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PBGC GUARANTEED BENEFIT OBLIGATIONS AND THE "NIFTY FIFTY"

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Do you have a client who may be a candidate for the "nifty fifty" list? Learn what your options are in calculating guaranteed benefits for use by the PBGC in compiling its list.

MR. JAMES A. KENNEY: Our first speaker is Dave Gustafson, who is the chief policy actuary of the PBGC. He has been with the PBGC for more than ten years. Prior to that he was a principal at a Washington, DC consulting firm. His responsibilities at the PBGC primarily revolve around legislation. He's also on the pension committee of the Actuarial Standards Board (ASB).

Our second speaker is Ron Gebhardtsbauer, who is a principal and practice head with William Mercer in New York. He was previously the chief actuary at the PBGC, so I think we have two people who are extremely well versed and knowledgeable about the material. The views of the speakers are their views and not necessarily of their companies or of the federal government.

MR. C. DAVID GUSTAFSON: Last year we met with the intersector group, which is a group of representatives from the various actuarial bodies, for one of its semiannual meetings with the pension regulators. One issue of interest was the pension actuary's role in the "top fifty" process. As you know the top fifty is the PBGC's annual list of those companies with the largest underfunding for guaranteed benefits. In recent years, several companies have asked their actuaries to demonstrate that underfunding for guaranteed benefits was substantially less than the value produced by the standard top-fifty assumptions.

For some, this demonstration has resulted in their not being included on the list. The intersector group suggested that because so few actuaries have to make PBGC guaranteed benefit calculations in their day-to-day practice, a refresher session at an actuarial meeting would be most helpful. We're here to go through the mechanics of developing the top-fifty list from the perspectives of the PBGC, the company, and the company's actuary. This begins each year in mid-April, with the accumulation of the *Financial Accounting Standard (FAS) 87* value reported to the SEC in clients' 10k filings for fiscal years ending during the previous calendar year. Standard and Poor's (S&P) database of corporate annual report information is the primary source for the starting point.

When 10k information is not available, the PBGC's latest Form-One filings are used. Because *FAS 87* and Form-One values are determined by using a variety of actuarial assumptions, our first step is to adjust the company's vested benefit obligations to a common assumption benefit.

These assumptions generally reflect the PBGC assumptions for valuing the liabilities of plans that are terminating. This year the top-fifty interest rate will be at a level of 7.15%.

The use of the 1983 Group Annuity Mortality (GAM-83) Table continues unchanged from 1994. As in previous years, the initial interest rate of 7.3% is the select rate from the February rate for valuing liabilities. Those February rates are based on our ACLI quarterly survey of group annuity prices that reflect market prices as of December 31 of the previous year.

The initial interest rate is reduced by 15 basis points to account for the loading for administrative expenses for large clients. The reduction is determined by the PBGC under the three-part formula in our regulations for evaluating terminated plans. For the first time this year, the PBGC issued an information release on technical updates on 5-5, announcing the assumptions for the 1995 top fifty. This release was intended to give companies more time to analyze their planned data and determine what additional contributions they want to make. We expect to continue issuing this information release in future years.

Unless we have actual mortality information, we assume that plan liabilities were valued by using the 1984 mortality table, and we adjust to the specified table. Also, we assume that guaranteed benefits are 95% of vested benefit obligations for all plans. The assumption adjustment is applied to the recorded value to produce underfunding totals that are comparable among companies.

The adjustment formula assumes that plan liabilities have a duration of approximately nine years. The formula is applied to the vested benefit obligation (VBO) recorded in both the assets-exceed-accumulated-benefits column and the accumulated benefits-exceed-assets column of the annual report disclosure footnote.

The initial screening process is used to identify companies with more than $25 million in unfunded vested benefits on an adjusted basis. Last year this initial screen identified more than 400 such companies of which about 25% were privately held or foreign owned. This year we expect the total number of companies to be in the 250–300 range, due largely to the increase in the interest rate since the last list. The PBGC routinely receives a large number of corporate owner reports. If we do not have a copy, we request one. If the firm does not respond, we search other sources, such as the SEC database of the electronically filed 10k's.

The annual report footnote is carefully reviewed to determine if any uncovered plans are included in the underfunding total. The footnote review also confirms that the data were correctly entered and occasionally provides additional information, such as the mortality table used that is not in the database. All companies identified as having more than $25 million in unfunded vested benefits are contacted and given the opportunity to review the preliminary data that we have for them. Companies are given the opportunity to respond to us and provide more detailed information on any or all of their VBOs, accumulated benefit obligations (ABOs), assets, guaranteed benefits, discount rate, and mortality table.

