RECORD OF SOCIETY OF ACTUARIES
1995 VOL. 21 NO. 4A

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

Moderator: CHARLES D. CAHILL
Panelist: DENNIS T. BLAIR*
Recorder: CHARLES D. CAHILL

This panel will discuss some of the major effects of the Retirement Protection Act of 1994 in areas other than funding. Topics will include calculation of lump sums and Internal Revenue Code (IRC) 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.

MR. CHARLES D. CAHILL: I'm an actuarial consultant with The Alexander Consulting Group (ACG) in our Newburyport, MA office. Joining me is Dennis Blair, Research Director for ACG.

GATT is a year old; however, we are still learning its ramifications. We know what we have to know, so please share comments on different situations you've encountered. Hearing your experiences or insights will be very helpful.

I'm covering GATT's impact on: cost-of-living adjustments to the various dollar limits, pension asset transfers to retiree health plans, and lump sums and Internal Revenue Code (IRC) Section 415 actuarial equivalence. Dennis will cover: other Internal Revenue Service (IRS) tax issues, Pension Benefit Guaranty Corporation (PBGC) enforcement and reporting issues, quarterly contributions, and other PBGC reforms.

GATT changed the timing for applying cost-of-living adjustments. We know as of last week the factors for next year since the adjustment is based on consumer price index (CPI) changes October 1 over October 1. This allows planning for the next year. For instance, actuarial systems can actually get updated before the next year instead of scrambling in January.

GATT also changed the rounding rules. This change results in some revenue raising. Limits are generally rounded down to the next lower $5,000. The 401(k) deferral limit is rounded down to the next lower $500. The tax-sheltered annuity (TSA) limit is now actually equal to the 401(k) limit. So, it is also rounded down to the next lower $500. The rounding level for the simplified employee pension (SEP) compensation limit is $50.

The third column of Table 1 represents the 1996 limits. The only limit that changes from 1995 is the 401(k) deferral limit. If the GATT rounding rules had been applied initially to the 401(k) deferral limit, then the $9,240 limit for 1994 would have dropped down to $9,000. Inflation has now brought it back up to $9,500. The defined-contribution (DC) limit stays at $30,000 for the 11th straight year. The defined-benefit (DB) limit and compensation limit remain unchanged.

---

*Mr. Blair, not a member of the sponsoring organizations, is Research Director of Alexander Consulting Group in Newburyport, MA.

TABLE 1
REVENUE RAISERS
COST-OF-LIVING ADJUSTMENT

	1994	1995	1996*	1996†
§401(k)	$ 9,240	$ 9,240	$ 9,500	$ 9,689
Defined contribution	30,000	30,000	30,000	31,461
Defined benefit	118,800	120,000	120,000	124,578
Compensation	150,000	150,000	150,000	157,305

*Estimated
†Pre-GATT result

The fourth column estimates where the limits would have been absent GATT. There is a fairly substantial reduction due to GATT. This is what generates "revenue" for the IRS. In determining actuarial liabilities for IRS contribution purposes, benefits are capped by the defined-benefit limit. So instead of being at $124,578 (or if we rounded to the nearest $5,000, it would be $125,000), the limit is $120,000, which is a 4% difference.

The 401(k) has gone up to $9,500, which has been the TSA limit. The TSA limit will now be tied to the 401(k) limit. So both the TSA and 401(k) would have been at $9,689, except for the GATT changes. The CPI increase was 2.6% for 1996.

GATT extended and modified the rules for pension asset transfers to 401(h) accounts under IRC 420. Previously, the ability to make these transfers was scheduled to end December 31, 1995. It has been extended five years to December 31, 2000.

Some requirements have been clarified under GATT. For example, employers need to maintain only the level of coverage, not the cost, for five years after the transfer. In theory, if the plan's cost decreases, which we've seen in some plans in the last year, the sponsor can keep those cost savings.

Transfers are only available to well-funded plans (125% of current liability). The IRS revenue enhancement results because, instead of the corporation paying the medical benefits out of pocket, they're paid through the qualified trust lowering corporate tax deductions.

As of today, the House Ways and Means Committee has a bill in front of it allowing transfers out of qualified plans for any corporate purpose, not just retiree health. I think that this could endanger large employers' long-range funding of plans. The bill provides that for transfers before July 1, 1996, there will be no excise tax payable. After July 1, 1996, the excise tax will only be 6.5%. Dennis was at the American Law Institute American Bar Association (ALI/ABA) meeting recently and the consensus was this portion of the bill will not pass.

MR. DENNIS T. BLAIR: That's right. None of the speakers at the ALI/ABA conference predicted that the House Ways and Means Committee's pension reversion provision will survive the legislative process. One speaker predicted the Senate simply will not agree to this proposal. This prediction may have been influenced by the evening news on at least one of the television networks on October 12, 1995. The television coverage presented the

proposal in an unfavorable light. The network reporters interviewed older workers who said they could not retire because their employer removed assets from their pension plan.

