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LATE-BREAKING DEVELOPMENTS

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A review of recent regulations, rulings, proposals, court decisions and happenings affecting pension practicioners.

MR. DONALD J. SEGAL: Max Schwartz is a partner with Kramer, Levin, Naftalis, Nessen, Kamin, and Frankel in New York. He's an ERISA partner and one of the outstanding ERISA lawyers in the country. I can say that because of personal experience in dealing with Max. Jim Holland is chief of the pension actuarial branch, of the Internal Revenue Service. And Harlan Weller is currently an actuary with the Treasury Department and was previously with the Wyatt Company in San Francisco.

MR. MAX J. SCHWARTZ: Rumor has it that the most distinguished part of this panel, Don excepted, is going to perhaps try to give us some expert inklings into the new final or the new proposed regulations on the nondiscrimination issues. In any event, I'm going to try to hit you with some rapid fire punches on the lore of benefits. There's a fair amount of interesting stuff out there that sometimes escapes people's busy schedules. A lot of material accumulates on your tables that you never get to read. I think you'll find some fodder for consulting in business development in them. We try to update our clients quarterly with those little items, hoping that generates some business for us, but we think it's also useful to the clients to present them with some things that they may not be seeing in other places. We do this quarterly. We drop stale items, and we add new items and identify them with an asterisk. We identify the particularly attractive items with a little square root sign. And what I'm going to do is simply go through this list in a random fashion. We obviously can't talk about everything, but I'll go through some of the things that I think really might be of interest to you folks.

On the executive compensation front, the Securities and Exchange Commission (SEC) has put out new rules regarding disclosure of executive compensation. To everybody's surprise, the SEC has taken a very aggressive position with respect to the kinds of disclosures that have to occur in the Compensation Committee Report. It has to explain why the chief executive officer (CEO) and the four other top officers of the company are being paid what they're being paid. And there has been a lot of comment by the SEC on the detail and the reasoning in those reports. I mention that only because that's something that's very much on our clients' minds and the senior level management corporations you folks advise. Surprisingly enough, there have been no comments, to my knowledge, on the pension table.

As you all probably know, plans that permit employees to invest in company stock are going to have to comply with the new SEC rules by September 1, 1993. It will

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probably affect most 401(k) plans of public companies. You and your clients should at least be aware of that if you aren't already; you might do them a service by reminding them that they ought to be communicating to these very senior level people in the company regarding the kinds of restrictions that may be applied to their ability to affect transactions in the company's stock fund. The SEC put off the September 1, 1992 date to 1993, because they received a lot of comments on how these rules are really unworkable and pose very heavy administrative burdens. So they delayed the effective date, but they still haven't told us what the new rules are going to be. On that same front, there's a big trend in corporate America to encourage employees at various levels within the organization to maintain a certain amount of their assets in company stock. There may be prohibited transactions issues if you let people count the shares that they hold in their 401(k) plan towards satisfying those objectives.

MR. HARLAN M. WELLER: Prohibited transactions are the Department of Labor's problem so we don't care.

MR. SCHWARTZ: I don't have to pay my excise tax. But we'll let them enforce it and maybe they'll still be going through the amnesty filings. We won't worry about the stuff.

The present tax proposals will affect income deferrals. I mention that because the IRS is planning on issuing a ruling soon dealing with securing the "debilitated" and I'll use that word in quotes, nonqualified deferred compensation with insurance. You ought to be keeping your eyes open to that.

I was going to talk a little bit about the nondiscrimination rules. I'll only say that the more we see from them, the more they seem to resemble the new math where it's more important to understand the concepts than to get the answer right, but we'll talk about that later.

Those of you who have clients who have bank investment contract (BIC) funds or funds with BICs as opposed to guaranteed investment contract (GIC) contracts in the 401(k) plan should watch out for the December 19, 1993 date when pass-through insurance (Federal Deposit Insurance Corporation Insurance) may not be available for those kinds of investments.

From my perspective, one of the aspects of the Voluntary Compliance Resolution (VCR) program that most troubles me is when an employer wants to engage in a review of its plan operations and the like. To what extent can that employer preserve the attorney-client privilege; whatever is discovered doesn't necessarily have to be followed through on either VCR or some other process. The privilege issue is one that should be very important to the client. The client should use the attorney rather than an accountant or somebody else, perhaps the client should use the accountant or consultant through the attorney.

The Pension Benefit Guarantee Corporation (PBGC) has put out new regulations regarding plan terminations. There's only one point that I want to make there. We have generally advised clients that it's useful, when you terminate a plan, to adopt an amendment freezing benefit accruals just in case something happens and a

termination doesn't quite go through as expected. Then, at least you have stopped the benefit accruals. And when you stop accruing benefits, obviously, you have to be concerned about 204(h) of ERISA which requires you to notify participants 15 days prior to the effective date of that freeze, but after you adopt the amendment.

