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PENSION PROVISIONS OF GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT): NONFUNDING ISSUES

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This session is part of the Minimum Funding Seminar Session Series. The panel will discuss some of the major effects of the Retirement Protection Act of 1994 in areas other than funding. Potential topics include calculation of lump sums and Section 415 limits, creation of the missing participants program, elimination of the excise tax for some nondeductible contributions and changes in the variable rate premium.

MS. JOAN M. WEISS: Our first speaker is a current colleague, Stuart Sirkin, who's the director of the PBGC's corporate policy and research department. Stu has held senior positions at all three ERISA agencies. He was the head of the policy office at the Pension and Welfare Benefits Administration (PWBA). He has worked in employee plans and exempt organizations at the IRS and is now at the PBGC. In between those positions he spent three years with Covington & Burling, a Washington law firm. Stu is a Columbia Law School graduate and has a master's degree in economics from Cornell and a master's in tax law from Georgetown.

Our second speaker is Ron Gebhardtsbauer. Ron is my former boss at the PBGC. He's currently a principal and the practice head of William M. Mercer's Retirement Practice in New York. As I said, he was formerly with the PBGC and formerly with the U.S. Office of Personnel Management, and the Wyatt Company. He has an M.S. in actuarial sciences from Northwestern University and a B.S. in mathematics from Penn State.

MR. STUART SIRKIN: I don't want to tell you the number of times I've had to rely on Ron, Joan, and Dave Gustafson, who is my chief policy actuary. I seem to spend half my life with actuarial concepts. We spent most of last year worrying about getting the the Retirement Protection Act through. Through the fortune of being able to tack it onto GATT, ours was one of the few bills that did get through last year. We worked hard last year. I thought we'd be able to take it easy this year, but the PBGC believes in getting regulations out, and GATT has a few such regulations. So, I've spent from January to June working harder than I did last year, so we could get regulations out to give you guidance.

I'm going to focus on the Retirement Protection Act (RPA) under PBGC authority. Ron, even though he's ex-PBGC, has been kind enough to deal with the areas that are under the Internal Revenue Code (IRC).

There are more than 41 million American workers and 58,000 plans in the PBGC's defined-benefit world. We believe all will benefit from the RPA. The RPA requires underfunded plans

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and their sponsors to accelerate funding, to pay a fairer share for the risk they pose to the insurance system, and to provide notice to participants about their underfunded plans and the PBGC guarantees. RPA also gives PBGC stronger enforcement tools and establishes a missing participant program to simplify termination of fully funded plans. The areas I want to focus on are: the premium rules, the new notice to participants, the new report to PBGC, the missing participant program, the changes in reportable events, and the PBGC's authority to enforce minimum funding.

We've been busy already this year. We issued two technical updates that basically tried to lay out how we would enforce the RPA; Technical Update 95-1 was an overview of RPA and included a summary of the tax provisions and guidance on the PBGC provisions. PBGC, of course, cannot interpret the tax provisions. Technical Update 95-3 dealt with some additional reportable event enforcement rules.

We issued a proposed regulation in March on notice to participants. We also issued a revised 1994 premium book, and now the 1995 premium book is out. These provide guidance on how you comply with the phase-out of the premium cap. Hopefully over the summer you will see final regulations on notice to participants. We are very close. You will see proposed regulations on reporting to the PBGC. Once again we are very close. You also will see proposed regulations on the missing participant program. We are committed to getting this guidance out, and we're committed to getting final regulations out on virtually all of this before the end of the year.

I want to start out with the notice to participant regulation because that's the one that's going to have the biggest impact in 1995. The vast majority of pension plans—75%—are fully funded. They have sufficient assets to pay all benefits. We still have 25% of plans that are underfunded. Our underfunding numbers climbed from $27 billion in 1987 to $71 billion in 1993. Nearly eight million workers and retirees are in underfunded plans. Most underfunded plans do not terminate. Participants retire and receive the same benefit they would have received if their plan was fully funded; however, some underfunded plans do terminate. In those cases some participants find their benefits are not fully guaranteed.

Congress passed rules that would strengthen plan funding in the long term, but Congress also heard many reports that, when underfunded plans terminated, the participants were surprised to find the plan was underfunded, and they were surprised to find out they were not going to receive all of their benefits. As a result, Congress required underfunded plans to provide an annual notice to participants. Under the statutes, most plans that are less than 90% funded will have to provide their workers with this annual notice. An estimated 1,500 companies with large plans—that's plans with over 100 participants—will have to provide the notice in 1995. The 4,000 companies with plans with under 100 participants will not be required to issue notices until the 1996 year. We wanted to give the small plans more time to understand the rules and to develop the necessary documents.

The challenge we faced in developing the notice to participants regulation was to find language that would inform participants about what they need to know without generating undue concern. We took a shot at that in the proposed regulation. We received some very useful comments on how well we achieved that. We've adopted many of those suggestions in our final regulation, which we hope will strike a balance that achieves Congress's purpose.

We also wanted to keep the requirements as simple as possible for plans. With that in mind, the regulation includes a model notice that plans can use and one we feel that employers will be comfortable using. Also the regulation does not require you to calculate any new numbers. Everything is based on the numbers that you already have for the deficit reduction contribution (DRC), or in the case of small plans (those with under 100 participants), the information on current liability on the Schedule B. There is no need to do new calculations.

The regulation relies heavily on the current liability you calculate for the DRC. It leaves interpretation of this to Treasury. Whatever rules apply for purposes of the DRC, that is, Section 412(l), also apply to this notice.

Who must give the notice? I call this the "gateway." It's really very simple. The statute basically says give a notice if you are subject to the variable rate premium for the year. It then creates quite a big exception from this rule. You do not have to give the notice if you're not subject to the DRC for a year for a reason other than because you are a small plan. Thus, generally, if you are subject to the DRC, you will have to give the notice. Because you might not know whether you are subject to the DRC for this year by the time the notice has to be given, the regulation allows plans that wish to do so to use the prior year's data. So, for instance, for the 1995 notice, you can use 1994 data. You can use it for determining whether you have to give the notice at all and for the funding information you give in the notice. Those who want to use current-year data can do so. This notice is not like the summary annual report (SAR). The SAR comes out in 1995 for the 1994 year. Because of the statute this is structured so that the 1995 notice comes out in 1995, but we're allowing you to use 1994 data. So, in effect, it's the same data as in the 1995 SAR, assuming you don't opt to use 1995 data. Thus, when we talk about the 1995 notice, it's the notice coming out in the 1995 year.