MR. CAHILL: By the way, actuarial losses that are generated by virtue of one of these transfers are funded over ten years.

The GATT change that most affects my daily work, other than funding issues, is the new mandated, actuarial, minimum lump-sum basis. For the first time, the IRS has dictated a mortality table. It's what I'm referring to as the modified Group Annuity Mortality (GAM) 1983 table. It's about a 50/50, male/female blend of the traditional GAM-1983 table. It was promulgated in Revenue Ruling 95-6. The interest basis is now a 30-year treasury rate instead of the graded PBGC rates that we used before, which is a very significant difference.

For early adopters, the immediate rate on January 1995 changed from 6% to 7.87%. What's even more profound, because there are no longer graded rates, are the changes in the discount rates applicable to lump sums for participants terminating before normal retirement. The discounting from age 45 to 46 changes from 4% to 7.87%. This leads to large reductions in lump sums. Depending on the mortality table the plan currently uses, the change in lump sums at older ages may be small or even slightly larger under the new basis.

The new basis can be adopted any time after 1994. You have five years (until the year 2000 plan year) to decide when you want to start using this basis. You can either use the PBGC or the new GATT basis.

Temporary regulations under Section 417(e) were issued in April which addressed grandfathering. A plan simply having the traditional lump-sum rules (graded rates and whatever mortality table) can get a "free" change. This allows plans to "save" money on lump-sum payouts. For instance, one of my clients cashed out 70–80 people (10% of the participants) which generated a significant actuarial loss due to the difference between the PBGC graded rates and the 8% actuarial valuation assumption. Those kinds of losses are eliminated with the GATT rates. Also, plans should be careful in timing the adoption of the GATT basis for lump sums because there's a tie-in with IRC Section 415 treatment of lump sums.

The point on grandfathering is if you're using the PBGC rates and whatever mortality, you can switch to the GATT basis and not worry. There's no IRC Section 411(d)(6) cutback. The exception is a lump sum basis that is something other than simply just PBGC rates (for example, the lesser of 5% or the PBGC graded rates). Such a plan would be required to grandfather the 5% lump-sum basis. You can freeze that amount and it'll fade away.

FROM THE FLOOR: Is the 50/50, male/female blend required under GATT for the mortality table, or can a plan develop its own male/female blend based on its population?

MR. CAHILL: My understanding is that the 50/50 blend is required under GATT.

These sample rates in Table 2 illustrate the impact of GATT on lump-sum factors. The first time I put this table together I actually used unisex pension (UP) table 84+1 because I wanted to demonstrate that at 65, the GATT basis actually produced a larger lump sum.

The change in mortality from GAM-83 to UP-84 is basically a wash with the interest rate change at age 65. This illustrates that plans were using UP 84, in the first place, to make up for the subsidy in the PBGC rates. The GATT basis is more realistic. However, at age 35, there's a significant difference; the pre-GATT lump sum was almost 2.5 times the GATT lump sum.

TABLE 2
MINIMUM LUMP SUMS
DEFERRED ANNUITY TO AGE 65 FACTORS

Age	Pre-GATT*	GATT†	Percentage Change
25	1.423	0.402	(72)
35	2.130	0.861	(60)
45	3.221	1.855	(42)
55	5.041	4.066	(19)
65	9.345	9.279	(1)

* Assumption: interest, 6% graded; mortality, UP-84
† Assumption: interest, 7.87% graded; mortality, UP-84

IRS actuary Jim Holland discussed these changes at the ALI/ABA meeting. This change has created an opportunity to terminate plans. Unfortunately, I've been through a few plan terminations this year, and what we're finding is that insurance companies didn't want small deferred vested liabilities. They charged a premium because of the administrative costs and the interest rate risk due to the long duration for these groups. Before GATT, if you lump summed the people out, you had a huge loss. You could have a plan that is seemingly well funded (125% of current liability), yet when you tried to terminate it, it was really only 90% funded, particularly if you had a young group. With GATT though, that's gone away. Cashing out the younger participants with smaller benefits is now cheaper than either the old PBGC basis or insurers' termination annuities. Jim Holland had an interesting read on what happens to the surplus.

MR. BLAIR: Assuming that the House Ways & Means pension reversion provision is not enacted into law, employers will incur either a 20% or 50% excise tax on reversions under current law. Notwithstanding these excise taxes, the IRS is concerned that some employers may still want to terminate plans to recapture surplus assets after changing to the GATT interest rate and mortality table. To discourage employers, Jim Holland announced that surplus assets attributable to changes in a plan's interest rate and mortality table are not created because of an actuarial error but because of a plan amendment. As a result, Mr. Holland said IRS regulation 1.401-2(b)(1) prevents employers from recapturing the surplus assets. According to Mr. Holland, these surplus assets should be allocated to plan participants by amending the plan to increase benefits in accordance with Revenue Ruling 80-229.