There haven't been any regulations published regarding 204(h) -- how you do that, who you notify -- but there are two cases out there, the *Canteen* case and the *Roadmaster* case, which I really encourage you to read because they suggest that courts will interpret 204(h) very literally. In the *Canteen* case, the amendment that was at issue was the elimination of income derived from stock option exercises from the compensation dates to calculate final average pay. No 204(h) notice was given under the theory that only two or three people in the company were affected by that yet those two or three people who were affected brought suit when their pensions were calculated without the very significant income derived from the option exercises that they made and they won. The court said it was a "significant reduction in the rate of benefit accruals." I think most of us in the profession have been thinking of that as a more general matter and affecting the benefit formula. This has an indirect impact on the benefit formula for only a few people, yet it was subject to 204(h). And I suggest to you that this decision might inspire us to issue a 204(h) notice in connection with our tax reform amendments to the extent that some of those might be viewed as affecting benefit accrual rates in some fashion.

The *Roadmaster Corporation* decision, also issued by the same circuit, was a perfect example of an employer doing the exact opposite of what the statute said to do. They notified employees before the freeze took effect, but they adopted the amendment afterwards. The freeze did not apply. Then, they corrected it and notified people again. That didn't work either and for all I know the benefit formula still isn't frozen, but that does comply with the literal reading of the statute.

There are two items in the IRS's new revenue procedure regarding application for the determination letters. Application must state whether the plan was considered under the VCR program. And you might also want to bear in mind the particular caveat, which is not new this year, but it was worth a reminder. The IRS may not be looking at your plan document depending upon what your application form says and what your Form 5300 says. Therefore, if you really haven't come clean with all of the controversial items either in a cover letter or in the context of questions on the form, you cannot assume that the IRS has read your plan document and that you will be protected based on the plan document alone. So, this is food for thought in applying for TRA determination letters.

FROM THE FLOOR: Hasn't that always been true?

MR. SCHWARTZ: I don't think that has always been true. My view has been that at least pre-TRA 86 you submitted a document and the IRS was supposed to read it. I think most people felt that you could feel confident about it.

The question is, what is disclosure? You might have an item in your plan that is questionable, or you would like to feel comfortable with it. It would be nice if they approved this, but if the IRS really knew what they were doing they wouldn't approve it. I think in the past one felt that if one got a determination letter, one was

at least protected to some degree on a retroactive basis. I don't think one can have that same comfort at this time.

MR. JAMES E. HOLLAND, JR.: If you look at some of the questions and the forms, you'll know it depends on the situation. They really do not get at the heart of some of the more controversial items. I've advised many people over the phone over the years to make full disclosure in a letter when they submit the determination letter if there is something that's particularly tricky or if there isn't any precedent about it. You can be sure that you have protection of that letter if you make that very full disclosure. If you simply check off boxes on the form, it will appear that you have run of the mill plans and they will be given very little review. And without the disclosure of the gray area that you're deciding to alert us to, you may not have reliance in the long run. One of the things that we're discussing and we haven't decided on yet is having various levels of coverage. Perhaps you want a letter that covers some of the more full blown 401(a)(4) situations; you must have additional disclosure. Where you have these varying levels, you may find that the extent to which you disclose things has a role to play in there. It's too early to say depending on how our determination letter program shapes up. But I would definitely urge people to disclose.

MR. SCHWARTZ: Most of you are familiar with The Harris Trust Second Circuit decision. The basic outcome there is an insurance company general account assets can make an insurance company a fiduciary to the extent that they haven't been allocated to buy annuities. The Supreme Court has heard arguments and we're expecting a decision to come down any day now. Keep your eyes open for that one.

FROM THE PANEL: Did they have arguments or did they just make a review?

MR. SCHWARTZ: No, they heard all arguments I believe, didn't they?

FROM THE PANEL: I don't know.

MR. SCHWARTZ: No maybe not. I guess maybe they haven't heard all of them.

Maybe we're confusing that with the *Keystone* case. On the topic of notice to participants, there's a case that in itself is not a very important case. It probably will get overturned, but I think it's worth spending just a little bit of time on that for the following reason. Summary plan descriptions (SPDs) can bind you. The law seems to be developing in two areas. One, the plan document governs. Can an SPD govern over a contrary provision in a plan document? The answer is maybe so, and this case points that out. If an SPD governs, the courts tend to be split on whether the employee who's relying on the SPD has to prove that he really relied on the SPD to his detriment. It's a detrimental reliance kind of argument. Courts are split on that. Some require that kind of demonstration, others don't.

FROM THE FLOOR: Even if there is a disclaimer in the SPD?

MR. SCHWARTZ: You'll see why I'm saying this when we talk about the court decision. This particular decision did not have a disclaimer. The SPD did not have a disclaimer in it which is astounding to me. At least the judge said, "No disclaimer."

What about all the representations from the employer or from the plan administrator? Can those bind the employer or the plan? The general body of law that's coming out seems to say no, but there are exceptions to that. That's sort of the way the trend is.

