planning is the part of the total termination process where you have an opportunity to make a major impact financially. Since it is so important, a lot more time needs to be spent in the initial stages due to the complexities involved. First we start with asset deployment. Where are the assets? Are assets readily available? If they are in an old insurance contract, an Immediate Participation Guarantee (IPG) or in a GIC, they may not be available or if they are available it might be within a time frame that is not in line with the plan sponsor timetable. There also may be penalties involved that nobody had anticipated. There could be a real estate investment that is going to take some time to sell. This can delay the placement since you usually have to deliver funds within five days after the contract is purchased. Unless you can liquidate your assets, I don't advise going to the marketplace.

The next issue related to assets involves hedging. If we have a tight situation where the assets and liabilities are fairly close, you run a very real risk of not having sufficient assets at the time you go to close on the annuity. One way to hedge this risk is to immunize the portfolio or dedicate the portfolio for the period between the time you solicit the bids and you actually make your commitment so that you are able to match movements in interest rates.

Data

The next item in preplacement planning is data. One word, but what an important word in the annuity purchase process. Data that are used to solicit annuity purchases are almost exclusively coming from the actuarial firm involved. Many plan sponsors haven't taken actuarial data requests seriously and we often find large numbers of errors in the data that have been submitted by the plan sponsors. It is only when you get into the annuity purchase process that you start finding out that data that have been assumed to be complete and accurate are not. We also find the spousal date of birth and the spousal Social Security number are often missing. This information is necessary in order to price the annuities, if the Joint and Survivorship (J&S) form of benefit is involved.
We strongly recommend that when you are doing an annuity purchase you put the data on tape when you submit it to the carriers, regardless of size. If it is not on tape and carriers have to manually produce the data, you decrease your

chances of getting a bid. What you are doing through this whole process is selling the plan liability to the carrier. The better job that you can do of selling it, the better job you are going to do for your client. Making it easier for the carrier is one way to do that.

Finally on data, the one point I want to make concerns proof of age. Carriers are all over the lot on their requirements for proof of age. Some will accept a plan sponsor's certification that the proof of age is accurate and is in house. Other carriers will run some kind of a sampling, maybe 10-20% of the data. They will want hard copy of proof of age and as long as you meet their minimum error ratios, they will accept plan certification for the rest of the data. Others will want hard copy documentation for proof of age for every life. These are major differences. One of the things that you are going to have to evaluate is whether the price that you are getting from the carrier with the more stringent requirements is worthwhile. By all means, get your client prepared for getting the proof of age data together before the annuity process begins because you are going to need it somewhere along the line.

Carrier Credit

We feel that carrier credit criteria should be established in the preplacement planning stage with the client. There should be an understanding of what credit is about. I think that you have probably heard about claims paying ability ratings that have been issued by Standard & Poor's, Moody's and Duff & Phelps. This is probably one of the better things that has happened to the insurance industry in recent years because people can now distinguish among carriers based on their ability to meet long-term obligations. Annuities are long-term obligations. As a result all the carriers are not viewed equally. We have triple A carriers, double A carriers, single A carriers and triple B carriers. When we are talking about a long-term liability, there should be some concern about going down below a double A credit rating and in some cases an A credit rating depending on the length of the liability. The big issue is whether you are getting paid to go down to a lower quality credit rating. We usually like to get the client involved in the early stages to figure out just how much it is he is going to need in the way of lower price to buy a lower-quality credit. In many cases, the client doesn't know and needs guidance in this area.

Costly Plan Provisions

I am going to run through them very quickly. Most carriers do not like lump sum options since they shorten the liability. They don't like temporary annuity benefits. They don't like employee contributions. Many of them have not done anything to handle employee contributions under the new OBRA 87 regulations. Heavily subsidized early retirement provisions can hurt you from a cost standpoint. Most carriers do not like COLAs. Some carriers will not participate if you have a COLA. These are all provisions that may or may not exist in a given plan; however, if the plan has them you may still have to annuitize these benefits. The point is that if you have some of these provisions in your plan, you are going to lose some of the carrier universe. The more of these provisions that you have, the more likely you are going to have a smaller number of bidders.

