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RECENT RULING AND REGULATIONS UPDATE -- LATE-BREAKING DEVELOPMENTS

Moderator: MARTHA PRIDDY PATTERSON*
Panelist: JOAN M. WEISS
Recorder: MARTHA PRIDDY PATTERSON

The panel will review rulings, regulations, and announcements that have been issued in the last year. The session will be an overview and not a detailed analysis.

MS. MARTHA PRIDDY PATTERSON: We will try to focus on the kinds of things that we hope you want to hear about. I'm going to talk a little bit about bankruptcy and things that are happening at the Pension Benefit Guarantee Corporation (PBGC). Joan, of course, will talk about what's happening at the IRS.

MS. JOAN M. WEISS: I'm going to talk about six or seven pieces of guidance that have come out of the IRS, mostly in recent months. I'm going to talk first about Announcement 92-29, which extended the effective dates for the 401(a)(4) and related regulations. Announcement 92-81 is the data procedure announcement for 401(a)(4) substantiation. I'm going to cover Revenue Procedure 92-42, which, in effect, repeals Revenue Procedure 89-45. After I look at those three, I'm going to talk a little about the Internal Revenue Service business plan, which may be new to some of you. Then I'm going to talk about three smaller items, but I'm not sure that I want to go into detail on them. The first of those is Announcement 92-56, which concerns the new line on the Schedule B. There's Revenue Procedure 92-16, which is on closing agreements. The IRS is now prepared to make closing agreements for people making restorative payments, in cases where there's an insurer who's under state delinquency proceedings. Revenue Procedure 92-24 is on IRS determination letters for 401(h) transfers. Those are the topics I intend to cover.

Okay, Announcement 92-29 was issued, extending the effect of compliance with a whole group of regulation sections. These sections -- I'm just going to read for completeness -- are 401(a)(4), 401(a)(17), 401(l), 410(b), 414(r), and 414(s). The effective date for compliance with these sections is the first day of the plan year beginning on or after January 1, 1993. The effective date for compliance with these sections for tax-exempt organizations is the plan year beginning on or after January 1, 1995.

These same six sections are also now covered by reasonable good faith from their Tax Reform Act (TRA) effective date to their compliance effective date. The Announcement had three or four other, minor items that are just worth mentioning quickly. Government plans have to begin complying with the applicable parts of these regulations for the first plan year on or after January 1, 1995. The 401(b) remedial amendment period for amending the plans has been extended to the last day

* Ms. Patterson, not a member of the sponsoring organizations, is Director of Employee Benefit Policy and Analysis at KPMG Peat Marwick in Washington, District of Columbia.

of the 1993 plan year, and for tax exempts to the corresponding later plan year. You can continue to rely on Alternative IID through the last day of the 1993 plan year.

This extension was set up to allow employers more time to look at the regulations, to understand them, and to consider their alternatives. Again, as we said, the Service and the Treasury are really interested in your further comments. We'd prefer them in writing, simply as I said before, because we do circulate them. Any comment is widely read, and I hope it will become apparent to you that your comments do matter. We do try to incorporate them into the guidance we provide. We intend, again, to issue future regulations.

People often ask me what reasonable good faith compliance is; what you're allowed to have until the regulations go into effect. I view this as acting in accordance with a reasonable interpretation of the statute, based on all the relevant facts and circumstances of the case. There are basically two things that I look at as safe harbors for good faith compliance. That is, we've issued a lot of proposed, temporary, and final regulations in these areas. Compliance with any of these will certainly be considered reasonable good faith during the reasonable good faith period.

Another way of looking at reasonable good faith is that Pretax Reform 1986 positions are generally okay, unless they're specifically modified by the statute.

Again, looking at reasonable good faith, I want to point out the three sections where there isn't any reasonable good faith. These are sections where the statute and the applicable regulations do apply. That is, 401(a)(26) on minimum participation, 411 on vesting and accrual of benefits, and 414(q) on the determination of highly compensated employees. Of course, as you probably know, the data procedure changed some of that. But where applicable, the regulations still should be followed. This announcement extended reasonable good faith, which was not in effect before, to Section 401(l) and the part of Section 410(b) that did not concern the average benefit percentage test.

There were some more comments in this Announcement about the retroactive amendment periods. Another thing that didn't change is the way the retroactive amendment period works. If you make use of the period and delay amending the plan, you have to do three things. The plan must comply in operation with all the changes retroactive to the effective date. The plan, of course, must be amended by the end of the remedial amendment period. And the plan must apply the amendment retroactive to the effective date in its wording.

The national IRS has issued guidance to its field representatives on how to apply reasonable good faith in this interim period. Although I'm not sure whether or not this guidance was intended for public distribution, it has been widely distributed. People have read it and asked us questions about what good faith in it means. We are now on a pretty fast track to update that compliance, and my guess is that, it too, will find its way into the press. I've been told by practitioners that it does shape what practitioners' intuitive ideas are about reasonable good faith. It shows you how this reasonable good faith might be applied to specific code sections. I'm not really free to say too much about specifics right now. But that's one of the things that I think will

be out fairly soon. I'm not supposed to tell jokes. But "fairly soon" to the IRS has a lot of different meanings. And you'll have to give it whatever meaning you want to.

Okay, let's move on to the other more substantive item, that is, Announcement 92-81. This is the first in a series of forthcoming guidance concerning Section 401(a)(4), 410(b), and related sections. We've been holding extensive meetings with the pension community to find areas where the regulations could be improved, made more workable, and made more user friendly, to reduce burden and so on. Much of this forthcoming guidance will be based on the comments of practitioners, and issued in a proposed form, again soliciting comments, in writing, if possible.