There are two other decisions that you may just want to note, but first let's take a pop quiz. A plan has worked in a typical fashion with a subsidized early retirement benefit of 4% versus 6% if a person retires with a certain number of years of service after a certain age. If you voluntarily go, resign, go someplace else, have you left the company? Those who think you did, raise your hand. (About one-third raised their hands.) Well, all right, now let's say the company discharges you. Did you leave the company? (About one-half raised their hands.) You're wrong according to this judge. You did not leave the company.

You did not leave the company. Under those circumstances you were entitled because of a slight ambiguity in the booklet to the subsidized benefit. Now the third question. If you die did you leave the company? Only one hand? Well, I know how this judge would answer.

Now another interesting point made by the judge in this case, and I don't know whether it will hold up or not, was a Supreme Court case that came down called *Firestone vs. Bruck*. It said that plan administrator terminations will be given the favorable standard of review for the arbitrating for purchase standard review as long as there's language in the plan document that says that the plan administrator has discretion to make these decisions. Pretty straightforward? Every plan document should have that language in it and that is one good reason to have a plan document. For example, many people don't have plan documents for severance plans. Now what this judge said is that there was no similar language like that in the SPD. Nowhere in the SPD did it say that the plan administrator has that discretion. The judge in this case said he would review the SPD on his own without paying any deference to what the plan administrator decided. So consider putting that kind of language in your SPD as well. Just an example of what judges can do when they want the case to come out a certain way.

Let's discuss a very important decision regarding control group liability. I don't have to tell anybody here about the problems with control group liability associated with pension underfunding and multiemployer plans. There is a lesson in this decision. If your client enters into an agreement that he can get out of an agreement to buy another company, and if he does so without looking to see what the pension liabilities of that company are, that's the equivalent to sliding down the hill without knowing where the cactus are. This company was subjected to multiemployer plan liability by having signed an executory contract from which it could walk away. The court viewed that as an option. Options under certain conditions make you part of the control group, so you're liable. A very important and nasty decision.

The *Halliburton* tax court decision on what's a partial termination is an important one. Nobody knows what a partial termination is, but this is additional lore in the area. It's a useful case for those of you who have clients who are borderline 20%. There is at least one lesson in this decision. You ought to be encouraging employers to categorize the reasons for terminations -- voluntary, involuntary, death, vested -- even if

people took an early retirement incentive. This decision has fairly good language in that regard.

Those of you who are involved in health care and postretirement health care, in particular, will love to read the *Wise* vs. *El Paso Natural Gas* case. The employer, in deciding what he was going to do and by looking at his booklets, realized that there wasn't the proper language to terminate the plan. He amended the booklets and then a couple of months later terminated the plan and that was okay.

MR. SEGAL: Is timing important in that? Could you do it the week before?

MR. SCHWARTZ: I didn't think you could do it three months before, but that's why this decision is interesting. I certainly wouldn't advise a client to test this one unless you're in the Fifth Circuit.

Regarding the plan amendment issue, there is another decision under which an employer modified its health plan by cutting back on the benefits available for acquired immune deficiency syndrome (AIDS)-related illnesses which was upheld by the Eleventh Circuit in *Owens* vs. *Storehouse*. Actually this is kind of an interesting direction. Let's contrast this. This is a little lesson in legal sophistry. Let's contrast this to the decision by the same circuit court, the Eleventh Circuit, to the *Seaman* case which just recently came down. In that case the employer was seeking to reduce its benefit costs and told a whole group of employees who became eligible for health benefits and a 401(k) that he didn't want to consider them employees anymore; the employer wanted to make them independent contractors to avoid providing these benefits. If the employees didn't agree to that they would be fired. An employee, Seaman, was fired. He sued. Sued for what? There's an important section of ERISA, Section 510, which prohibits employers from interfering or discharging employees for exercising ERISA rights. But this is exactly what the employer did. He could have done what he tried to do if he'd done it a different way and the same circuit court would have allowed it. He could have carved these people out as benefit plans. Now maybe he would of run into discrimination issues and the like, but instead of firing them he could have amended the plan to say this group of employees is excluded provided they continue to pass a nondiscrimination test that applied to the plan. Instead he had to provide the benefits. If you really want to do something there's probably a way to do it but you ought to do it the right way.

The last item that I'll mention is the new Schedule F for fringe benefit plan reporting and cafeteria plan reporting. My experience generally has been with the manner in which an employer reports or is advised to report. The cafeteria plan is something that generally can be viewed as lacking uniformity as to how you deal with the cafeteria plans as a part of your medical plan. Is it something separate? How do you report it? This new Schedule F sort of forces you to deal with the issue a little bit more intensely than has been done in the past. And when completing Schedule F and figuring out which 5500 to attach it to, you really ought to take special care to think about how that affects the manner in which you report a cafeteria plan or your client reported cafeteria plans in the past, because depending on what you do and how you do it and what you've done in the past, you may find yourself faced with penalties for having failed to file forms and the like.

The IRS has put out proposed guidelines for examination of terminated plans. You ought to read those.

MR. HOLLAND: After my presentation, Harlan Weller has graciously agreed to join us and talk about some upcoming regulations and a notice that was released the other day. I think it will be of great interest.

