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PLAN TERMINATION ISSUES

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- Are plans still terminating?
- Distress and insufficient terminations
- Annuity outlook and procedures
- Alternatives to termination

MS. MARY S. RIEBOLD: I'm a consultant with William Mercer in New York. Larry Zimpleman is a second vice president at Principal Financial Group and deals with annuity products. Ron Gebhardtsbauer is the chief actuary with the PBGC and is the author of the Society of Actuaries study note on plan terminations.

My role will be that of the consultant in this session receiving the call from the plan sponsor who says, "I would like to terminate my plan." Either the plan sponsor will say, "I'd like to get my hands on that money," or "I can't afford it anymore." And I'm going to say, "Well, sir or madam, there are some very interesting issues involved here. Let me go through them for you. First of all, if you think you really do want to terminate your plan and get some money back, you have very complicated problems to deal with on purchasing annuities. You certainly want to recover the maximum amount possible and you should talk to Larry Zimpleman. On the other hand, if you really can't afford your plan, you should know that you've got to pay up anyway; unless, of course, your situation is so bad that you're in 'distress,' and then you need to talk to Ron Gebhardtsbauer. Faced with these alternatives, you may want to keep the plan, and then I'll give you some options."

MR. RONALD GEBHARDTSBAUER: Normally I talk about standard terminations, and there are about 10,000 standard terminations every year. But we thought we would do something a little bit different and talk about distress terminations and what to do when you have an insufficient plan and you want to terminate it. We don't talk about them as often, but we thought we'd give you a little background in this area in case you ever have to advise a client with an insufficient plan. What should we do? What kind of process do we have to go through at the PBGC? Hopefully after I talk, you'll advise your clients not to do a distress termination. It's a very difficult process. The standard termination process is a lot easier than a distress termination process.

Well first off, I want to mention that there are only certain ways of terminating a pension plan if it's covered by the PBGC. Most of you are familiar with standard terminations, but if you want to terminate a plan in any other form, it has to be a distress termination.

I'm going to just mention some of the criteria in order to satisfy a distress termination, but basically you have to be in really horrible financial condition. In the old days you didn't have to be, and people would just terminate their plans and dump them on the PBGC. As you all know from the Long Temco Vought (LTV) case, if you dump it on the PBGC, it may just give it back to you. And the Supreme Court supported the

PBGC. The law says as long as it's consistent with the purposes of the PBGC, the plan can be restored back to the company, and as I mention later in Appendix A, because the dollar had gotten weaker, LTV was doing a lot more in the way of exports, and it also had set up an abusive follow-on plan. So the PBGC decided to give this pension plan back to LTV, and the Supreme Court did support us. That's still causing a little bit of a problem in LTV's reorganization process, and maybe I'll get to that a little bit later too.

But ever since the passing of the Single Employer Pension Plan Amendment Act of 1986 (SEPPAA), a company has to be in really bad financial condition in order to satisfy the criteria for distress. That is the only way to terminate the pension plan if it's insufficient. In fact a court case even says that. You can see it right in the law. It says the only ways you can terminate are through distress or standard. There is one way in which the PBGC can terminate the pension plan. If it sees that the pension plan is really running out of assets, in fact if it's totally out of assets and people are not being put into pay status, the law in fact forces the PBGC to come in and involuntarily terminate the pension plan. Otherwise, that's the only way a plan can be terminated. It is a very long and difficult process (see Appendix A, A[2]), and on average it takes at least six years. The PBGC is still working on a pension plan that tried to terminate back in the 1970s. So you can see that if you're involved in something like this, it could be a long, long process.

One of the things it does is it slows down the reorganization process. LTV is still in reorganization. The PBGC is forcing LTV to put more money into its pension plan. It's so close to zero dollars in assets that we're telling LTV to put a lot of money in the plan right now, and of course that's giving problems to the creditors. They don't like it, so we're fighting back and forth, and it's really drawing out the reorganization process at LTV. If you've ever read my study note, the calculations are quite complex. And when Congress passed the PBGC's rules on what a guaranteed benefit is and how to allocate assets, it never contemplated steel plans or United Auto Worker plans. The calculations are so complex that that's another reason why you don't want to go through a distress termination. I also mention that after you go through all those calculations, the PBGC could still restore the plan.

The last point on Appendix A, A(2) is that it affects the whole controlled group. So if there's no more money left in the plan, we're going to go after everybody. For instance, Eastern Airlines has very little money so we went after Continental Airlines because it at one time was a parent of Eastern Airlines, and so we're putting out a claim against Continental. Of course, Continental then went into bankruptcy too so it's causing us lots of problems. I'm giving you all these reasons to avoid going through a distress termination.

The question now is, if you have an insufficient plan, what else can you do? As Mary mentioned, you can keep the plan going and she'll talk to you about that a little bit later. You can still terminate the plan, and ways in which you can do that are listed under Appendix A (A)3. A substantial owner can waive a benefit, and I guess maybe if you've done something like this before, sometimes the IRS causes a problem. The PBGC has always felt that a substantial owner can waive a benefit, and it will just clear it right on through. I guess the IRS has problems with that person alienating their benefit. It's a cutback in somebody's benefit, so the IRS doesn't like it, but its law on making a plan sufficient isn't the same as the PBGC's. It only looks at the code, and the code includes 401(b)(2) that says money cannot be diverted out of this trust because that trust is there for the employees. You can't divert any money out of that until you satisfy all the pension liabilities. The code doesn't say that you have to be totally sufficient in order to terminate that plan. So the IRS will allow you to do a substantial owner waiver. If you say you allocated assets to the nonhighly compensated first, the nonsubstantial owners. Then if there isn't enough money left to allocate to the substantial owners, that's okay. There's an old revenue ruling that says you can't discriminate when you allocate these monies first to nonsubstantial owners. That's the only thing that the IRS cares about.

Well, that's one way of making the plan sufficient and going standard. Another way is to possibly pay lump sums. Regulation 1.411d-4 says that the lump sum doesn't have to include the value of early retirement subsidies. So that's a possible way. The employees would have to elect lump sums instead of the benefits, but that's frequently the case. So that's another way in which maybe the plan might become sufficient. Enough people must elect these lump sums that don't have the early retirement subsidies in them. I'll mention a court case on that a little bit later.

Another possibility is to buy an annuity from an insurance company that's just a little bit cheaper because of maybe better rates than the PBGC. Even though the PBGC's interest rate appears low, for retired people, our rates are fairly close to an insurance company. Deferred people may be slightly cheaper.

The other possibility is to freeze and fund the plan, but as I mention in Appendix A, the plan is continuing; you must comply with the Tax Reform Act (TRA) and all the coverage and discrimination rules, etc. You also have to keep on having accruals for top-heavy plans. There's a safe harbor where if there are leased employees, they can be given a certain amount of accruals per year, but I think that's only in a defined contribution plan so that maybe is not applicable here.

Also, you can encourage your employer to make a commitment to make the plan sufficient. Under 404(g), you can deduct up to guaranteed benefits, and so there will be a little bit of a problem in getting a deduction. You can also get a deduction up to current liability if there are more than 100 people, but that doesn't cover the subsidies in lump sums. For instance, you have to calculate the lump sum at the current liability interest rate so you may not be able to deduct everything there. It also doesn't cover unpredictable contingent event benefits, USEBs, which are mainly shutdown benefits. It is also not for multiemployer plans. Also, if there is a defined benefit (DB) and a defined contribution (DC) plan, you can't go beyond the 25% of pay limit. By the way, at the PBGC we're working on a legislative package right now that will not allow you to put more money into the plan than now, and it will waive the excise tax. You still won't be able to deduct it that year. You'll have to carry your deductions over the next 10 years, but at least you won't get the excise tax.