MR. CAHILL: I think some plans suddenly will find that they can terminate. If they're inclined to terminate the plan, they will be happy to use that surplus in some other way. For example, they could transfer it to the DC plan. There's a period of time that you can use it to fund defined-contribution benefits.

GATT is further dictating the actuarial assumptions to be used for IRC Section 415 purposes. We now need to use the modified GAM table for all purposes under IRC section 415. Before GATT, the mortality table was dictated by the plan's actuarial equivalence definition. The interest rate has changed to the IRC Section 417(e) rate for lump sums and other forms except nondecreasing annuities.

It is not clear exactly what is a "nondecreasing annuity." It's clear that a lump sum is a decreasing annuity. You get a bunch of money one day and nothing the next. It is clear that a life annuity is a nondecreasing annuity. It is clear in the regulations that a qualified joint and survivor benefit is a nondecreasing annuity. It is not clear that a joint and survivor benefit, where the survivor benefits are paid to someone other than the spouse, is a nondecreasing annuity.

The new actuarial basis for calculating IRC 415 limits for optional forms of benefits is now effective. There is legislation to change the effective date to be the same date that the plan adopts the new IRC 417(e) basis for lump sums. You have the option of grandfathering accrued benefits, but there is some tension between 417(e) rates and 415. For a retiring executive that's coming up against the lump-sum limit under 415, the plan may want to wait to adopt the new 417(e) rates. You would think you would be able to grandfather the lump sum for the executive as of January 1, 1995. However, if you're not grandfathering the lump-sum basis for everybody else, then you can't grandfather the lump sum under Section 415 for the executive.

Revenue Ruling 95-29 clarified how to calculate actuarial equivalence of maximum benefits. Some actuaries are concerned with the methodology. I'm going to point out the differences in the methodologies before and after GATT. The regulations have an example that we've modified slightly. In Table 3, we have someone who's retiring at age 55, Social Security retirement age is 66, early retirement factors were 4% a year, and the plan's mortality table is UP-84.

TABLE 3
MAXIMUM BENEFITS
EARLY RETIREMENT FACTORS

Social Security retirement age: 66 Retirement age: 55 Plan's early retirement factor: 4%/year Plan's mortality table: UP 84			
Method	**Plan**	**Pre-GATT**	**GATT**
§415 Early Retirement Factor	51.14%	41.55%	44.44%
Maximum Benefit	$61,368	$49,856	$53,328

GATT actually generates a larger Section 415 benefit on a life annuity basis than the pre-GATT basis. The $120,000 limit is reduced to age 55 in two steps. First, the limit is reduced from age 66 to 62, using the Social Security Rules. Second, the plan's early retirement factors (not the plan's actuarial equivalent factors) are used to go from 62 back to 55. You then compare that reduction to the regulatory basis, which before GATT, would have 5%, UP 84. The maximum Section 415 benefit would have been the lesser of those two amounts. Before GATT, it was $49,856. After GATT, it's actually up to $53,328 for this individual on a life annuity basis.

Why the uproar in the trade press about early retirement and GATT? It's because there's this lump-sum issue. Many small plans provide for lump-sum payouts as ways of delivering significant capital accumulation. Actually, a number of my larger plans have lump-sum provisions. Post-GATT, when you calculate the early retirement factor as part of determining a lump sum, you have to use the 417(e) rate (7.87% at January 1, 1995). Because a lump sum is a decreasing annuity, it generates a much lower early retirement factor. You see it's 38.2% for the lump-sum form versus 44.44% for a life annuity. The lump-sum factor post-GATT at 55 is also lower. If combined, you have a very substantial reduction of $84,000 due to GATT changes.

FROM THE FLOOR: It sounds as though you are indicating a trend towards adding the lump-sum option to terminating plans. And if so, how does this affect the pricing perspective of the annuities? I'd be interested in any comments.

MR. CAHILL: I've been through a couple of plan terminations this year plus a couple that were avoided. If you add a lump-sum feature to the plan, typically the younger participants with smaller benefits take the lump sum. The older participants tend to be afraid to get a big lump sum. So they are actually the people who are more likely to select the annuity. When you have someone who's been around for 30 years who's making $40,000 a year, he or she may not be comfortable with that lump-sum amount. What happens is all the younger people end up taking cash for their smaller benefits. The insurance companies hopefully end up with the people that they prefer to have and the plan actually ends up with better quotes if you add the cash out.

You could always do things like only provide some cashouts. I have a number of plans where, due to the current GATT basis, we've added optional lump sums for the deferred vested between $3,500 and $10,000.

