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PLAN TERMINATION ISSUES

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Recorder: MARY ELIZABETH A. REDDING

- A review of how to terminate a plan
- PBGC requirements and reactions
- IRS issues
- Do reversions occur any more?
- Distribution problems

MS. MARY ELIZABETH A. REDDING: I'm with KPMG Peat Marwick in Los Angeles. Ron Gebhardtsbauer is the chief actuary at the PBGC. He was formerly with The Wyatt Company in Washington and is also the author of a study note on plan terminations. Mary Brauer is a partner with Reinhart, Boerner, Van Deuren and is an attorney specializing in employee benefits.

MR. RONALD GEBHARDTSBAUER: I'm going to go quickly through the steps in a plan termination.

TERMINATION TIME LINE

Chart 1 is a time line of the termination process. Wherever the days appear in quotes in the chart, that time period is in a PBGC proposed regulation. The final regulation is not out yet, so these don't have full force of law yet.

If you want to distribute assets very quickly, it's possible to distribute within 60 days after you decide to terminate the plan.

The long time line is 420 days before you distribute. Actually, you can distribute earlier, but you have to distribute before 420 days.

The notice of intent to terminate (NOIT) has to be sent out at least 60 days before the date of plan termination (DOPT), but the proposed DOPT can be up to 90 days after sending the NOIT. Also, you have to send out a §204(h) notice 15 days before you either reduce or eliminate benefits, including stopping accruals in a termination. After DOPT, you have 90 days to send your form 500 to the PBGC. That's the notice to us that you're terminating the plan. That is the first time that the PBGC knows what's happening, because you don't have to send us the NOIT in a standard termination.

You'll notice there are two asterisks next to that 90 days. That's because we had originally said that you had 60 days after the proposed DOPT, and we've changed it to 90 days. I think the final regulation is going to extend that to something around 120 days, since people find that 90 days after a proposed DOPT is too soon.

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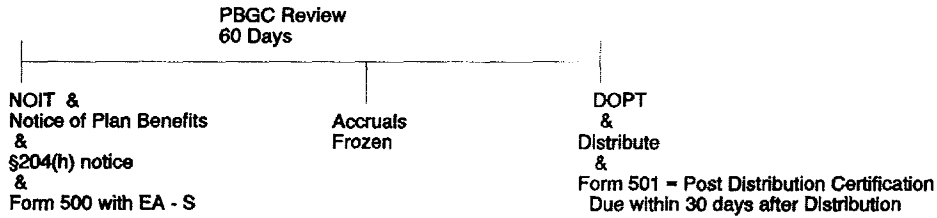
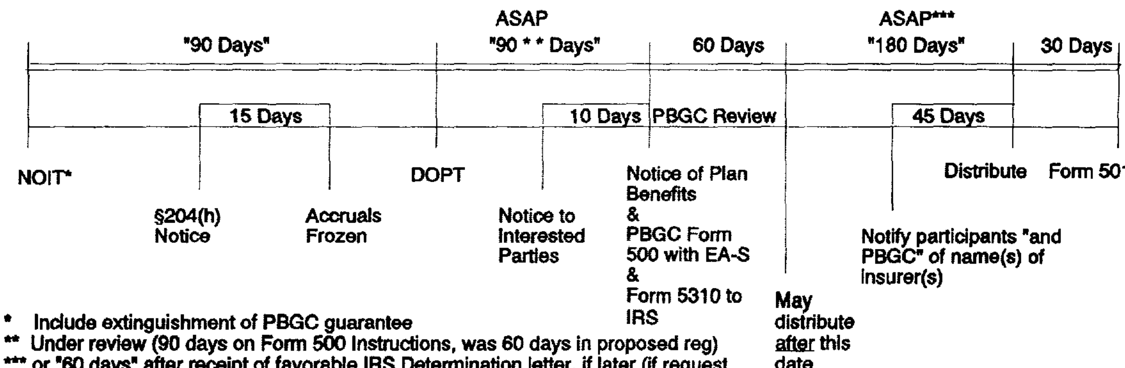
STANDARD TERMINATION TIMELINE

1) Shortest Possible: 60 days

ASAP means "As Soon As Practicable"
Quantities below in quotes are not in Law



2) Longest Possible (w/o extensions): 450 days



* Include extinguishment of PBGC guarantee
** Under review (90 days on Form 500 Instructions, was 60 days in proposed reg)
*** or "60 days" after receipt of favorable IRS Determination letter, if later (if request for IRS Determination filed on or before PBGC Form 500)

After the Form 500 is filed, the PBGC has a 60-day review period to see if everything you filed is complete. There are two things that can go wrong. First, if the filing isn't complete, we will send it back to you and say, "Hey, you forgot to fill in this box," or "You forgot to sign it," or something like that. You send it back to us and then everything is okay. We continue our 60-day period beginning from when you've actually completed the form.

The second thing is worse. It's called a notice of noncompliance. That's where we find you didn't do something in the law; for instance, you didn't send out your NOIT a full 60 days before the proposed DOPT. A lot of people miscount. For example, when the 60 days includes February, they forget that February only has 28 days. That's our major problem: counting. Please make sure to send the NOIT a full 60 days before the proposed DOPT.

Another point is that you have to send out your notice of plan benefits to the participants before you file with us. That doesn't mean they actually have to have it in their hands, but you must have sent it to them before you file. If you haven't done that, you haven't complied with the law. Then we have to send a Notice of Noncompliance, and the termination is dead. You can do an administrative appeal, and if you can explain to us why the circumstances in your case merit it, we can relook at what happened. Otherwise, you don't have a termination.