You also get to use all the volatility rules in Section 412(l)(9), which are in the law for purposes of the DRC. So, you don't have to give the notice for a year if you satisfy the two years in a row over 90% test, or the two out of three-year transition test that's in the code for the DRC. Once again, whatever rules apply for the DRC will apply whether or not you have to give this notice.

For small plans we've set up a series of special rules. Besides saying you don't have to give the notice in 1995, we're allowing you to use Schedule B data for current liability. We're allowing you to use a simplified rule for calculating pre-1995 years and a simplified rule for adjusting interest to the top of the corridor. These are all laid out in the proposed regulation and will be pretty much the same in the final regulation. We hope you can just copy numbers, and you don't have to do a lot of original work. Also, if you have a new plan, small or large, you get a one-year pass. That's not a 1995 pass. It occurs any time you have a new plan, and the first year of that plan you do not have to provide a notice.

The notice has to be given to all participants, but when should you count the number of participants? We don't care when you count it. Just do it some time between January 1 and the time you give the notice. Pick a date and try to stick with that date. Generally, you can switch dates between years as long as you're not excluding a lot of people. We've had lots of problems trying to figure out rules for mergers and acquisitions. What we're trying to do is give you as much flexibility as possible as long as you don't misuse it. As long as you're not trying to avoid giving people notices, I think you'll find the rules on what you can do and the kind of information you can have very flexible.

We received comments from 14 participants. We received no comments on using current liability for the notice gateway, nor any comments on the small plan rules. I'd like to think it's because we struck the right balance. In the past, no one hesitated to give us comments when we haven't.

We timed the notice so it can be given with the SAR. That's two months after the annual report. You don't have to give it with the SAR, but you can. Very important. It has to be in a separate document, a separate piece of paper from the SAR. Congress created this as a Title IV notice and not a Title I notice. We didn't want the notice to get cluttered up with the SAR. We want it to be a clear document. It can be in the same envelope, but it has to be on a separate piece of paper. If you're mailing the SAR, you can mail this with it. For a calendar-year plan you can give the notice as late as, I believe, December 15, so you'll have most of the year. We gave you reliance on the proposed regulations, but we will have final regulations out well before September, the earliest the notice can be due.

The notice basically has to be given in a manner reasonably calculated to ensure actual receipt. The SAR methods are fine, but you cannot post. We just don't think it gets the people the information they need. The notice funding percentage that you have to include is the current liability percentage that you have for the DRC. It's the same information. Also, as the proposed regulation made clear, or if you've had funding waivers in the last five years, or if you've missed minimum contributions, you have to inform the participants.

You have to give a description of the PBGC guarantees. The model notice has a sample description of PBGC guarantees. The regulation itself does not elaborate on how much detail you have to give. We do require you tell people that they can get a booklet called, "Your Guaranteed Pension" from the PBGC. This allowed us to be comfortable with what you tell them about the guarantee being brief. We wanted to make sure that they knew where they could get more information.

As I said, we got comments from 14 groups. Most of the comments dealt with two things. Some thought the language created undue concern, and, interestingly, we heard that from both participants and employers. We've tried to take some of these suggestions and strike a balance so that people would understand that most plans terminate in a standard termination, and participants get full benefits. It's only the unusual cases where they're terminating in distress.

There were also many questions about whether additional information could be included in the same document. The same concept that we talked about for the SAR applies. You can provide all the additional information you want, but it must be on a different piece of paper. We don't want the basic notice that's from the PBGC—the notice that the law requires—to be cluttered up and diluted; otherwise you can include it in the same envelope, the same mailing, and so on.

Let me turn to premiums. In formulating RPA we had a combined approach. One was to improve funding over the long run. We wanted to get funding up in plans. We believe we succeeded. Under our 15-year projection, average funding for plans will be something like 87%. But also, in the short term, we needed to correct the PBGC deficit and protect the system. We did that by increasing the premium.

When we were formulating this bill, the one thing we heard from everybody was don't increase the flat-rate premium. Actually, what we heard was decrease the flat-rate premium. The first rule was we were not going to decrease our premium. At the same time we wanted to try to pass the cost to the companies that were creating the risk for the system. I believe the numbers were that the companies at the $53 cap accounted for 80% of the underfunding, yet paid only 25% of the premiums. We decided we had to change that. We had to create an incentive in the system for plans to be better funded. So, we removed the cap over three years. The phase-in requires 20% of the difference between the uncapped amount and the capped amount to be paid for plan years beginning on or after July 1, 1994. Starting with July 1995 plan years, you have to pay 60% of the difference. And with July 1997 plan years, the cap is off totally. This will eliminate our deficit within ten years or sooner, depending on interest rates and other things.

But you have to remember that if the PBGC has no deficit next week, it doesn't mean that three plans can't go under four years from now. Therefore, getting funding up is the most important thing to us. And getting funding up will reduce the premiums because the variable rate premium is tied directly to underfunding at $9 per thousand.

The 5,300 companies now at the cap will see their variable rate premium rise from the current rate of $53 to an average of $123 once the cap is totally phased-out. The cap phase-out is the one premium change that impacts you now. We've had a number of people ask us about the change to the group annuity mortality table (GAM) 83 because it applies to funding for the 1995 year, but, if you remember, on premiums we're looking back a year. So, the change to GAM 83 mortality should not affect your premium calculations until your 1996 premium year.

Also, some of you might know that during the RPA process we clarified how the full-funding limit exception to the variable rate premium applies. The instructions to the Form 1 booklet explain this, but essentially look solely at Section 412(c)(7); don't reduce the assets by credit balances.