Some of you may be aware that on March 31, the government filed a brief in the *Vincent Elkins* case making it formal that we are appealing that decision. The Justice Department filed it on behalf of the United States and contends that the judge used the wrong legal standard in analyzing the assumptions. The appeal requests that the cases be overturned and remanded for analysis in light of the proper legal standard.

To summarize the government's position as expressed in that brief, there was undo and improper deference given to the actuaries in the cases. There was an emphasis on conservatism, which is found nowhere in the law or in the Committee Reports. And there was a reliance on assumptions not being substantially unreasonable which permeated some of the analysis. And, again, that is not in accordance with the statute or the legislative history in our view. Those are the three main points. There are other points as well. It's a 50-page brief, so there's not a lot of room to go into a full-blown description, but it is official that we have appealed.

Vincent Elkins will have an opportunity to write a brief in reply, which will be done 30-60 days after March 31, 1993. Then the government will have a response brief to that and then at some point the Fifth Circuit will schedule oral arguments.

In a somewhat parallel track, decisions were entered in the *Watell* and *Citrus Valley* cases in February (about a week apart). After being entered, we then have 90 days from the dates in February to appeal those decisions. The deadline will be in May, so in the coming months you should see something one way or another. There's a lot more to say about it at this point, obviously. We will wait to see what happens with the appeal. The way it has shaped up, I presume we'd go back to the tax court with the description of the proper legal standard and then the judge would have to go back and reanalyze the facts and the testimony in light of the proper standard. This is assuming that we win.

There were actually two cases where there were contributions in kind: The IRS, following what the Department of Labor has advised, assessed excise taxes for prohibited transactions. The companies contested the excise taxes saying the contributions were not prohibited transactions. In *Keystone*, it was truck terminals. In *Wood*, it was third-party promissory notes. We lost both cases in the tax court. The cases were appealed to different circuits. The *Keystone* case went to the Fifth Circuit; the *Wood* case went to the Fourth Circuit. We lost *Keystone* in the Fifth Circuit and we won *Wood* in the Fourth Circuit. *Wood* was appealed to the Supreme Court. They agreed to hear it. The taxpayer decided to withdraw the appeal and then the Supreme Court agreed to hear *Keystone*. Briefs were filed. Argument was held by the court on February 22 and a decision can come down any day.

If you glean anything from the tone of questions and their statements, it looks like the government may be victorious but it's hard to say. I'll wait and see what happens. I

would suggest, and Max can comment if he likes, that if you have a client who is contemplating making a contribution in kind, they might want to hold off and see what the Supreme Court says, because they may suddenly find they've engaged in a prohibited transaction. This is not the time to be adventurous.

MR. SCHWARTZ: Would the decision be retroactive? If I made that contribution today and the decision came out Monday, am I clean?

MR. HOLLAND: No, this is an earlier tax year that's involved, so the judges would be saying this is a prohibitive transaction.

February 22 was a fascinating day for the Supreme Court. There's another case that should be very much on your minds. It's called *Mertens* vs. *Hewitt*. That also was argued before the Supreme Court on February 22 and I attended that argument. Let me describe what's at stake here and mention some of the briefs that were filed and where things stand.

Hewitt was the actuary for the Kaiser Steel plan and Mertens is a participant. Kaiser Steel went bankrupt. The plan was underfunded, and the PBGC took it over. The participants sued alleging that there was a conspiracy to use improper actuarial assumptions that did not correctly reflect the increased early retirements because of the downsizing of Kaiser and the eventual shutdown and cessation of operations. That, among other things, was a breach of fiduciary responsibilities that Hewitt, as the actuary, participated in. They also have said that the actuaries were fiduciaries. What's risen to the level of the Supreme Court is the question, did the actuaries participate in a breach of fiduciary duties as nonfiduciaries whether or not they're libel? That's a mouthful. Let me go back through it.

The Ninth Circuit said actuaries weren't fiduciaries. Assume actuaries are not fiduciaries, but they participated in a breach of fiduciary duties. Are they libel, yes or no? The Ninth Circuit said no. The Supreme Court is looking at that very question and the Department of Justice, on behalf of the Department of Labor, filed an amicus brief and asked to argue before the Supreme Court that nonfiduciaries could be libel for breach of fiduciary duties. Now the $64,000 question is, was there a breach? Well, because of the way things work, we don't know. I mean there has been no trial on the merits. So what happens if the government, on Mertens' side, wins? Then everything goes back to the lower courts to actually have a trial to see whether there was a breach of fiduciary duties. For purposes of this legal argument, the allegations are presumed true. So if anything comes down don't go away with the feeling that there necessarily was or wasn't a breach. That hasn't been addressed. It's presumed true. So what you have here is a fairly narrow legal question. It would simply mean, and I'll invite Max's comment, that if actuaries or accountants or somebody else participates in a breach of fiduciary duties they might be libel even though they aren't fiduciaries. Do you want to comment, Max?

MR. SCHWARTZ: It's a narrow question with mammoth consequences.