One of the things we do during the 60-day review period after we've gotten your Form 500, is send you a notice acknowledging receipt of your Form 500. If you don't receive that within 60 days, you should not feel confident that the PBGC has gone through their 60-day review period. If you haven't received an acknowledgment, then you should call up the PBGC and ask if we ever got the form.

After the 60 days, you are allowed to distribute assets. Many people don't, because they want to wait until they get a qualification letter from the IRS saying the plan is still qualified. If you filed with the IRS before you filed with the PBGC, or at least on the same day, then we will let you wait until 60 days after you get the determination letter from the IRS. If you hadn't done that, you get only 180 days after the end of the 60-day review period. Again, that is in quotes, because it's in our proposed regulation and not final yet.

If you are going to purchase annuities from an insurance company, you have to let us and the participants know what insurance company you have selected at least 45 days in advance of distributing those annuities to the participants. If you haven't selected one yet, you can give a short list. This gives us and the participants a chance to react. We will look over the list of insurance companies. You might want to keep the list small, because if there is an insurance company that we're a little uncomfortable about, we'll send it to the Department of Labor (DOL) and then you may get a letter from the DOL saying, "Please let us know why you picked these insurance companies."

Within 30 days after you distribute, you have to send in the Form 501.

TERMINATION CHECKLIST

I have a checklist of all the different things that someone's supposed to, or can, do for a plan termination. Some of these I've already talked about.

1. You have to notify your employees that you're intending to terminate the plan. You also have to notify the affected parties, who are more than just the employees; they could be retirees, or a union. If you don't have a union now, but the union was decertified in the last five years, it is one of the affected parties.

2. One thing that you don't have to do, but that I always mention, as it concerns your assets, is that if the process takes a long time, insurance company prices may increase. They have recently increased, because interest rates have dropped. Lump sums will go up, too. You might be paying out lump sums at a PBGC interest rate. So, right up front, you might want to think about immunizing your assets, perhaps by buying 10-year duration bonds. The other consideration is liquidity needs. You may have to distribute assets quickly, and so you should talk to your investment manager about that now, instead of at the last minute.

3. I talked about the 15-day notice already. Mary will talk later about *Roadmaster*, a recent court case on this subject.

4. Here are some things you might want to think about:

- You can freeze accruals at this point in the termination schedule; you don't have to wait until the DOPT. You can freeze them even earlier, but, of course, at least 15 days after the §204(h) notice. One of the reasons to do that is if your standard termination doesn't go through, at least you won't continue to have accruals and additional costs.

- If you don't want to pay death or disability benefits after DOPT, you can amend the plan and eliminate them. That makes sure that they're no longer in benefit liabilities. Insurance companies, for instance, find it difficult to pay disability benefits after DOPT, so that's another reason to take them out of the plan. Anything not protected by the Internal Revenue Code §411(d)(6) is something that you might want to consider taking out of the plan.

MS. MARY A. BRAUER: You also have to worry about what you've communicated to participants. It's one thing to worry about §411(d)(6) protections, and maybe they don't apply, but also check whether any promises have been made in the summary plan description that could lead you to some contractual obligation to continue those benefits.

MR. GEBHARDTSBAUER: As another example, §411(d)(6) would let you cut not only supplements and future disability benefits, but supplements that are being paid right now. You could also cut somebody's current disability benefit because it's not protected by §411(d)(6). I don't know if you'd want to do that; you'd have a hard time communicating it to your employees.

- You might want to put a "deemed cash-out" provision in the plan for people who are nonvested, separated employees.

- A lot of plans find that it's easier to lump sum people out than to buy annuities, so you might want to put a lump sum provision in the plan, too.

5. The notice of plan benefits to participants and beneficiaries gives them information on the benefit that you expect them to get, and how you calculated it. I have a caveat to this. This is a good time to send the Retirement Equity Act (REA) election and tax information. One problem with sending out the REA election (as to whether the employee wants a joint and survivorship (J&S) annuity or a lump sum, or a life annuity only) is that the election has to be made within 30-90 days before the benefit commences. So, if you're not going to commence within 90 days, you might have to have the election made again.

6. You don't have to request a determination letter from the IRS, but I've heard that that is really being looked into a lot more thoroughly now. There's a box that you have to check on the Form 5500, if you're terminating a plan, asking whether you requested a determination letter. If you didn't, I think there is a high probability the IRS may audit you in two areas. One, they want to make sure you comply with all the recent rules that have come out, including changes due to tax reform. Also, they're interested in the reversion.

7. Some plans don't have enough money in them as of the DOPT, so you should get a commitment from the plan sponsor -- and be sure that it can reasonably make a contribution to the plan - to cover the benefit liabilities. You may have some deduction problems with that contribution. You may have to put in the required amount to get the plan fully funded, and then take some of the tax deductions in future years, over, say, 10 years. Because you've put in more money than is currently deductible and you're carrying it over, I might have said in the past that you might have incurred a 10% excise tax. However, I heard there was a private letter ruling that said since after termination there is no longer a pension plan, there is not a 10% excise tax.

There are a couple of other ways in which you can get the deduction besides normal cost plus 10-year amortization. You can deduct up to the current liability, except for a multiemployer plan or a plan which has under 100 employees. One problem in deducting up to the current liability is that the IRS says you have to use the current liability interest rate when you calculate the present value. You can't go outside that corridor, so there is a possibility you can't deduct the full amount of the lump sums that you're paying out.

Also, if you have both a defined benefit (DB) and a defined-contribution (DC) plan, you can't deduct more than 25% of pay in total.