I still think from a cash-flow standpoint, companies are better off keeping the liabilities. If your investments can't outstrip Treasury rates by enough to make it worthwhile paying PBGC premiums, then you should be looking for another investment manager.

FROM THE FLOOR: Yes, but only as long as the employer recognizes the fact that it has to provide this option at that point in time.

MR. CAHILL: Yes, it's elective and it does add administration to the termination process to the extent that you're now giving an option that you may not have had to give before. Most of the DB plans that I've been involved in are looking to enhance or dress up their 401(k) plan or their money purchase plan. They're looking for a way to say, "Here's your money out of the DB plan. You can put it into the DC plan." The only way you can do

that is by adding a lump-sum option. Usually it's done in tandem with that kind of change.

FROM THE FLOOR: Do you feel that the pension reversion provision will have some positive impacts? For example, will more employers start DB plans who otherwise wouldn't have? It's my feeling that among small employers, DB plans are dying and this might be a shot in the arm.

MR. CAHILL: I would think small employers, if they're looking at a potential reversion as a reason to set up the DB plan, probably shouldn't be thinking about a DB plan. I suppose employers are scared off because they fear that the plan may end up with more money than the plan needs and they won't be able to touch it because of the fairly substantial excise taxes. Clearly, if you have 200 employees or 150 employees (and you're just as likely to have 50 in five years as you are to have 500 in five years), then with actuarial gains, you could end up with substantial excess assets.

FROM THE FLOOR: Suppose you have much smaller employers with five and ten employees. Would you agree with my impression that right now it's a no-no to think about setting up a DB plan?

MR. CAHILL: I think you've asked two questions. Yes, they do have a bad rap, so many of five- and ten-life groups don't think about setting up DB plans. But I still am willing to step up on the soap box and say that DB plans do things that DC plans can't. If you have a ten-life group and you put in the DB plan and you're looking to deliver benefits out into the future for a select portion in that ten-life group, then a DB plan is the best way to go. I think if you keep it simple, a DB plan doesn't cost that much to run. I'm perfectly happy to stand up here, particularly in this group, and talk about how wonderful DB plans are. I hope the pendulum will turn.

MR. BLAIR: Some benefit practitioners in the legal community may also understand that DB plans may be appropriate for small employers. At the ALI/ABA conference, an actuary named Bruce Temkin with Louis Kravitz & Associates in Encino, CA, explained the benefits of DB plans for small employers.

MR. CAHILL: Thankfully those clients of mine who have looked at terminating their DB plans, after they spent the time to do the full-blown analysis, have backed away. They may end up in a cash-balance plan. When you start looking at Mr. Smith and Mrs. Jones, who are 45 years old and have been around for ten years, you realize you just can't get them whole in a DC plan unless you give everybody a windfall.

FROM THE FLOOR: I have two comments, one is about the reversion question. I would say that what Congress gives Congress can take away. I'd be very suspicious that those reversion provisions would stay forever.

MR. CAHILL: This is a Republican idea. Of course, that's no indication that the Republicans aren't going to be around for a while. It appears they're going to be. But the Democrats will come back into favor.

FROM THE FLOOR: It seems to me that GATT has amended the minimum amount that needs to be paid in a lump sum under the qualified plan. What's the interaction between

ERISA and GATT? What are the potential problems employers have under ERISA by going to GATT and lump summing people out at the much lower amounts than they previously thought they had?

MR. BLAIR: Clearly, participants will have disappointed expectations. When that happens, they may bring a lawsuit. The strongest defense employers have is that Congress, when they allowed employers to change lump-sum amounts, specifically waived the so-called anticutback protection plan participants usually get whenever there is a plan change. With that waiver from Congress, employers will likely prevail against the plan participants when they sue. But, that doesn't mean the lawsuit is not going to occur.

MR. MARTIN S. FOX: I'm primarily a small plan actuary. The comparisons between large plans and small plans are very difficult to make without really recognizing that the small plans are primarily tax shelters. Consequently, small plan sponsors don't like the idea of not being able to revert some of these monies back to the corporation without being exposed to a rather onerous 50% excise tax. It's difficult to comprehend how to come up with a way to get the money back without experiencing that tax. I mean, you can invent all sorts of ways. You can bring your wife or kids into the plan, or you keep the plan going forever. We have different theories, philosophies, and so on. So the idea of putting the money back into the business for small plans isn't really the case.

The IRS, on the other hand, is actually encouraging the idea of the reversion from small plans because they know the monies are going to go back to the corporations and come out as salaries. There's an immediate gratification. There are considerably different philosophies involved.

MR. CAHILL: I'm not that familiar with the small plan market. Unless you get the plan designed to pay out maximum Section 415, then can't you balloon up the payments anyway and spread the reversion out among the participants?