The major concern of the practitioners did seem to be data collection, and what data to use to substantiate compliance with the nondiscrimination rules. This led to the proposed revenue procedure contained in the Announcement, which talks about changing the substantiation procedure in four major ways. I'm going to go over them briefly and then comment in a little more detail on each one.

The first item is the quality of the data used in the substantiation process. If precise data are not available at reasonable cost, you can use something called substantiation quality data. The second item is single-day or snapshot testing. You can choose a single representative day to do your substantiation. This replaces either the four quarterly tests or the full-year look back. One of the practitioners who came in to talk to us had a very interesting image. That is, the tests, as the regulations are currently written, were a video. And you had to keep your camera posed all the time. We decided the use of snapshot was a reasonably good word, in contrast to the view that many practitioners had that the regulations were a video. Snapshot is older than video, so I don't know.

Anyway, the third item is the simplified method for identifying the highly compensated employees. The fourth item is the ability to skip two testing years if there are no significant changes in the plan, the data, the work force, and so on. Again, at the risk of becoming repetitious, I want to just outline very quickly the specific sections covered by the data procedure: testing for coverage under 410(b), testing for amount of contributions and benefits, determining the current availability of benefits, the rights and features under 401(a)(4), and the test for nondiscriminatory compensation is defined under regulation Section 1.414(s)-1(d)(3). Anyway, collectively these are known as the nondiscrimination rules. Unless stated otherwise in the procedure, it doesn't apply to nondiscrimination amounts testing under 401(k) and 401(m).

I view this proposed procedure as setting an overall standard for the quality of data to be used and the kind of tests that are going to be carried out. I view it that the practitioner needs to establish a high likelihood that the plan would pass actual testing on precise data. And this high likelihood has to be interpreted in a reasonably consistent manner with the intent of the revenue procedure.

What does that mean? I guess I see this means going back to the section in the 401(a)(4) regulations, where it talks about the whole testing procedure being interpreted in a reasonable manner consistent with the purpose of preventing discrimination in favor of highly compensated employees. So what we're asking you to do is set up procedures that comply with the revenue procedure, and have a high likelihood

that things are going to come out the way they would, if all the real data were available.

I'm going to come back through the four items now and try to provide a little bit more detail.

The first one, as I said, was the quality of the data. If precise data are not available at reasonable cost, the employer has the right to use less than precise data. We view this as having two basic ideas. The first of these is the reasonable cost issue, that the data should be the best available for the year at reasonable expense. The second is that the employer should reasonably conclude that demonstrating compliance using these data establishes a high likelihood the plan would satisfy the nondiscrimination requirements if the theoretically precise data were available.

When you apply this definition to defined-contribution plans, you've got to think for a second. Defined-contribution plans do have exact data on the allocations for the plan year. And, in general, that data should be used to the extent it's relevant. However, if your plan is in a safe harbor, and you wouldn't be doing testing on the allocations, you're certainly free to use substantiation quality data to test coverage under Section 410(b).

The second item is the single-day, the snapshot testing. I have to admit, when we first started talking about this, I found it a little bit hard to separate the day from the data, because I'm just so used to doing actuarial valuations on a given date, where you establish the population, and you look at the data. But after having talked about it and thought about it, with the help of the committee members who are lawyers and who have a very different, and often interesting point of view, I think I'm able to separate the two conceptually. The idea is that you fix or set the population by considering only the employees who are present on a specific day, provided that day is representative.

That does leave us the anomaly that there really are some plans that may never have a representative testing date. For instance, the company may be subject to extreme seasonality. And it's not clear whether having the extra employees or not having them is more representative of what the company really does. That type of plan probably doesn't lend itself to snapshot testing.

However, for defined-contribution plans and for employers with more than one plan, you've got to be careful with the day and the date dichotomy. The obvious example is an employer with more than one defined-benefit plan that uses different valuation dates. If you're going to do 410(b) testing, and not collect data on everyone more than once, you have to pick one snapshot date. Collect the data to do the 410(b) testing and then decide how to modify that data, so that you can do the proper kind of testing for 401(a)(4), if you're in the general test.

The proposed revenue procedure talks about a couple of examples. And it talks about one where you need to meld defined-benefit and defined-contribution testing. In some ways, the most interesting and controversial piece of this guidance has to do with how to adjust for plan provisions where snapshot testing would tend to overestimate the number of people who accrue a benefit. The best example is probably a

plan that has a last-day-of-the-year rule. In other words, a defined-contribution plan usually says that a participant has to be present on the last day of the plan year to accrue a benefit. If you were going to test this plan at the beginning of the year, you would say, this is my snapshot, all these people are in it. I would attribute a benefit to all these people. It's fairly clear that in this case, you've got the right denominator, but you've overstated the numerator.

If you were going to test, on a snapshot basis, the same plan at the end of the year, you have the right numerator. But it's clear that your denominator is too small, because you're omitting all the people who have left during the plan year. To the extent this happens in your plan, you have to make an adjustment. The adjustment has to reflect the differences in turnover among highly compensated and nonhighly compensated employees. We can't tell you what this adjustment should be for your plan representing your demographics. However, we have provided some safe harbors. I don't know how clear it is in the procedure that the two percentages provided are safe harbors, but they are certainly meant to be. And if you feel you can demonstrate on your own data that a smaller number is appropriate, you can use it.

The two safe harbors are a 10% safe harbor for the elapsed time and a 5% safe harbor for the 1,000-hour rule. That is, the test you would otherwise carry out has a threshold that's 5% or 10% higher than it would be.