8. If there is a substantial owner, the PBGC has always allowed it to waive its benefits. The IRS does not like the word waive, because it is alienating the benefit and this causes problems with the anticutback rules in §411(d)(6). So don't use the word waive when talking to the IRS. Jim Holland of the IRS has been at meetings where he said that in these situations where you don't have enough assets, you have to decide who gets the funds. So, just allocate all the way to the nonhighly compensated, but only allocate to the highly compensated employees as far as you have assets. As long as you're not allocating proportionately more to the highly

compensated, then you don't have a problem with §401(a)(4). And, you haven't cut back the accrued benefit.

There's a possibility that in our final regulation, we may say this waiver only applies to majority owners. The IRS seems to be very concerned that a majority owner could twist the arm of a minority owner into waiving a benefit. We define majority owners to include people who own 50% of the company. You can have one or maybe even two majority owners, if the two majority owners each own half. In that situation, we can use what we now call not a waiver, but an "alternative treatment," whereby they do not get their full benefit. That will be another way to make the plan sufficient.

The reason the PBGC has always permitted this is that it doesn't want to take over more insufficient pension plans. The PBGC was happy to allow these waivers to occur, because if it had to take the plan over, and you didn't have enough assets, it would end up giving only a very small guaranteed benefit to the substantial owners. The PBGC decided it was a lot easier to close the plan out in the private sector.

MS. BRAUER: In other words, Ron is saying that we anticipate the IRS will go along with this PBGC final regulation, allowing waivers of benefits by substantial owners. We still don't have the IRS independently saying that these "waivers" are okay, but there is a condition attached that you can only "waive" if you're a majority owner. My question then is, if you have a non-PBGC plan termination, like a small professional corporation plan, will that same concept now carry over? Will the IRS apply this same concept to limit the individuals who can "waive" benefits on termination of that type of a plan? Right now, people in non-PBGC plans are often waiving, if they are owners, to make the plans sufficient.

MR. GEBHARDTSBAUER: Number 9 is the PBGC Form 500 and Schedule EA-S. That's the schedule the actuary signs, saying that the assets are more than sufficient to cover the liabilities in the plan. Back in the old days, we used to have to get all the information to make sure ourselves, inside the PBGC, that the plan was sufficient for all the liabilities. Now we have the actuarial certification process, where you certify that the assets are sufficient. We've eliminated a lot of bureaucracy at the PBGC because of that form.

The liability that you put on the Form 500 for people who are going to get annuities is the cost of the annuity from the insurance company. For people who are going to get lump sums, the liability is the amount of the lump sum. It's not the value of the insurance policy, if they were to buy one from an insurance company, but the amount of the lump sum itself.

Also on Form 500 is a question about whether this is something like a spin-off/termination or a termination where you will reestablish the plan later. If it is, we want to make sure that you comply with the joint guidelines that were put together back in 1984. The joint guidelines came about when the three agencies (PBGC, IRS, and DOL) got together and said a spin-off/termination is just another way of withdrawing assets from a plan, so basically you really terminated the plan. From the perspective of the PBGC, you terminate the whole plan, so we want to make sure everybody vests, and everybody is protected by having an annuity purchased for them. The IRS, DOL and the PBGC are also concerned if all the money is taken out of the plan and then the plan that remains is very poorly funded. So the joint guidelines also say you have to speed up the funding in the remaining plan.

10. You're not supposed to buy an annuity or to lump-sum everybody out before the PBGC review process has finished. You should just do your normal processing of the plan. Don't distribute anything special. The final PBGC regulation is going to have more details on exactly what "normal" processing is like.

FROM THE FLOOR: Is it okay to distribute assets to everyone before the final 60-day review period is over?

MR. GEBHARDTSBAUER: I'd warn you not to.

FROM THE FLOOR: Could you cash out most of the plan participants, but leave the benefits that are due to the owners until after the 60-day review period?

MR. GEBHARDTSBAUER: The PBGC would have some concerns in that situation. Suppose the plan termination did not go through. Then you could end up having lots of problems. You might have in-service distributions. You might have partial distributions because now the plan has to continue and there are more accruals. Suppose the plan ended up being insufficient? At that point, the PBGC has to take it over. If you've already paid out lump sums or annuities, those amounts might be greater than the PBGC's guarantees. We can't very easily go after the insurance company or the participant to get those amounts back, so we can make sure that other people get what they're due up to their guaranteed benefit.

11. One of the things that will stop us is if a collective bargaining group challenges us. They might say that the termination doesn't comply with the collective bargaining agreement. This has actually happened with a company in Ohio. The steelworkers stopped us, saying the collective bargaining agreement never said anything about allowing the company to terminate the plan. It wasn't a standard termination; the company ended up being short on money. But the challenge delayed the DOPT, and the company had to pay full benefits up to the new DOPT. Meanwhile, it had stopped paying supplements, because the PBGC doesn't guarantee certain supplements. The judge finally agreed with the company, that it could terminate the plan, but it took nine more months to do that. So this company had to pay nine more months of supplemental benefits.

12. If you're going to have to get annuities, you have to go to an insurance company. Remember, you have to preserve all the benefits and options and the spousal consent provisions.

13. Here are some fiduciary decisions. Choosing the insurance company is a fiduciary decision, and so is determining how much and how big the lump sum is going to be, by choosing the interest rate you use. Any plan interpretation that affects somebody's benefit is a fiduciary decision.

14. Hopefully, the 60-day period goes by and the PBGC has not said that anything is wrong.

15. If assets are still sufficient, then you can finally distribute, and you must distribute within 180 days. If the determination letter from the IRS has not come yet, you may want to wait until after it does. The PBGC does allow you an extra 60 days after the receipt of that IRS determination letter, as long as you filed the request on or before the day that you filed the Form 500.

16. Within 30 days after distribution, you have to send the PBGC a post distribution form; that's the Form 501.

17. Pay the excise tax and income tax and, of course, the excise tax is not deducted for income tax purposes.

18. You still have to file Form 5500 and the PBGC-1 until you've actually distributed. The last Schedule B you have to file is for the plan year in which the plan terminated.