MR. FOX: Yes, and that will probably be the case if it is prorated by present value of benefits (PVBs) and the owner gets his fair ratio, you obviously would do so. And that would be the idea. The ultimate idea is to accumulate as much money in the deferred situation as possible. And, as far as these disappointments, I realize that we're in a litigious society, but the disappointments of not getting what you thought you were going to get happens all the time. PBGC rates change. I mean, there are no guarantees.

MR. CAHILL: They have been moving up a point-and-a-half in the past year.

MR. FOX: Right. So consequently, we are careful even when giving statements to employees. I'm usually speaking of the death benefits in these cases which would have a direct relationship to the PBGC benefit. For a long period of time, the PBGC benefit gave greater benefits than the actuarial equivalency in the plan. In small plans, of course, we deal generally with the actuarial equivalency as opposed to, in your large plans, we'll have to get a lump sum. It's going to be based on PBGC rates. So that's where they received the big shot in the arm when GATT came in. The small plans really don't get that benefit because they have to fall back on the plan guarantees.

MR. CAHILL: You probably have a 5% rate in your plan anyway.

MR. FOX: If we could have four or three, we would.

MR. CAHILL: Thanks for insight on your part. I am now going to turn the presentation over to Dennis.

MR. BLAIR: I'm going to cover the rest of the GATT changes that are administered or enforced by the IRS. The first one deals with collectively bargained plans. Before GATT, these plans did not have to anticipate scheduled benefit increases. GATT now requires actuarial methods that project benefits to recognize scheduled benefit increases.

Because of this GATT change, Jim Holland says he is no longer sure that the unit credit method is an acceptable actuarial method for collectively bargained plans. I believe the IRS will grandfather collectively bargained plans that currently use the unit credit method, but will not allow a plan using another method to change to the unit credit method.

FROM THE FLOOR: When will a scheduled benefit increase be made?

MR. BLAIR: I believe it occurs when the collective bargaining agreement is approved.

FROM THE FLOOR: So in other words, it's sufficient that the benefit increase be in the collective bargaining agreement. The plan itself doesn't have to be amended.

MR. BLAIR: I believe that is correct, but the IRS has not published any guidance on this GATT change.

The next change deals with bankruptcy. Before GATT, employers could amend their plans to increase benefits, even though they were in bankruptcy. PBGC lobbied to prevent these amendments during an employer's bankruptcy. Although PBGC was the principal advocate for this GATT change, the IRS will administer this change in the law.

Essentially, prohibited plan amendments include those that increase benefits, accelerate vesting or improve the accrual rate. The plan amendment prohibition does not apply to plans that are 100% funded on a current liability basis after the plan amendment. The prohibition also does not apply to plan amendments that were adopted before bankruptcy or changes that become effective after bankruptcy.

The plan amendment prohibition also does not apply to those amendments needed to preserve the plan's tax qualification. It also does not apply to plan amendments that have a de minimis cost impact so long as the IRS improves them.

The prohibition against plan amendments does not apply on a controlled-group basis. It only applies to contributing employers who are in bankruptcy. The plan amendment prohibition is a qualification requirement that is IRC Section 401(a)(33). This means employers will have to amend their plans to include this prohibition.

The next GATT change deals with so-called liquidity shortfalls. GATT requires employers to increase their quarterly contributions up to an amount necessary to eliminate the liquidity shortfall. However, the increase in quarterly contributions is capped at an amount that makes the plan 100% funded on a current-liability basis.

While the plan has a liquidity shortfall, plan fiduciaries cannot make distributions in excess of monthly annuity amounts. For example, the plan cannot make lump-sum distributions. Plan fiduciaries cannot purchase annuities and cannot pay other amounts IRS will describe in regulations. Although the IRS has not yet published regulations, it published Revenue Ruling 95-31 in March 1995 to provide some interim guidance on this liquidity shortfall requirement.

I'll now define liquidity shortfall. First, we begin with the base amount which is essentially three times the plan's distributions during the last 12 months. We then adjust those disbursements by multiplying lump sums and annuity purchases by the plan's current-liability funding percentage. Next, we compare that adjusted base amount to liquid assets. Liquid assets are cash and marketable securities. The excess of the adjusted base amount over the liquid assets is the liquidity shortfall.

GATT imposes significant penalties on employers that do not make up the liquidity shortfall. Initially, the penalty is a 10% excise tax per quarter on the shortfall. If it is not cured within four calendar quarters, then the excise tax rate increases to 100%. GATT also imposes a sanction on the plan fiduciary for distributing prohibited benefit payments during the liquidity shortfall. The plan fiduciary must reimburse the plan for the amounts they should not have paid or, if less, $10,000.

The liquidity shortfall rules do not apply to plans with fewer than 100 participants and multiemployer plans. These rules also do not apply to plans that are not subject to the quarterly contribution requirements.