In late July or early August, we send the initial contact letter to each of the companies, showing both the information that we have captured and our adjusted values. Some have compared this letter with the "Uncle-Sam-Wants-You" letter received by many in my generation a couple decades ago. Others have merely stricken our name from their holiday card list. In the letter we ask each company to aggregate the obligations and assets of all plans that are not covered by the PBGC insurance program. Generally, the noncovered

plans are top-hat plans and foreign plans although, occasionally, other plans not covered under Section 4021(B) of ERISA are included in the FASB total.

Along with the discount rate and mortality table used to calculate the liabilities, we also ask for a confirmation of the employer identification numbers (EINs) and plan numbers (PNs) for the companies' single-employer plans. The contact letter then invites the company to include in plan assets any contributions that are not reflected in the FASB data. The cut-off date for making the contribution is September 15, and the PBGC must be notified of the contributions in writing by September 20. Verification that the contributions were made must be received by the PBGC by October 21 for this year's top fifty. A copy of the Schedule B is required verification. Contributions not reflected in the Schedule B, such as current plan-year quarterlies, can be verified through a copy of the plan's trust statement.

Counting these postyear-end contributions provides an incentive to make additional contributions. As reported on last year's top fifty, several companies made contributions substantially in excess of their minimums. One of these companies, Chrysler Corporation, made several billion dollars in additional contributions and came off the top-fifty list for the very first time. Likewise, Deere & Company made extra contributions and moved off the list. Now these additional contributions may have been made to build credit balances to weather the next downturn in the economy.

They also may have been made to improve balance sheets for the credit rating agencies in order to reduce borrowing costs. As in previous years, some companies may have contributed to get off or to stay off the top-fifty list. We've received numerous letters and have had phone conversations with many major companies whose only concerns were to contribute enough to avoid the list. This postyear-end grace period provides that opportunity.

Another option is the security interest. We have been approached in the past about the possibility of accepting a security interest in exchange for reducing the amount of underfunding, accounted for purposes of determining if the company is on the top-fifty list. A security interest in plant and equipment in favor of the plan that would be exercisable by the PBGC could be negotiated to reduce or eliminate top-fifty funding.

The top-fifty process that I've described to this point doesn't involve much input from the company's actuary. However, the contact letter ends with an invitation to the company to recalculate the ABOs, VBOs, and guaranteed benefits by using the top-fifty assumptions or to calculate the administrative expense loadings directly and value liabilities at 7.3%. All these optional calculations must be certified by an Enrolled Actuary. The simpler of the two options, direct calculation of the administrative expense loading charge, involves application of the loading formula in our November 1, 1993 regulation on valuing liabilities for terminating plans. Of course, only the very largest plans will generate loading charges less than the assumed loading charges of 15 basis points.

Under the regulation, the charge for plans with more than $200,000 of benefit liabilities has three components: a flat charge of $10,000, plus a loading percentage applied to the excess of the value of benefit liabilities over $200,000, plus $200 for each plan participant. The loading percentage is equal to 1% plus 10% of the difference between the applicable PBGC select interest percentage and 7.5%. Thus, if the PBGC select rate is 9%, the

loading percentage is 1.15%. If the PBGC select rate is 6.5%, the loading percentage is 0.09%. The loading formula in the regulations requires the value of benefit liabilities computed at the applicable PBGC select interest rate. Because this value has generally not been calculated by most plans, for this purpose, you may substitute the plans' ABO and the ABO discount rate. Those plans that don't have *FAS 87* values may substitute current liability in the current liability interest rate.

The second set of optional calculations is the recalculation of the plans' ABOs, VBOs, and guaranteed benefits, which also require the certification of an Enrolled Actuary. There are two levels of recalculation under this option. The simpler approach is to redetermine only the ABOs and VBOs by using the top-fifty interest rate and mortality assumption. Under this approach, we will continue to assume that guaranteed benefits are 95% of adjusted VBOs.

The more complex approach involves recalculation of guaranteed benefits. This would be appropriate if the plan provides significant nonguaranteed benefits, such as benefits that exceed the insurance maximum, or temporary supplements that exceed the accrued benefit payable at normal retirement. This approach requires a precise determination of guaranteed benefits, which for several companies has resulted in their not being included on the list. If the company chooses to recalculate guaranteed benefits, you must first recalculate the accumulative and vested benefits. In this case, however, you base the recalculation on benefit liabilities, not ABOs. Benefit liabilities and vested benefit liabilities are recalculated by using the top-fifty interest and mortality assumptions and the expected retirement age tables found in our regulation for valuing liabilities in terminating plans.