Marketing Strategy

What about the marketing strategy? What do I mean by that? If we are trying to maximize return, it may be beneficial to split the immediates from the deferreds. Remember, I noted earlier that some carriers like immediates, some like deferreds, and others like mixes. Unless you can collect bids that take into

consideration the specialties of the various carriers, you may be leaving a considerable amount of money on the table. We like to obtain bids on a total basis and on a split basis. Then we evaluate whether it is worthwhile buying multiple contracts. Certainly, if you buy from two carriers or three carriers in order to accomplish your objective, you are going to have more administrative work. It becomes a matter of placing a cost estimate on dealing with an additional carrier.

Timetable

Going through an annuity purchase is a long process. We have not been involved in one that has been finalized in much less than six months. Most annuity purchases require anywhere from six to eighteen months. There are a few that require a couple of years depending on the data. The carrier is not going to do his repricing until he has proof of age and data which have been signed off on by the plan sponsors. If the data are not good, you are in for a long haul. A plan sponsor needs to know that up front because the data rest squarely on his shoulders in most cases. If he is unhappy about not getting the contract finalized it is usually because he is not in very good shape on the data side. You need to cover this up front with the client.

STRUCTURED PLACEMENT PROCESS

The last point to hit on is structured placement process -- an organized approach. We have already talked about preplacement planning where we get the client informed and into the process. The next step is to get detailed bid specifications put together. I will grant you that this is a matter of style. We have found that sending the plan document to carriers does not help a whole lot. In most cases, carriers do not really want to see the plan document. What they want to know is exactly what it is they have to price. As a result, we summarize the various plan provisions that have pricing implications. However, we include an extra step. We get the input of the plan sponsor so that the specifications reflect the plan provisions in operation, not just what is stated in the plan document.

Once you get the specifications drafted, it is a matter of sending them out alone with the tape to the entire universe of qualified carriers. Hopefully, you have done some prequalification based on the carrier credit issues. Next you have to follow up with the carriers. Remember, you are in competition for the carrier's time and interest. You have got to make sure that the carrier understands what it is that you are trying to accomplish. In many cases, when it's a matter of your placement versus someone else's, personal contact can make all the difference.

Proposal Analysis

I can't emphasize enough the need to review the proposal. These proposals need to be reviewed against the specifications. Your whole objective in this process should be to get apples-to-apples comparisons. You have to know where the proposals differ. Proof of age, for example, is one thing that may have a lot to do with whether that plan sponsor is willing to use a given carrier. If a carrier is willing to use plan certification and another requires complete documentation, guess where the plan sponsor will want to go? These are issues that you need to recognize and put on the table prior to making a final decision.

The Purchase Itself

Usually, the purchase is confirmed verbally and a written confirmation will follow. Money is then transferred within five working days in most cases. Prior to making that verbal commitment, I strongly suggest that you go through

a checklist that covers all the key items so that there is total agreement on what is being purchased. In the analysis stage if you receive preliminary bids from carriers that are out of sink, it is time for dialogue to find out if you have an apples-to-apples comparison. The whole objective here is to be as thorough as possible, represent the risk properly to the insurance industry, and then run a fair auction to obtain the best deal.