There were several other RPA premium changes. The interest rate, as you know, is 80% of the 30-year Treasuries. We're going to move from 80% to 85% for plan years beginning after July 1, 1997, the same time the cap phases out. When Treasury comes out with mortality tables after the year 2000 that moves mortality from GAM-83 to a new table, the premium interest rate switches to 100% of the 30-year Treasuries. We also switch to the market value of assets from the actuarial value of assets. In addition, there's a special rule for regulated utilities that basically leaves them with a cap until plan years beginning after January 1, 1998.

We mailed new Form 1 booklets in early June. People have asked us to get it out earlier than in the past. June was a step ahead and I hope was helpful to people. We're going to try to do it even earlier in future years. If you saw the revised 1994 R booklet, you'll see very few differences in the 1995 booklet. We do have both the 20% and 60% phase-out percentage in the forms. If your plan year started in January, you have the 20% phase-out. If it starts in July, you'll have the 60% phase-out. But it's all in one booklet. You'll see a worksheet in there that will help you with the calculations. If you didn't see the 1994 booklet because you only deal with calendar-year plans, you want to look at 1995 carefully because there are some changes from 1994, but we tried to minimize them.

We're working on a regulation, and I've been spending an awful lot of time lately on missing participants. It's a program that I find very interesting because it's very much needed. When I was at the IRS it was a problem and when I moved to private practice, it was a problem. And now it's a problem with the PBGC. We're happy we were able to do something in the legislation.

As you know, when you have a missing participant, you have to do something with their money. The insurance companies don't want it, or you're lumping everybody else out. Technically, if it's over $3,500, you cannot give it to a bank even if you could find one who would take it. The missing participant program will change this. It will say you can go to an insurance company, annuitize, or you can give the money to the PBGC after a diligent search. You can no longer go to the bank. When people went to the bank, no one ever found it.

We're serious about a diligent search. We don't want you to come in and say, "Hey, why don't you take the money? It's too costly for us to search." You have to do the search before you come to us. We're going to be reasonable on what the search is, and I understand from talking to people that they use credit bureaus and other commercial services. The rates are cheap, and they have a very good success rate in finding people. We'll be more explicit on what diligent search is when we come out with regulations.

We think the program helps plans, and we think it helps participants, but we want to run the program only for truly missing participants. We don't want plans to just dump people on us. We're working to get the regulation out. The law is effective only after we get out final regulations. We will have final regulations out by December somehow, because we want it to be effective for plan years beginning January 1, 1996. We cannot lose the 1996 year. We all understand that.

Please look at these regulations. There are many actuarial concepts in them, especially in defining when money has to come to the PBGC and calculating the missing participant's benefit. We ask for your help. Take a look at it and see if it works. See if it creates problems. We want to try to keep it simple. We cannot take money before the final regulations are out. We cannot take money from plans that closed out in the past. The criteria will be whether you've completed distributions by January 1. If you're close in October or November, and you haven't run your 180 days, you may want to wait, or you might want to get any permissible extensions. But, if you've run out of time, you can't just hold the missing participant around and ignore the standard termination deadlines.

Let me just take a minute to talk about standard terminations. Since the new regulations have come out on standard terminations, we've run into a number of problems with people missing deadlines, especially the postdistribution certification. Some of you have had to pay penalties. We don't like that any more than you do. But you have to pay attention to the deadlines. Similarly, some people haven't asked for available extensions. The automatic extension because you're still waiting for an IRS letter must be requested. Get in and ask us for the extensions. They're there and free, but you have to apply. There are also other extensions.

You cannot get extensions for missing participants, but we hope the new regulations will deal with that.

We've been working with some of the actuarial groups to get out in newsletters and other publications more information on what these requirements are. The Form 500 lays it out. We have very little discretion here. We are looking at the regulations to see if there's something we can do in the future. We're looking at the filing deadlines. We're looking at penalties in the postdistribution certification area. As I think Executive Director Slate has indicated, we are going to be doing something in that area in coordination with the president's program to simplify penalties. But nothing's a substitute for meeting the deadlines. What we are finding out is that much of it isn't that people couldn't do it, but instead they just don't realize that the deadlines are there. Please take the time to take a look at the deadlines when you start this process.

I want to cover a few other areas before turning this over to Ron. Improved compliance and powers for the PBGC were big parts of RPA. There were changes in those provisions during the legislative process. Some of the things we kept are very important to us.

For those of you with big plans, we have an early warning program at the PBGC where we monitor some 400 large employers and keep an eye on them. We've been very active in trying to deal with situations where transactions would weaken the pension plan's protection. If you're in those kinds of transactions, we urge you to come to the PBGC and talk to us. It saves many problems. As many of you know, we did a deal with General Motors in which over $10 billion was put into the pension plan in return for giving GM flexibility with respect to disposition of its electronic data systems (EDS) subsidiary.

We worry about subsidiaries, healthy subsidiaries, leaving the control group. We worry about plans being left with weak members of the control group, and we will follow up. Many of you have heard about what we did at Western Union where we went to terminate the plan because we didn't think PBGC had sufficient protections.

The legislation gives us some more information and authority. About 100 companies with underfunded plans of $50 million or more will have to provide us with annual actuarial information and financial information after we issue regulations. We are working hard on this regulation. I think you will probably see a proposed regulation in July. We are trying our best to tie it as much as possible to existing reporting requirements and existing information that you have. There's other information that the PBGC needs. We are trying to work off data that you already have available or can easily make available. Information, when it comes to the PBGC, is under very strict confidence limits, and you don't have to worry about it being leaked.

One of the big things that the legislation did was to require private companies and foreign companies to give PBGC 30 days advance notice on certain reportable events added by RPA. The technical updates explain some of this. We will have regulations later in the year, but it's an area in which we're still trying to understand the problems for practitioners. The new reportable events apply to other companies 30 days after the event. If you have a transaction that you think might be subject to advance notice, call us. Let's talk about it. We're willing to work with you. If you have questions, call us because we'd like to know what the issues are out there so, when we do the regulations, we can try to deal with them.

The Technical Updates give you very detailed information on how to deal with reportable events in the interim. The Updates tell you which waivers under existing reportable events apply. We explain what information has to be given. I don't want to take the time to go through it in detail, but if you take a look at the Technical Updates, you will see it laid out quite clearly. One important issue is the exception for control groups whose plans are all fully funded. The exception applies only to after-the-fact reporting, not to the advance reporting.