At the beginning, I said it's very difficult to terminate an insufficient plan because your company has to be in really poor shape. I list the ways in which you can do it in Appendix A, (4). I think of Chapter 7 liquidation as the death of a company, and reorganization as disability. I used to work at an insurance company many, many years ago, and I'm trying to equate what the PBGC does to the insurance company.

Right now it pays death benefits, the whole big thing, the whole unfunded benefit liability of that pension plan when it is taken over when the company dies, or in other words, liquidates. But also the PBGC pays the whole unfunded benefit liability when it takes over the whole thing even though the company's only disabled. The PBGC takes over the whole pension plan; it is paying everybody's benefits just because that company went into reorganization. Hopefully a few years later, the company will come out of it and be as Wheeling Pittsburgh calls itself now, a mean, lean company because it doesn't have to pay for its old pension benefits. I would have said Wheeling Pittsburgh was disabled for a while, and maybe the PBGC should just pay the normal cost for awhile, or maybe the minimum funding contribution, but those are just my own personal thoughts.

The other ways to terminate a pension plan, in fact the PBGC determines whether this last condition is satisfied, is: in order to stay in business and continue to pay debts, you must get rid of the pension plan. The PBGC will then terminate the plan although we make it very difficult to satisfy that condition. Reasons why plans can be insufficient are listed in Appendix A, (5).

Appendix A, (B) lists what it's actually like to go through a distress termination. The first thing you have to do is notify all participants that you have an intent to terminate the plan. You also have to let the PBGC know, and this is a little bit different than standard terminations, because we are affected. If the PBGC has to take over this pension plan, we have to quickly go into court and tell the judge that we want the assets of this plan. The judge has to rule that the PBGC is now the trustee.

In a distress termination, the plan is insufficient so if it's in bankruptcy, we immediately want to get our claims into court, that the company owes the PBGC. For instance, Eastern Airlines owes us $750 million in unfunded benefit liabilities. We want to get it in there, we want to say what our priorities are. We usually have problems getting our claim reimbursed, and we usually end up with about six cents on the dollar of our claim, and so your premiums pay for the rest of it. That notice has to be made 60 days in advance in standard and distress terminations. (February has 28 days so please count the days.)

Another thing I would suggest, and I always suggest this for standard terminations but it's also very valid here, is to freeze the benefits in your plan and send out the 15-day 204(h) notice because if things go awry and you don't satisfy all the rules, you'll at least have no more accruals after that. The plan's not going to continue to eat up your money. Also, you cannot only stop accruals, but you can eliminate anything that's not protected by 411(d)(6). So those are items like future death and disability benefits or supplemental benefits.

When you do a distress termination, the PBGC is a little bit more stiff. As soon as you say you're going to go into a distress termination, you cannot do any lump sums and you cannot purchase any annuities, because we're afraid we're going to have to take it over. If you provide a lump sum or an annuity, it's harder for the PBGC to go after that person and say, "You got more than a guaranteed benefit and we want to take it back." So that's why you cannot do that. You can just pay those level annuities, and starting on the date of plan termination, you can't even pay the full annuity. Actually our regulations say the plan administrator has to calculate what that person's guaranteed benefit is and cut that person down to the guaranteed benefit. Hopefully you'll get paid if you are asked to do the calculations, which I will bring up later.

Appendix A,(3)i talks about a court case that was in Michigan. The PBGC went into this particular plan where I guess the employer was not very satisfied. The employer was in pretty bad financial shape, and the actuary was not getting paid. But this actuary did all the actuarial work in the past for this client, and the client and the PBGC blamed it on the actuary for not continuing the termination process, and because the whole process did not get continued, the distress termination failed. The required forms were not completed. So the judge agreed with the PBGC that the actuary was at fault, and if the plan ended up being in worse shape because of this failure to satisfy the distress termination process, then the actuarial firm was actually subject to paying the PBGC some of the difference that was caused by that. That's something that lawyers are very used to. They're on the hook for that client until they send that client a letter saying that because you're not paying us, we're going to stop working for you. So if that ever happens to you, you should put something in writing to the client saying that you are not going to be doing work anymore because you're not being paid. So that should be in writing; that will save you.

The next step is you have to send in the distress termination notice, PBGC form 601, and EA-D. We can determine whether each member of the controlled group satisfies one of those distress criteria, which they have to, and it also will tell us if this plan is sufficient or insufficient.

Just like in standard terminations, a collective bargaining agreement can stop the whole process.

Who owes the PBGC money? The whole controlled group, it's in our law, is jointly and severally liable. So for instance, since Eastern went down, we're going after Continental. And what does it owe us? It owes us the unfunded benefit liability as of date of plan termination, and our claim is in two parts. The unfunded benefit liability is equal to the unfunded guaranteed benefits. That's what the company owes the PBGC. In a way, you can say that's the claim the PBGC has. The PBGC has to pay at least guaranteed benefits so the excess of the value of those guaranteed benefits over the assets in the plan, and there are some caveats to that, is what they owe the PBGC.

But the unfunded benefit liabilities equal that plus what we call the outstanding benefit liabilities, and that's sort of a claim that the PBGC now is putting in for the participants because their benefits got cut back. They now have a claim, and so we go together to bankruptcy court for ourselves and for the participants, and try and get as much money as we can. In the old days, we only had to go in for ourselves. We now have to share our money in effect with the participants. We pay them the guaranteed benefits and then when we get money say from Continental, we would go back to those Eastern employees and tell them that they get the guaranteed benefit plus a little bit more of the collections that we got from the employer. So that's something new for us to do. We don't usually get very much money from the companies. Right now we get a lien for 30% of the net worth of the companies, and most of the time, the net worth is close to zero so we're getting zero. So part of our legislative package is that we want to change that lien amount that we have against the employer from 30% of net worth up to 50% of unfunded benefit liabilities, and we'll gradually have that phase in from 10%, 12, 14, 16, 18, all the way up to 50%.

We also have another claim in bankruptcy, and that is for the employer contributions. Typically, they haven't put contributions into the pension plan for a few years. I don't know if you've had any distress terminations in your client base, but usually not only have they not been paying the actuary and they haven't had any actuarial service for three years, but they also haven't been putting any money into the pension plan. So that is also a claim of the PBGC.

And the other thing that we get is if there were any waivers that still have outstanding balances, those are also a special claim that we put into the bankruptcy court. The full amount of the outstanding balance of that waiver becomes a claim in bankruptcy court and we have priority for that.

I said earlier there were a couple of caveats a pension plan sometimes has. This is kind of rare, but sometimes the pension plan had enough assets that it actually covered all guaranteed benefits. It actually went through all the priority categories, 1, 2, 3 and 4, and covered all those benefits which actually are more than guaranteed benefits. You can actually have some benefits, priority category 3, for retirees that exceed our guarantees so that eats up some money. Eastern may have a plan like that for the pilots. Their plan was fairly well off so their money may cover all the pension benefits through the guarantees. In such a case, the plan sponsor will be told to go out and annuitize and pay at least guaranteed benefits or whatever the assets will buy. At that point, the PBGC is not on the hook, there are no unfunded guaranteed benefits. So the unfunded benefit liability just equals the outstanding benefit liability. So when we go into bankruptcy court, we're not going to have a claim for ourselves because we didn't lose anything. But the pilots did lose something so we go in for them and we get some collections, and the full amount that we collect on the Eastern pilots plan will go to those pilots by improving their benefits.