For many plans the census and benefit information for current liabilities and benefit liabilities are the same; the participant database is already available. However, this information generally is beginning-of-the-year information and thus must be projected to the end of the year. Such projections must follow the general rule guidelines used in determining the PBGC variable rate premium, including the requirement to adjust the values to properly reflect the occurrence of the significant event. The alternative calculation method permitted under the premium rules may not be used for this recalculation.

The value of guaranteed benefits is the present value of benefits in the first-through-fourth priority categories when assets have been allocated under Section 4044 of ERISA. Thus, it is not sufficient to merely calculate the present value of guaranteed benefits in the fourth priority category. A determination of the value of benefits in the third priority category will be necessary for virtually all plans that will benefit from this recalculation. This is where the heavy actuarial lifting begins. As some of you may recall from your examination days, the third priority category encompasses the benefits payable to participants who are in pay status or who could have been in pay status three years ago. The category-three benefit is based upon plan provisions in effect during the last five years that would have produced the smallest benefits. But now I'm getting into Ron's presentation, so I'll turn it over to him.

MR. RONALD GEBHARDTSBAUER: I used to do this presentation when I was with the PBGC. It teaches people how to calculate guaranteed benefits and allocated benefits. Like Dave said, probably not many of you will calculate them because the only time you

have to do so is when you have a distress termination. Most of the time an employer is not willing to pay for all that work.

You can do the calculations possibly when you have merger work, or a spin-off, if you had an underfunded plan. If you're doing a standard termination, Section 404(g) deduction rule says you can always put money in the plan and deduct up to guaranteed benefits. So there is a particular situation where maybe there are no nonvested benefits. All the benefits in your plan are guaranteed. Then you could deduct all the benefits in your plan when you do your standard termination. That's one situation in which you could do that. It's a very minute situation.

Now we have another reason for you to know these rules. If your plan looks like it's going to be in the top fifty, it may help you to get your plan off the top fifty. Now that I'm at Mercer in New York City, I've helped some of the consultants there get plans off the top fifty. One plan, for instance, had an automatic cost-of-living adjustment (COLA); you don't see that very often in a plan. But it's not guaranteed, so I said, "You know, the PBGC doesn't know that." The PBGC just assumes that when you go down from accrued benefits to guaranteed benefits that it's only going to be these minor little reductions. But because this plan had a COLA, there was a big drop between vested benefits and guaranteed benefits. It's much more than 5%. It was closer to 50% of it.

Congress asked what kind of benefits should be guaranteed? And it said that if it's not nonforfeitable, then the PBGC does not have to guarantee it. It could be an ancillary benefit. It could be a temporary benefit. Actually, Congress did not get into details. The law just says that there are basic benefits and nonbasic benefits and the definition of nonbasic benefits are benefits that are not basic. That's all it says in the law. There's nothing in there. So the PBGC had to come up with some rules and it looked to the committee reports that came out with ERISA. It said that on nonbasic benefits, the PBGC doesn't have to guarantee things such as ancillary benefits, death/disability, or supplements. So the PBGC just took that guide and created these rules.

The first rule is that the benefit must be payable. But the definition of payable for the PBGC is, you know, "you satisfied all requirements except for making an application." If you are disabled but you just haven't satisfied the waiting period, it's still a guaranteed benefit. The PBGC has a rule if you made contributions. You don't have to have died yet. So even if you die after the plan termination, a beneficiary would still get a return of employee contributions.

The second rule is you have to be entitled to it. And the reason that the PBGC has that in there is that it basically cuts out lump sums and having to administer all the different forms and options in the plan. The PBGC will guarantee benefits if it's already paid in a given form, if you're getting a full joint and survivor, and if you've already elected ten-year certain and continuous (C&C). If you elected before the plan termination and you wanted the ten C&C, then that's guaranteed. Otherwise, it's the automatic form. So if you're married, you get half the joint-and-survivor form, whatever is the automatic qualified form. If you're single, you get the straight life.

MR. KENNEY: So you lose the right to choose the option you want?

MR. GEBHARDTSBAUER: That's correct.