For small companies we have published in the *Federal Register* a simplified Form 10-SP. This is a simplified reportable event form, which as soon as the paperwork period runs, which I think is some time in July, will be available. You will be able basically to check a box on the form to tell us about a reportable event. If we need more information, we'll contact you. But basically, for small plans, and I think we define them as plans with under 500 participants, it will simplify the reportable event process greatly.

Finally, there's a couple of other things in the bill. PBGC has given authority to enforce the minimum funding contributions requirement for amounts over $1 million. We can impose liens for missed contributions immediately. We don't have to wait for the 60 days, which was required in the past. Also, outside of GATT there was a new bankruptcy law passed where PBGC now can sit on the creditor's committee in bankruptcy. There were many other things in GATT. Many of them impact the PBGC but are not under the PBGCs authority. I think Ron will deal with some of them.

MR. RONALD GEBHARDTSBAUER: I'm going to talk about the parts in GATT that amended the IRS's law—the IRC. What I found when working with the IRS when I was at the PBGC is both agencies are very particular about their provisions and where their authority is and isn't. So, I guess the IRS probably would prefer someone else to talk about the IRC instead of someone at the PBGC. So, here I am talking about the IRC. Most of these provisions, though, were provisions that the PBGC wanted and has been interested in getting for a long time. Some of them were something the PBGC wanted back in 1987 but couldn't get into Omnibus Budget Reconciliation Act (OBRA) 87. Stu was a part of the task force that was set up by Secretary of Labor Reich and Marty Slate, the head of the PBGC, to look into all these things. Many of them were put together and formed something called the Retirement Protection Act of 1993, which was modified and passed in December 1994.

I'm just going to go through my outline in the order of the provisions as they were in GATT. The first three items (Section 420 Transfers, cost-of-living adjustments, and extension of IRS user fees) were not in RPA. They were in GATT. These first three items were basically revenue raisers. The following items are from RPA.

The first of the GATT items that raises revenue is the Section 420 transfer. If you've ever wanted to use the surplus in your plan, and now the excise tax is getting so big that you don't want to take the money out of the plan by terminating and taking the surplus, or you don't want to improve people's benefits, there's another way of doing it. Five years ago, Congress let you move money over into a 401(h) account. That's a retiree health account in your pension plan from which you can pay retiree health benefits. If you move your surplus over there, one of the things you have to do is vest all your participants' benefits in the pension plan. So, if you're willing to do that, then you might move the money over. Originally, when Congress passed it five years ago, it was only for five years, and I didn't know that there were any or many employers that were actually using it. Evidently three major companies, IBM, AT&T, and DuPont, were actually using it, and so they lobbied Congress to extend this, and Congress liked the idea, too, because it raises revenue. If they're paying it from their pension surplus, then they're not taking the deduction for the health contribution. So, it raised money and helped pay for the tariffs that they were reducing in GATT.

In addition to extending it for another five years, they made a change. In the provisions five years ago it said that you had to not only vest your employees in the pension plan, but you also had to maintain a certain level of health benefits. It required maintenance of health costs. So, your cost could not go down. Some companies I guess had some good years. Maybe there was less utilization. Maybe a whole bunch of retirees died. I don't know exactly what it was, but costs went down. They hadn't changed their benefits, and so they went to the IRS, and the IRS said it was OK. If they at least maintain benefits, it's OK. So, you could either maintain benefits or maintain cost. Well, GATT passed this bill which changed maintaining cost to maintaining benefits. So now the question is, is there something that could go back in the opposite direction? Suppose you're maintaining benefits, but maybe, let's say, you had a cap on benefits on a particular surgery or something like that. Say it's $2,000. It'll pay up to $2,000. If medical inflation is very high, and this thing now costs $4,000 (twice as much, so maybe you're only providing half as much in the way of benefits, so there's still a question in that area) what does it mean to maintain benefits?

The next issue in GATT that raised money is something where your benefits in a DB plan can be up to $90,000 with indexing (or $120,000). The indexing now is rounded down to the lower $5,000. Another new item, and this was an idea that Dick Schreitmueller had suggested a long time ago, which would also help pension practitioners, is to postpone these cost-of-living adjustments until after you know the cost-of-living increases all the way through December. So you might not know what it is until the next year when you want to pay somebody's benefit in January. So, one of his ideas is to use third quarter of the prior year over the prior base and that way the information can come out earlier. Congress also liked that idea because it raised some revenue. The maximum's now not as high as it would have been otherwise.

Table 1 shows the different indexes that will go up to the third quarter of the prior year; it also shows the multiples. So, for instance, the defined-contribution maximum, $30,000, was supposed to go up to one-fourth of the indexed $90,000, and it was close to $120,000. So, it was getting close to one-fourth, and it would move up with the DB maximum in Section 415. But now that relationship has been struck, and it has its own base which is October 1993, the quarter following that. That's the base, and it'll go up when it reaches the next multiple of $5,000 which is—$35,000. So, I think it's going to be a long time before the $30,000 base goes up.

There's one other thing that may affect this cost-of-living increase, and that is Congress right now is debating whether the CPI is the correct index to use to update these limits, and if, in fact, the CPI is 1% lower, then that's another revenue raiser Congress can take in the future. It would reduce Social Security benefits, and it would mean your income taxes would be slightly higher. So, it would be a great revenue increase for the government.

TABLE 1
DIFFERENT INDEXES

Item	IRC Section	1994 Amount	Multiple	1995 Amount	1995 Unrounded Amount	Next Amount
Maximum Compensation*	§401(a)(17)	$150,000	$10,000	$150,000	$153,255	$160,000
DB Maximum Benefit	§415(d)	118,800	5,000	120,000	121,374	125,000
DC Maximum Contribution	§415(d)	30,000	5,000	30,000	30,651	35,000[†]
401(k) & SARSEPs Elective Deferrals	§402(g)(5)	9,240	500	9,240	9,440	9,500
SEP eligibility	§408(k)(2)(C)	396	50	400	405	450
Compensation Limit in §415	§415(b)(1)(B)	94 limit	N/A	94 limit X 1.0217	N/A	N/A

*Only a minor change in RPA from 1994.
†This will be a long time coming. Also, the DC limit is no longer tied to 1/4 of DB limit.