Another comment here is that you adjust the ratio percentage and the nondiscriminatory classification percentage for these things; you needn't adjust the gateway for the average benefit percentage test. That's a question I've been asked a number of times.

Another comment here is that the intent of the snapshot is to include all the plan amendments during the plan year. That is, if your snapshot is the first day, as it's likely to be for a defined-benefit plan using valuation data, you have to consider all the amendments to the end of the plan year. You also need to consider whether the population you're using as the testing population is a reasonable population for that amendment. For instance, let's say you're testing near the end of the year, and you've had an early retirement window open at the beginning. It's probably best, and required, to test that early retirement window on a population that makes some sense for that window. It makes no sense to test it after all the people who have taken the window are gone. You're not going to get the kind of results you want.

Another area where this might be of interest is shutdown benefits. In this case, you need to test a population representative of the population actually eligible for the benefits.

As I think I've said, and I'm going to repeat, you can't use the snapshot testing for the 401(k) average deferred percentage (ADP) test, or for the 401(m) average contribution percentage (ACP) test. However, you can use snapshot testing for other features of those plans; for instance, testing benefits, rights, and features in a plan with a salary deferral.

None of this would make a whole lot of sense if you had to wait until the end of the plan year to determine who your highly compensated employees were. So, as an integral piece of the guidance, we've included a simplified rule for testing highly compensated employees. This rule basically says you can approximate 414(q)(7) compensation based on the data you have. You need to make sure, of course, that the data are projected or annualized, so you get the right kind of number. You can also use the people present on the snapshot date for determining the 20% that constitute the top paid group.

There is a slight modification here if you're going to use this to determine the highly compensated for the ADP and the ACP tests. There are people who you do need to classify who may not be present on your snapshot date. I'm not going to spend time on the rule, but I just want to point out that it's there.

The three-year cycle is kind of self-explanatory. If you do your test, you can use the results of that same test for the two subsequent years. We say this is true if there are not substantial or significant changes. I don't view significant as an absolute standard. I view it as a standard that depends on the test you're performing, the margin by which you pass the test, and how confident you are of the data you use to pass the test. All of these go into whether any given change is significant.

Again, I sound like a broken record, but I want to emphasize that this is proposed, as is much of our guidance. And it's proposed because we want your comments. If we don't receive any comments, something proposed may well go to final. If there's something you don't like about it, please tell us.

The third of the longer items that I'm going to spend some time on is Revenue Procedure 92-42. Basically, I want to give a little bit of history. The Tax Reform Act in Section 415(b)(5) made the $90,000 indexed limit subject to a phase-in over 10 years of participation. This also was made to apply to plan amendments, as well as to newly adopted plans.

The legislative history of that change, however, indicated that it wasn't intended to apply to benefits that were primarily for nonhighly compensated employees. The kind of benefits where the phase-in wasn't really intended to apply are, within reasonable limits, cost of living adjustments (COLAs), early retirement windows, and pay updates to career average plans. Those are the three I think of most.

So we published Notice 87-21 that provided that there was no phase-in prior to the adoption of regulations. But changes in benefit structure, on or after these regulations, would be subject to the phase-in. Notice 89-45 modified 87-21 to provide that, again, as specified in future regulations, the 10-year phase-in applied to future changes. Revenue Ruling 92-42 repealed Notice 89-45, which puts us back in the area where the phase-in does not apply. This does not apply to changes adopted on or after August 3, 1992.

Why did we pick August 3? We picked it because we felt employers might be in the process of considering amendments and would have priced them on a basis that wouldn't have involved full recognition of the amendment, but rather would have involved the phase-in. We decided to give employers a choice. In fact, we're giving

employers a choice also on retroactive amendments. Obviously, what you need to do on any amendment that you have been phasing in, depends exactly on how the plan is worded. But conceptually I see two sets of choices. One is to continue operating as is with the phase-in. This means relative to the amendment in question, treating it as if Revenue procedure 92-42 has never been issued.

The other alternative is to cease to recognize the phase-in. Here, too, you have at least two choices. One is to say, "I'm not going to recognize the phase-in for currently active employees only. That is, if I've already paid someone, that's that." The other is to go back and pay these people what they would have had, had you not had the phase-in. Again, proper plan amendments may be required.

I think we need to do a little bit more work on the issue of the tax treatment of some of these additional payments. There's nothing definitive. So, I mean, if you want to ask, you can ask, but I'm not sure that we've decided anything about any additional payments to individuals and their tax treatment. We've decided how to handle the payment into the plan.

The employer who chooses retroactive application has to make another choice. He has the choice of adopting something which I'll call the special deduction option for Section 404. What happens for 412 purposes? Nothing special. If you go back and eliminate the phase-in, you have an amendment for 412 purposes, which is funded the way the funding method would fund any other amendment.

For 404 purposes, the employer can choose to consider the change in accrued liability as a special base. We have a special make-up option in the year that special base is established. If you choose the special make-up option, you have to indicate, on your schedule B for the year in which you implement it, the amount of the base, the amount of the make-up adjustment, and the associated limit adjustment. The year in which you do this is called the revocation year. For this revocation year, the maximum deductible contribution, again, given the method, will recognize the regular limit adjustment plus a make-up adjustment, which is the present value at the valuation interest rate of a number of payments. The number is the number of years in which the phase-in had been in effect. And the amount is the regular limit adjustment. The following year you recompute the limit adjustment according to the formula in the procedure.

If you use a method that doesn't normally establish a base, you have the option of establishing a base to make use of this option.

These are the three major pieces of guidance that I would call the most recent events. I just want to very briefly alert you to four other items.