MR. GUSTAFSON: Yes, that's correct. There's another aspect of this that you should probably note. When you have the contingent benefits, such as if you have a 30-and-out benefit in your plan, and you have 28 years of service and your plan terminates, you have not met the conditions for entitlement to that benefit. Therefore, you are not eligible for it on a guaranteed benefit basis. That makes a big difference for many folks.

MR. GEBHARDTSBAUER: Right. The requirements for that option have not been met. You are not nonforfeitable in that benefit. When the IRS talks about benefits, it always talks about whether they are accrued. But the PBGC is always trying to find out whether they are nonforfeitable. In fact, that's the way to help you get down to your guaranteed benefits.

One other item is that if you had a partial termination a couple years ago and everybody became fully vested, the PBGC would not consider those people to be vested. Their benefits would not be nonforfeitable. They are not guaranteed. Another point: the PBGC only guarantees a level annuity or something that's level in conjunction with Social Security. A Social Security level income option will be fully guaranteed. That leads to the subject of supplemental benefits and when those are guaranteed. Generally, because the supplement stops at age 65, it isn't a level annuity so it's not guaranteed.

MR. GUSTAFSON: Ron, could I add one more thought to this? In many plans, the benefit is a supplement on top of an unreduced early-retirement benefit. There's perhaps still a supplement that's guaranteeable under that circumstance. The reason is that this limitation says to look at the accrued benefit payable at normal retirement age in a single-life form. Very often you're going to pay the basic benefit in a joint survivor form.

If the normal retirement benefit in a single form is $1,000, but a married participant gets a reduction and makes, say, $900, then $100 of that supplement is still guaranteed. So it's not truly the case that supplements are not guaranteed. They're not guaranteed to the extent that they exceed the accrued benefit at normal retirement age.

MR. ROBERT L. NOVAK: With regard to qualified preretirement survivor annuity (QPSA) benefits and whether they're guaranteed, does it matter if the plan is such that upon termination former employees have to pay for the QPSA benefit or if employees are subsidized by the employer?

MR. GEBHARDTSBAUER: The PBGC actually has been told that it is a law now for them to do it. It doesn't actually pay the one in the plan. It administers the one that is created and charges for it.

FROM THE FLOOR: It doesn't matter then whether the plan charges former employees?

MR. JOSHUA DAVID BANK: Just before we get much further, I want to put this into perspective. My main concern is PBGC premiums and the uncapped variable. Is there a direct analogy between what you're talking about now and the calculations for the PBGC Form-One?

MR. GEBHARDTSBAUER: This will get you a slightly smaller number when you do the phase-in calculations for benefit improvements.

MR. BANK: I'm speaking more generally than for phase-ins and maximums. I have a plan that has been capped forever and now I am going to have to go to $500 per person.

MR. GUSTAFSON: Maybe I can take a shot at that one. The PBGC premium calculations are based upon the vested portion of current liability. What we're talking about here deals with how you get the guaranteed benefits and how you allocate assets under Section 4044. They are not related.

MR. BANK: Basically, we're paying premiums on nonguaranteeable benefits.

MR. GUSTAFSON: Well, you aren't adjusting the expected retirement ages either. I mean there are trade-offs along the way here that were put into this statue. There's no perfect way to calculate underfunding.

MR. GEBHARDTSBAUER: Here's another area where you can get your liability down for nifty-fifty purposes. If you purchase annuities for some people in the plan, you can subtract that out of the PBGC guarantees. For instance, if your PBGC guaranteed benefit was $1,800 for this person, but $1,300 has already been purchased, the PBGC will only pay $500. That's the only portion that's guaranteed. Say you have purchased annuities for some people. Some plans just do that, because they thought the PBGC would still pay the $1,800 on top of what has been purchased. But that's not the case. They didn't get around the PBGC after all. So here's a situation in which you get your nifty-fifty number down a little bit.

Now I'd like to talk about the assumptions. Dave mentioned these already. The PBGC interest rate for February was determined on December 30, based on what was in *The Wall Street Journal* that day, and based on what the interest rates were. Through a little formula it comes down to about 7.3%. That's for the first 20 or 25 years. Then the PBGC also has expenses, and if you go to your regulation, you can get the actual expense formula for the PBGC.

The reason why that was put in is that at one time the assumption was 5%, whether you had a huge plan or small plan. They've been refined somewhat under the new rules, so the loading percentage is slightly smaller for a huge plan, and for a small plan, the loading percentage is slightly more. But anyway, you can do that calculation, or you can do it based on 7.15%. And that was based on a typical loading of about 0.15 or 15 basis points for expenses. So it will be a little simpler to calculate using 7.15%.