The third item that raises a little money is that great favorite of ours, IRS user fees, something we love paying. It's extended five more years, and I guess I'm not sure exactly why they extended it five years. Maybe Stu would know. It's possibly because they're not sure it's something they want to do forever. Another possibility is they're allowing Congress in five years to take it and use it as another revenue raiser, so it can find some more legislation that costs some money and pair them together.

MR. SIRKIN: The budget has a five-year window. So, many things will be tied to five years.

MR. GEBHARDTSBAUER: Once you know the budget, you'll understand much more about legislation that passes through Congress. For instance, some of the transition rules in RPA last for five or seven years, and then, all of the sudden, the transition comes off, and that's because it's beyond the budget of the U.S. government. So, all of a sudden you'll have to put in much more money. You no longer have a transition on the new RPA contributions, and if contributions go up, well, that would decrease revenue to the government, but since it's beyond this window, Congress doesn't reflect it in its revenue losses.

That brings us to RPA. One of the things I wanted to do in this talk is to describe why these provisions were created so that you understand why it's happening.

The solvency rule requires assets to be at least equal to three times the benefits. The reason for this rule is because the PBGC has a rule that they have to take over a pension plan—it's called a mandatory termination—if the pension plan runs out of money. For instance, even though the PBGC won a Supreme Court case against Ling Temco Vought (LTV) and was able to restore LTV's plans, it still kept one plan because that plan was out of money. PBGC had to take that plan over. The same thing happened with Allis-Chalmers. The assets in that plan were 3% of liabilities. In another month they would have been out of assets. So, the PBGC had to take over that plan and keep the pension benefits going. It was very easy to do something like this in the past, at least. You just annuitize as many people as you can, and eliminate all your assets. I'm not sure if that's the prudent thing to do, but then next month you wouldn't be able to pay your next pension payment; the PBGC would have to take it over. So, that's why you have this liquidity contribution idea that's in the RPA that says you must have assets at least equal to three times benefits.

Let's get into the specifics of that. When I say assets, I don't mean just any asset. I wouldn't include something like a real estate that you can't cash in really quickly. I'm referring to liquid assets. And IRS came out with something in Notice 95-31. It says if anything is on the stock exchange, you can convert it to money right away. Suppose you have an annuity. Is that liquid? The IRS said maybe during the first 36 months of that annuity it can be counted as your liquid assets. What about a GIC? If it's something that can be surrendered, you just take out the surrender charge, and that would be the liquidity value. If the GIC would only pay out fairly level payments, then the first 36 payments would be in the liquid value of assets. Those assets have to be greater than three times benefits. So, what are benefits then? Benefits also includes administrative expenses, if they're paid from the plan. If you're paying lump sums and annuities, that could be a very huge number. So, they went back to the idea of liquidity contribution that the PBGC had several years ago. If you pay this huge lump sum, and your pension plan is 40% funded, you could say 40% of the money is coming from the plan. The other 60% must come from the employer's pocket. So, they used that idea and said, for annuities and lump sums, your base amount of benefits is the unfunded portion of the lump sum or the annuity.

For calendar-year plans, you had to pay it by April 15. I think that the 15th ended up being a Saturday. I think the IRS came out and said you had to put it in by that Saturday the 15th. You don't get until Monday like you do for filing. So, get that money in or else you have an interest charge of 175% of the federal mid-term rate. What are the penalties for not putting this money in? If you want to pay somebody their lump sum, or if you want to purchase an annuity for them, you can no longer do that. You have to put the money in before you do that. And if you go ahead and purchase those annuities or pay those lump sums, then the fiduciary doing that is assessed a penalty up to $10,000 or the amount of the infraction, if less. And then you wonder if this is something that's in the pension plan. How can I not pay what the pension plan document is telling me? There's a new provision in 401(a)—it's 401(a)(32)—that says, you don't have to pay the whole amount. And I guess one issue is maybe you need to amend your plan and put something in the plan that also says you can't pay more than that if you have one of these liquidity problems.

When I was at the EA meeting, they were explaining this and someone got up and said, well, suppose your assets are very large, but they're all illiquid. Well, I guess it's probably not the prudent thing, but if all your money is in real estate or in an IOU, and say your assets cover your current liability, what happens in that situation? Well, the liquidity contribution does not need to be more than the unfunded current liability. So, if your assets exceed current liability, you don't have to make this liquidity contribution. In effect, your liquidity contribution is really the smaller of the two, enough to get you up to three times benefits or enough to get you up to 100% of the full current liability.

There was one thing I noticed that was kind of interesting in the RPA regarding LTV and TWA. The RPA uses code language for it; it doesn't actually say LTV and TWA. Plans that had a restoration schedule and plans that had a certain agreement in 1993 with the PBGC don't have to comply with any of the funding rules in 412. I'm wondering if they have to comply with this liquidity requirement? I would be surprised if they didn't have to, but I sort of wonder what those sentences mean. It just said you don't have to comply with any of these new changes to 412 from RPA. That is not what the PBGC would want. They should have to pay this liquidity contribution. Another thing that you get in RPA is waiver of quarterlies, which I'm going to talk about later. If LTV or TWA, doesn't have to obey that liquidity contribution, maybe they shouldn't get the benefit of the waiver of the quarterlies. That was a provision I was a little bit surprised about.

The next provision that I was going to talk about is if your pension plan has some very huge unfunded vested benefits, and when I say pension fund I guess I should have said all the pension plans in the control group that are underfunded, if all their underfunding adds up, and it's greater than $50 million, and it's covered by the PBGC, and this change in assumptions would decrease the current liability by a fairly large amount, you cannot just make this change in your assumptions. You have to go to the Treasury and ask for a change in assumptions, and it's a little bit retroactive, too. Let's say, for instance, you thought your 1994 valuation was done. Correct me if I'm wrong, but if your plan is under this situation, you may not be finished on your 1994 valuation, because it's retroactive back to October 28, 1993, and on any funding changes after that. So you probably haven't filed your Schedule B yet. You may have to do some more calculations. It goes even further. For assumption changes that you did after December 31, 1992, for instance, if you changed assumptions when you went in to do your 1993 valuation for your calendar-year plan, that's fine, but now that you're doing your 1995 valuation, your assumptions have to revert back to the old assumptions in 1992, unless you again go to the IRS and get your assumption changes approved by the IRS.