The first of these is something I didn't know anything about until I came to the IRS nine months ago. That's what we call our business plan. And the idea here is that we want to hold ourselves a little bit more accountable to getting things out the door. So we've identified some broad subject matter areas that we feel are very important, and we intend to provide guidance in the next year or so. Again, this isn't a promise, because of the various levels of approval that are necessary. But these are things

that various groups in the IRS have identified as being important to the practitioner community we serve. And we're going to try to get out some guidance.

Let me read you the 14 items that are under the employee benefit section. This business plan has been released and if you'd like to get it, it's available. But really it's just a listing of the items I'm going to go over. The first three are the three I've just talked about. Other items include broadening the 401(a)(4) safe harbors, and simplifying testing; establishing protocols for more flexible rules on crediting compensation and service in the 401(a)(4) testing; providing more guidance on restricted amounts and early termination provisions; conforming the 401(k) and (m) rules to the final 401(a)(4) regulations; talking about corrective distributions under Section 415; setting up the determination letter program for qualified plans; and talking a little bit more about administrative procedures for Notice 88-131. There have been a lot of questions from employers who adopted one of the model amendments under that notice, how some of the administrative things work out. We want to talk a little bit more about early retirement window programs to provide some more guidance. There's been a lot of concern about insurance contracts and switching over funded plans to becoming insured under Section 412(i). We intend to publish some guidance on that. There have been a lot of questions about the treatment of qualified disability under the 401(a)(4) regulations. We hope to publish some guidance in that area. A number of people are concerned as to how 401(a)(4) might apply in situations where there's really no employer. Somehow we've gotten ourselves into a situation where there's a plan but there is no employer sponsor. Last but not least, we want to do something about the model explanation for recipients of qualified plan distributions, so that participants are better aware of their rollover rights.

When I looked over this extensive list, I found two other areas not called employee benefits that I thought would be interesting to the actuarial community. One of these is sort of in the special concerns of nonqualified plans. We're hoping to get out some guidance on Rabbi trusts, and some of the issues concerning them. And another issue that's near and dear to my heart, although I think of it as a qualified plan issue, is some discussion of the 4972 excise taxes for plans that have terminated, where the sponsor has made a contribution in order to terminate the plan.

Another item is, as most of you are aware, line 6B of the 1991 Schedule B. It asks for the last independent appraisal date for such property as real estate, collectibles, and closely held stock. Announcement 92-56 provided a little bit of clarification as to what that really meant. You provide the latest date that any piece of property has been appraised. If you have other property, you list it in an attachment to the Schedule B. This is probably a good time for me to politic that actuaries are also subject to talking about what they've relied on. There are ways in which the actuary can caveat the Schedule B. I call your attention to regulation Section 301.6059-1, which lists the ways in which the actuary can caveat the Schedule B. And now that it's become very clear that you're relying on something probably done by other people, you should think about that in relation to the caveats.

There are other revenue procedures, and one of them is Revenue Procedure 92-16. This talks about things like Executive Life, where a number of responsible employers have decided they want to make their employees whole. Making your employees whole by contributing extra money, or by helping employees get payments they

otherwise wouldn't have gotten, creates a lot of problems if you start thinking of the various Code sections under deductibility, under exclusive benefit, under prohibited transactions. The Department of Labor is beginning to enter into agreements with various sponsors on relief from the prohibited transaction rules. The IRS Revenue Procedure 92-16 is to facilitate the whole combined package for employers who are getting these agreements with the Department of Labor, or who are coming under class exemptions from the prohibited transactions.

The last item is Revenue Procedure 92-24, which allows a sponsor to come in and request a determination letter for its plan provision on the transfer of assets under 401(h). The IRS is not ready to rule on the amount of qualified current retiree health liabilities, but we will rule if you specifically ask for it on your application, on your provision for transferring retiree health liabilities. There's a checklist of the provisions you need in your plan. And this is somewhat helpful guidance if you're considering taking that step.

MS. PATTERSON: We've gone almost two years and we haven't had any changes in the pension laws. This hasn't happened to us in a long time. We had a threat, we had a little scare. The pension simplification provisions were included in the tax bill H.R. 4210 that went to the President, that he vetoed. Now, those pension simplification proposals are, of course, in separate bills, and they keep bubbling up. I think one of the things that you might want to keep your eye on is the possibility, and I've stressed no more than a 30% possibility, that those pension proposals would be picked up very shortly and put on the Unemployment Extension Bill. That's about the only game in town, the only tax bill going along right now. And there is some talk of putting those onto that bill.

Because the pension package that they've put together generally is revenue neutral -- it doesn't cost any money because the things in there that cost money are offset by things that will raise some revenue -- it would be relatively easy to pick them up and put them in the unemployment bill. The unemployment extension bill itself is not an assured shoe-in, well it is for passage by the two Houses. But the President has suggested that he will veto it as it currently stands. The reason that he is thinking about veto again is because there's a provision in there that would limit the deductibility to companies' compensation for officers in excess of $1 million. I have a hard time seeing Mr. Bush veto an unemployment extension bill because it would limit the deductibility of compensation in excess of $1 million. But he says he will do it. So, even if you get the pension provisions in there, they're not a done deal.

Again, there is a 30% chance, but it may be there. So that's sort of what's happening on pension simplification. I think we're safe or, depending upon your view, we will suffer withdrawal from not reading new laws, for at least another year.

The next thing I want to talk about are some bankruptcy issues in the current case in the courts, *Patterson vs. Shumate*. Patterson is the bankruptcy trustee; Shumate is the bankrupt. We'll talk about that, and about some of the regulations that the PBGC has proposed on premium payments. And then we'll talk about the DOL's penalty programs, and the kinds of things that it is coming out with.