You probably looked at priority categories when you were studying for the exams and you hoped that you would never have to deal with that subject again. Well, there are a couple more reasons why you need to do a guaranteed benefit calculation. One is if you have a spin-off and there are not enough assets in the plan, you have to do a 4044 allocation; figure the amount of assets that go to these people that you're spinning off. Another reason you might need to do a calculation is if the plan sponsor promises to make the plan sufficient, and then wants a deduction for the whole amount. As I mentioned earlier, you don't get a full deduction. Your deduction is only up to guaranteed benefits, so in that particular situation, you have to calculate guaranteed benefits and priority categories. Also, you have to do the priority category 2 calculation if the plan has employee contributions, and you decide that you want to terminate the plan and get a reversion. I don't know if anybody's getting reversions anymore these days. We've had a few at the PBGC, but they are definitely down; not many people are getting them. Appendix A,(C)(2) talks about a couple changes since you studied this material. Employee contributions, as you know, accumulate at 120% of some federal midterm rate. Then starting at the date of determination, they accumulate up to normal retirement using a PBGC interest rate, and they then are discounted also at the PBGC interest rate. Appendix A,(C)2(b) priority category 6, brings up a few issues. Number ii is the *Tilly* vs. *Meade* case, I don't know if you remember but it went to the Supreme Court, and the Supreme Court said that the district court or the appeals court was wrong, that PBGC's 4044 allocation process is just an allocation process, it doesn't give any more benefits to participants. So they sent it back to the District court and the court came back and said it still thought that these people deserved some of these early retirement supplements. I don't know if you remember what happened, but there were employees who had satisfied the 30-year service requirement but they hadn't satisfied the age-62 age requirement. The company was bought out, and I guess the facility was shut down so these employees were no longer working for the old employer. Under 411(d)6, if employees continue working with the former employer, then that would be a contingent benefit and they could get it. The court said that the employees do deserve the value of that subsidy in their lump sum, and that's being appealed. In fact, the PBGC put in an amicus brief on that.

One other issue that hasn't been resolved is what to do with nonvested people who separated within the last five years and who are really hard to find, and who didn't get a lump sum amount. How far do you have to go back? One question the PBGC has always asked is, does the PBGC force you to pay these people something? I want to make it clear that even though the instructions say these people are active participants, we're not saying that you have to pay them something. We're not saying they actually have a benefit you have to pay. You need to talk to the IRS. The IRS says it is coming out with something this year, and it won't be retroactive.

If the PBGC gets some collections, it has to share it with the participants because they had cutbacks to their benefits. The last part of Appendix A talks about that. I don't know that very many of you will get involved in that, but that's the section where I discuss that participants can get more than just their guaranteed benefit from the PBGC. If we do well and get collections from that company, then we will share it with the participants and give them a little bit more.

And just to give you an example, the recovery ratio is what we collect divided by what our claim was, and we've been averaging six cents on the dollar. In the Eastern case we thought we had a deal worked out with Continental where we were going to own many of their routes to Japan, and there was a lot of confusion about whether the PBGC, a government agency, could own routes. But at one point, we thought we were going to get 100 cents on the dollar. In other words, the PBGC would get the full unfunded benefit liability, so that would have meant that it could have paid full benefits to everybody at Eastern. But that fell through and Continental went bankrupt and sold the Japan routes to somebody else so the PBGC couldn't have them as security. But at one point, if that had worked, our recovery ratio, which was six cents on the dollar, would have gone up to 60 cents on the dollar. We would have been paying a lot more benefits in this area, but because that fell through, we get very little collections so we pass on very little to the participants.

MR. PHILIP M. TENENBAUM: I have a savings and loan client with an insufficient cash balance plan that was taken over by the Resolution Trust Corporation (RTC) a couple of weeks ago. The only thing I've heard up to now from the RTC is that it feels the plan was terminated on the date that it came in. We're wondering what we should do. Do we have a distress termination?

MR. GEBHARDTSBAUER: According to our legislative package, I believe those institutions don't go through the typical Chapter 11 and Chapter 7 process. Our legislative package is going to modify that to say that if you're going through a similar process that will also count as a distress termination, but that's not true right now. I would definitely suggest you contact the PBGC.

MS. RIEBOLD: Did you say your volume of terminations is really down?

MR. GEBHARDTSBAUER: Right. The volume of reversions is down 20%. We also only get about 80 distress terminations a year.

MS. RIEBOLD: Larry, is that also what you found on your annuity quotes?

MR. LARRY D. ZIMPLEMAN: Yes, the numbers are down.

I will talk a little bit about sufficient plans. I won't be talking procedure in this part as much as talking about part of the back-end process, the annuity purchase part of the process.

Ron said that distress terminations take six years. Sufficient terminations don't take quite that long. But they take a lot longer than our customers want them to take, and quite often it is 6, 9, 12, or 24 months. So what we're talking about here again is the back end of that process. At this point in time, you've already done your work to do your certifications and so forth. What we see for the most part are the plan sponsors and their consultants coming over to us to seek annuity bids, normally after the IRS and PBGC approvals have been obtained, and also after the employee elections have been made. Ron made a good point about a plan that may be at the margin, maybe a sufficient plan, and some decisions must be made about which forms of distribution the employer wants to offer because that has a big influence in many cases on the level of sufficiency in the plan, again especially when there are subsidized early retirement benefits. So that's one of the critical items you need to discuss with your clients: the form of distributions and how those values will may be calculated.

We do see some situations where annuity buys are made prior to this time. For example, quite often we'll see a 2-piece buy. We may buy the retirees, the vested quits, more near the front end. If there were any subsequent elections, maybe we would go back a second time, which again could be six or nine months later, to make a second annuity buy. Another one we often see is at the front end, again because of some concern. Perhaps the plan is marginally sufficient and the client's concerned, and may go ahead at the front end or much nearer the front end, and buy all the annuities. Again, that would be in a situation with no employee election, and there would be a provision for a refund of those dollars, should for some reason the termination not work out. And I think you certainly want to cover that aspect if you buy prior to IRS and PBGC approvals.

Item B of Appendix B really is stating the obvious. This really is an investment decision, and now the world is kind of coming to understand that, but I've tried to maintain for many, many years that the annuity purchase buy is really only an investment decision. And because it is an investment decision, just like the process of hiring an investment manager, it does involve several steps, it takes a period of time, and there are some anticipatory things that you have to do as you're getting ready to make the annuity buy, especially for plans whose sufficiency levels are close. In my opinion you need to think a lot about what the asset portfolio looks like, and how that relates to the liability portfolio from a durational standpoint and from an asset volatility standpoint. For example, take retirees. Of course, you'd like to have assets of intermediate length. Some sort of fixed income asset would be the most obvious choice there from an asset perspective. You need high quality, you need good liquidity, something that could be easily transferred.

For vested terminations, if you have any of those, you typically would be dealing with a longer duration so you'd need some sort of longer fixed income investment. Again, oftentimes we see those two pieces combined together rather than separate. The active life liability will depend a lot on what kind of distribution options are offered. Again, over time you would want to move as much towards a fixed income investment approach on the active life liability as you could. The closer the plan is to insufficiency, the faster you'd want to make that conversion. The whole idea here again is to get yourself in a position where your asset portfolio and your liability portfolio will perform nearly the same. As I'm sure all of you know, the question of asset sufficiency is not as of date of plan termination, but it is as of date of distribution. So the mere fact that you may have been okay, so to speak, back on the date of plan termination is nice, but the question is, will you be sufficient on date of distribution?