Something that's interesting about this is not only does it affect your current liability calculation, but it also can affect your premium calculations, too. Stu was talking earlier about how your premium calculations are based on some of the assumptions that you use in your current liability calculation—for instance, your retirement assumption. Some actuaries have been using methods to reduce their PBGC premiums by using a little loophole in 412 that says all your assumptions individually can be unreasonable just as long as your assumptions in aggregate are reasonable. They move over to the PBGC law which says use this interest rate. I could go into more details, later, but that's a way of getting your PBGC premium down. In order to do that you might have to change your assumptions, and go to all these unreasonable assumptions. This is a place where you're possibly going to get caught. Also just as an aside, the Actuarial Standards Board (ASB) has also heard about this. Even though maybe the letter of the law would allow you to do this, the spirit of the law wouldn't. The spirit of the law would say you shouldn't be doing this just to get your premiums down because that's not what was intended in the law, and so the ASB in its economic assumptions standard is probably going to come out and say don't do this. So even though you'd still be following the letter of the law, (and law and regulations can't change fast enough to correct this) and the standard, the ASB could fix this problem for us as a profession much faster.

One of the problems PBGC had was that a lot of the plans that amend their benefits every three years and constantly have benefit increases are always behind. It's like getting a new improvement on the house every three years and always paying this mortgage. They're always behind. They're always underfunded. And so the PBGC wanted some way of projecting these things or somehow getting this into the funding in advance. So for purposes of your funding method, rather than for current liability, when you project your liabilities you have to project these future benefit increases that are already scheduled to go into effect because of a collective bargaining agreement or something like that. This doesn't apply to multiemployer plans. The reason that many of these things don't apply to multiemployer plans, by the way, is because the multiemployer fund is solvent at the PBGC. So, it's just the single-employer fund.

FROM THE FLOOR: I have one question regarding the collective bargaining increases, and I'm pretty sure I know the answer, but I've never heard it actually said. Someone at my company said, well, "We're not using a projected funding method. We're using unit credit." I said, "Well, unit credit also projects benefits." Am I right to say that in any funding method, if you have dollars per year of service, for which you normally use unit credit, you still have to project the benefits? Is that correct?

MR. GEBHARDTSBAUER: That's correct. That's just like back in the days when we said we were using the traditional unit credit method, and we had a salary increase in the plan, and we said, well, we're using it traditionally. The regulation says if you have salary increases, then you must project them. The same thing applies here. You have to now project these scheduled increases. You don't have to project the increases that may come after the three-year collective bargaining cycle, but you have to project these. You do have one out, though, and that is the old Revenue Ruling 77-2. Suppose you're doing your January 1, 1995 valuation. If the bargaining is going on now, maybe they don't close the deal until December, and you don't have to reflect that this year. You can reflect it next year. It's a part of your method. So, if you haven't done that in the past, you must apply for a change of method, but something you can defer at least for one year is anything that's happening in the future.

The next issue is modifying the quarterly contribution requirement. Here's another one. If your plan is well funded, why does the PBGC care about quarterly contributions? Actually, we didn't care. But we had to wait in order to couple it up with some legislation where Congress was going to lose money. This one gained money. By not making a contribution this fiscal year, the government is actually going to have less deductions, and therefore, more taxable income coming in.

So, we waited for RPA in order to use it. You'll find that it says you don't have to pay the interest penalty, but it was clearly the intent of the people who put this through that it not only eliminate the fact that you don't have to pay the interest, but it also would just eliminate the fact that you had to pay that contribution on April 15 and July 15, and so on. So the IRS did come out with Notice 95-31 saying that, in fact, you don't have to make a contribution. We called the Department of Labor (DOL), and they confirmed with us that in the old days you had to tell participants, oops, we didn't make this quarterly contribution. DOL says you don't have to tell the participants if your funded current liability percentage is greater than 100%.

FROM THE FLOOR: For the prior year?

MR. GEBHARDTSBAUER: Yes. One other thing, too, is the PBGC's 412(n) lien is no longer applicable for the plans that are over 100% funded on current liability, and that's effective already.

Again, here's another issue in which the administration and Congress were trying to do something that was responsive to the benefits community. I think there was a particular company testifying on the Hill, and it wasn't happy about the top 50 most underfunded plans. One of the things it mentioned to Congress was it can't pay money when it wants to sometimes, and this was the issue where plans of more than 100 employees can put in up to the unfunded current liability. There's another provision in 404 that says if you have a DB and a DC plan, the total contributions cannot exceed 25% of compensation unless they cover the unfunded current liability. So, if you put the unfunded current liability in this DB plan, then you couldn't put anything in your 401(k) plan or your DC plan, even if you were supposed to. So, that has been changed now, and it says you can put the money in. By the way, it's still not deductible, but at least we won't give you an excise tax.

There's another one just like that, and that's for terminating plans. It used to be when I was giving my speeches that one of the most frequent situations was: We'd like to put more money in. We'd like to get the plan fully funded so that we can terminate it in a standard termination, but we can't deduct this money, and since we can't deduct, there's going to be an excise tax. What can you do? Well, you could put in the unfunded current liability. You can put in the unfunded guaranteed benefits. But I think if you had under 100 employees, you couldn't even put in the unfunded current liability. So, this rule allows plans with less than 100 employees to contribute the unfunded current liability. They don't get the deduction, but at least they don't have to worry about the excise tax now. The 25% of compensation limit item was effective for taxable years ending December 31, 1992 (on or after that). They couldn't do it back in 1992. Well, now they can do it. It was retroactive to 1992.