The mortality table is the PBGC mortality table. By the way, just for those who don't know, the IRS said to use the male and female tables in the GAM-83 Table, but in the PBGC's version of the GAM-83 Table, the female table is actually the male minus six years. I guess you have both 1983 GAMs in your computer. At the time I was putting this together, I wasn't sure what the retirement age was going to be, but it has been decided by the PBGC, as Dave mentioned in his speech. It's the expected retirement assumption.

MR. GUSTAFSON: It's from the tables for the expected retirement age upon plan termination.

MR. GEBHARDTSBAUER: We're done with calculating guaranteed benefits. So you would think the unfunded guaranteed benefits are equal to the present value of guaranteed benefits minus assets. Is that true? The answer is no because of the Section 4044 asset allocation process.

Actually, you could see the PBGC as the fourth priority. The assets in the plan go to many other people before they ever get to the PBGC. So the first claim goes to people who voluntarily put their contributions in. The next claimants are the people who have mandatory contributions in there. The third and very large group, which Dave mentioned, are "the retireds." Basically, I guess Congress thought that if you are retired and you are used to this income, you ought to have a priority on the money. Congress thought that was more important then the PBGC's priority. Now I should define that better.

The way Congress defines it is, anybody who was retired three years ago or anybody who could have retired three years ago has a higher claim on the money than the PBGC. So first you must take the assets away from the plan and sort of assign them to all these "retirees." Finding there's money left for the other guaranteed benefits for the PBGC, at that point you can do your substraction.

I just defined each one of the priority categories here. Priority category one is the voluntary employee contributions. Priority category two is a very complicated calculation now under the PBGC rules. And I guess Joan, Stu, and Dave are dealing with exactly what this calculation should be. Basically, it's just very close to the amount of employee contributions with interest that you have in the plan. It can get much more confusing than that.

If the employee decides to take an annuity instead of getting his or her employee contributions back in cash, it's the present value of the annuity that these employee contributions would buy. That isn't always the same thing as the account balance. It gets very confusing, and I'm going to skip through that. You can read the regulation.

The main one that's important is priority category three. Here's where you have the large amount that is going to make your unfunded guaranteed benefits fairly large. In the letters that the PBGC sends you, it will say, are you sure you did this calculation right? I know guaranteed benefits are down here. But did you remember to allocate your money to the people in priority category three? So what is a priority category three benefit?

Well, if you've already retired more than three years ago, it's your benefit. If you haven't retired yet, you calculate the benefit you would have gotten if you had retired three years ago. You use the early retirement factor; then use your joint-and-survivorship (J&S) factor as of three years ago. Use your salary average and your service you had back then. You use the present value factor, and then which plan document do you use? Well, the law says that it is the worst plan in the last five years. So usually it's the plan five years ago.

FROM THE FLOOR: Just for curiosity, it appears that the government assumes that the information necessary to do a priority category three calculation is virtually always going

to be available. In the real world, you're not going to know who was married three years ago, and you're not going to know what service people had three years ago.

MR. GEBHARDTSBAUER: That definitely complicates it because we had to do the calculations. We're forever trying to simplify it. In fact, when I was there I would like to have just gotten rid of it actually. Personally, priority category three only helps you if your benefits are over the maximum. So for instance, if your benefit is under the maximum and there are perhaps no plan improvements in the last five years, so there's no phase-in problem, your benefit would be guaranteed up to that $30,000 per year at age 65.

This gives more to the people with the huge benefits up to $90,000. For instance, we took over an airline, and many pilots have huge benefits that are being paid by the PBGC. That's because of priority category three, complex calculations; perhaps the money is going in the wrong place.

MR. GUSTAFSON: This is in the statue. It's not a regulation that the PBGC sort of threw together. And this provision not only aids people at the maximum, who may not be as sympathetic as most (especially if you're talking about a group of pilots who otherwise wouldn't get the big benefit), but it also aids folks such as steel workers who have temporary supplements, who otherwise wouldn't receive those because of normal retirement limitation. From an administrative standpoint, it is a nightmare. There's no doubt about it. But when you start to talk about changing provisions and cutting people's benefits who have been paid in the past, it gets difficult.

FROM THE FLOOR: Cutting, for example, wouldn't be the only option. One could, for example, redefine it so that someone who could have retired three years ago gets his or her benefit calculated with the benefit of the subsequent service.