MR. HOLLAND: I don't have any predictions about that case. I think there were three appearances: Mertens' attorney, Hewitt's attorney, and the Justice

Department's attorney on behalf of the Department of Labor. I'm not going to go into the more esoteric legal points. There were a few interesting things in there. It's quite clear that some of the justices did not think much of the way ERISA was drafted. Chief Justice Renquist made a comment that they've had a number of ERISA cases and they haven't yet seen a section of ERISA that was clear.

MR. SCHWARTZ: I think another comment that was made was ERISA's coming out of our ears.

MR. HOLLAND: Well, I'll have to agree. That was the second ERISA case in the day and from some of the looks I saw I think they were a little tired of hearing about ERISA. They have this harassment case coming up and Mertens may have an influence on that or vice versa. It's hard to say because it does involve fiduciary responsibilities. So I would keep an eye out for those any day now. There were a number of briefs filed. The American Association of Retired Persons filed a brief on Mertens' side. I believe the Academy asked a coalition of large consulting firms to file briefs on Hewitt's side, so the judges have more than enough to read. I'll be curious to see which comes down first, *Keystone* or *Mertens*.

I'm going to turn it over to Harlan who will talk about some more current matters.

MR. WELLER: I guess I could start with something very current, but to help you out I need to give you some background. The topic I want to start with is the Unemployment Compensation Acts of 1992, which, as you I'm sure are aware, mandated a required rollover option, a direct rollover option from employers. Essentially, there were three parts that affected pension plans. There's a direct rollover option. There is a mandatory withholding if you do not take the option. And, there was an expansion of the eligible rollover benefits in the first place. That was passed last summer. In October, the Treasury and the IRS published temporary and proposed regulations implementing some of this. The effective date of the requirement was January 1, 1993. That didn't give people a whole lot of time to gear up. We rushed things out as fast as we could. We immediately heard some comments that there were problems in a few areas in those temporary and proposed regulations. One of the problem areas was the treatment of loans, such as where an employer offsets a distribution by an outstanding loan balance. That question was addressed in the Notice 93-3 (I believe the number was issued back in January).

We had hearings in January on the proposed and temporary regulations and I'd say the topic we heard the most about was what I call the 30-90-day rule. The 30-90-day rule had to do with a period of time in which an employer must notify the employees of their rights to have a direct rollover and the tax implications of the various options they had. Now just as a point of reference, since 1984, I believe, there had been a notice requirement in the Code, in Section 402(f), that you had to inform participants of their rights to have a rollover. In the past, the rollover window of 60 days was consistent with the idea that you could give the notice after the distribution. The employee had time to make his choices after the distribution. With the changes in Unemployment Compensation Acts, the employee had to make some important decisions before the distribution, so the Section 402(f) notice required a reasonable period of time before the distribution date.

When the employee comes in the door and says I want to have a distribution, the employer must give him or her this tax explanation that says, you have 30 days to read this. You can take the 30 days, but if you want to take your distribution earlier, you must understand that you've gotten this notice and you're waiving your right to take your time to make this distribution. So we are providing an opportunity for the 30-90-day rule. At the same time, the 90-day rule is not changing, so you cannot provide a notice once a year to accommodate the need. You do have to have something reasonably current and we're defining that as 90 days prior to the distribution so the employee knows their tax options.

The IRS and the Treasury did develop a model notice and I'd like to see a show of hands as to how many people have seen the model notice and then how many have been using it for their clients. How many have seen the notice? How many of you have been using it for your clients? Well, that's not a bad percentage. We worked hard on it. As you can imagine, these are very tough issues to explain to employees and I wish the law wasn't so complicated in this regard.

MR. SCHWARTZ: Must the waiver of the 30-90 days be given orally as in Miranda rights or is a signed waiver needed?

MR. WELLER: We are still working in a paper system. A second issue that was picked up a lot in that hearing was the idea that employers want to get to a paperless system. The employers would like to use the technology of telephone transfers. We are looking at that issue at this point. Just to reemphasize -- it's the waiver of the 30 day, not the 90 day.

The second topic I want to discuss is my old favorite -- nondiscrimination regulations. This is a project I've been working on for 2 1/2 years. The most recent development on the nondiscrimination regulations was the issuance of a proposed amendment to the final regulations on 401(a)(4). That was issued in January. The regulations under 401(a)(4) were actually finalized back in September 1991, along with four related regulation sections. Since that time, we have proposed amendments to those regulations. The amendments were so substantial that we decided to rewrite the whole thing. We're reissuing the whole thing. We made changes that were discussed in notices in the summer of 1992, but we also tried to make other changes that we had not previewed in those notices. We tried to make it simpler and shorter and easier to use. There's a hearing scheduled on that proposed amendment to the regulation soon. We're anxiously awaiting feedback on that regulation. We intend to move very quickly to finalize this regulation. I know that the pension community is awfully tired of not knowing how you have to design your plan to satisfy nondiscrimination rules. Employees and the government are tired too.