We get lots of questions about how to get the best price, and I don't have any great words of wisdom, but I think procedurally there are a few things that you can do to help yourself. If not necessarily getting the best price, what it may allow you to do is get bids from a wider variety of carriers, and through that process perhaps, you either get the best price or at least you get a better choice so to speak in terms of the annuity carrier. My first suggestion is that you try to time the annuity purchase decision to be as close to the date for transferring money as possible. We still see a number of situations where the annuity request will come in, but there's little, if any, information about when assets are going to be transferred. We follow up to try to get a handle on that, and the answer often is, "Well, I'm not sure about that because I really haven't talked to the investment managers" or so forth. Well, those are the kinds of things that are really going to hurt from the standpoint of the insurance company. The closer the money can be transferred relative to the date of the buy obviously reduces interest rate volatility. If you have a six-month period, for example, between when you decide to buy and when you're going to transfer the money, the insurance company clearly is going to have to take action for that six-month period of time to protect itself. Anytime it is going to do that, it's going to cost you a little bit of money in terms of hedging or the action that it is going to have to take to protect itself so it does minimize hedge cost.

The second thing is that it's important to put in your request for annuity quotes, that in fact an annuity buy will be made. For the most part insurance companies don't need practice quoting. So if you are going to make a buy, put that in there. I think it will really help you, and you'll get a lot more interest from insurance companies if in fact they know another annuity buy is going to occur. As far as the time needed to do a quote, normally it is two to four weeks. Although if Ron comes in with Eastern Airlines, we might ask him for a little bit longer period of time, but normally two to four weeks would be okay.

The other thing that's very helpful, which we're seeing a lot of by the way, is to have the data on tape or diskette. That's a very big help from an insurance company's perspective.

The process of calculating the single premium cost is just a cash-flow discounting process. Whenever there are subsidized benefits – lump sum benefits, death benefits – there is more volatility in the future cash flows, and those are the things that insurance companies generally will react to on a negative basis.

Ron talked about contributory plans. To make that short and sweet, I would just say they add a lot of complication. Ron may think that maybe the rules are in fact well formulated but I still see a tremendous amount of confusion about how to handle contributory plans.

MR. GEBHARDTSBAUER: I agree.

MR. ZIMPLEMAN: It really does add complications. If there's some way, prior to the annuity buy, to deal with contributory plans, refund employee contributions or some other mechanism, that would be a big help. Again, I think you'll get more interest in terms of quoting on the annuity.

We're now starting to see some plans that have made partial settlements for FASB purposes and now want to terminate and annuitize out the rest of the plan liabilities. Sometimes what's left may be a very long or very short obligation, and again insurance companies may not be as interested in those kinds of quotes.

Another one that causes problems are acquisitions. Some of you may have clients who 30 years ago had some sort of insurance or annuity product with a commitment from an insurer. As a result of that, there is some portion of the benefits, probably small, that another carrier has the obligation on. It is basically still holding money and it is going to pay that obligation whenever, those people come up to retirement. Therefore, there has to be this coordination between the carrier for the termination and the old carrier that had these prior benefits. Again, it is very difficult and complicated. I don't have any good suggestions on how to work with that, other than just pointing out that's another area that causes complication.

Ask about whether the bid can be split, and whether the price is affected. There are times where this can work to your advantage; there are times it can work to your disadvantage. I think insurance carriers are occasionally in different income tax positions. Carriers are on occasion more interested in immediate annuities versus deferred annuities. Carriers are trying to maintain immunized portfolios that fund this business so there are occasions when carriers are more interested in long durations or short durations or whatever it may be, and certainly you should feel free to inquire about that and see whether there's a greater interest in one side or the other there.

How do you pick an insurance carrier? Well, again this gets a lot of focus these days. The buy is fundamentally an investment decision. Now I would maintain that price is understandably and obviously important, but it is far from the only thing that you need to look at. You need to really take a look at the bids very carefully. What's really important is not so much what's in the bid, but what's not in the bid, and that's where the problems occur. Early retirement options are things that need to be provided. Are you sure they're in there? Another area of confusion is optional annuity forms. If the plan would have a basis for optional annuities, you need to make sure that your annuity bid is priced to include that. Survivor benefit is another area of confusion. Know how the bid price is going to be adjusted. It just seems almost inevitable that in every bid, every case, there are going to be census data changes. Work out some procedures so that you're aware of how that's going to happen. Ask questions about the carrier. What kind of experience does it have in administration? The best price up front or even a good price up front isn't going to be worth a whole lot if it's going to cause administrative troubles for the next 30 or 40 years as this carrier tries to administer the single premiums. So think a lot about that. How does it handle this business? Is it a separate unit? Does it have separate people devoted to it or does it somehow try and do it as part of its regular operation? How long has it been at it? What kind of experience are we going to get here in terms of the people who are going to be working with us on a day-to-day basis? Again, these things are obvious, but I'm really not sure how many times they actually get looked at.

Will the carrier offer certain forms of disbursement on monthly annuity payments? For example, does it have a facility for handling a bulk deposit versus individual checks? Does it have a facility for direct deposit? We're seeing more and more usage of these kinds of things as opposed to actually cutting a monthly check. And if they do those kinds of things, is there a price break for doing that? For example, especially in the case of a bulk deposit, we'll make one check each month payable to the trustee, rather than individual checks payable to the members. How about an 800 telephone number, if participants have questions? Is that sort of service available? Are we charged extra for that or is that part of the package price? Another one that is difficult is evidence of birth dates. Is the plan administrator's certification sufficient? If you have to actually go out and get evidence of birth dates, you may find that that's a very, very difficult process. How about annuitants who get to normal retirement age? I'm sure you're not going to have addresses for all the people for whom an annuity buy is made. When these people get to normal retirement, is the insurance carrier going to be helpful in terms of finding them? If you don't know where the annuitants are today, how are you going to track them 20 years from now when they reach normal retirement? Does the insurance carrier have a procedure for dealing with that? If it doesn't find them, then what happens? Will the insurance carrier take small amounts? Again, you may decide that you're going to lump sum out some people. Or maybe you're going to make annuity buys on everybody, but you have a few people who have small amounts. Will the carrier be willing to take some of those? Again these can be very important considerations for a given case.

One of the key issues today is insurer solvency, and I have no particular great insight into this. Certainly there are credit ratings. I think you're all familiar with Moody, Standard & Poor's, Duff & Phelps and all the others that are out there. You need to look at not just where they are today, but you need to gain a sense of how those ratings have varied over time. Are we dealing with somebody who has shown us through prior periods that they know how to manage their business? Or is this somebody whose credit rating seems to bounce around a little bit? This would imply maybe some instability in terms of their management capabilities. You can get good information from annual statements about the quality of asset portfolios. I would not maintain that you'd want to rely totally and exclusively on the credit ratings. I think you want to do some of your own investigation, ask a little bit about their investment management approach. As I said before, I would assume in most cases they're dealing with immunized portfolios, but check that out. What are their particular guidelines for their portfolios, asset-liability matching, segmentation, etc? Finally, depending on the state, you want to know what the situation is for guaranty funds.

MR. THOMAS B. BOWLING: Have you ever been in a situation where you've gotten a bid, and then you find out there may be potential unknown claimants? Would you ever give a quote on an unknown number of people who may make claims on the fund at a future date?

MR. ZIMPLEMAN: Are you describing a situation where the employer knows that there are unknown claimants, and they're somehow asking us to step in that situation?

MR. BOWLING: Yes.

MR. ZIMPLEMAN: I don't recall to my knowledge that that's ever come up.

MS. RIEBOLD: Ron, what would the PBGC require?

MR. GEBHARDTSBAUER: In order to complete the termination process, the plan administrator has to sign a form saying that participants whose lump sum benefit is less than $3,500 will be given cash, and participants with present values over $3,500, have an irrevocable commitment.

MS. RIEBOLD: And what happens with the people who you know about, but just can't find?