19. We beefed up our audit staff so that there could be a lot more audits of terminated plans. We now audit about 10% of terminations. We're mainly interested in ensuring that the people received their correct benefits and that the spousal consent provisions were followed. I think one of the items that people get wrong most often is the calculation of the lump sums. We check calculations very thoroughly to make sure you used the correct interest rate. The lump sum has to be at least as big as if you had used the PBGC interest rates in §417(e) on the date of distribution, not the date of plan termination. You can also use the PBGC interest rates at the beginning of the plan year, if the plan document says so.

MS. BRAUER: What I'm going to do is quickly go through some recent tidbits that have happened. Ron alluded to the forthcoming PBGC regulations. That would certainly be the biggest item that we could add to this list of new developments. Are you allowed to say anything about the likely prospect of final PBGC regulations on this whole subject of plan terminations?

MR. GEBHARDTSBAUER: I think they're really close, but I said that back in September, after I had reviewed them. I can just say that they're closer now.

The PBGC is a corporation in the government, and we have three members on our Board of Directors. They're the Secretary of the Treasury, the Secretary of Commerce and the Secretary of Labor. So whenever we want to do anything like change a regulation, we have to send it to all three of those very important people, who are very busy. It takes awhile for that process to go through. The people at the IRS have looked over the regulation and have asked us questions and have suggested some ways to fix to the regulation. We've made those changes, so I think it should be really close. There is still one more hurdle and that is the Office of Management and Budget (OMB). The OMB has to go along with any regulation that goes outside the government, and right now there is a 90-day moratorium on regulations that end up costing the private sector more work, more time, and more money. I think this regulation will help the private sector know what the rules are, so maybe it won't be subject to that 90-day moratorium, but I really don't know the answer to that question.

MS. BRAUER: Did you say that some of these deadlines will be extended, but we'll have to wait to see exactly how the time line works out in the final regulations?

MR. GEBHARDTSBAUER: I think the time period to be extended is the one for sending in the Form 500 to the PBGC. The proposed regulations said 60 days, and the instructions to our Form 500 say 90 days. Commenters have said that is still not enough time.

PBGC REGULATIONS

MS. BRAUER: I'm going to go through recent developments. I think these are things that have happened within the last 10 months to a year. The first point is the fact that the PBGC is joining with the DOL and the IRS in their efforts to make you file reports and give notices on time. To do that, they're adding some penalties; in particular, penalties of as much as $50 a day or $200 per participant for tardy notices or filings. The postdistribution certification is specifically mentioned as being one where, if you don't make that certification to the PBGC on time, they will be glad to send you a bill for the penalties. Of course, all these things are negotiable; the idea is to take what Ron is saying as seriously as possible, and try to meet those deadlines.

The NOIT now must contain a statement that the PBGC has no liability after annuities are purchased. This is the way that the PBGC is alerting the public that if the employer buys annuities from the wrong carrier, it's not the PBGC's problem.

Also, Ron mentioned the need to identify the annuity providers that you're selecting, either in the original NOIT (it is unlikely you'll know what carrier you're selecting then), or 45 days before the distribution. You can submit a list of alternative names if you want to, but remember that they're looking over those and sending suspicious names to the DOL.

MR. CHARLES N. VEST: Ron, earlier in your comments you made a statement that you do some sort of determination of whether you're comfortable with an insurance company. I'm interested in how you determine that and, if you're not comfortable, what do you do?

MR. GEBHARDTSBAUER: Actually it's a very closely held secret. I'm not even part of that process, so I don't even actually know every last detail of the rules. I know the PBGC is very concerned about not letting those rules out, because of the effects it would have on the insurance industry. I think the American Society of Pension Actuaries has filed a Freedom-of-Information-Act request to get that information from us, and our legal counsel was able to make a decision that this was not subject to the Freedom of Information Act. So that is not information that we are providing at the moment.

MR. THOMAS J. MURPHY: I was wondering, Mary, if you could expand on the exposure that the plan fiduciary would have if, in fact, after the plan terminates and you go out and purchase annuities, the insurance company goes under?

MS. BRAUER: Very good question. The Department of Labor is following up on these issues through litigation. Actually, I haven't been personally involved in any of these lawsuits, but I notice that the trend seems to be that the DOL is particularly interested in situations where there is not only a choice of a poor insurer, but as a result of that, the employer received an increased reversion. In other words, by buying cheaper annuities, the employer reaped financial benefit. They are also interested in other situations in which there may be conflicts of interest, such as the insurance company having some investment in the employer through junk bonds. The DOL is sending out a lot of inquiries and has commenced a lot of lawsuits.

The other thing that both the DOL and the PBGC did last June or July was to send out a questionnaire saying, "Could you people in the private sector give us some ideas as to guidelines that we might look at in evaluating annuity carriers?" It was a lengthy set of questions published in the federal register, soliciting comments. Nothing has come out of that yet, that we know of. I think a lot of people are reluctant to try and answer those questions, because they're afraid that the answers will be used to create standards in the selection of these carriers that are either just impossible to actually administer, or that will have this sort of adverse effect that Ron's describing, once these standards become public. Those carriers that are on the wrong side of the line would suddenly be in more trouble than if these were never published, sort of the "run on the bank" kind of situation.

Certainly from a lawyer's standpoint, all the concepts of procedural prudence apply in making any fiduciary decision involving a plan, and the selection of an annuity carrier is a fiduciary decision. No one can be certain that their decision is ultimately going to be the best decision, but by documenting that you went through extensive procedures, that you asked the right questions, and that you looked at the interest of the participants, you will be helped a great deal. Also in conversations on the subject, I know the DOL keeps saying that you must look for the safest available annuity. Whether that always means the most expensive is something that they won't give you a straight answer on.