I'm going to talk first about the situations where there is an individual plan participant who has gone into bankruptcy, and whether or not the bankruptcy trustee can attach his or her qualified plan assets, his or her accrued benefit. And that is what *Patterson vs. Shumate* is all about.

Now, the question arises before the Supreme Court, because of differing opinions by different circuit courts. Some of the courts have said ERISA plans are not part of a debtor's estate, and therefore, are not available to attachment by creditors. That is the minority stand, and that is the decision or the stand that the fourth circuit took in *Patterson vs. Shumate*.

The majority of the courts that have looked at this have said they really think that ERISA plans are, in fact, not inviolate by the creditor; they can be reached by the creditor. Now, how do these cases come up? Well they come up through the bankruptcy courts. And which side is the bankruptcy court going to come down on? Why, the creditors, of course. Because they deal with them all the time and that is their natural bent.

Let me just give you a little brief outline of bankruptcy law in terms of creating the estate of the debtor. The general presumption is that everything that the debtor has any interest in at all is in the estate. And then you begin to shave back the size of that estate and pull out what you will hold safe from the creditors. So you've got a section of the Bankruptcy Code 541(c) that excludes various kinds of interest. And what that says is, if you have an interest that is limited in its rights to an individual, in this case, to the debtor, under other nonbankruptcy law, that limited interest will be recognized by the court, by the bankruptcy court, and it will also protect that kind of interest. We're not going to give you, the creditor, any more rights to that asset than the debtor himself has.

Now in a trust situation, assume that, in this case the debtors or the plan participants, do have a limited interest. They have their vested benefit, but they can reach it only upon the operation of the plan, i.e., when they reach retirement age or when they separate from service or something like that. Also, on the ERISA side, there is clearly the protection of that plan through the anti-alienation clause. So, to those of us who come at this from the benefits side, we really don't see how there can be an argument. We feel very strongly that clearly these assets are protected from creditors. That's one of the purposes of ERISA. Needless to say, the bankruptcy bar views it very, very differently.

In looking at these things, some courts will take a second step. They will say they will agree that ERISA interests may be protected from creditors, but only if the ERISA trust itself is a qualified spendthrift trust under state law. The spendthrift trust means that you can't get at it as a plan participant, that you're limited. And a general spendthrift trust under a state law, of course, whether it's an ERISA trust or not, is not available to your creditors, because your interest in it is so limited.

This is sort of a situation that arose with Shumate. It's why it's much more complicated and why the court can give us a lot of different answers that may not really, fully take care of our problems in determining whether or not this is really a clear-cut case now.

Shumate owned a company and had 96% of the stock. The company went bankrupt. It had a defined-benefit pension plan. There were about 200 people in the plan of which Shumate was one, but he had the largest single interest in the plan. Shortly after the company went bankrupt, he went bankrupt. The company plan paid out everybody but Shumate. Shumate, of course, didn't want to be paid out. It's obvious that as soon as he got the money, it went to the creditors. His bankruptcy trustee went after his interest in that plan. The court basically said, "It's an ERISA plan; you can't touch it. We're not even going to entertain the issue of whether or not, because he was a majority shareholder in that company, he could have terminated the trust and paid himself. We won't even look at the issue of whether or not he was the settlor. We will stipulate that he had the powers to do that. That's not the issue. We just look at whether or not it's an ERISA trust and we stop right there."

So that case is now set up for the Supreme Court to come out with a number of different kinds of decisions. It could agree with the court completely, which is, I think, what the benefits community would like to see. It might simply say, "Look, ERISA trusts are not available to creditors -- period. We don't have to look at it any further." It could say, which would be almost a nightmare scenario, "ERISA trusts may or may not be available to creditors, depending upon whether or not they meet the standards of a spendthrift trust." Well the standards of a spendthrift trust, of course, are set out by state law, which means a plan now needs to meet the state law for spendthrift trusts in 50 different states. This is, of course, what we were trying to avoid by having ERISA in the first place.

Now, there's a real problem here because the IRS, of course, has always taken the position that the trust will be disqualified if you, as a plan administrator, honor a bankruptcy decree and pay money out of that trust before the plan participants, can get their hands on it. The IRS filed an amicus brief with the Supreme Court, pointing out its position and arguing strongly that ERISA trusts should not be available to creditors in bankruptcy. It has done this even though it notes that from time to time the IRS is a creditor. And it does it sometimes to try to levy against plans. And I want to talk about that in a little bit, because we are seeing a lot of that. Several cases have come to us for questions in the last few weeks. So those are the kinds of issues that are there for the conflicts between the bankruptcy court and the individual plan participant.

ERISA gives the PBGC a priority in bankruptcy. The bankruptcy judge looks down on them and says, "I don't care about that, I only look at the bankruptcy code and I can tell you, you don't have priorities in the bankruptcy code. You go over there and stand with the unsecured creditors just like everybody else." Well, we all know what happens with the unsecured creditors. The PBGC argues very, I think, effectively that when financiers sit down to look at a company's balance sheet, and they're doing restructurings, they are well aware of the fact that the bankruptcy court will not give the PBGC any kind of priority. So this frees up the company to enter into all sorts of negotiations that tend to favor increased retirement benefits as a trade-off for salary; thereby allowing, essentially, the PBGC, and therefore the taxpayers, to support these kinds of negotiations that will permit restructured kinds of work-outs or wage give-backs, so that the company can go forward. Because they know there will be basically no liability when they get to the bankruptcy court. Now, not surprisingly,

the PBGC has gone to the Congress to ask for priority now in the bankruptcy code. The problem they're going to have there is not so much the substances. Clearly this is the laudable thing to do, and they're arguing, and I think with some justification, that to ignore this kind of a problem sets up another, almost savings and loan (S&L) crisis. But when they do this, they're now before the judiciary committees on the House and the Senate side. They've always got to deal with four committees whenever they do anything. They've got to go and talk to the Ways and Means Committee, and get their bill through the Ways and Means Committee on the House side and through its counterpart on the Senate side, the Senate Finance Committee. But they also have Education and Labor to deal with, and that committee on the House side, as well as Labor and Human Resources on the Senate side. Now there are six committees to get their legislation through.