MR. ZIMPLEMAN: Well, now it gets to the point I had about willingness to take small amounts, because that's usually where we see it come in. Most of the time, the employer knows they're out there, it just doesn't know where they are. Since the employer has no way to get rid of them, we are asked to take them.

MR. GEBHARDTSBAUER: You can also get information from the Social Security Administration and the IRS. The PBGC no longer directly helps in that area as much.

MS. TILLIE Y. CROSBY: Do you treat immunization on a contract-by-contract basis or on an aggregate basis?

MR. ZIMPLEMAN: It would be on an aggregate basis.

MS. RIEBOLD. Someone had a question that I offered to ask about a plan that he thought would be sufficient when it terminated. I reminded him that the first thing that should be done is to freeze the benefit. If, by the distribution date, the plan turns out not to be sufficient, what are the choices? The sponsor either can make the plan sufficient or try to undo the termination. This person then asked if the PBGC would be agreeable to the latter. I said that the PBGC is in business to keep plans going, so of course it is likely to be agreeable. Was that the right advice?

MR. GEBHARDTSBAUER: Yes, in fact a court case specifically allowed an employer to undo a termination. (The employees sued because they were looking forward to some cash.)

MS. RIEBOLD: The person then asked what happens with all those funding standard accounts in the meantime? We decided that they still run, and there may be excise taxes to be paid for the intervening years. Any objections to this advice? (None received.)

MR. GERALD ANTHONY SCHILLACI: Is there any problem with an insurance company that's terminating a pension plan, to purchase the annuities from itself and not solicit bids from other companies?

MS. RIEBOLD: I know that the choice of a carrier is a fiduciary action which would be actionable if the carrier was ultimately unable to pay the annuities. I doubt if it's a prohibited transaction. I have been involved with a controlled group that included an insurance company that had purchased annuities from themselves.

FROM THE FLOOR: It's a plan termination with surplus assets so there will be a reversion. The question is whether the IRS has any interest in the basis of the annuity purchase or whether or not that affects the amount of the reversion tax.

MS. RIEBOLD: That's a good question. In a 1989 case, the IRS was not very specific on how it valued participating annuities. You would think it would be a lot more specific because this valuation does affect the reversion and the excise taxes. So far, however, the IRS has accepted roughly-conceived logic and calculations of what the constructively-received amount should be when the annuity is a participating one or has some features of a participating annuity.

If the volume of standard terminations is down and if the volume of insufficient terminations is down, has anyone done any of these things we're going to discuss next? In the old days, we used to say, "Well, you don't really have to terminate your plans to use the surplus money." There are always ways of putting some of that surplus to your advantage right there in the fund; and of course the most obvious way that can still be done is to use it for funding holidays and that's certainly true. You used to be able to go a little bit further than you can now and pay expenses from the fund. Benefits departments had been known to incorporate themselves and just pay all the salaries and the rent and everything right from the pension fund. They've tightened up a little bit on that. They used to think of creative ways to tap the surplus or reduce the excise tax that's payable.

Appendix C summarizes ways in which plan surplus monies can be tapped. The first page of Appendix C is a summary in words; the second page is a summary in numbers; and then after that, there are some details. I believe they adequately cover the issues pertaining to "Reaching Excess Assets After OBRA 90."

I'll bring back to the table the question that we had already. What about insurer solvency issues? We know the PBGC has been protesting, maybe a little too much, here. Why don't you tell us what the story is, Ron?

MR. GEBHARDTSBAUER: The PBGC's official position is that this is a Title 1 issue, not Title 4, not PBGC, and that means it's a fiduciary question. As Larry was saying earlier, it was an investment decision earlier of the employer and the employer's sponsor has to deal with that issue now.

MS. RIEBOLD: Are you permitted to say what your official position is? That annuities after they have been purchased, that –

MR. GEBHARDTSBAUER: Oh, right, that we're not going to guarantee them.

MS. RIEBOLD: And so if an annuity carrier from whom you purchased an irrevocable commitment turns out to be unable to pay those benefits, that's just too bad. They will not go back to the PBGC for payment.

MR. GEBHARDTSBAUER: Right, and the General Accounting Office (GAO) just did a study recently. It said it agreed with our legal interpretation of Title 4 saying that that's not something for the PBGC covers. Insurance companies probably also don't want us in there because we would probably start wanting to regulate the insurance companies.

MS. RIEBOLD: I know there are a lot of tax issues and we probably aren't the people who have the answers, but if the company itself decides to make whole any payments, even if it's only temporary, is that a nondeductible contribution, assuming it exceeds the tax-deductible limits, and is it subject to excise tax? Conceivably, some of you were at sessions where the IRS has spoken on that, and if you happen to know answers, we'd be pleased if you could share them with the group.

MR. GEBHARDTSBAUER: Appendix D is called miscellaneous standard termination items. One thing that I thought might be helpful to you is when you're doing a standard termination, just to kind of get a feeling for what's really important, what the PBGC is going to reject. The PBGC is going to reject what you've done if there's been an incomplete filing. Maybe you didn't sign the forms or you didn't fill in a date or something like that. In the old days, a lot of people did not fill in the date when they notified their plan participants of their benefit commitments, and that was because you had to use these old forms where you had to cross out something and then you had to fill in some other lines, and it never asked for the date so a lot of people never gave it to us. That was an incomplete filing so we had to send it back and people had to fill it out again with the complete answers and all that sort of stuff. That just made the process a little bit longer. We get 60 days to review your application. The clock then stops and starts over, so when you give that information back to us with a complete filing, then we get another 60 days. The only thing that really does is delay your distribution. At one time somebody asked me, would that cause problems with these increased reversion taxes? The reversion tax went from 15% to either 20% or 50%, depending on what Mary was talking about a little bit earlier, and actually the answer to that was no. We're just slowing down your distribution, but actually the OBRA 90 said that if you had your notice of intent to terminate prior to September 30, you would use the old 15% excise tax rules.

One thing that's really important, if you are not a member of the Pension Section, I would encourage you to get into the Pension Section. We have a good newsletter and Susan Smith wrote a little article warning you that when you fill out the PBGC forms, please put the 90- in front of your enrolled actuary number. Some people actually had their standard termination notices rejected because they didn't have the 90- in front; so do put that in there.

The worst thing that could happen to you is if we find that you have a noncompliant filing. That's different than incomplete. Incomplete means you just didn't fill out the boxes or sign it or have something like that. Noncompliant is where you didn't follow what the law requires. The law requires for instance that you notify people 60 full days in advance. (That's why I mentioned that February has 28 days.) If you end up being 59 days off, we're going to say the whole thing fell apart and you can't get that date of plan termination that you originally asked for, so that's a little bit worse than an incomplete filing. That is probably the most frequent reason for noncompliant filings. And that probably seems harsh, but you have to remember that we're doing 10,000 of these forms a year. We just have to have rules or people will get lax. And we can't change the law. We have to follow it.

Another place where you can probably run afoul of the law is if your notice of benefits to the plan participants is not sent out before you filed the Form 500 with the PBGC.

If the plan's not sufficient, that's another reason for a noncompliant filing. Only about 5% of filings are noncompliant. Also, one other thing I probably should pass on is that we still don't have a regulation out. The instructions just say that you get 90 days or 180 days or something like that. Those are just safe harbors or guidelines for right now. They don't have the full effect of a regulation backing them up so the law is really in effect, and the law says you have to get it in as soon as possible. So just make sure that's really what you're doing. One time a plan sponsor said that the actuary was busy doing other things so he did it as soon as he could. We told him he could have gone to another actuary who wasn't busy.