MR. GUSTAFSON: That's right. And we've looked at multiple iterations of trying to simplify it by way of somehow reproducing a value that's close to that. But we haven't gotten very far on it.

MR. GEBHARDTSBAUER: I guess what you could do, for instance, is just assume that service three years ago would be three less than now.

FROM THE FLOOR: You may not even have the service when the person retired.

FROM THE FLOOR: For purposes of doing an actual termination calculation, one would need to go through this level of precision, because the law requires it.

I'm just wondering if, for purposes of getting off the top fifty, whether one could adopt a conservative approach and make some conservative assumptions in the PC-3 category and whether that would be sufficient to avoid much of this.

MR. GUSTAFSON: That's a good point. We're not talking about doing a calculation that ends up being the basis for assessing a liability in a bankruptcy proceeding and having something that's going to be debated by attorneys as well as actuaries. What we're talking about is trying to come to a number that is a reasonable estimate of underfunding for Title IV purposes.

Let me first give you an example of why this is important; this is not a unique case. We had an airline several years ago, and one of the airline plans said that it didn't have an underfunded plan. It had $290 million of guaranteed benefits and $400 million of assets. But when the company went through the PC-3 allocation, it ended up that in categories one through four, it had $440 million of benefits, and that plan was underfunded. Subsequently, that number went up substantially.

We can't ignore this PC-3 business; it's part of the statue. We must deal with it. Ron is showing you the way that we deal with it quite precisely when we're calculating individual determination of benefits for participants. If the actuary can make a solid case and can certify that what he or she is doing gives a reasonable representation, that it will be at least as great as this, that's fine. But you must map it out to convince us that that's what you're doing.

MR. GEBHARDTSBAUER: The important thing is the two benefits that Dave and I mentioned: allocate cash to the supplement for anybody who could have retired or was retired three years ago and allocate cash to the people who are over the PBGC maximum who could have retired three years ago or who did retire three years ago. Those are the two large amounts. For instance, for people who retired more than three years ago, a very simple estimate for them is that it is their whole benefit.

FROM THE FLOOR: I just have a question regarding a person classified as "could have retired three years ago." If your plan requires termination to receive retirement benefits at age 55 and the person was aged 60 but was actually working three years ago, do you count the person as "could have retired?"

MR. GEBHARDTSBAUER: That's correct, yes.

FROM THE FLOOR: So if you have a retirement age of 55, then it's anyone who is 58 or over right now.

MR. GEBHARDTSBAUER: Right, they could have retired if they had stopped working.

MS. CAROLYN EVANNA ZIMMERMAN: Dave, you mentioned with the priority category three that you would include, of course, the supplements for steel workers. I'm working on something right now in which there's somewhat of a disagreement as to whether the special payments that are paid to steel workers would be also in priority category three? What are your thoughts on that?

MR. GUSTAFSON: Are these the special payments that are paid for the first three months after the plan terminates?

MS. ZIMMERMAN: Right. Based on the vacation pay.

MR. GEBHARDTSBAUER: It is like severance or whatever.

MR. GUSTAFSON: Yes, that's how we've generally treated them, as Ron has suggested, as severance benefits and not as pension benefits. So that helps you.

FROM THE FLOOR: That would mean that's not guaranteeable. But would that become a nonbasic-type benefit in priority category three?

MR. GUSTAFSON: No, because we're dealing with pension benefits.

MR. GEBHARDTSBAUER: The PBGC does assume that if you didn't get those severance benefits, then your retirement benefit would have started three months earlier. So it sort of guaranteed up to the amount of your benefits.