The other problem is, they really don't have a constituency on the judiciary committee, because judiciary doesn't deal with them very often. So they're not really very knowledgeable about the different kinds of problems and the sophisticated levels of issues that come up there. Who does judiciary deal with a lot? It deals with the bankruptcy bars and with various representatives of the creditors committee. So the committee is going to be very much attuned or inclined toward the bankruptcy side of the issues. And it's going to be, I think, a real up-hill battle for the PBGC to get the judiciary committee people educated and to move this legislation forward. And that's part of the problem that they're having with other legislation.

I'll now talk about some of the other legislation that they're trying to seek before the Congress. They've gotten bills introduced. Senator Dole has introduced a bill for them, which would change the minimum funding requirements. It would limit their guarantees on benefits to benefits or plan amendments that were fully funded when granted. And it would eliminate the guarantee for contingent benefits completely. They also would seek, in addition to their priority status in bankruptcy, a seat on the creditors' committee. And that's very, very important. Because in most of these cases, the PBGC turns out to be one of the larger creditors in the whole bankruptcy estate. It is unconscionable that they cannot, like other creditors, serve on a creditors' committee. So they're working that kind of an issue too.

This legislation is not going anywhere. I don't see any progress being made right now. None is going to be made this year, but maybe next year.

There's also the issue of accrual accounting. The PBGC wants to move to accrual accounting. Well, of course, that makes total sense for it. I mean this is a body that is dealing with liabilities that are far in the future. And clearly those liabilities should be accounted for as they are incurred, not when they actually come to fruition, and you're writing the check.

There are two reasons why there are going to be big problems getting accrual accounting from the Congress, even though Congress thinks it's probably the right thing to do. The first is the way it was first proposed. It came up to the Hill as part of a budget package that said it would raise a lot of money. Well, of course, we all know it won't raise any money at all. I mean this is all on the books. But, under the Budget Authority Act, if you want to do something, as I mentioned earlier, you've got to have a revenue-raising sort of project over here. For example, cutting the capital

gains tax is a revenue-losing proposition in its early days. You've got to have a revenue-raising measure. So, Dick Darman, who is the Director of the Office of Management and Budget said, "Well, why don't we propose that we'll shift the PBGC to accrual accounting? And that's one of the ways we'll pay for cutting the capital gains rate." Now, this made the Congress nuts. One of the reasons it made them nuts is because if there was any money, any phantom money, to be played with, they wanted to be the ones playing with it. And they wanted to use it to finance their own little projects. So, that put them off.

And the second part of it is, the General Accounting Office (GAO) comes in and says, "We can't tell you how to audit the PBGC. We don't know how to audit them. Their books are such that we cannot do an audit of them." And I mean they recently released another one of their blue covered reports saying that the GAO can't audit the PBGC, that there is not enough information. The books aren't in a good enough state. That's not the first one of those reports that have come out. So that makes it also very difficult when you're arguing for a change in accounting -- to convince the Congress to give you a change in accounting when you can't really audit in the first place.

Those are problems that they're just going to face. So, back to their home ground and away from the Hill. What have they been doing in terms of regulations? In April, they put out a set of regulations on premium payments. And these are things that I think really will simplify the premium payments, although they probably will not be too popular among large plan sponsors, because of some of the changes that are made.

The first thing they've done is suggest that they would simplify the definition of a participant. Now, you know, we've always been a little uneasy about that. The definition of participant on the 5500 is a little different than the definition of participant under the PBGC's rules. And which one is really the right one? Is there a difference at all? What they're proposing now is that the definition of participant for PBGC premium payment purposes will be whatever definition is on the 5500 for the year before. So you don't have to worry about that kind of confusion.

They also are suggesting a change in the premium due dates and the way the premiums will be paid. Basically for plans that have under 5,000 participants, you would pay the premium only one time. Once. And that premium payment date would be the end of the 9th month after the close of the prior plan year. Their theory there being that, that is essentially, with the extension, a few days before you would file your 5500. You use the data that's on the 5500. And therefore, you'd know precisely how many people you have in your plan, and you pay once. If you've got a calendar plan, you're going to pay on September 15.

If there is a plan with more than 5,000 participants, you're still going to have to pay twice. And the bad news is, the first payment is January 15, if you're a calendar year player. Or, in other words, 15 days after the close of the prior plan year. There they would also require that you would pay part of the variable premium as well. And what you would do is set it based on a definitely determinable dollar amount that would be keyed to what you had paid the year before. Then you would have a reconciliation payment back later in the year on that September date. Or, in other words, you'd have a reconciliation nine months after the end of your plan year.

So that would be something that I suspect will be very, very popular among all employers with plans that have less than 5,000 participants. The PBGC estimates that there are probably only about 1,000 plans that have more than 5,000 participants. So this is going to cut the double filing way back and it really would be much more simple. They're suggesting that this proposed effective date for this be the 1993 plan year. They're accepting comments through May 26, 1992. So if you really want to comment, you've got four days to do it. I suspect that they'd be happy to have your comments after then as well.