There were four other regulations issued simultaneously with the 401(a)(4) package which are 600 pages long. This time we separated them out. The 401(a)(4) regulation went out in January. We had hoped to have the other regulation amended or an issue proposed and amendments to those regulations in time for people to read them in order to integrate their comments about those regulations with their comments on the 401(a)(4) regulation at an upcoming hearing. Unfortunately, with the changeover in administration things have become bogged down in the Treasury Department and IRS. We haven't been able to get the regulations out in time for

people to read them. I think that they will be out before the hearing. We don't intend to actually rewrite those other regulations like we rewrote the 401(a)(4) regulations. There will be a discreet amendment to the regulation, so it's not a huge reading task, but the mental gymnastics involved in integrating those regulations together with the 401(a)(4) probably are too difficult to do in a few days prior to the hearing. I apologize for not getting it out sooner like we had hoped.

I want to move from regulatory matters to legislative affairs. One of the issues taking place in the legislative arena, which is of interest to the pension community, is a proposal in the Clinton budget to reduce the compensation that may be taken into account under 401(a)(17) in pension plans down to $150,000. This was a part of the package that Clinton announced in February in the State of the Union Address and it has been incorporated in the budget. We've heard from a lot of people who say that this is going to hurt and I think that the administration was aware that it would hurt. I guess the expression was the "shared sacrifice;" the pension plans must take their hit along with other constituencies. I don't know for sure whether or not this will be passed. The keynote speaker, President Ford, talked about how things changed in the House and in the Senate, so it's possible that someone else will have a different way of coming up with the kind of revenue involved in reducing the compensation limits. Just for your information, it was estimated that over a five-year period, revenues will increase by $3.7 billion because of this specific change. So it's a significant amount of revenue, and although it sounds shortsighted to view things in terms of revenue when it may endanger the pension system, the reality of Washington is that revenue is important, the reduction is important and we believe that the change to $150,000 is not that significant in terms of reducing the attractiveness of pensions.

MR. SCHWARTZ: Is that $150,000 indexed or is it the flat amount?

MR. WELLER: The $150,000 amount will continue to have the same indexing that the $200,000 amount has now; it's a one-time cutback. Other recent developments on the legislative front dealing with PBGC legislation will be discussed. The topic is heating up. The PBGC has some new leadership. I'm sure you've seen Marty Slate mentioned in the tax press. Jim's former boss is now the executive director of the PBGC. It is taking a thorough review of the current status and looking at possible changes in funding rules and things that may help shore up the deficit or eliminate the deficit in the PBGC. It's still too early to tell what's going to happen there. In March an interagency task force was established to look at these issues. I think the group has met about ten times so far. Congress is showing some interest in the issue. There are hearings scheduled very soon. And another set of hearings is scheduled to discuss the issue of the PBGC's solvency and what should be done to help out the PBGC. So I think you'll be hearing more on that topic in the near future, but I can't predict where it's going to go.

I want to emphasize that the discrimination regulations are moving along. It is very important to hear from you. The comment period for the 401(a)(4) regulation was officially closed, but we don't shut our ears to good comments before the regulations are finalized. We don't stop listening even after the fat lady has finished her song, so we encourage all of you who have an interest in the topic, who can add some enlightenment to the staff, and who can come up with workable regulations. We'd

love to hear from you. As I say I expect to see the rest of the package in the very near future. There will be hearings scheduled.

MR. ETHAN E. KRA: Harlan, you made the comment that you felt that the pension community had to make its sacrifice in dealing with the budgetary process. Don't you feel that significant sacrifice over the past number of years has already been made along the way? We started out with ERISA with the $75,000 Section 415 limit payable at age 55. The cost of living has virtually tripled and at age 55 we're probably around $55,000 or $60,000 as opposed to well in excess of $200,000. Over the years, this has been an area that has been whittled away. The PBGC, at the EA meeting, reported that the number of plans that they cover is down by a third in the past seven years and that doesn't count all the noncovered plans that have been terminated. The system's hemorrhaging.

MR. WELLER: You may be aware that there was a proposal floated inside the administration that actually leaked to the press. It proposed lowering the 415 limits from their current level. During the internal deliberations, it was decided that was even more destructive than changing the compensation limits. We expect that changing the compensation limits slants the benefit away from the highly compensated (the people who are making over a $150,000) down to other people. There is an option for an employer to increase the contribution rates or the benefit percentages to offset some of that. Admittedly, that is a cost to the employer and there's some redistribution effects involved, but that policy is preferable to putting a sure cap on the dollar amounts that can be provided.

MR. KRA: You had many of those similar alternatives after tax reform, yet a third of the plans have disappeared into thin air. Probably half of all the defined-benefit plans have disappeared in the past seven years. Is this just another nail in the coffin?

MR. WELLER: It is possible. We've heard nails in the coffin, and last straw on the camel's back analogies for quite a while. I think the bottom line is that the federal government does not believe that it can have a big tax expenditure that provides benefits for people who are making large amounts of money or who are given huge benefits given all our deficit problems.