IRS DEVELOPMENTS

With that, I'll go on to some of these other recent developments that involve plan terminations. We were talking a little bit about waiver of benefits. Again, I'm not sure I should be using the word *waiver*, but obviously, the waivers that we were talking about were used to make the plan sufficient. A technical advice memorandum 9146005 from the IRS says what may be obvious: you can't correct a funding deficiency by waiving benefits.

I'm sure you've heard of the IRS's Revenue Ruling that says that in order to consider a plan terminated, you must distribute assets as soon as practicable after the plan termination. If we're just looking at IRS requirements, our concern now is that we do not have to amend a plan to comply with new tax laws and new requirements, after we thought we had "terminated" it. For IRS purposes, (and it has made some clarifications of this informally in its newsletters), if you get an IRS determination letter and close out the plan within six months, then that plan will be considered to have distributed assets as soon as administratively feasible after the termination.

Certainly there are plans that were thought to be terminated before tax law changes took effect and then it was discovered that, particularly because of the recent revenue ruling, in fact, all of the tax reform format changes in the plan have to be put in, and it has to be updated for any other tax law developments.

Returning briefly to these Executive-Life-type problems, the IRS has given us some assistance by saying that if you're unable to meet the minimum distribution requirements, because part of the plan's assets are with an insurance carrier that is insolvent, it will waive that distribution requirement until you're able to make the payment. And similarly, lump sum tax treatment will not be denied, simply because some of the assets are tied up in insolvency proceedings.

The next point on my list is an unpleasant one for anyone who is a government contractor. If you're a government contractor and you get a reversion from a terminated plan and under your contract with the federal government you have to return the reversion to the federal government, you, nonetheless, according to Private Letter Ruling 9136017, owe a tax on the reversion that you don't even keep. This is certainly an unpleasant situation.

The next item I believe is self-evident, but I know that it's a hot issue with actuaries for small defined benefit plans. The fact that the IRS has issued a favorable determination letter on the termination of a plan does not, in the IRS's view, prevent the IRS from challenging the deductions that were taken for plan contributions made before the termination.

Another point that may be self-evident, but which you might overlook is that in order to reduce the reversion tax on a defined benefit plan termination, you may want to go through this procedure of improving benefits for the participants in the plan, through a pro rata increase as described in Code Section 4980(d). One thing to remember is that the IRS doesn't consider that pro rata increase to be an escape from the usual nondiscrimination rules of §401(a)(4). You still have to make sure that as you're improving benefits to reduce the reversion, you're not violating the nondiscrimination rules of §401(a)(4).

DEPARTMENT OF LABOR

As far as what the DOL is doing, it is very active in the Executive-Life-type problems. It has been granting prohibited transaction exemptions quite routinely for employers who are willing to step up to the plate and say, "We'll take this contract out of the plan and make the plan whole, and we'll see how the losses work out." It's really very routine to be eligible for such an exemption, but these are individual exemptions and you do have to go in and apply for them individually. We're still waiting for more guidance.

LITIGATION

As far as some of the recent court cases, the PBGC has taken its lumps, I'm afraid, in the bankruptcy proceedings involving Long Temco Vought (LTV). There was a string of tough decisions in bankruptcy court rejecting the PBGC's interest assumption. The more recent one, which I believe was in September 1991, just ruled flat out that PBGC claims do not take priority over other unsecured creditors in bankruptcy, and that's a real blow to the PBGC. I know that there is some legislation pending. I believe the chances of passage are considered to be fairly good right now, at least on this point of giving the PBGC some priority status in bankruptcy and letting the PBGC sit at the creditors' committee, so that they'll have a little more control than now.

When you're terminating a plan, you should give the §204(h) notice. That's the ERISA notice that says we're going to freeze benefit accruals, and we plan to do that in the next 15 days. *Production and Maintenance Employees' Local 504* vs. *Roadmaster Corporation* involved a disaster of facts. The employer failed to adopt the amendment before it gave the notice, and then it gave the notice by just posting the notice on a bulletin board. At the time that notice was given, the employer acknowledged there were a lot of employees on vacation and he couldn't really be sure that they all saw it. The warning here is to look at the rules of §204(h), and follow them carefully. Posting is not a good idea, unless you can say, "I know that every individual saw this posted notice." This court leaves open that possibility, but it's unlikely you'll be able to say that. Mailing is a much safer method of giving this notice of freezing benefit accruals.

Another recent case, *Hammond* vs. *TWA*, was a warning both to lawyers and to actuaries about doing what you can to plan ahead for the possibility that a plan termination might result in litigation. From the actuary's standpoint, this case said that the actuary's work papers were not privileged. When the litigation subsequently developed, the opposing side, the people who were suing the plan sponsor for this termination, could have access to the actuary's work papers because they were not prepared in anticipation of litigation.

Certainly when you're terminating a plan, I think it would be very hard in the preliminary work to predict whether or not there is going to be litigation. One thing to keep in mind as you're documenting the plan termination, is that as an actuary, you definitely don't ever want to be put in the situation of being considered a fiduciary to the plan. You don't want to be portrayed as the person who's making decisions between alternative courses of action. So, to the extent that you keep records of decisions that are being made along the way, it would be best to make it clear that you were only offering alternatives to the plan sponsor, and that the decisions were all being made by the plan sponsor.

The other thing is that there were lawyers involved in this case who were saying, "Gee, we have some ability to shield our work product from the opposing side as well." The court came down very hard on these lawyers, saying they were representing the plan and the employer at the same time, which is very common. You know, the employer will come to any one of us and say, "How do I terminate this plan, what are the considerations that I should be giving here?" The court says that because you did not separately represent the employer, and you are now being sued by the plan, you can't claim that all of your work was for one client versus the other, and so you can't be shielded from discovery by the plan participants or those who are suing on behalf of the plan participants.