Installation

Finally, installation, because this is probably one of the most important aspects of the whole process. Installation is crucial. We have a saying in our shop that there is not a gun big enough to kill an annuity. The reason we say that is because annuity purchases continually seem to come out of the wood-work even after we think we have put them to bed. They are messy and require a considerable administrative effort. In the installation process, you must finalize the data. You need to provide names, addresses and tax information on retired lives. You may have to provide proof of age documentation. The carrier needs to do its final pricing. Then the carrier can finalize the contract document which must then be reviewed. Once the contract is signed, then certificates will be released. Somewhere along the line the participants are going to have to be notified of what happened. This process can take a long time and in most cases we find that the plan sponsor is not aware of these complexities. That is why the preplacement planning meeting is important. These are just some of the areas that we focus on in the annuity placement process. We are now going to switch over to Allen Beard, who is Manager of Actuarial Services with the PBGC, and get a PBGC perspective on the plan termination process.

MR. ALLEN R. BEARD: I have not heard any one of you talk about that $500,000 that each of us makes. When it came out in *USA Today*, I got a letter from my brother that said that he realized I had a snap of a job, but he just did not realize how much! A few days later, the *Wall Street Journal* picked up on the *USA Today* story and said there were some actuaries that made as much as $500,000. Now I contend that no actuary makes that much money just doing actuarial work. He has to have a little control of something else. Anyway, that gives you boasting rights. My sister asked me how much I made. I said I don't make $500,000. I'd be embarrassed to tell her how much I actually make.

Let me respond to Jim Hiner. Almost everything Jim said goes double for us. We would like to find out everything that the insurance company tries to find out. One thing that occurs most often is that insurance companies use their own actuarial equivalents instead of the plan actuarial equivalents. We look to the plan. We have to provide the plan benefits and that is what we want the insurance company to provide if it is going to take over. The Single-Employer Pension Plan Amendments Act of 1986 (SEPPAA), as you know, created two distinct types of voluntary pension plan terminations: standard and distress. The plan may terminate in a standard termination only if the plan administrator issues a 60-day advance notice of intent to terminate to affected parties other than PBGC, issues a termination notice to the PBGC and issues notices of plan benefits to plan participants and beneficiaries. The standard termination notice must include certification by an enrolled actuary of certain information, including a statement that plan assets are sufficient to provide plan benefits. Plan benefits are either benefit commitments or benefit liabilities depending upon when the notice of intent to terminate was issued. If the PBGC does not issue the plan a notice of noncompliance and plan assets are sufficient to satisfy plan benefits at the date of distribution, the plan is free to distribute assets.

Regarding the 60-day advance notice of intent to terminate, the plan administrator must either hand deliver or mail a notice to participants stating that the plan will be terminated on a date that is no earlier than the date the notice is issued plus 60 days. In order to comply with the requirements of Section 4041(a)(2) of ERISA, the notice to affected parties, the plan administrator's intent to terminate must be issued at least 60 days in advance of the proposed plan termination and must state clearly that the plan administrator intends to terminate the plan on the proposed termination date specified. In order to qualify as a notice of intent to terminate, such a notice must explicitly convey to affected parties that the plan will terminate. Statements such as "a sponsor will stop contributions to this plan" or "benefits will cease to accrue" or "the sponsor intends to merge this plan with the profit sharing plan and contribute only to the profit sharing plan in the future" are so ambiguous and leave doubt in the minds of the affected parties as to whether the plan will be terminating. Finally, the notice of intent to terminate must state the actual date as of which the plan administrator proposes to terminate the plan. This is also the date used by the plan administrator in filing with the PBGC.

SEPPAA provided that a plan must be able to discharge all benefit commitments under the plan in order to terminate in a standard termination. Benefit commitments were those benefits guaranteed by the PBGC or that would be guaranteed but for the limitations in ERISA Section 4022B. In addition, benefit commitments include early retirement supplements or subsidies and plant closing benefits provided the participant or beneficiary prior to the plan termination date satisfied the plan's condition for entitlement to the benefit. The Pension Protection Act eliminated the concept of benefit commitments and required instead that the plan pay all benefit liabilities under the plan in order to terminate in a standard termination. The term benefit liabilities is synonymous with the pre-Pension Protection Act term termination liabilities and includes all fixed and contingent benefits to plan participants and beneficiaries. Therefore, in order to terminate in a standard termination, a plan will have to purchase an irrevocable commitment that will preserve all benefit and benefit forms in effect on the date of termination or pay lump sum benefits that include the value of all such benefits. In order to reflect this change, the notice to participants and beneficiaries of the benefits they will receive on plan termination referred to before as the "notice of benefit commitments" should now be referred to as the "notice of plan benefits." This notice should include a statement of the participant's or beneficiary's full benefits under the plan.