MR. SEGAL: I'll just add to what Ethan said. When ERISA was passed one of its objectives was to protect the benefits of participants in qualified plans, especially the lower-paid participants. Everything that's happened since then has tended to cutback on the benefits. The highly compensated people will still get their benefit through nonqualified plans. ERISA was intended to drive people into qualified plans, but everything that has happened since then has driven them back into nonqualified plans, so it's going to be the lower-paid person who will get hurt.

MR. WILLIAM E. NEAL: I'd like to state that my comment is not necessarily that of my employer, it's just mine. Shared sacrifice means that the government gets the share and the rest of us make a sacrifice.

MR. HOLLAND: My comment affects federal employees. The government's plan allows for 30 years and out at 55, at least for certain groups of employees. Older employees who started a while ago have cost of living increases. The proposal does

include a cutback on the extent of cost of living adjustments (COLAs) so that there would be no COLAs prior to age 62. So there's certainly some sacrifice there. Obviously, this provision is not popular with a lot of federal employees.

MR. SEGAL: And that's not a 411 violation because they don't have that protection, right?

MR. WELLER: That's correct, too.

MS. LORI A. BLACK: My question is for Max and concerns the ERISA 204(h). Is it only going to be expanded to apply to things affecting the benefit accruals? What about removal of an optional form that's highly subsidized? Is something like that considered a reduction?

MR. SCHWARTZ: I don't like to predict what courts will do. My sense is no. The statute calls for a significant reduction in the rate of benefit accrual. It does not mention the 411(d)(6) protected benefits. I hope the section will not be expanded to that degree.

MS. BLACK: Now a quick question for Harlan. I understand you don't have to apply the mandatory withholding for mandatory distributions for employees age 70 1/2. Is that true for both annuity forms and lump sums?

MR. WELLER: It's to the extent you have a portion of a lump sum which reflects the 401(a)(9) minimum requirement. That is not subject to a mandatory withholding. The balance of it would be a bifurcation kind of rule. This gives me an opportunity to mention something which I didn't say in my prepared remarks. The 93-26 notice was issued, but there has been a second topic added in addition to the change to the 30-90-day rule: the rollover rights and the mandatory withholding and the whole package that was part of the Unemployed Compensation Acts will also apply in the case of the distribution of an annuity. So insurance companies that are taking over terminated plans will have to gear up to handle the mandatory withholding, the notice, etc. Again, there's a tradeoff. It's going to be some additional burden for the insurance company. Employees are going to have some relief on their rollover distributions if; for instance, they have something that is a rollover from an annuity contract: an eligible distribution, a lump sum, or a five-year certain. They will be able to roll it over even though it's not directly from a qualified plan. It is allowed if it is from a terminated plan and an annuity.

MR. SCHWARTZ: On the 204(h) issue I think there's a general sense that if an amendment is adopted to a plan that affects the benefit accrual rates for some employees it makes sense for those employees or that group of potentially affected people to get the notice. But the statute requires that the notice be sent to all participants. Unless you've received your full accrued benefit under the plan you are a participant. Does that cover retirees? To the extent that the service at some point in time will develop regulations, one might be able to develop a sensible notion of who the notice has to be provided to with respect to that kind of amendment. It might be hard to do without an amendment to the statute.

MR. SEGAL: Max, in your presentation you had said that based upon this court decision, when doing your TRA amendments the safe approach might be to issue a 204(h) notice. But assuming you're doing what I will call run of the mill TRA 86 amendments with no real substantive changes, what form would this notice take? Would you just say this is to notify you we've amended our plan?

MR. SCHWARTZ: Yeah, the issues with respect to what the notice has to do are interesting. In theory we have to describe the amendment, so you're going to describe everything you've done in your TRA 86 amendment. Are you going to describe every amendment you make to your plan that has a partial affect on the benefit accrual? I don't know. I would hope the answer would be no and that something like a summary plan description type of disclosure would be satisfactory. Do you have to attach the amendment?

MR. DONALD S. GRUBBS: Harlan, of all the regulatory requirements I deal with, the one that seems most burdensome to me and to my client in terms of the data gathering is 415(e). Most people do them right and the IRS can't audit most of them anyway because they are just too complex. Several years ago, the Treasury recognized this and proposed to eliminate 415(e) and replace it with a tax on excess distribution. Indeed, we got that in 4980(a), but they forgot or didn't drop out 415(e) when it happened. Now with the proposed cutback in compensation to $150,000, 415 itself and particularly 415(e) will apply far less frequently and it will have far less effect on anyone's benefit. Is it possible that Treasury would reconsider the problems of 415(e) and combine this with the cutback in compensation and get rid of 415(e)?