Appendix D lists the effects of a noncompliant filing is and it's pretty horrible. You could lose your qualification. One of the reasons why I told you to freeze benefits is so that when the distress termination does not go through and you don't have a termination, at least you're not getting additional accruals.

Appendix D, Item D mentions that the law requires us to audit standard terminations, and we try to audit about 10% of all standard terminations. And one of the things that we do is make sure that every plan participant received all their different possible options; that if they have a benefit they're getting the right benefit amount, that it was calculated correctly. We want to make sure that the anti-cutback rules in

411(d)(6) were not violated. We want to make sure you paid your PBGC premiums. We also make sure that you filed all your forms on time. If you didn't, we could actually say this was a noncompliant termination and we could just undo the whole thing but everybody would hate that so all we'll do is maybe give a $1,000/per day fine.

The two most typical violations are the last two items on Appendix D: married participants didn't get their proper joint and survivorship (J&S) election forms and spousal consent forms, and you have to comply with the plan's terms on the size of the lump sum. It must be the greater of what the plan document would have calculated the lump sum to be. Say you use 6% to calculate lump sums; it must be the greater of that lump sum or the lump sum using PBGC interest rates. You can use a different mortality table by the way.

MR. VINCENT F. SPINA: We're involved with a plan that, before C&L had actuaries, did a spinoff termination. Under the 1984 Joint Implementation Guidelines, the plan was supposed to have bought annuities, but they didn't. Also, there were cost of living adjustments (COLAs) involved with the actives but not the retirees. The plan spun off the actives, then tried to terminate that plan, and now the IRS is saying the plan has to buy annuities. The problem is that no insurance company will bid on this because of the long duration of the COLAs. Any comments on what the IRS should do or could do or what we should do?

MS. RIEBOLD: On the list of benefits that you have to pay, COLAs are certainly one of them; everyone will agree with that. Larry, what do you do if you have a plan provision that you can't get a quote on? I think if you're willing to pay enough, you could probably get the quote.

MR. ZIMPLEMAN: That's probably true. You just have to go and talk to people.

PLAN TERMINATION ISSUES

APPENDIX A

TERMINATING INSUFFICIENT PLANS

A. Evaluating a Distress Termination

(1) Voluntary termination can only be through a distress termination.
  (a) *Philips* vs. *Bebber* (4th Cir. 1990). Title IV is only way to terminate a covered plan.
  (b) The PBGC can instigate an involuntary termination of an insufficient plan to protect itself or plan participants (mandatory if plan is out of cash).
  (c) Can't dispose of plan by selling to weak buyer -- Section 4069, e.g., Navistar sold Wisconsin Steel plant (and plan) to weak buyer. Judge said Navistar owes on plan insufficiency.

(2) It is a very long and difficult process
  (a) Takes at least six years
  (b) Slows down reorganization process
  (c) Filing submission to PBGC is extensive
  (d) PBGC guarantee and 4044 allocation process is complex
  (e) PBGC claims, participant suits, and union problems
  (f) There are under 100 distress and involuntary terminations each year. Each one is heavily scrutinized by PBGC. There are 10,000 standard termination filings annually.
  (g) PBGC could restore under 4047. Supreme Court restored three of four LTV plans to LTV, because LTV was stronger (due to weaker dollar and more exports) and because it started an abusive follow-on plan
  (h) Affects whole controlled group

(3) You should consider other alternatives such as:
  (a) Substantial owner waiver -- PBGC
      Allocate to nonsubstantial owner first -- IRS
  (b) Lump sums without early retirement subsidies
  (c) Annuities
  (d) Freeze and fund
    (i) Continue to meet new laws, 401(a), coverage requirements
    (ii) Top heavy accruals and vesting -- Section 416
    (iii) Leased employee safe harbor -- Section 414(n)(5)
  (e) Commitment to make plan sufficient for a standard termination
    (i) Special 404(g) deductions are only up to present value of guaranteed benefits
    (ii) Deduct up to current liability -- 404(a)(1)(D)
      (a) Doesn't cover lump sum subsidy over current liability interest rate
      (b) Doesn't cover unpredictable contingent event liability
      (c) Can only be used if more than 100 employees
      (d) Not for multiemployer plans
    (iii) DB/DC plans must be careful of 25% limit in 404(a)(7)

(4) Every member of controlled group must satisfy one of the four difficult distress criteria
   (a) Liquidation in bankruptcy = death
   (b) Reorganization in bankruptcy and court determines that distress plan termination is necessary for reorganization = disability?
   (c) Termination required to:
      (i) Stay in business and pay debts, or
      (ii) Avoid unreasonably burdensome pension costs caused by declining work force

(5) Why are plans insufficient?
   (a) 30-year amortization of retiree increases
   (b) 40-year amortization of initial liability
   (c) Contributions waived or missed
   (d) Annuity purchases and lump sum (the PBGC legislative agenda includes adding a cash flow rule to Section 412)
   (e) Declining industries
   (f) Liberal assumptions
   (g) Funding to accrued benefits (not projected) in plans that are frequently improved

B. Implementation of Distress Termination
   (1) Notice of intent to terminate goes to all affected parties (including PBGC using Form 600) at least 60 days before proposed date of plan termination (DOPT).
      (a) Count the days
      (b) February has 28 days!

   (2) Freeze accruals in case something fails and remove ancillary benefits not protected by 411(d)(6) to reduce costs.
      (a) Don't forget 15-day 204(h) notice
      (b) You might request determination letter for plan changes and for termination -- 5310 and 6088

   (3) Only pay pension benefits and death benefits.
      (a) No lump sums or annuity purchases
      (b) Pay all benefits up to DOPT
      (c) Pay only guaranteed benefits after DOPT (or 4044 allocated benefits, if larger).
         (i) The plan actuary should request the assistance of the PBGC's actuaries for this. Plans often can't pay for actuaries' services. If actuaries stop work, they should notify parties involved. Otherwise, actuary could be sued for failure of termination. *PBGC* vs. *Beadle*, 9 EBC 1809 (E.D. Mich. 1988), held that the PBGC may sue an actuarial firm for breach of its professional obligations and for any adverse effects on plan's insufficiency, due to the actuarial firm's failure to file a notice of intent to terminate a pension plan. The PBGC alleged that the plan sponsor directed the actuarial firm to file the notice with PBGC.

The actuarial firm was not being paid, but never told the sponsor, in writing, that it would not file.
- (ii) If termination fails, benefit reductions will have to be returned with interest.

(4) Submit distress termination notice (Form 601 and EA-D) to PBGC, as soon as practicable. Information is needed
- (a) To show that each controlled group member meets a distress criteria
- (b) To determine insufficiency of plan based on actuary's information
- (c) As PBGC responds as soon as practicable regarding whether plan is insufficient and meets criteria
- (d) To provide PBGC with the information to trustee and administer the plan and trust.

(5) A challenge based on a collective bargaining agreement stops the clock.

(6) Plan and whole controlled group are *jointly and severally* liable under Section 4062 to PBGC for:
- (a) Unfunded benefit liability (UBL) as of DOPT (or date of subsequent insufficiency if such happens). This PBGC claim is composed of:
  - (i) The unfunded guaranteed benefits (UGBs) owed to the PBGC for *its guaranteed, and*
  - (ii) The outstanding benefit liabilities (OBLs) owed to plan participants for their benefit reductions.