The plan administrator sends the notice of plan benefits to participants and beneficiaries either before the plan administrator sends the standard termination date notice to the PBGC or on the same date. The plan administrator must send a notice to everybody who is a participant or beneficiary under the plan.

This notice must be written in plain and understandable language and state the following: (1) the name of the plan; (2) the employer ID number; (3) the name, address and telephone number of a contact who will answer any questions concerning benefits payable; (4) the proposed termination date; (5) a statement that lump sum values of plan benefits in the notice are estimated and actual benefits paid may be greater than the estimate; (6) the monthly amount of the person's plan benefits as of the proposed termination date; (7) the form or forms of the benefits that were used to determine amounts; and (8) specific data used to determine plan benefit commitments.

This specific data include the person's length of service, age, salary history, etc., and other information such as conversion factors, interest rates for lump sums and so forth.

Although notices of plan benefits must be sent to all participants and beneficiaries, the information required to be provided to participants or beneficiaries who were in pay status for more than one year as of the proposed termination date is limited to the following: (1) the amount and form of the benefit in pay status; (2) the amount and form of any benefit payable to a beneficiary upon the Participant's death and the name of the beneficiary; and (3) the amount and date of any increase or decrease scheduled to occur after the proposed termination date with an explanation of the same.

Notice of noncompliance. The provisions for PBGC issuance of a notice of noncompliance is new under SEPPAA. The PBGC must issue this notice within 60 days after receipt of a valid standard termination notice in order to stop a proposed standard termination and thereby prohibit a plan administrator from making the final distribution of assets. The PBGC will issue a notice of noncompliance if it determines that any of the notice requirements were not met or that there is reason to believe that the plan is not sufficient for plan benefits. Under SEPPAA, if a plan is not sufficient for benefit commitments at the date of distribution, the proposed termination is nullified and the plan continues as an ongoing plan. For plan terminations for which a notice of intent is issued after December 17, 1987, if the plan is not sufficient for all benefit liabilities at date of distribution, the plan may not distribute assets.

Unless the PBGC issues a notice of noncompliance barring the termination, and assuming that the plan can in fact satisfy benefit liabilities, the plan administrator must close out the plan in the same manner as under prior law and submit a post-distribution certification to the PBGC within 30 days after completion of the distribution. If the plan proves to be insufficient to provide all benefits, the termination must cease. If assets are sufficient and the distribution is completed, the plan administrator must submit a post-distribution certification to the PBGC within 30 days after completion of the distribution.

The post-distribution certificate must state the following: (1) the name of the insurer, if any, who is providing annuity benefits; (2) the date the distribution was made; and (3) the location of plan records.

In addition, the plan administrator must certify to certain information regarding the distribution. Our suggested wording is "I certify that to the best of my knowledge and belief and with the understanding that knowingly and willfully making a false, fictitious or fraudulent statement to the PBGC is punishable under 18 US Code Section 1001." After plan assets are allocated and distributed in accordance with Section 4044 of ERISA and the PBGC's regulation on allocation of assets and all plan benefits and beneficiaries have received all benefit liabilities or commitments (depending upon the date of the notice of intent to terminate under the plan), this certification should be returned to the PBGC. It should be identified by the name of the plan and a case number assigned by the PBGC.

I would like to talk about distress terminations. A plan may terminate in a distress termination only if the following occurs: (1) the plan administrator issues a 60-day advance notice of intent to terminate to affected parties, including the PBGC; (2) the plan administrator issues a subsequent termination notice

to the PBGC called a distress termination notice; and (3) the PBGC determines that one of the distress tests is satisfied.