MR. BLAIR: How do the liquidity shortfall rules affect the purchase of deposit administration (DA) and immediate participation guarantee (IPG) contracts. If the plan purchases those contracts to make benefit distributions during a liquidity shortfall, the IRS would probably treat them as prohibited annuity purchases. However, if the plan purchases those contracts as an investment, they would not be considered annuity purchases.

MR. RICHARD G. SCHREITMUELLER: I believe the question is whether the DA or IPG contracts would be treated as liquid assets under the liquidity shortfall rules. Revenue Ruling 95-31 addresses this issue. It says an annuity contract is a liquid asset if the plan has the right to receive, without restrictions, disbursements from the contract in order to pay benefits for any participant in the plan. An annuity contract is also considered a liquid asset if the plan can immediately redeem it for cash. If the contract provides for substantially equal monthly disbursements, the only portion of the contract that may be treated as a liquid asset is the amount equal to 36 times the monthly disbursement.

MR. BLAIR: Before GATT, employers had to make quarterly contributions, even if their plans were well funded. Under GATT, an employer is now exempt from the quarterly contribution requirement if its plan is 100% funded on a current liability basis in the prior year. GATT eliminates an excise tax on employers that fully fund a small plan that is terminating. By small plan, I mean a plan with 100 or fewer participants.

Employers with large plans can deduct the amount necessary to make the plan 100% funded on a current liability basis. Thus, employers with large plans can deduct most of the contributions needed to fund the plan termination liability. This tax deduction is not available to small plans. Under GATT, however, if an employer with a small plan does

contribute an amount to make the plan 100% funded on a current liability basis, that contribution will not be subject to the 10% excise tax on nondeductible contributions.

The excise tax on nondeductible contributions also had an adverse affect on an employer that sponsored both a severely underfunded DB plan and a DC plan. In this situation, the 25%-of-pay overall limit on tax deductible contributions to both plans effectively prevented the employer from making tax deductible contributions to the DC plan.

The overall 25%-of-pay limit still applies. Under GATT, however, the excise tax on nondeductible contributions does not apply to contributions to the DC plan to the extent they do not exceed 6% of pay. This relief applies only to employers with large DB plans. That is, the DB plan has 100 or more participants. Also, the employer must first apply the overall 25% of pay deduction limit to the underfunded defined-benefit plan.

GATT includes several other technical tax law changes. They include correcting the cross references relating to the tax deduction for payments to satisfy employer liability on plan termination and correcting the definition of contributing employer. Charlie Cahill will help explain the change for employers that used the frozen initial liability method and created an amortization basis during 1987–92 to eliminate a negative normal cost.

MR. CAHILL: When the present value of benefits becomes less than the plan's unfunded accrued liabilities plus assets, the frozen initial liability method creates a negative normal cost. To eliminate the negative normal cost, an employer sets up an amortization base to reduce the unfunded accrued liabilities. I believe this base is amortized over five years. GATT says an employer cannot use the amortization payments for this base to reduce its deficit reduction charge.

This technical provision seems to address a fairly unique set of circumstances because it applies to a plan that had a negative normal cost and now has an unfunded current liability. This could occur if the employer had a large initial unfunded liability and few assets, and then decreased its present value of future benefits through a reduction in force.

MR. BLAIR: Now that we have finished reviewing the GATT tax law changes that the IRS will administer, let's take a look at the GATT changes that the PBGC will administer.

The first one is the phase out of the variable premium cap, which is currently $53. For plan years beginning on or after July 1, 1994, the cap is $53 plus 20% of the total premium, without applying the cap, in excess of $53. For the next plan year, the premium increases to $53 plus 60% of the excess. For plan years beginning after July 1, 1996, there is no cap.

The PBGC has published *Technical Update 95-1* which discusses this change. The PBGC has also created a so-called 1994-R premium payment package for those employers who had to deal with the early effective date of July 1, 1994.

In calculating the variable premium, employers can currently use an interest rate equal to 80% of the rate on 30-year Treasury bonds. Effective July 1, 1997, that rate will increase to 85% of the rate on 30-year Treasury bonds. It will then increase to 100% of the rate on

30-year Treasury bonds after the IRS publishes the new mortality table for deficit reduction contribution calculations. Charlie, what do you think the new mortality table will look like?

MR. CAHILL: The only mortality table available that will be more restrictive than GAM-83 will be the new GAM-93 table. However, it is possible the IRS will develop its own table in the interim.

MR. BLAIR: GATT made several changes dealing with reportable events. Before GATT, the plan administrator had to report events, at the earliest, only 30 days after the event occurred. Under GATT, the employer as well as the plan administrator is now responsible for reporting certain events, and they must report those events 30 days in advance. I'll describe these events in a moment.

This advance reporting requirement applies if the aggregate unfunded vested benefits are $50 million within the controlled group, and the funded vested percentage is less than 90%. Advance reporting does not apply to employers that are subject to SEC reporting requirements.