Also part of that is a simplified filing method for the variable premium. Right now you have an alternative calculation method that you can use for calculating the variable premium. The PBGC feels like it is losing money on that deal. It believes that many of the plans are simply calculating it both ways and paying the lower amount for their variable premium. Obviously, you'd be irresponsible if you weren't. You could make a very good case that you're violating your fiduciary duties to do otherwise. But at any rate, they've kind of caught onto that now finally, too. What we would like to have here is a simplified filing method. It will not require actuarial calculations. They have a set of tables and arithmetic calculations. I suspect from looking at them that you will still want actuaries to do the simplified filing method.

That kind of a change, they believe, would take them out of economic hazard, as they say. So, that's also out there and available.

I want to move on now to talk about the Department of Labor's penalty announcements and penalty programs. I think we all know that, unless they've run across truly egregious cases, they have not exactly been a bull dog enforcer on the filing of 5500s. I think you can make a good argument that they shouldn't be. Of course, they've had now, for several years, this $1,000 a day penalty, which is hanging out there. That's pretty significant. If you've got clients who are at all inclined to be law obeying, they look at that, and they're probably filing their 5500s fairly promptly anyway.

At any rate, earlier this year they announced, "Look, no more nice guy on 5500s. We admit we've only gone after the really egregious abusers, but now, we're going to go after you when you're late. Or if you haven't been filing them at all." Now, if you haven't been filing them at all, how are they going to find you? But that's a separate issue. You'd know how to do that. Joan will tell you how they'll do that. At any rate, they have lowered the penalties, and essentially said it's going to be $50 a day if you're late. It will be $300 a day if you don't file at all, up to a maximum of $30,000 a year. When they assess these penalties, if they have to take you to court, they don't want to walk into court having used their full $1,000-a-day liability. No judge on earth is going to give them $365,000, because you were late filing your 5500. They know it. Congress may not have recognized that, but I think the people at DOL know that.

So now they're in a position where they can say, "Your Honor, it's only $30,000. We could have charged them $365,000 a year." And it sounds very reasonable. It is less than a tenth of what they're really statutorily entitled to charge you.

So they've also set up this amnesty program and basically said, "Look, you haven't been filing 5500s, or you're late. File them now, file them with the IRS. Send us a copy that has an original signature on it. And send us $1,000 for every late 5500." Now they instituted this from plan years 1988 forward, so, marginally you're thinking that you could have plans that would have due as much as $3,000 in penalties. But, compared with what the liability is, $3,000 is not all that much to pay. It's a $1,000 per 5500. So if you're three years late, you're late on filing three 5500s.

There's a lot of discussion about how this would apply to top hat plans, to the executive plans. Because, you know, there's a simplified procedure for filing with the DOL for these plans under the regulation Section 2520.104-23. You basically need to file just a disclosure statement saying you have this plan that covers X number of people. That's essentially it. If you do that, you don't have to file 5500s on them, you don't have to do anything else.

So there was a lot of discussion about how this would apply to top hat plans. Basically the DOL was saying that if you haven't filed under this simplified disclosure provision, you should have been filing 5500s. If you haven't been filing 5500s, then they suggest you file in under the amnesty program.

There's a lot of response to that. It is our understanding from two or three sources within the Department of Labor, that they are unofficially going to revisit that within the next few weeks. And if you call them, they will tell you to not file 5500s on top hat plans quite yet. They are going to revisit the issue. It looks like what they are thinking about saying is to send them the simplified disclosure, and send a penalty check for $1,000. They'll call the whole thing even and let you go forward from there on the top hat plans. So if you've been thinking about that, hold off on that one for a while. For the other 5500s, September 30 is the deadline. I suspect that they're going to pick some poor person out there and make a great example of them. You don't want it to be you and one of your plans.

MR. DONALD S. GRUBBS, JR.: Just a few thoughts on the PBGC legislative proposals. They do have problems. However, in my opinion, they've been grossly overstated by Jim Lockhart, who always assumes that the worst possible thing is going to happen. But they do have some problems.

The tendency to overstate those problems has created a problem itself. People are losing confidence in defined-benefit plans. The man on the street in many cases now is saying, "I hear pension plans are about to all collapse like savings and loans." I feel that those actions by the PBGC have irresponsibly created that problem. With respect to their funding proposals, there are some serious technical flaws in the proposals. I think they're quite aware of those technical flaws, and the PBGC will revise them. But we're not sure exactly what shape those revisions will take.

On the bankruptcy side, they do have a sympathetic claim for getting moved up in the bankruptcy scheme of things. But so does every creditor in bankruptcy. One needs to look at those things with balance. If an actuarial firm has done work for a client, and has already paid the people to do that work, it would like to get its bill paid. The same is true with every claimant in bankruptcy. To move one person up in the bankruptcy scales automatically moves everyone else down. That's the reason

that Congress has addressed priorities in bankruptcy with considerable caution. I don't know what the right answer is. I just say that there are arguments on all sides of that question.

With respect to the question of the PBGC's liabilities, it is important that it get good measurements of its liabilities and of its contingent liabilities, and good projections of those liabilities and contingent liabilities.

The next question though is what does one do with those amounts? It's important to recognize them. But to say that those are accruals of the federal government is another question. These are not liabilities of the federal government. They are paid for by employer premiums, not by taxpayers in general. And if the premiums are inadequate, the premiums will be raised. To book these on the government's revenues as an accrual would seem to be inappropriate, in my judgment. The entire effort, it seems to me, was to finance other things that the administration wanted to do in the budget.