The contributing sponsor and each member of its controlled group must satisfy at least one of the distress tests. The liability runs to all members of the contributing sponsor's controlled group and an enrolled actuary must certify to certain required information, including sufficiency and insufficiency of assets.

The distress tests are as follows:

(1) Liquidation in Bankruptcy. A petition seeking liquidation under Title 11 US Code or similar State law has been initiated and as of the proposed termination date, the petition has not been dismissed;

(2) Reorganization in Bankruptcy. A petition seeking reorganization under Title 11 US Code or under similar state law has been initiated, has not been dismissed as of the termination date and a plan termination has been approved by a bankruptcy court or the appropriate state court;

(3) Inability to Continue in Business. A person must demonstrate that unless a distress termination occurs, that person will be unable to pay his debts when due and continue in business; and

(4) Unreasonably Burdensome Pension Costs. A person demonstrates that his cost of providing pension coverage has become unreasonably burdensome solely as a result of declining employment of employees covered under all single employer plans maintained by that person.

The rules for implementing a distress termination are a hybrid of the rules applicable to a standard termination and the rules under prior law applicable to the termination of plans insufficient for guaranteed benefits. We are finding a lot of abuse of the bankruptcy provisions.

MR. DONALD S. GRUBBS, JR.: How is the purchasing of annuities and timing of it related to the remainder of the process? How do you fit in the solicitation of bids timewise with the notice of plan benefits and the time you eventually get around to IRS approval and being ready for distribution?

MR. HINER: The place we start, quite frankly, is working pretty closely with the actuary and letting him know that it is going to take usually six to eight weeks in order to complete a purchase. That is from the time we start drafting the specifications until the time we actually have a placement day and make the buy. It is a matter of working it backwards and fitting it in. I think Paul could elaborate a little bit more because in our firm, we specialize in just doing the annuity placement so it is a focus that can be done anytime during the process and before any of the notifications are done and so forth.

MR. ZEISLER: Annuitization is something that is perfectly legal at any time. Understand that the processes are occurring simultaneously and that one does not have to wait until after the notice of intent to terminate is filed to begin the annuitization process.

MR. J. REUBEN RIGEL: Does GCM 39310 require a one-year look-back in the case where the defined benefit plan clearly provides for the termination of the participant's participation in the plan at his termination date or is that one-year

look-back applicable in all situations regardless? I thought that there was some language in the GCM that led you to believe that if the plan said a person is treated as terminating his participation at termination of employment, then that person is really no longer relevant for purposes of the retirement plan.

MR. ZEISLER: I think that is fair. If we go back to the language which says "who will not suffer a forfeiture of his non-vested accrued benefit under the terms of a qualified plan until he occurs a one year break-in-service," I think the key language is "under the terms of the qualified plan."

MR. WILLIAM CARROLL: In describing the OBRA 87 provisions with regard to contributory plans, one of the speakers said that the change in the rules either permitted an opportunity for employer planning or permitted an opportunity for employer abuse. Which is it and what is the actuary's role in all this?

MR. ZEISLER: Well I suspect that there is a very fine line between use and abuse of an opportunity under the law. It would appear that the responsibility of an enrolled actuary is certainly to the plan participants. On the other hand, most consultants serve a dual role to that of the plan sponsor as well. I think it is a very tough call. I don't think there is a clear answer. In a discussion I was having with Allan earlier, he told me the PBGC would look very carefully to ensure that there was no abuse of the provisions of the new law. Allan perhaps you will follow up on that.

MR. BEARD: We have gotten pragmatic on these things, but we still don't want abuse of the law. If there is a good and substantial reason why it should be one way as opposed to another, you build your case, but we may look with suspicion at something that looks out of line. We're going to look carefully at these things.