  UBL = UGB + OBL. The PBGC shares the collections on the UBL claim proportionately with participants, by paying it directly to some of their OBLs under Section 4022(c).
  - (iii) Some of this UBL claim gets a lien (up to 30% of the controlled group net worth, determined on a date chosen by the PBGC within 120 days of DOPT). The PBGC hopes to increase this to 50% of UBL, as net worth usually equals zero.
- (b) Due and unpaid employer contribution (DUEC) or accumulated funding deficiency
  - (i) These amounts have priority in bankruptcy
  - (ii) If large enough, they will be subject to a lien, perfected by the PBGC, for missed contributions under 412(n).
- (c) The outstanding balance of waived contributions (or amortization extensions)

All amounts collected on b. and c. go directly to the trust and could affect benefits through a 4044 allocation.

(7) If plan is sufficient for guaranteed benefits:
- (a) Plan administrator shall distribute all plan assets using a 4044 allocation as in a standard termination.
- (b) The PBGC will just collect on its UBL = OBL claim and pay it to participants, picking up where the assets left off in 7(a).

C. Priority Categories

(1) *Priority category calculations are needed for:*
- (a) Distress and involuntary terminations (insufficient plans)

(b) Mergers and spin-offs of insufficient plans
(c) Deductibility under 404(g) when making plan sufficient
(d) When priority category 2 is needed to determine residual due to employee contributions.

(2) PC2 and PC6 have been affected lately
   (a) PC2 -- accumulate at 417(e) rates. Could exceed accrued benefit. Discount at PBGC rates and mortality. Add in the present value death benefit = refund of employee contributions upon death.
   (b) PC6 Update
      (i) Same desk rule issues
      (ii) *Tilley* vs. *Mead* post-Supreme Court decision gives contingent benefits when employer shuts down facility before employee can meet age requirement, even if provided in lump sum! It's being appealed.
      (iii) Five-year look-back for separated nonvesteds rules may come out this year, but IRS spokesperson said they would not be retroactive.

(3) 4022(c) Benefits
   (a) PBGC's claim = UBL = UGB + OBL
   (b) PBGC collects on its unfunded guaranteed benefits (UGB) claim
   (c) PBGC collects on participants outstanding benefits liability (OBL) claim and gives to participants (through another 4044 allocation on just the OBL's in each priority category)
   (d) Mechanics of calculation
      (i) Recovery ratio (RR) = PBGC UBL collections/PBGC's UBL claim
      (ii) Money to participants = RR x OBL
      (iii) Allocate this money by priority category, starting with where the plan assets left off
      (iv) Only allocate to the OBL in each priority category. Don't allocate to those benefits that the PBGC is already guaranteeing. The PBGC has been compensated for that through RR x UGB.

PLAN TERMINATION ISSUES

APPENDIX B

TERMINATING SUFFICIENT PLANS

A. Time for Seeking Annuity Bids
   1. Normally done after IRS and PBGC approvals and employee elections have been received.

   2. Some buys made prior to this
      a. May buy retirees and vested quits
      b. May buy all annuities (if no employee election) and then refund if termination not approved.

B. Annuity Purchase is an Investment Decision
   1. Should take steps to prepare for annuity purchase well before the time the data are sent out.

   2. One of the very important issues to maintaining sufficiency (or maximum reversion) is for plan sponsor and their consultant to decide on appropriate investment strategy.
      a. Retirees – intermediate length, fixed income assets. Need high quality and good liquidity.
      b. Vested terminations – somewhat longer fixed income investments. Might combine a. and b. into one portfolio.
      c. Actives – depends on their distribution options (and the basis for determining values). But will likely require prudent conversion for fixed/equity combination towards fixed income. The closer to plan insufficiency, the faster you may want to do this.
      d. Reversion – high quality, shorter term fixed income.

C. Getting the Best Price
   1. First, try to time the annuity decision to be as close to date for transferring money as possible.
      a. Reduces interest rate volatility
      b. Minimizes any hedge cost

   2. Let carriers know that a buy decision will be made – companies rarely need practice quoting!

   3. Allow sufficient time to do the quote
      a. Two to four weeks generally OK
      b. Having data on tape or diskette can be big help

   4. Structure of the Benefits
      a. Carriers want benefits that have predictable cash flow – monthly retirement and survivor income benefits are good examples.
      b. Lump sum cash benefits, death benefits, and disability benefits add volatility to the expected cash flow and increase the price.
      c. Contributory plans add complication.

   d. Prior annuity buys sometimes mean remaining plan obligations are not attractive to insurers.
   e. Are there other carriers already obligated for some portion of the benefits?

5. Ask if bid can be split and how price will be affected.
   a. Usually best if split involves combination of immediates and deferred.
   b. May be difference in income tax or effect of annuity on asset (liability position).

D. Picking an Insurance Carrier

1. Annuity buy is fundamentally an investment decision. So price is an important consideration (but not the only one).

2. First, review all bids carefully -- know what is in bid -- and more importantly what is not in the bid.
   a. Early retirement options
   b. Plan optional annuity factors
   c. Retirement Equity Act (REA) survivor benefits

3. Know how bid price will be adjusted if (when) there are census data changes.

4. Think about experience of carrier in administering the annuity benefits.
   a. Is this separate unit?
   b. How long has company done this?
   c. What is experience level?

5. Other Issues
   a. Forms of disbursement for retirees (bulk deposit, direct deposit, etc.)
   b. 800 number for participant questions
   c. Evidence of birth dates
   d. Assistance in finding annuitants at normal retirement age
   e. Willingness to take small amounts

6. Key Issue Today is Insurer Solvency
   a. Evaluate past and future credit ratings
   b. Review quality of asset portfolio
   c. Investment management approach -- degree of asset/liability matching, segmentation, etc.
   d. Existence of guaranty funds

APPENDIX C
Reaching Excess Assets Under OBRA 90 – A Summary

Terminate Plan?	Yes			No
Strategy	Straight Reversion	Transfer to Qualified Replacement Plan	Pro Rata Benefit Increase	*Qualified Retiree Health* Transfer (401(h) account)
Code Section	4980	4980	4980	420
Main Advantage	Employer gets cash without providing additional benefits	Lower excise tax than straight reversion (20% versus 50%)	Lower excise tax than straight reversion (20% versus 50%)	No excise tax (transfer is not treated as a reversion)
Effective Date	*Excise tax increased from* 15% to 50% effective October 1, 1990	Applies to *reversion on or after* October 1, 1990 except if termination was announced before that date	Applies to *reversion on or after* October 1, 1990 except if termination was announced before that date	Applies to taxable years 1991 through 1995 inclusive (may apply to 1990 taxable year if certain conditions are met)
Main Requirements	Plan assets in excess of PBGC termination liabilities may revert to the employer upon following the usual termination procedures	Replacement plan must benefit at least 95% of active participants from terminating plan who remain employed by the employer after *plan termination* Benefits under qualified replacement plan (QRP) need not be the same as under terminating plan. However, as with *all qualified plans*, 401(a)(4) *must be* satisfied Transfer must EQUAL 25% of maximum reversion offset by *PV of certain "final 60-day"* benefit increases QRP may be new or existing DB or DC plan. However, QRP must *be "maintained in connection with* the termination"	Amendment must be adopted granting increases to ALL qualified participants *Proration based on PV of accrued* benefits Must take effect immediately upon termination PV *of increases must be* AT LEAST 20% of maximum reversion (up to 100%) Certain restrictions may cause *increases not to be "pro rata"*	Amount transferred may not exceed lesser of: (1) "excess pension assets" OR (2) *expected year's payments* attributable to "qualified current retiree health liabilities" Only one qualified transfer per taxable year Accrued benefits by all participants must become nonforfeitable as of transfer date *(as if plan had terminated just before transfer)* In the taxable year of transfer, each health plan maintained by the employer must provide the *greater of the previous two* years' "applicable employer cost"

Numerical Illustration

	Straight Reversion	Qualified Replacement Plan	Pro rata Increase
1. Market value of assets	$11,000	$11,000	$11,000
2. PBGC termination liability	10,000	10,000	10,000
3. Maximum reversion (1) – (2)	1,000	1,000	1,000
4. Cost of providing additional benefits	0	250	200*
5. Reversion subject to excise tax (3) – (4)	1,000	750	800
6. Excise tax rate	50%	20%	20%
7. Assumed corporate federal tax rate	34%	34%	34%
8. Total tax rate (6) + (7)	84%	54%	54%
9. Amount payable to IRS (5) x (8)	$ 840	$ 405	$ 432
10. Net reversion to employer (5) – (9)	$ 160	$ 345	$ 368

* It was assumed that the employer elected a 20% increase, although any percentage between 20% and 100% is permitted.