MS. PATTERSON: I'm glad you mentioned the technical problems in the funding. Joan and I had been talking about that earlier, and then I didn't mention it. I think clearly that your point is well taken about two sides of the bankruptcy issue for individuals. Many commentators, particularly if they come from the bankruptcy bars, say that this is protection for the already overprivileged. Why should you be able to protect your assets from your creditors, simply because you were either in a position where you were wealthy enough to set up a plan for your own business and therefore, put plenty of money in it, or even if you worked for a very rich corporation that provided very generous benefits, why should that protect you from having those benefits attached by a creditor? Because, after all, that really just represents deferred compensation. It should be there and it should be available to creditors. So clearly I think your view is very much patterned by whether you're looking at it from the benefit side, or from the creditors' side. Being a lawyer, I can argue it round or argue it flat.

MR. F. PIERCE NOBLE: I had a question relating to the repeal of the 10-year phase-in on 415 limits. It's not uncommon, obviously, to have benefits that are restricted under 415; paid under excess benefit plans. In implementing the repeal retroactively there is, obviously, an issue that the company would like to get the money back that it paid the employee. In the mechanics of doing so, obviously, you could have a check issued to the employee, and then ask the employee to reimburse the employer. I think many employers are reluctant to do that. What about a process where the employee elects to have the distribution, and signs an authorization to have the pension trust pay the employer directly for the amount that was subject to the 415 phase-in and pay it under an excess benefit plan? What problems do you see that might cause? Or would that be acceptable?

MS. WEISS: Not being an attorney, I'm really not willing to give an answer on that, other than you just have to be very careful about prohibited transaction problems, about exclusive benefit problems, the plans for the exclusive benefit of the plan participants. I just will say that that is one of the thornier areas that have been pointed out. Just to rephrase this question, a lot of employers did implement the phase-in and did provide the other benefits through various nonqualified plans. Now if

they want to move the payment to the qualified plan, what happens? I'm not sure we've completely thought it out to be honest with you.

MR. NOBLE: Okay.

MR. JAMES L. HILLMAN: There's that recent technical advice memorandum about not waiving benefits to correct a funding deficiency. What about the situation where benefits are waived on a plan termination, in order to meet the PBGC's standard plan termination?

MS. WEISS: This has gone round and round a bit. The question, if I may rephrase it, is about having a plan that you'd like to terminate. Technically, if you want a sufficient termination, you have to be able to pay all the benefits. Let's say there's an owner who is willing to accept fewer benefits for himself in order to terminate the plan in a sufficient termination. The IRS position is that those benefits are accrued. The plan does not have the right to let people, other than in certain specific situations, cut back on previously accrued benefits. However, the IRS has no position that the plan must be sufficient to be terminated. That's a PBGC position. So our view is that you can't reduce the benefit. However, we also say that if you don't have the assets, you needn't pay it. So my understanding is the way that this is getting resolved, is the PBGC will – I'm not sure exactly how they're going to do it, but a possibility might be to change the priority for unfunded benefits – let you terminate without that benefit being covered. So, no, we won't let you waive it technically, but there may still be a way to terminate the plan so that you don't have to pay in the money and then just pay it out again. I think the problem comes with the two different jurisdictions.

MR. HILLMAN: You're saying we can't do it but we can?

MS. WEISS: I'm saying the IRS technically won't let you reduce the accrued benefit. But the PBGC may let you terminate the plan without funding the benefit. I also want to warn you. That doesn't mean that we're going to waive funding on it. We consider it an accrued benefit that does come under the minimum funding standards.

MS. WEISS: In some cases while the accrued benefits are maintained, the PBGC will often let you terminate the plan if a substantial owner is the one not being paid. There aren't assets to pay the owner. Often this is not even a plan that's under PBGC jurisdiction or the PBGC doesn't consider it to be a guaranteed benefit to the principal.

FROM THE FLOOR: Regarding Revenue Procedure 92-16 about guaranteed investment contracts (GICs), I presume that that's what it's dealing with primarily.

MS. WEISS: Primarily yes.

FROM THE FLOOR: I'm not sure whether the DOL or IRS is primarily involved. I read last year a lot of those Executive Life cases. This year it's Mutual Benefit – about plan sponsors buying GICs out of their pension plans. I see it under the prohibited transaction exemption sections. Has either of you been involved or has anyone been involved with some of their clients doing this in the valuation of the

GICs? The trouble I've had is assigning a value to these GICs, and potentially or actually bankrupt insurance companies. I've not been able to find any guidance in that area.

MS. PATTERSON: I can't give you any help.

MS. WEISS: Other than being involved somewhat in discussing the procedure, no, I've never really looked at valuing one.

FROM THE FLOOR: In the request for exemption, have you come across any of them? Do they typically include the information as to what value they're assigning? Or do they just say they want an exemption, they are going to buy the GIC, and they are going to worry about the value itself?

MS. WEISS: Are you saying you are familiar with companies who are buying the GIC out of the plan? The situation I thought the revenue procedure thought about, was, you have something where the insurer or the state insurance department won't let the insurer release the full value. But the individual needs the money, either to have minimum distributions, or so on. So the employer makes an additional payment to the trust. What happens is to get around a prohibited transaction and a list of other things, the Department of Labor asks the employer to put conditions on the payment. That is, if the GIC later does pay off, if the state insurance fund releases the values under the GIC, the employer will take back the extra money, so that the employer somehow doesn't get to put in an extra contribution. It may well be that insurers are actually buying them out of the plan, but that's not the situation that the model was proposed on, I don't think.