I don't know if there are any ways to avoid this problem, other than by keeping an eye out for pending litigation and advising a plan sponsor that by using a single lawyer for all purposes, they may be foregoing some protections. And again, assume that what you're doing may be discoverable in court by the opposing side.

Another recent case that I thought would be particularly interesting to actuaries, *Holland* vs. *Amalgamated Sugar*, involved a court challenge to the method that was used to allocate excess assets between employers and employees, for a contributory plan. Ron, would you like to talk a little bit about this case?

MR. GEBHARDTSBAUER: Sure. The law says that when there are excess assets in a contributory plan, you have to figure out what portion of those excess assets are surpluses attributable to those employee contributions. If the employees put in, for instance, 10% of the total contributions, you might then think that they should get 10% of the surplus some day. But the actual calculation is now right in the law, not in the regulations. It says that you calculate the portion of excess assets as the total amount of liability in Priority Category II, divided by the total amount of liability in Priority Categories II-VI. That's the liability due to employee contributions, or benefits attributable to employee contributions, over the total. For purposes of calculating the numerator for a retiree, you calculate the total amount of employee contributions at retirement, and then you subtract out the paid benefits. The law is not really clear there, but it has been interpreted that way. Looking back to a preamble of a PBGC regulation, someone asked if you shouldn't just subtract the employee-provided portion of the annuity from the total employee contributions. The PBGC said that its reading of the law is that you subtract out the full amount of the benefit. In fact, prior to the Tax Reform Act of 1986, that was how individuals handled taxes, too. If within a year or two, you'd already received back more than you had put in the plan, those first payments were considered a return of your own contributions. So you didn't have to pay tax on them.

This particular case, *Amalgamated Sugar,* happened before the law defined what the proportion of surplus due to the employee contributions was. It was back during the period when the law just said that an equitable amount should be going to the employees based on their contributions. The PBGC had a regulation that said under the presumptive method, which is the one that's in the law now, you use the employee contribution liability divided by total liability, as I described before. In this particular case, the retirees were hardly getting anything out of this reversion. I think it was like 0.1 . . . .

MS. BRAUER: 0.0015%.

MR. GEBHARDTSBAUER: Some incredibly small percent. Yet, they had put in lots of employee contributions and thought they deserved more. Evidently the judge said, "It doesn't seem right." The judge felt the employees were correct when they said that about one-fourth of the money going into this plan came from employee contributions, so why didn't they get one-fourth of the surplus? I guess there is a question exactly how to calculate that one-fourth, but still, it was a big difference, 25% versus 0.0015%. The judge sided with the retirees saying that they should have gotten more, to be equitable. Now that was prior to the Omnibus Budget Reconciliation Act (OBRA 87).

MS. BRAUER: So this case says that what's written in the statute doesn't make sense. At that time, it wasn't written in the statute, but now it is. Now this court is interpreting the old statute saying, "Well, that didn't work very well." So I don't know what precedental value this has, other than that it raises a lot of questions about whether the statute is going to work correctly. I think if a lawsuit were brought now, it would be harder for the court to argue that the statute can be changed. You have to go back to Congress to change the statute. So it's a strange situation.

Very quickly, I'll talk about just a couple more cases. *Horan* vs. *Kaiser Steel Retirement Plan* involved a steel company plan that routinely purchased annuities for employees as they retired, but it was running short of money. The investment committee began to realize that in another month, if they kept doing this, they'd be out of money. So they stopped purchasing annuities, and lo and behold, within a year or so, they had to terminate the plan and, of course, the plan was insufficient. All the people who weren't in on the original annuity purchases were pretty mad. They went to court and said there must be some fiduciary breach. The court found against the participants. It said there was no promise made that these annuities would be purchased forever into the future. Again, communications to the employees affect these cases very importantly. The court said it was not an arbitrary practice for the company to do this.

The court also said that if they were going to claim that there was a fiduciary breach there, the claim must be made on behalf of the plan as a whole, and they were just a little group of people from this plan. Of course, they were the group that had gotten the bad end of the deal there, but the court didn't think it could really even apply any fiduciary breach concepts under ERISA when it would just reward a small group. Again, it is a very strange and I'm not sure a very just ruling, but it's from the 9th Circuit. It has very strong precedental value.

MR. GEBHARDTSBAUER: There are other cases like that one, where the assets in the plan were less than the amount of employee contribution balances for each employee, where the assets shrunk to basically nothing. One of the big reasons for that is that a lot of people had annuities purchased upon retirement, or a lot of people were lump-summed out. In those situations, the plan's assets can run down to zero, even though a plan is paying the minimum contribution. That's why the PBGC has the cash-flow or solvency rule that it wants to add to Section 412. It says that if you're paying out a lot in lump sums or annuities, you should at least put enough into the plan so that assets don't go down to zero. For instance, in a plan where assets are less than the present value of retiree liability, you could just buy an annuity for all your retirees, and then you'd be out of assets. The PBGC is really concerned that something like that would happen.

MS. BRAUER: To end on a happy note on these cases, *Mertens* vs. *Hewitt Associates* upholds the concept that you, as actuaries, are not liable as fiduciaries under ERISA. Again, I would advise you, in whatever documents you're creating, to try to always portray your role as not being a decision-maker. Here's a situation that involved an attack by participants, again after a plan termination. The participants sued because the plan's actuary failed to amend its actuarial assumptions to reflect the fact that this was a dying industry and early retirements had increased substantially. As a result of that, a lot more of the plan assets were used up, and the plan was insufficient upon termination. The court said that the actuary was not a fiduciary and could not be held liable for a fiduciary breach.