PRO RATA BENEFIT INCREASE

Special Rules

- Present value of benefit increases for inactive participants may not exceed 8% of maximum reversion (any excess must be allocated among active participants on a pro rata basis)

- If individuals 415 limits are exceeded by increases, then excess amounts are reallocated to other participants

- Pro rata benefit increases are exempt from 10-year phase-in rule under IRC Section 415, if nondiscriminatory.

- If 401(a)(4) rules are violated by pro rata benefit increases, then excess increases to HCEs must be reallocated to NHCEs.

The inflexibility caused by these restrictions will likely cause some employers to use the qualified replacement plan approach even though the 25% requirement could be more expensive than the 20% requirement.

TRANSFER TO QUALIFIED REPLACEMENT PLAN

Special rules regarding final 60-day benefit increases

- Increases must take effect on plan termination date.

- Amendment must be adopted during 60-day period ending with termination date.

- Only increases in accrued benefits are treated as final 60-day benefit increases.

- Increases need only be provided to all participants. May be provided to actives only, for example, subject to 401(a)(4) requirements.

- Increases are exempt from 10-year phase-in of 415 limits, if nondiscriminatory.

What if replacement plan is a DC plan?

- Transferred amounts are credited to a suspense account before being allocated to participants.

- Amounts in suspense are allocated to participants ratably over seven years or faster.

New Opportunities?

- Prior law imposed income and excise taxes on transfers from DB to DC plans. Transfers under OBRA 90 are tax free.

- Under OBRA 90 transfers to a suspense account in a matched 401(k) plan will be allocated in lieu of normal matching contributions. However, if 401(k) plan already exists, IRS may argue that it is not "maintained in connection with the termination" of the DB plan.

- Funds may be transferred to a suspense account in a nonleveraged ESOP where they will be used to purchase employer stock (preferably from the employer).

QUALIFIED RETIREE HEALTH TRANSFERS
Special Rules

- Transfer can be made for 1990 taxable year if:
  1. Transfer is made after the end of the 1990 taxable year but before 1990 tax return is filed, and
  2. Transfer does not exceed 1990 expenditures for "qualified current retiree health liabilities" (see below)

- "Excess pension assets" are the excess (if any) of:
  1. The lesser of market value and actuarial value of plan assets, over
  2. The greater of full funding limit or 125% of current liability

- "Qualified current retiree health liabilities" are:
  the unfunded portion of the aggregate amounts that would have been allowable as a deduction to the employer with respect to retiree health benefits provided during the taxable year.

- "Applicable employer cost" for a taxable year is:
  1. The "qualified current retiree health liability" divided by
  2. The number of individuals who received such "qualified current retiree health liabilities" during the taxable year.

- Any amounts transferred but not used to pay health benefits must be transferred out of the 401(h) account back to the pension plan. These amounts are treated as an employer reversion and are subject to 20% excise tax.

- Employer may not take a deduction for the transfer to or for any payments from the 401(h) account up to the amount of the transfer.

- No additional contributions to the 401(h) account are permitted in the taxable year of the transfer.

- For minimum funding purposes, the transferred amount is considered part of plan assets as of the valuation date and is treated as an experience loss. The loss is amortized over 10 years starting with the first plan year following the transfer. (For FASB 87, the transferred amount is treated as a negative contribution.)

- At least 60 days prior to the transfer, the employer must provide written notice to:
  - Participants and beneficiaries

- -- Secretary of Labor
- -- Secretary of the Treasury
- -- Plan administrator
- -- Employee organizations representing participants, if any

Practical Issues

- It may be difficult to predict the amount of the year's retiree health payments. A conservative estimate may be necessary to avoid excise tax.

- Employees should consider whether the cash flow advantage outweighs the disadvantages of pension vesting and restrictions on reducing health payments per retiree.

PANEL DISCUSSION

APPENDIX D

MISCELLANEOUS STANDARD TERMINATION ITEMS

A. Clarification and correction of Standard Termination (Form 500) Instructions

   1. The definition of participant was defined to accommodate whatever definition the IRS makes with respect to five-year look back. The PBGC did not intend to require vesting for them.

   2. Instructions incorrectly state that an accompanying power of attorney be notarized.

B. Incomplete filings

   1. Be careful to complete all the items on the PBGC forms. Because the PBGC receives approximately 10,000 of these forms each year, it is very strict about what is a complete filing. Typical reasons for incomplete filings are: use of old forms, no signatures, missing the dates that the notice of interest to terminate (NOIT) and the notice of plan benefits were issued, and forgetting the "90-" prefix on your EA number.

   2. If the PBGC returns your forms for minor corrections, complete and return them immediately. The proposed DOPT will generally still be valid, but the 60-day period for PBGC review starts over. This only delays distribution of assets and will not force you under a higher reversion excise tax. OBRA 90 did not affect plans with NOIT before 10/1/90.

C. Noncompliant Filings
A worse problem is noncompliant filing. About 5% of filings receive a "Notice of Noncompliance" (NONC), typically because they fail one of the rules or deadlines in the law.
Examples are (by frequency):

   1. The most frequent by far is that the NOIT was not 60 full days before the proposed DOPT.

   2. The Form 500 filing and the distribution of assets, were not "as soon as practicable." As a regulation has not been issued, the deadlines in the form's instructions are only guidelines or safe harbors.

   3. The NOIT and/or the Notice of Plan Benefits were not issued before the Form 500 filing.

   4. There is sufficient reason to believe that the plan is not sufficient for all plan benefits. (If the sponsor commits to make the plan sufficient, include the value of such commitment in asset amount on Form EA-S. Otherwise, the PBGC will issue a NONC.)

   5. Plan administrator never filed with PBGC

The effect of a NONC are:

1. The plan continues – including accruals, vesting, funding, etc.

2. Participants will have only gotten partial distributions, which could lose their tax advantages and rollover abilities.

3. In-service distributions

4. After the appeal period runs out, PBGC will send notices of the NONC to the IRS, which could hurt the determination letter process

D. PBGC Audit of Standard Terminations

Under Section 4003(a) the PBGC must annually audit a significant number of standard terminations. The primary purposes of the audit are:

1. Ensure that participants and beneficiaries entitled to a benefit received all their benefit liabilities and that benefit amounts certified by the Enrolled Actuary are correct.

2. Anticutback rules of 411(d)(6) were not violated

3. To respond to participant complaints

4. To ensure that all PBGC premiums were paid

5. To ensure that all notices were made timely. If not, civil actions may be considered and a $1,000 fine could be assessed.

6. To ensure that annuity contracts provide all elections, notices, benefits, and options to participants.

E. Typical violations that have been caught by the PBGC auditors are:

1. Married participants did not get their proper J&S election forms and spousal consent forms.

2. Plans used the PBGC interest rates to determine lump sums but didn't ensure that the plan rate wouldn't get a larger lump sum (and vice versa).