MR. WELLER: Last year, the Treasury during the Bush administration, supported a pension simplification proposal. As I said, with the new administration it's taken us some time to get up to gear and we don't have specific positions on a lot of issues that are important such as the pension simplification that was included in HR13 this year. You might be able to glean what our positions might be based on the positions that Senator Bentsen, now Secretary Bentsen, took last year. But I don't think that we've gotten very far with the issues of what would be reasonable simplifications. Now I happen to agree with you that 415(e) is very complex and that the 4980 tax was intended initially to be a substitute for the 4145(e) calculation. I have also heard people surmise a couple of years ago that if there comes a time during which tax rates go up, there may be some pressure that would eliminate the 4980 tax to the extent that you're starting with a 40% tax rate and adding an additional 15% on top of that. You might hear some screams of "confiscatory tax." One staffer was unwilling to depend on the continued existence of the 4980 tax to control the issue of people who are reaching both the defined benefit and the defined-contribution limits. But I think we are willing to look at simplifications in this regard.

MR. HOLLAND: Let me add a footnote if I may. Don, you made a comment about the complication of 415(e) and I think everybody will agree it is complicated. However, I would like to point out that it's not altogether inaudible by our agents. Right now we have field actuaries and I know there have been a number of cases where they've either had disallowances or qualification problems raised because of 415(e) calculations. I think that the level of ability at our field offices is increasing significantly.

FROM THE FLOOR: I've been an actuary for a long time so I'm becoming more interested in social security than I was a while back. From that perspective, I wonder if the Treasury Department would be or could possibly get involved in this discussion about fairness and sacrifice. I was particularly disturbed by President Ford's apparent ignorance of the time value of money. He just took contributions and the minute you have your contributions back you've received a fair return. Also, I haven't heard any mention about retirement benefits and social security and the benefit gradation on social security. The way I read it, the higher income amounts produce a benefit at about one-sixth the level of the lower benefits. That would seem to be quite a considerable sacrifice in terms of a uniform contribution rate and employer tax rate. Would the Treasury Department have any opportunity to educate the administration or register an opinion in this general area?

MR. WELLER: Once again I have to confess that the Treasury Department is still trying to get itself organized in the new administration and policies have not been set with regard to things like social security. I know the new Chairman of the Senate Finance Committee, Senator Moynihan, has had a long time interest in social security issues. He has a view that the social security taxes are too high relative to the needs for the social security system; the payroll tax system is helping to support nonpayroll based or nonsocial security type of spending by the federal government. If Senator Moynihan continues his interest in this issue and starts pushing for changes in the payroll tax system, that certainly will be something that will be in the purview of the Treasury Department. I anticipate that I would get involved in some actuarial demonstrations of what's appropriate.

FROM THE FLOOR: Fine, because I certainly would be more interested in the actuarial viewpoint than in Senator Moynihan controlling our future.

MR. WELLER: I don't think that the Treasury Department is going to go out in the absence of being prodded by Senator Moynihan and start making changes in the funding or the benefit levels of social security other than the ones we've talked about or the ones introduced by the president in terms of the taxation of social security.

MR. DAVID PRATT WARD: My questions are directed toward Harlan. I know that you and Adrian will review the general test soon. I am interested in a summary of the new 401(a)(4) directions and any of the issues on that did not relate to your discussion, specifically more about the general test.

MR. WELLER: Am I getting the question? You want to hear about other changes in the 401(a)(4) package other than the general test?

MR. WARD: Could you give us a summary of what those new IRS changes are that replace the September 1991 final regulations?

MR. WELLER: There are a lot of them.

MR. SEGAL: Well, are you asking for a summary of the reproposed 401(a)(4) regulations or a summary of what is to come out within the next week on the rest of the package?

MR. WARD: The reproposed 401(a)(4) regulations. I note that this session, Jim's session, and the general test session are the only three sessions that cover these issues. Jim gave us a summary on the type of regulations, but we didn't cover any details. We're not covering details here, so I'm concerned that I won't get the full message.

MR. WELLER: I'll give it a try. One of the directions in the 401(a)(4) reproposed regulations was to ease the standards for what a safe-harbor plan is. The idea of a safe-harbor plan is you have a single design for everyone. The final regulations had some stiff standards as to how uniform the safe-harbor plan has to be. We include such items as uniformity in the vesting and uniformity in the service calculation method which have been changed from a uniform standard to a discrimination standard. So you can have some variance in vesting schedules between groups of employees in a safe-harbor plan. You can have variance in service accounting rules in a safe-harbor plan. Those are important changes because that's one of the reasons that people were falling out of the safe-harbor plans. Some of these changes actually had been previewed in Notices 92-31, 32, and 37 last summer; I really don't want to repeat information that is six or nine months old.

Let me talk about a few of the new ones. I think one of the important changes that was in the package was the liberalization of compensation definitions. The averaging period that you can use, or the ability to drop out periods of no compensation in the averaging period has been significantly liberalized. Treatment of the windows has been clarified. I think that a lot of people were unclear about the nondiscrimination standards that apply to windows. We've established a whole mechanism that says, when you have a window, it may be viewed as either (1) a new benefit formula, which is temporarily in place, and is then subject to the normal safe-harbor standards for the benefit formula, or (2) depending on how it's been designed it may be a new optional form of benefits, which is subject to the optional form of benefit accruals. There are some useful examples in the window context in Section 3 of the regulations.