The plaintiffs in this case then went on to try to argue that the actuary was liable for participating in a breach by the fiduciary. In other words, if you can't label the actuary a fiduciary, the actuary is working with the employer and certainly the employer is a fiduciary. There is a concept that the DOL, and I think even the PBGC, uses at times to bring in knowingly participating individuals who assist a fiduciary in a breach of fiduciary duty. But this court said, "Well that's fine. The DOL can bring that kind of a lawsuit, but it's the DOL and not the participants; participants don't have the right under ERISA to bring that kind of a lawsuit." So, so far, the actuaries have come out very well in these fiduciary lawsuits.

MR. LANE B. WEST: I have a question about a §401(k) plan. I know of a situation where the company has a §401(k) plan that has a GIC with one of these impaired insurance companies, and the rate of interest credited has been reduced. The company has said that it is going to make up the difference, so the employees will get their 10% or 8% or whatever it might be. The question is, I'm assuming the DOL would approve of that, but I'm wondering what the deduction issues might be? This would be a question for Mary.

MS. BRAUER: I haven't looked at that issue, but I believe I have a Revenue Ruling here where it is allowed. There are §415 problems and a lot of issues, but I think there is an opportunity for permission to do that.

MS. BARBARA J. EVERSBERG: I have a question for Ron. On your timetable, let's assume that the notice of plan benefits has been sent to the participants, and the Form 500 has been filed. At that point in time, the plan sponsor has not yet purchased annuities and perhaps has not even solicited annuities. So the enrolled actuary fills out the form, with the best knowledge that he or she has available. After that form is filed, the enrolled actuary gets information that the plan sponsor is not going to purchase annuities. Do we owe the PBGC any explanation, or is the PBGC monitoring the transaction from then on?

MR. GEBHARDTSBAUER: You're saying that some employees may have not elected out of the annuity, but the employer is just refusing to buy annuities?

MS. EVERSBERG: Let's just say that at the time, there was a sufficient plan, but the interest rates have dropped. The plan sponsor doesn't like that situation, and is going to wait for the economic climate to improve. Now at some point, does the enrolled actuary have any responsibility, or does the PBGC have a tickler file where at some point it says, "Get your act together and buy an annuity, or you have to start all over again?"

MR. GEBHARDTSBAUER: We do have a tickler file. If you have not sent in your Form 501, which is your certification of distribution, we will send out a letter asking what's happened, and why you haven't bought your annuities.

MS. EVERSBERG: But on this chart, that could be 360 days, so would you say that you do anything in between? Is that situation worrisome to you? Do you want the actuary to do anything?

MR. GEBHARDTSBAUER: Well, you've got 180 days to distribute. If you don't do anything in the first few months, we're not concerned.

MS. EVERSBERG: So the enrolled actuary really doesn't have to notify the PBGC that the plan sponsor is holding off and that maybe this isn't going to happen? After 360 days, you would do something. Is that correct or incorrect?

MR. GEBHARDTSBAUER: Maybe since I don't know the exact details, I should get back in touch with you. But I don't see that we're going to be concerned before 180 days.

MS. EVERSBERG: Okay. I'd like to squeeze in one other question. Is it still the case that the plan sponsor has to certify that it has distributed to all plan participants, and if someone cannot be located, the sponsor is supposed to open a bank account for that person?

MR. GEBHARDTSBAUER: It's even rougher than that, actually. You'll see it right on the Form 501. The plan administrator has to certify that an annuity has been purchased for anybody whose benefit value is above $3,500. For under $3,500, a bank's escrow account for each individual is okay. We've heard that some people have difficulties working out the individual escrow accounts with a bank. We allow you to pool all the money in one escrow account, as long as you have named a fiduciary who will be responsible to make sure that that money is distributed to the unlocated people when they're found. In fact, the fiduciary not only waits for them to come, but actually actively searches for those unlocatable people.

MS. REDDING: Have you had any comments about plan sponsors not being able to find a financial institution that would go into a transaction like that and open a bank account for someone they're not even sure exists?

MR. GEBHARDTSBAUER: That's why there is that pooled alternative, so that you don't have to do it for each individual. You can do it for all the individuals, as long as there is a named fiduciary who is going to be responsible.

FROM THE FLOOR: Could the fiduciary be the plan sponsor?

MR. GEBHARDTSBAUER: Yes.

FROM THE FLOOR: Is there a mechanism for after, for example, seven years, if a bank account doesn't have any activity, it escheats to the state?

MS. BRAUER: I think the DOL's position is that those state laws are preempted by ERISA.

MS. REDDING: There have been some comments that that period can't start until the benefit was due, which is as late as age 70½. Is there something that overrules the state escheat laws?

MS. BRAUER: That's the DOL's position. I think there is some dispute as to whether it is right. One other comment: sometimes people find it helpful to transfer the liability for missing participants to an ongoing plan of some sort.

In answer to the §401(k) question, Revenue Procedure 92-16 has a procedure whereby you can enter into a closing agreement with the IRS for making restorative payments to a defined contribution plan where you have a GIC insolvency problem.

MR. KEVIN W. MAHAN*: I have a client who had terminated and distributed all his assets in a closely held small defined benefit plan. A year later, the stockbroker handling the assets gave me a call and said that he found $20,000 extra. Everything was originally lump-summed out, and he'd like to distribute the extra pro rata. Any suggestions?

MS. BRAUER: It's better for the participants to have cash that's not eligible for lump-sum treatment than to not have cash.

MR. MAHAN: That subsequent distribution won't spoil the lump-sum treatment that was given on the earlier distribution.

FROM THE FLOOR: It would ruin the rollover that everybody took.