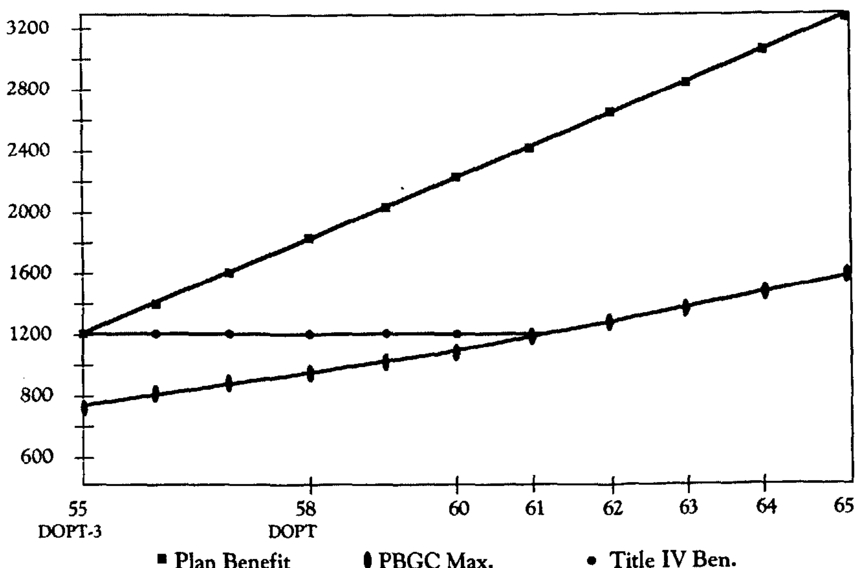
I want to mention one other thing on priority category three. I said it's the worst plan in the last five years.

Suppose your plan five years ago had scheduled benefit increases. Then it would include the benefit increases up to three years ago. That is another little rule that you must remember if you want to do an exact calculation. But I agree that perhaps conservative estimates are better for this nifty-fifty process.

Take an example of someone who at 55 has a benefit of $750 or something such as that (Chart 1). This is what the plan's large benefit would have been. But the PBGC maximum is this one. So you can see that if the person left before age 61, in this particular example, his or her PC-3 benefit is $1,200. If he left at any time before age 61, he would get $1,200. No matter when he leaves he will get $1,200.

So even though he is above the maximum, he will get $1,200 because he was retired more than three years ago. $1,200 is the benefit he would have gotten three years prior to date of plan termination (DOPT). It looks as if he should leave right away.

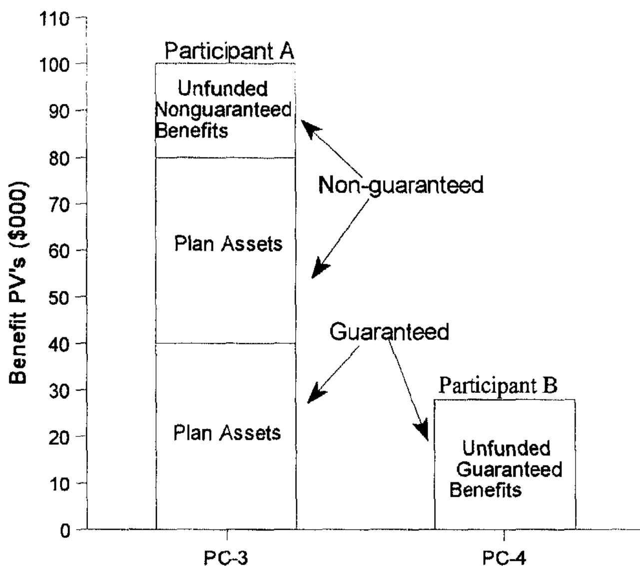
CHART 1
PC-3 CALCULATION
FUNDED PC-3 BENEFIT = $1,200



Now I'm going to show you the mechanics of 4044 allocation. So in Chart 2, we have priority category three; Participant A is 58 years old. He was able to retire three years ago, so he's priority category three and the benefit he would have received three years ago is $100,000 in value. Participant B is 56 and therefore is not eligible for priority category three. So his whole benefit is in priority category four. In both cases their benefits have been calculated, but the guaranteed benefits also have been calculated. Participant B's whole benefit would have been guaranteed because it's small. Participant A has a large benefit, so only $40,000 worth of his benefit would have been guaranteed.

Initially you'd say, OK, $40,000 went to this one person, $30,000 went to this other person, and total guaranteed benefits are $70,000. This is like the airline Dave was talking about. And if the plan has $80,000 in assets you'd say that this plan is well funded. Assets exceed guaranteed benefits. So the question is, what are the unfunded guaranteed benefits? They are actually going to be $30,000.

CHART 2
PC-3 ALLOCATION OF ASSETS



Participant	Age	Assets in PC-3	Guaranteed	PBGC Pays
A	58	$80,000	$40,000	$80,000
B	56	0	30,000	30,000
		$80,000	$70,000	$110,000 -80,000 (Plan Assets)
Plan assets go to retirees before the PBGC.				UGB = $30,000

So why has that happened? The reason why that happened is because all the money in the plan went to Participant A before he even reached the PBGC's priority category. So A received not only his guaranteed benefits, but assets filled up his benefit up to about $80,000. Some of his nonguaranteed benefits will be paid because of a Section 4044 allocation. Some won't be paid because there's not enough money.