The PBGC published *Technical Update 95-3* in February of 1995 to explain this change in reportable events. In August, they also published a notice of negotiated rulemaking. With negotiated rulemaking, PBGC invites the public to participate in developing the proposed regulation on reportable events.

Let's discuss the events that require advanced reporting: cessation of membership in a controlled group; liquidation of a member in a controlled group during a bankruptcy reorganization; a controlled group member declaring an extraordinary dividend or redeeming 10% or more of its stock within 12 months; 3% or more of a controlled group member's benefit liabilities transferred outside of the controlled group; and, any event that the PBGC specifies in the regulation that is currently being developed.

GATT also imposes a new type of reporting that did not previously exist. It is an annual report to the PBGC that includes actuarial valuation reports on plans within the controlled group and audited financial statements for each member of the controlled group.

The annual reporting requirement applies to underfunded single-employer plans. Each controlled group member must comply with the annual reporting requirement. The annual report requirement applies when unfunded vested benefits exceed $50 million within the controlled group, when a controlled group member is subject to a PBGC lien for missed contributions, or when the controlled group has funding waivers in excess of $1 million.

The annual report information is not directly available to the public. However, the information may become public through testimony at Congressional hearings or through court proceedings.

In July 1995, PBGC issued a proposed regulation interpreting this annual report requirement. Among other things, it provides relief for other plans within the controlled group that do not have unfunded benefits and for small plans. Small plan means a plan with 500 or fewer employees.

The first annual report will be due for so-called information reporting years ending on or after December 31, 1995. In most cases, the information reporting year will probably be the employer's fiscal year. If not, it will be the calendar year. The annual report will be due 105 days after the close of the information reporting year.

Before GATT, PBGC could not bring a civil action to enforce the minimum funding rules. It now has authority to sue to collect unpaid minimum funding contributions when they exceed $1 million. It has no enforcement authority for unpaid contributions to multi-employer plans.

GATT also changed the PBGC lien enforcement mechanism for the unpaid contributions. Before GATT, PBGC could take action only 60 days after the employer accrued $1 million in delinquent contributions, and the lien covered only contributions in excess of the first million dollars. GATT retains the $1 million trigger, but allows the PBGC to impose the lien on the first one million dollars as well as on the excess. It also allows the PBGC to bring a civil action immediately after the $1 million threshold is triggered instead of waiting 60 days.

GATT requires employers to send a notice to plan participants describing the funded status of the plan and the limits of PBGC's guarantees. Plans subject to this participant notice requirement are those that must pay PBGC variable premiums. However, plans exempt from the deficit reduction contributions are not subject to the participant notice requirement. The deficit reduction contribution requirement will be discussed in the other GATT session offered at this meeting of the SOA.

Small plans automatically exempt from the deficit reduction contribution requirement are still subject to the participant notice requirement. However, the PBGC final regulations published in June explain how small plans determine whether or not they would be exempt from the deficit reduction contribution requirement, assuming they were large plans. However, the regulations provide an exception to the exception to the exception for small plans in 1995. They do not have to provide a notice to plan participants in 1995.

The final regulations also say employers can send the notice to plan participants with their summary annual reports. The PBGC's notice to plan participants will also satisfy the Department of Labor's (DOL) participant notice requirements for delinquent contributions. It also will satisfy the participant notice requirement for funding waivers.

When I discussed with Charlie the model participant notice included in the PBGC's final regulations, he commented it is only a model and employers should supplement it.

MR. CAHILL: For that plan, the credit balance is enormous. We added language to say that contributions to the plan not only meet the minimum funding requirements, but exceed them. My point is, if you just use the model language, it's fairly alarming. Employers should consider supplementing the model notice by adding a cover piece to include some positive messages.

MR. BLAIR: Under GATT, PBGC administers a program for missing participants affected by a standard plan termination. The missing participants program requires employers to transfer assets to the PBGC to pay the benefits of missing participants or to purchase annuities for them.

The PBGC published proposed regulations in August. The proposed regulations require employers to conduct a diligent search for missing participants before transferring assets or buying an annuity. This means asking known participants about the missing participants and using a commercial locator service.

GATT also made several technical changes to the PBGC's plan termination insurance program. Before GATT, the PBCG reduced its guarantee for benefits paid before normal retirement age. GATT provides relief from the early retirement reduction for disabled individuals who meet the Social Security Administration's definition of disability.

Before GATT, the PBGC apparently had to issue a notice of noncompliance to noncomplying plans. GATT gives PBGC discretionary authority to handle noncompliance with the standard termination procedures. For example, PBGC can now use other sanctions in addition to stopping the plan termination process.

Finally, before GATT, it was unclear how some insolvent banking institutions would be handled under the PBGC's plan termination insurance program. GATT clarifies that these insolvent banking institutions are eligible for distressed terminations under the PBGC's insurance program.