MS. BRAUER: I don't think that's true.

FROM THE FLOOR: But they wouldn't be able to roll this over.

MR. GEBHARDTSBAUER: Because the first part was more than half?

MR. MAHAN: It had a different calendar year.

MS. BRAUER: There is a statement in some committee report that a corrective distribution in a subsequent year should be eligible for rollover. I'm not sure that the IRS has acquiesced to what this committee report says, but I still think the participants would be happy to have the money, even if they couldn't roll it over. Have you finished the termination procedure?

MR. MAHAN: Everything is wrapped up.

MS. BRAUER: Were there any communications to the participants saying you distributed the entire amount?

MR. MAHAN: Yes. All the disclosures were made.

MS. BRAUER: I guess I'm just wondering if the employer is thinking of taking it back as a reversion.

MR. MAHAN: Well, the company was sold to another interest.

MS. BRAUER: Oh, I see. Well yes, I'd want to look at the document. Now that you've discovered there are more plan assets, you would just look back to the documents as to how to distribute this.

* Mr. Mahan, not a member of the sponsoring organizations, is owner of Mahan Actuarial Consultants, Inc., in Pasadena, California.

MR. MAHAN: I have another question also. I'd just like to know if there is any actuarial funding technique that you might be aware of that would be helpful in creating a deductible contribution; that would allow the assets to be brought up to the present value of accumulated benefits for termination?

MS. REDDING: It's a tricky question and I don't know if there are any real answers. You can fund up to your full current liability. The IRS says that if you're paying lump sums, you can't use the lump sum value because those interest rates are not within the current liability interest rate range. You could think about changing your valuation date to the end of the year of plan termination. Maybe at that point most of your benefits are paid out and you don't have any liabilities or assets, and maybe those contributions become deductible.

MR. MAHAN: Well, assume that there are less than 100 people in the plan.

MS. REDDING: You can contribute up to the amount of guaranteed benefits, but that's not going to help you. If you can't use current liability, the only other thing you can do is look at your funding assumptions, which might not be as conservative as they ought to be in some way. But generally, it's really hard to get a full deduction if you can't find some way to use the current liability rule, if you're paying lump sums.

MR. MARK A. COHEN*: We occasionally have plans that terminate with the PBGC, and between the date of our 500 filing and our distribution date, we are advised of discrepancies in employee data, such as date of birth. As long as the plan remains sufficient and we correct our calculations, is there any additional requirement to report different liability amounts resulting from these discrepancies to the PBGC?

MR. GEBHARDTSBAUER: As you point out, if you still are very much sufficient, I don't know of any particular requirements.

MS. BRAUER: I have one other topic I will address just briefly. Often when you're filing for a plan termination, you'd really like to clear up any issues as to whether or not there was partial termination of the plan shortly before the plan termination.

The IRS form for terminating a plan, the 5310, is not the form on which you indicate that you would like a ruling regarding whether or not there has been a partial termination of the plan. That box appears on Form 5300. Since the partial termination concept is so nebulous, you may want to consider filing both forms and paying both fees. The IRS standards are so nebulous, and now the courts have gone in with different views as to whether you exclude certain vested participants or nonvested participants in calculating the ratios, and also as to whether there has been a cutback in accrued benefits that may lead to a partial termination.

Another question is, what experience have people had regarding the IRS requiring full vesting of people who have not had a break in service as of the plan termination date? Is your experience that they are going back five years and saying you need to vest anybody who left within the last five years with a partially vested benefit,

* Mr. Cohen, not a member of the sponsoring organizations, is President of Actuarial Ideas, Inc., in Spring Valley, New York.

because they have not had a break in service, and what are you saying in your plan documents to try and avoid these problems?

MS. REDDING: On that subject Ron, do all those people have to get all the PBGC filing notices? And would you ever check the notice to interested parties or the NOIT?

MR. GEBHARDTSBAUER: We defined "participant" to include nonvested people who left within the last five years, as well as partially vested people no matter how long ago they left. So, they are supposed to get the notice. Whether they have a benefit or not, that's really an IRS question, and the PBGC has not made a decision that these people need to get a benefit. We purposely left it vague so that it's left up to whatever the IRS decides, and that's where you might want to try the idea "of deemed cashout" and say that they are no longer participants in the plan. They got their zero dollar/check and that means that all rights to anything in the plan have been forfeited.

MS. REDDING: You didn't answer whether or not you're checking.

MR. GEBHARDTSBAUER: If there is an audit, are we checking to make sure you did that? I guess it could happen on the audit. If you didn't deem these people cashed out, we could check someone who has left recently. It would be important if you terminated a whole bunch of people right before the DOPT, or a partial termination maybe occurred right before the DOPT. We'd probably want to check those people and think about whether they really should have been fully vested.

I did remember one more thing that we check on the audit that I had forgotten at the end of my talk. We not only check the amount of the lump sum, to make sure that it meets the minimum under §417, using the PBGC rates, but we also check to make sure that if, for instance, the plan says that lump sums are calculated at 5%, you are using the plan's 5% interest rate. A lot of people are not doing that. We find it on audit and go back and tell them to make it the correct amount. That goes back to that earlier question of how to deduct it. I guess you just have to deduct it ratably over 10 years, as the IRS is saying.

MS. CHRISTINE P. DAILLAK*: Do you feel that the court case on the actuarial assumptions has any significance to actuarial liability for small-plan audit?

MS. BRAUER: I doubt it. Unfortunately, this is an issue of fiduciary breach under ERISA. You're concerned about the IRS and its standards for deductibility. I'm afraid they are two different issues.

* Ms. Daillak, not a member of the sponsoring organizations, is with Lebenson Actuarial Services, Inc., in White Plains, New York.