Person A will get $80,000. Person B is not in priority category three, so none will get allocated in PC-3. So person A then gets the greater of $80,000, his allocated benefit, or his guaranteed benefit. That's $80,000. Person B gets the greater of zero and $30,000, or $30,000. The total amount that the PBGC will have to pay is $110,000.

There's only $80,000 in the plan. So unfunded guaranteed benefits amount to $30,000. This doesn't help your calculation to get off the nifty-fifty list, but the PBGC wants to make sure you do this calculation because you have to certify to it.

Perhaps you're going to try to revise the numbers that the PBGC pulled off the SEC form 10k, or wherever it gains the information (premium forms or whatever), and you want to revise what it has because you have some better numbers that are lower.

You will have to certify it saying not only have you calculated guaranteed benefits, but you also understand Section 4044 because you went to this session and you know that the answer is $30,000.

MR. KENNEY: Ron, if the employer put in the $30,000 of underfunding, that wouldn't correct the situation, would it? It would still be underfunded.

MR. GEBHARDTSBAUER: Exactly. That's right. Yes, put $30,000 more in here, and it fills up Participant A and then it fills up a little bit of Participant B. So Participant A will be happy.

The PBGC is somewhat happier but not totally happy because it will have to pay Participant A's full benefit and still pay all of Participant B's benefit. It would be $100,000 to Person A plus $130,000 to Person B minus assets of $110,000. So yes, the company would be $20,000 short.

MR. GUSTAFSON: It probably is worth pointing out that if it puts in $30,000, it probably would not fill up the rest there. The PC-3 benefit generally has a present value if it's less than the total value of the benefit without any deductions for the maximums. So if you put $30,000 in, it isn't all likely to go to that nonguaranteed benefit in PC-3.

MR. KENNEY: So if you're underfunded, putting in more money doesn't always solve the problem.

MR. GUSTAFSON: That's right.

MR. GEBHARDTSBAUER: Yes. We're almost done. Charts 3 and 4 are just a reminder of what all the priority categories are. And one of the things I've put in here is the PC-4 calculation.

Priority category 4 is slightly different from the previous guaranteed calculation. Priority category four is other guaranteed benefits, but for purposes of substantial owners, there is a 5-year phase-in, not a 30-year phase-in.

There's also the multiple plan maximum. For instance, if you're in several different plans, the maximum benefit you calculate is $30,000. But if you're in several different plans, you only get that $30,000 once. Well, if your assets are large enough to go priority category four, you may get your multiple-plan maximum cuts back.

PC-5 is other vested benefits. PC-6 is all other benefits. In fact, this gets into IRS territory; it is really defining what all other benefits and benefit liabilities are. That includes grow-ins and nonvested benefits. But you don't care about much of that because you're doing it for the nifty-fifty.

CHART 3
SECTION 4044 ALLOCATION OF ASSETS

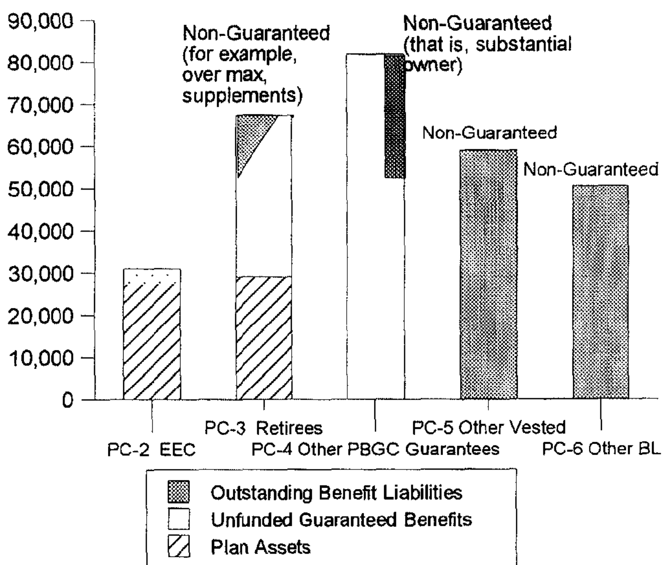


CHART 4
SECTION 4044 ALLOCATION OF ASSETS
RETIREES OVER MAX AND S/Os BENEFIT
FROM DUES COLLECTION IN PC-3 and PC-4 RESPECTIVELY