With regard to benefits, you're trying to figure out ways to not use cash when you're in bankruptcy. Many employers will encourage their employees to accept a pay decrease and instead improve pension benefits. Of course, the PBGC doesn't like that if the company is in bankruptcy. It is increasing the exposure of the PBGC, and the PBGC perhaps doesn't have very many tools to deal with that. It's like being in bankruptcy and getting a loan from the bank and not even having to put security down. So, there's now a rule that says while you're in bankruptcy you cannot increase benefits, and in fact if you do it, it's not going to be effective until you come out of reorganization (per ERISA). Also, the PBGC's phase-in won't start until then. So, maybe one year after the reorganization is all over, and you're back solid again, employees will get 20% and then 40%, 60%, and 80%. Finally, five years after the reorganization's over employees get all the benefits, but during the bankruptcy, the PBGC would not guarantee any of that benefit. It's interesting. The code is a little bit different. The IRS uses the "atomic bomb," and it just says, boom, you're not qualified if you do something like this. So, the provisions in the code are slightly different than in ERISA.

One of the more important issues, and probably the most important one that came out of GATT that affects most people, are the changes in lump sums. I will give a little bit of background on this. I guess the PBGC has been talking about changing its valuation assumptions for a long time because everybody knew the PBGC's interest rate was low. It's tough changing something when you're fighting to support it in a court case, but it finally was changed in 1993. In 1993 the interest rate became much higher, and the 1983 GAM was used. Together they get about the same answer. They're still created so that the liability is approximately what the insurance companies would charge for the annuity. So, the answer comes out about the same, but it looks a lot better. Again, you're coming much closer to each of your assumptions being individually reasonable. The PBGC wanted to go ahead with this. Well, this would not only affect PBGC's distress terminations. It would affect everybody's lump sum all around the country. And so people inside and outside of the PBGC felt that's not something a little, small agency should have to do. So, in the PBGC's preamble it said something to the effect: we're only doing this for our distress rules. For purposes of paying lump sums, we'll still be using the old rules, and that meant that all of you out there had to use the old rules for lump sums. So, you still had those low PBGC interest rates of 4–5%. In the preamble it asked Congress to do something about this, and please sever the relationship between lump-sum calculations and PBGC's interest rates. It's hard to change our interest rates when everybody looks at them for a lump-sum calculation. So, Congress finally did that in the RPA.

If you're going to come up with an interest rate, what do you choose? Well, a 30-year Treasury sounds like a good idea. One of the things that's really nice about that, of course, is it's much higher. All of the sudden everybody's lump sums went down. Employers were happy about that. The surprise was that you didn't find any lobbyists in Washington, D.C. lobbying for the participants on this issue (evidently lobbyists are not big on paying lump sums anyway). There was one fairly powerful and rich union that received lump sums. It didn't like the idea that this interest rate would go up so much, but all its lump sums were over $25,000. It was already using 120% of the PBGC rate. It said, "You ought to at least force them to use a good mortality table." So, Congress said not only do you have to use 30-year Treasuries, but you also have to use GAM-83, and, in fact, eventually it's going to be something like the GAM-94 or whatever the Secretary of Treasury chooses from the GAM-94. Some people predict that's the table that half the states are going to be using by 1997 or 1998. So, that's the mortality table that the IRS then will look at to decide which part of it is appropriate for lump sums. Then that will be promulgated as the lump-sum mortality table. Many people are switching to GAM-83 now, but you can wait until the year 2000 to change your calculation. You might want to wait until this next mortality table comes out. That's a little bit of the background. Maybe I should get into some particulars on that.

First question the law just says GAM-83. So, the IRS had to come up with whether it is the male table, the female table, or something in between? Does it vary by the mix in the plan? They decided 50% male, 50% female. You might want to look at the actual Revenue Ruling 95-6 that shows that because evidently some people's copies of GAM-83 have some bad Qs in them. My copy of the *Transactions* was correct. You can look at the IRS regulation too. I've heard there are copies out there of the 1983 GAM that are wrong, so make sure your computer has the right table.

What are the effects on lump sums? Charts 1 and 2 show that people at retirement, like age 65, will not have much of a change in their lump sum, but it is going to change the lump sums drastically for people who are 30 because you're using that 30-year Treasury. Not only is it higher, it's the only interest rate you use. You don't use the deferred interest rates that the PBGC had. So, many people's lump sums could go down to something like one-fourth or one-third of what they used to be.

Chart 2 is for a $100 monthly benefit, and Chart 1 shows a $1,000 monthly benefit. That shows the difference between people who had under and over $25,000. If you had over $25,000, there was a $1,000 monthly benefit, and the lines come together at one point. Whether you're using the Unisex Pension Table of 1984 (UP-84) or whether you're using the 1983 GAM, the answer still comes out $25,000, and that's why those lines came together.