MR. SCHREITMUELLER: I have just a couple of add-on comments. Most of the GATT regulations are pretty straightforward. If they're not final, they'll probably be made final without much red tape. Two regulations have turned out to be controversial.

First, there are rules on how to calculate the 415 limit under GATT. Led by Ethan Crop from Mercer, actuaries from just about all the big firms have participated in writing a letter to IRS to comment on these Section 415 rules. The main issues are: is it retroactive or not, what way does it apply to deferred retirement after Social Security retirement age, and what way does it apply to early retirement before Social Security? I'd say there's a fair chance that those rules will be changed somewhere along the line.

Second, there are the PBGC annual report rules that apply to plan sponsors with plans that are underfunded by $50 million or more. There are also a couple of other ways you can get into that box. But anyway, there's a lot of dismay on the part of large employers. Even those who are not now underfunded say: "Hey, if we ever got into that boat, we sure wouldn't want to have to comply with this." Some of those rules are either asking for information that is not available or it's terribly expensive to collect. Because those rules have been subject to severe criticism, many people expect the final rules will be much more lenient than what has been proposed.

FROM THE FLOOR: We've had problems with the liquidity requirement. In particular, we've seen that it can be extremely volatile. For instance, an employer had a liquidity shortfall that was essentially about one-and-a-half years worth its normal contribution which it couldn't afford to pay and didn't pay. In the next quarter, it disappeared. And then, the quarter after that, it came back again even higher.

With regard to the first liquidity shortfall, which corrected itself, when will the 100% excise tax come in? Would that be the fourth quarter after the initial shortfall, or does the self-correction start the time clock going again?

MR. BLAIR: I believe the self correction starts the clock again for purposes of determining when the 100% excise tax will be imposed, but the employer still has to pay the 10% excise tax on the liquidity shortfall.

MR. SCHREITMUELLER: With regard to starting the clock again, the statute is very poorly drafted. It's clear what the purpose ought to be, and I agree with Dennis, on how it ought to work. But I don't think that's the way it does work. I think a technical correction is badly needed in the law.

FROM THE FLOOR: I also want to revisit the question I asked before about scheduled benefit increases for collectively bargained plans. Assume the collective bargaining agreement only calls for increases in the contribution rate but doesn't specify how those increases in the rate be used. However, the trustees of the multiemployer plan have discussed how they want to use it, and have explained their intentions to members of the union. In that circumstance, will the scheduled increase become effective only when the plan is amended?

FROM THE FLOOR: Although GATT requires collectively bargained plans using actuarial methods that project benefits to recognize scheduled benefits increases, this GATT rule does not apply to multiemployer plans.

MS. LOUISE CIRELLI O'BRIEN: I have two questions. First, do you believe that the removal of the cap on the variable premium is going to push more employers to terminate their DB plan? Second, how do you explain to clients thinking about terminating their plans that the prices from insurers for terminal funding contracts will very likely exceed the present value figures that they are seeing in valuation reports?

MR. CAHILL: I usually start any discussion with the *FAS 35* result; the present value of the accumulated benefits. I try to say "ongoing basis" as many times as I possibly can, and I see a lot of people nodding their heads. You must make the distinction because the differences between an ongoing and a terminating plan are enormous. We constantly get questions from our clients about the funded status of the plan. The answers depend on what they're focusing on.

As far as the variable premium goes, employers adversely affected by the removal of the cap are generally the least able to terminate their plans. With respect to installing new DB plans, I believe you can still phase-in participation service to minimize unfunded past service and, thus, reduce the exposure to the variable premium. Of course, an employer can also reduce its variable premiums by putting more money into the plan. I have one small plan that we just threw a lot of money in, but it was one small plan of a corporation that had four or five plans. It happens to have the luxury of just reallocating funds from well-funded plans to underfunded plans.

MR. STEPHEN E. BAIRD: I know mortality tables aren't real exciting, but I have a comment about the post 2000 mortality table. Originally, in the draft of the legislation, I believe that the 1994 Group Annuity Mortality table was supposed to become the mortality table as soon as 26 insurance commissioners adopted it as their standard. After a successful lobbying effort, we now have language that says the Treasury will publish a table. An SOA committee is assembling data from large industrial plans and creating mortality tables to influence the mortality table that the Treasury will publish.

MR. CAHILL: I just hope they look at which table generates the larger liabilities and stick with the 1994 table.

MR. MARVIN LEE STOKES: Just a quick comment on the 50/50 male/female mix for the GATT GAM-83 mortality table. We have at least one large employer that is complaining about the 50/50 mix because they have a predominantly male population. The client is writing letters urging the IRS to allow employers to base the mix on their own male/ female population. There may be some changes allowing this flexibility for large plans.