CHART 1
COMPARISON OF MINIMUM CASHOUT VALUES
FOR $1,000 MONTHLY BENEFIT

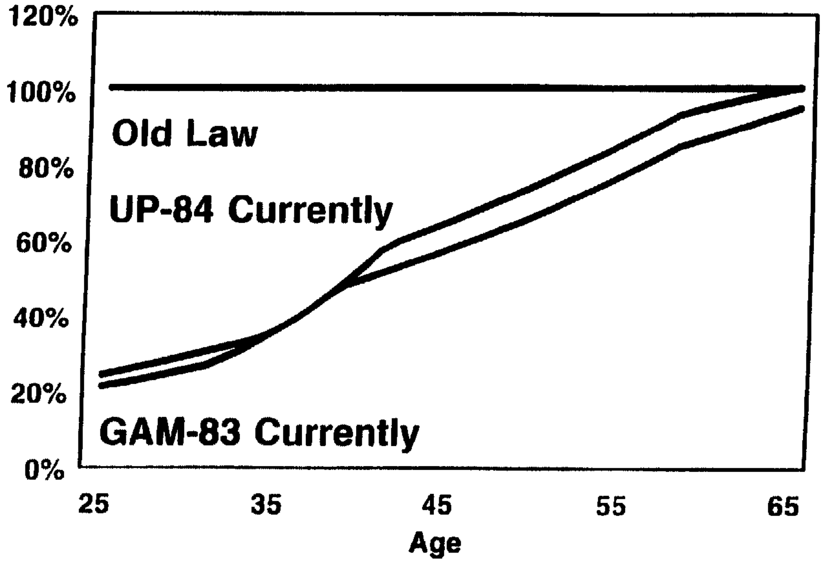
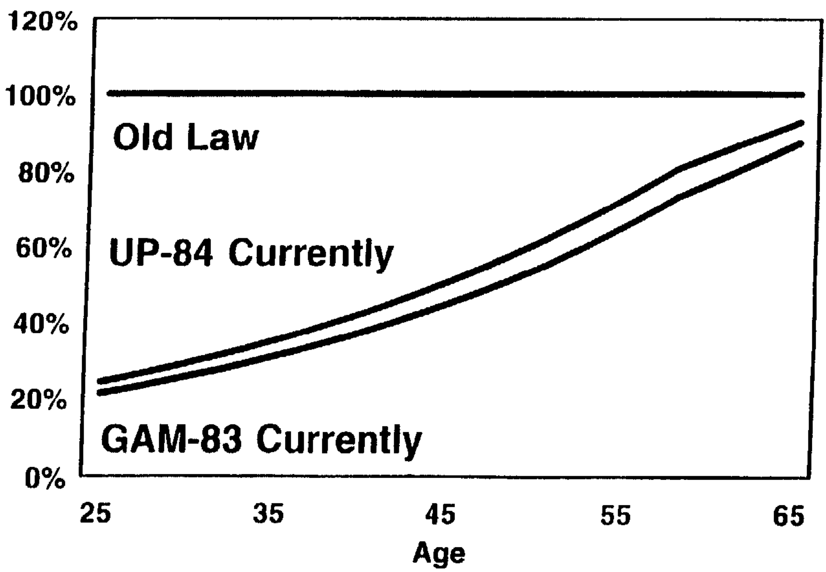


CHART 2
COMPARISON OF MINIMUM CASHOUT VALUES
FOR $100 MONTHLY BENEFIT



When can you change to new lump sum assumptions? You could do it effective immediately, as soon as the law passed, or you can wait until the 2000 plan year. I'm not sure I would do it retroactively back to December 1994 because I'm not sure that you can lower somebody's benefit that has already been paid. Also, even though the 204(h) notice would be required when you decrease benefits, 204(h) in ERISA only really talked about decreasing future accruals. This is technically not one of them. I don't think Congress ever contemplated, when they wrote 204(h), that you'd even be cutting back people's benefits. In this particular provision of RPA, you're actually cutting back benefits. So, I would think that the intent of the law is still that you should warn your employees. I think there are court cases out there in which plantiffs believe they should have been warned the lump sums were dropping. If they had told them yesterday, they would have quit yesterday to get the larger lump sums. I think there are court cases that help employees in that situation.

As I mentioned, Congress says you can cut back everybody's benefit, only if you were using PBGC's interest rates in the past. If you were subsidizing your lump sums by saying it's the greater of PBGC's rates or lump sums calculated at 5%, you cannot cut that 5% lump sum. You have to keep that, at least on accruals to date. So, the IRS said, in its Revenue Ruling 95-29 that if the interest rates that you were using were a function of the PBGC rate, if it was 100% or 120% or even 110%, or if it was the PBGC rate plus one or minus one or something like that, then you can cut back; otherwise there's a subsidy, and you can't do it.

There's another provision, too. Maybe you're sort of a nice employer. You don't want to all of a sudden have lump sums drop a huge amount. You can actually phase that in 20%, 40%, 60%, 80%, and 100%.

What about if terminated vested employees left in the past? That question was asked at the EA meeting and Harlan Weller of the Treasury Department said it depends on whether you had language in the pension plan that said you can redetermine terminated vested employee benefits. Whenever you change your assumptions, their benefits are also redetermined. Then you could do something like that. So, that's an issue from the past. He said some court cases have said, no, you can't do that. For instance, suppose you told the terminated vested employee here's what your lump sum is going to be. You put it in writing, and here's what it's going to be if you leave at this age. Unless you have a caveat saying this could change depending on the interest rate and the plan document in effect when you actually get your lump sum, you may not be able to do that. Some people have said, "Suppose there was no lump-sum provision above $3,500. Suppose you only cashed-out people under $3,500." Then you're sort of adding a new provision in the plan. They were over $3,500, and they couldn't get a lump sum. Now they can get a lump sum. In fact, it's mandatorily cashed-out. Some people would say, well, maybe you should at least let them choose it. Some people are saying, in that case, that you can pay them out, but many people are many nervous about mandatorily cashing-out without consent if they could have gotten a much larger lump sum in the past.

I guess a couple major things that I haven't mentioned is that the law says that you can use the interest rate from the month prior to the distribution. Many plans were using some of the prior IRS regulations for Section 417(e) saying that you could have a stability period of a whole plan year. You could use the same interest rate for that whole plan year. That's right. If you want to keep your stability period the same, you can still have the same interest rate for the whole year, and you can use any one of the five months prior to that. They call it the look-back month. So, you can use anywhere between December, November, October, September, or August. You can use any one of those five months for your interest rate the whole next plan year. So, for instance, many companies are using November. The reason they're using November is because you have to give your participants a 30-day notice so they can think about it before they choose what they want. So, if you use the November Treasury, then you get your 30-days notice. Also, the other thing that's good about November 1994, is that's when there were the highest interest rate on Treasuries in a long time. So, that's a way to, I guess, arbitrage or something like that.

FROM THE FLOOR: To be technical, if you use the November rate, you probably won't satisfy your 30-day notice period if you want to distribute on the first of January, let's say, because the rate is released the first Tuesday of the month which could be as late as December 7.

MR. GEBHARDTSBAUER: Right.

FROM THE FLOOR: From a practical view, I agree with your recommendation of November.

MR. GEBHARDTSBAUER: That's right. Yes, they are faxed to us from the Federal Reserve. So, I think you're right; the 7th is the best you can do.

Maximum lump sums also can drop. The law allows you to grandfather. So, you can grandfather the 1994 plan year maximum, but if all of your employees' lump sums drop, then the same thing is going to happen to your grandfathered maximum. You can still protect the grandfather maximum, but the grandfather can only be used for the lower-paid employees. So, I just wanted to warn you about that. Don't feel that you can continue to pay the large 415 maximum lump sums to the top paid people but pay much smaller lump sums to the lower paid people.